

UCL Inaugural Lecture: Building a Better Government

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I would like to thank UCL and in particular Robert Hazell and his excellent team in the Constitution Unit for the opportunity to work at this great University. On subjects as diverse as House of Lords Reform, Devolution, FoI and coalition government, the Constitution Unit has played a leading role in stimulating reform. Of course, sometimes the reforms have petered out, such as I fear is happening with regard to Lords' reform. But Robert Hazell's help, with others, in commenting on the draft chapter of the Cabinet Manual relating to Hung Parliaments, was very influential.

Despite all the Unit's good work, much remains to be done. In tonight's lecture, I hope to explain the key reforms that would lead to better government. As you would expect given my work championing the use of wellbeing as the objective of policy, better government for me is a government that enhances wellbeing. But I also believe that better processes also matter, so we need to worry about the 'how' as well as the 'what' government has achieved.

First it is important to understand the economic context.

Employment growth in the UK is likely to be sluggish for a number of years. Britain is, above all, an open trading nation, but unfortunately our main trading partner, the euro area, is unlikely to increase its demand for UK exports very much in the short or medium term. Our historical trading patterns, which have been so beneficial in the past, are likely to condemn us to the global slow lane for years to come. Our share of world trade has declined over the last decade by more than that of all our G20 partners. And while our exports to the non-euro area are growing faster than those to the euro area, the overall pattern will only change very slowly over the next decade.

Our productivity performance, which is the key driver of growth, is also far from stellar. And the government's determination to bring down net migration may lower future potential output. Our over reliance on the financial sector for jobs and tax revenue is a real problem as recoveries from these kinds of crises are usually slower. However, we know that our wellbeing is rather more affected by our relative position. Unfortunately, while as a country we may not be as aware that we are losing out relative to the rest of the world, many of us are also losing out relative to our neighbors. The increase in income and wealth inequalities in the UK has been substantial and well documented.

To summarise, our economic problems are a lack of global competitiveness, the 'wrong' set of trading patterns, the wrong areas of comparative advantage (like financial services), weak productivity growth and increasing inequality.

On the social side, as in most advanced economies, we have the problem of a rapidly ageing population, with insufficient savings and poor pensions in the private sector. The resulting pressure on health and social care budgets will be most unwelcome as the UK struggles to restore public finances to a sustainable level. In addition, the rising trend in obesity, the growth of dementia and Alzheimer's and mental health issues in general make it hard to see how the state can afford to help all who need it.

The combination of the decline in the potential growth rate, at least for the next few years, and the increasing demands on public services, is a vicious pincer movement. It cannot be solved simply by putting up taxes because this could damage growth and many factors of production are globally mobile so you may not get as much extra revenue as you had hoped. One obvious solution is a more efficient state, producing better services for less.

Unfortunately we are suffering from a lack of belief by the public in the ability of government to come up with good answers. So while people often believe that it is the job of the State to solve their problems, it is increasingly true that they do not expect this job to be done well. It is an interesting paradox that people, and legislatures, increasingly call for more action by the state while simultaneously bemoaning its failures. There is a feeling that 'it doesn't matter who governs' and a lack of trust in, and respect for, politicians. The main two parties are finding that their cumulative share of votes is declining as third (or fourth) parties gain ground as well as independents. Various ideas, like different voting systems, have been tried to enhance political engagement but none have worked.

SOLUTIONS

How can we encourage a better political process which produces better government, and what are the constitutional and policy changes that are needed? In this lecture I want to propose a set of policy changes that I believe would enhance wellbeing and then consider what kind of political and constitutional changes would deliver such policies.

On the economic side, there would be a strong consensus for improving our tax and benefit system to encourage people back into work. A combination of lower marginal tax rates and better, more affordable childcare could enhance the employment rate substantially.

Universal credit attempts to improve incentives but much more could be done with a more radical reform.

On expenditure taxes, many would favour broader bases and lower rates. Overall tax simplification can also lead to much fewer opportunities for tax evasion. Of course, these changes are desirable in efficiency terms but they will have impacts on equity. The income tax system, with income tax and NICs lumped together, remains the simplest way of achieving the politically desired degree of progressivity. And money could be raised as the combined income tax and NICs rate would be applied to pensions.

When it comes to the reforms needed to raise productivity, there is again a fairly broad consensus: our planning laws are too rigid and slow; our infrastructure is outdated and in need of urgent attention; our education system is not producing the skills that our businesses need; our health system is expensive and inefficient, with too little spent on prevention and mental health resulting in too much being needed for drugs and hospitals. All these factors help to explain our poor levels of productivity and the evidence is broadly accepted. So why has so little been done to address these fundamental issues?

Let me suggest three reasons:

(1) 'Policy hysteresis':

I realise that hysteresis is a term economists have stolen from engineers so I should explain its meaning. For example, economists used the term to describe the impact of a very high exchange rate on our exporters. Basically many went bust so when the exchange rate returned to a more normal level they didn't exist to take advantage of the lower rate. More generally it describes a situation where you can't go back to where you were as the change does not happen symmetrically. In this context a good example would be any subsidy or tax break for a company or activity. It is much harder to abolish existing subsidies or tax breaks as the potential losers are a powerful lobby, who are very clear that the changes will harm them. The future winners are diffuse, disorganised and sometimes disenfranchised. One obvious example is the plethora of special payments and perks given to the over sixties, like free bus passes, or prescriptions.

(2) Short termism: rebuilding infrastructure takes time. The costs may be borne by an incumbent government but the benefits accrue to its successors.

(3) Vested interests: reforms change the status quo and change the existing power structure. Doing nothing is always an easy option.

In the light of these powerful obstacles against change how can we get the better government we clearly need? I want to propose changes that will overcome or sidestep these three obstacles.

(1a) The Politicians

The main political parties have seen declines ,over many years now, in their membership and share of the vote in general elections.

The public are simply not attracted to politics by the behaviour of occasions like Prime Ministerial Questions, and there are worrying signs that some of the new intake of MPs are disillusioned already with their career choice.

An engaged, vibrant democracy needs engaging and competent MPs but the fears about 'gaffes' are making politicians of all parties very conservative. And many of those standing for election from outside the main parties are single issue protagonists ('save our hospital' campaigners) or attention seekers (hoping to promote a particular cause). It need not be like this. The issue of how to create a level playing field for serious independent candidates is extremely complex. I hope to come back to it in a future lecture. I am glad to see that the Electoral Commission is looking into this area and realises that the current system is a barrier to participation in elections.

More generally it would be useful if a senior politician, possibly a former Minister, could work on how to improve the effectiveness of our parliamentarians, and our Ministers, possibly working in collaboration with one or more of the excellent non execs that have come in from the private sector. The non execs on Whitehall departmental boards are growing in understanding of the public sector and are seeing how civil servants and Ministers interact on a regular basis.

Issues worth considering are:

- 1) Pre- qualification criteria for candidates;
- 2) More open primaries, as suggested by the Prime Minister;
- 3) Offering more training and development for MPs, not least to prepare them for Ministerial office; there are very few jobs that do not require individuals to undertake training and development before being promoted, so this would bring MPs into line with the reality of their constituents' lives.
- 4) Creating a better relationship between the centre and departments by having agreed objectives which would be assessed by the Prime Minister at annual reviews with the whole Ministerial team and the Permanent Secretary. This would also entail a bilateral between the PM and the Secretary of State to cover the political side and the performance of the special advisers. The former session would be based on notes from the No 10 policy unit and the department. The latter would be prepared by the PM's chief political adviser. In a sensible world this would also be based on proper paperwork but FOI probably makes this unworkable.

(1b) The Bureaucrats

In the UK public spending (Total Managed Expenditure) accounts for around 45% of GDP. Is this money spent wisely? Could the resources be used more effectively?

Any serious attempt to match our social conditions with our resources will need to concentrate on three areas: tax, benefits and health. On tax, the Mirrlees Report is a good place to start. On benefits, the government is already tackling some issues with the introduction of universal credit. But there are plenty of other issues across the welfare spectrum. We should build on the policy success in the pensions area. The key here was the establishment of a strong, independent evidence-based approach led by Lord Turner. And making changes which involve losers, but not immediate losers. (In a sense its success was applying one of the problems, namely the public's myopia, and harnessing this as a way of producing an acceptable solution: since the public undervalued the future costs to them of being poor in old age, they would also undervalue the cost of having to work longer in many years time.)

Not all areas of welfare can be addressed in this way as the problems are more immediate, but the independent body now being used for London airport capacity could be a way forward. But it is absolutely vital that the body has a clear political steer about the overall objective and any absolute political constraints.

On health the overwhelming priority is to focus more on prevention. The second task is to rebalance the resources to ensure mental health is taken as seriously as physical health. All these changes would help enormously if the overall objective were defined as improving the wellbeing of the public. (At the moment a lot of decisions are made on the basis of Quality Adjusted Life Years [QUALYs] but as Prof Dolan and others have pointed out, this measure is far from perfect.)

The public, and I believe, the majority of public servants are of the view that productivity and standards of customer service could be higher. This is not surprising, indeed economic theory suggests that consumers lose out when there is a monopoly provider. The nature of providing public services, which often involves a requirement to treat everybody equally, can damage customer service.

There is little doubt that further savings can be made while improving public services by taking on board the latest developments in digital delivery. Similarly a widespread application of the latest advances in behavioural science can make a huge difference. The work of the Behavioral insight team in the Cabinet Office, which is now being taken further by departmental initiatives, is stunningly successful.

There are also policy changes that could make a difference. Is it sensible for Londoners over 60 to be able to travel for free even during peak periods? Should all over 60's get free prescriptions? Why are we paying winter fuel allowances to millionaire pensioners on the Costa Brava?

This is all part of the ludicrous bias whereby the old are subsidised by the young. It is bad economics and bad social policy. Unfortunately it has been judged to be good politics as the old have a higher propensity to vote. It is also another example of policy hysteresis: once someone has introduced a bad policy, no future administration can easily get rid of it as the gainers come to believe that such perks are a right. And those in their fifties look forward to getting the benefit in a few years that they have been financing for many years. The losers will be very aware of their loss if the perks are taken away and the potential winners would probably see only a small reduction in the increase in their taxes which is too small to concern them. One 'solution' would be compulsory voting so it would no longer make sense to redistribute money from the non-voters to the voters. (It would be interesting to see whether such policies are found less often in states or countries with compulsory voting.)

More generally I worry that in ever more areas the public are being faced with a choice between a free, but second rate, public service following the cut backs, and an expensive, but very customer focused, private sector. This is the choice in areas like schools, dentistry and in some cases the health sector. Is this what we want as a society?

One factor reinforcing this trend is the fact that in the private sector failed producers go broke and their business is picked up by those best at providing what the customer wants. That process of creative destruction, much loved by Schumpeter, simply does not happen in the public sector where failure of a school or hospital is regarded as a disaster to be avoided at all costs.

Using Wellbeing as a Success Measure

The first of my 10 commandments on how to improve public policy referred to the need for clarity about the outcome achieved. (See my lecture at the LSE on their website.) At the moment we tend to regard the impact of GDP as a success measure. This is rarely a very sensible measure but it is particularly inappropriate for many public sector projects. Take the case of a policy designed to reduce prisoner re-offending. We want to do this because it will raise the wellbeing of individuals who will avoid being victims of crimes, it will raise the prisoner's wellbeing by leading him or her away from a life spent largely in prison and there are all sorts of gains in wellbeing for the families concerned. The reduced strain on the resources of the criminal justice system will raise wellbeing for many groups, not least the taxpayers who will not need to pay for so many prison places. So how should we add up all the gains? At the moment we attempt to translate them all into money and to come up with an overall figure of x% GDP as a saving and then compare this to the cost of the policy. But if we could measure each step in wellbeing units we could end up with the question 'is x units of wellbeing worth y units of money?' In the end we have to find a way of answering this question if we are ever to make progress in using wellbeing as a 'numeraire'. This is one of the tasks of the Legatum Commission on Wellbeing that is currently underway.

The more basic point is the need to motivate public sector staff in the right way. For example, all hospital staff from the cleaners to the consultants should be absolutely clear that their objective is to improve the wellbeing of patients. Subject to that, they may well have intermediate targets, like reducing waiting times and cleaner wards, but the main goal should be clear.

There are some bodies who look at value for money in the public sector, such as the National Audit Office. In general I believe they do a good job but they are required to operate through a Parliamentary Committee (the PAC) which has meant the process generates far more heat than light. As Permanent Secretary for over a decade, I attended countless meetings of the Public Accounts Committee. I have also worked closely at times with the National Audit Office (NAO). All Treasury Permanent Secretaries feel a close bond with the NAO as both are passionate about achieving value for money for the taxpayer. It is hugely important to have an effective accountability body. The fear of being called in front of the PAC is hopefully a useful deterrent. But given the scale of the state - over £4 out of £10 of our income - it is too backward looking and the PAC too politicised to make a real difference. When Tony Blair wanted to modernise public services he didn't start by saying bring me all the PAC recommendations and we will implement them.

This may mean building some new institutions. The basic requirements are as follows:

- (i) agreed definitions of outcomes and how they will be measured;
- (ii) clear lines of responsibility showing who has been given the power and resources to deliver the outcomes;

(iii) an agreed public understanding of the political constraints that will be imposed on the delivery body.

At the moment we are living in a '50 shades of grey' world where none of the above is clear. As a result public servants and ministers can blame each other, the former privately, the latter publicly. This is a recipe for mutual distrust.

One of the best examples of an accountable institution is the Bank of England's Monetary Policy Committee. There is an agreed outcome, namely the inflation target and subject to that the need to support economic growth. The members have a clear personal responsibility to vote to achieve the right interest rate to achieve the target inflation rate. The bank has plenty of resources to support the MPC members. (They have a very tough job as we still know very little about the so-called transmission mechanism from interest rates to inflation, let alone that from QE to inflation and whether the impact is symmetrical. It is not at all clear that more resources would enhance the knowledge much. It is just that the economy is very complex and hard to predict.) It is agreed that Ministers will not put pressure on MPC members to vote in particular ways so the process is free of political constraints. And there is a Treasury Select Committee that can hold all members of the MPC to account, while parliament holds the Chancellor to account for the overall system including the choice of inflation target. Personally I feel these accountability systems have not worked as well as they might, perhaps because of their highly politicised nature. The Parliamentary Commission on Banking Standards, including members of both Houses, is perceived to have done a better job. Andrew Tyrie is the very capable chair of both Committees so it cannot be the choice of Chair that explains the difference. It is probably the reduced degree of politicisation, shown by the inclusion of cross benchers and Bishops, and the presence of political heavyweights like Nigel Lawson. More joint Committees of both houses with the remit to look at departmental value for money would improve accountability dramatically, in my view.

Stronger joint committees could look at past decisions but how can we stop bad new policies being introduced? (It is interesting that the House of Lords is now increasingly taking on this task and has successfully asked the government to think again on many occasions. This week the Lords defeated the government three times; and under the coalition government one in five votes have resulted in government defeats. This is crucial because of the policy hysteresis described above.)

What would work? First you need a body that has strong professional integrity. Its conclusions should be accepted in the same way that the IFS's conclusions are on tax issues. The nearest existing analogy is the OBR so let's call the new body the OTR, the Office for Taxpayer Responsibility. The OTR would have its own professional staff, and would draw on secondments from the big 4 accountancy firms, some ex civil servants, particularly those with Treasury experience, some ex-Ministers and private sector members, particularly those with experience of working with the public sector. (Perhaps another role for the new NEDs?) Their job would be to vet new policies. They would require the government to specify the objectives of any new policy and explain how successes would be measured. Then they would assess whether the evidence suggested the policy would work, drawing where possible on the evidence provided by the new 'what works' centres. And they would vet the proposed evaluation mechanism. Their report would be available to Parliament before any legislation could be passed. Members of the body would be called before the joint select committees to explain their findings. In addition, this body could apply the same rigour to manifestos, including costings, following the example set by the Netherlands. If the latter task is felt to be too political and would damage their ability to do the main task then I would reluctantly accept that it could go elsewhere. (The coalition are interested in getting 'outside' policy advice, although it looks to be running a little late, so why not put this task out to tender?)

In time it might be possible for the OTR to work more on existing policies and could provide real professional support for the joint Committees. This would be a lot harder as it is not clear who would be responsible for stating the objective of each policy. Presumably government statements at the time the policy was introduced would give some clues. As it builds up experience in both aspects, it could provide periodic assessments of the capabilities of departments. I would favour publishing, say every 3 years, league tables of departmental capabilities. The old capability reviews were published and my only regret is that I did not make them more independent. The coalition government could put this right. One new element would be a comprehensive assessment of how the ideas now coming out of the behavioural sciences are being applied to the provision and administration of public services. The OTR could assess the scope for applying these ideas, check that the departments were on the case and spread best practice.

I realise that I have fallen into the common trap of equating public services with departments. The capability reviews and the work on policies need to look closely at Whitehall but the public rightly care about schools, hospitals, libraries, waste collection and want good service, irrespective of whether it is provided by a government department, a local authority or a public-private partnership. The OTR would eventually ideally cover all services but would have sub-divisions for local authorities, government departments, and health and education sectors. This is a huge task and in the spirit of my own analysis you would be right to ask where was the evidence that suggests such a body would work. Therefore it would make sense to start with Whitehall and evaluate the success of the body, learn what works, adapt its modus operandi, and then apply a revised approach to the wider public sector.

TOWARDS A MORE COMMERCIAL PUBLIC SERVICE

This heading will puzzle many readers. Isn't the whole point of something being done by the public sector to ensure it is not driven by the profit motive?

That is true but it is very likely that there will be cases where the private sector, or a mutual or a third sector organisation can do the job much more effectively than the public sector. Obviously they need to be monitored or regulated if given a monopoly. But we have processes, like tenders, or auctions or franchises that can overcome many of the problems. The important point is that the choice of provider should be driven by what provides the best service for the customer and best value for the taxpayer.

The tricky part of this process is the commissioning. This kind of problem crops up throughout the public service, from hip replacements to train services, so why isn't this model being applied successfully throughout our public sector? One reason is the shortage of commissioning skills. My proposed solution is to steal a Canadian idea: set up an agency, staffed with real experts paid at rates much closer to market rates, that would take on such tasks. Indeed such an agency could become a broader commercial hub, along the lines of Infrastructure Ontario in Canada. It would take over all activities where commercial skills were needed. And it would have an 'innovation' arm that would suggest new areas where it could improve outcomes for the service users and, of course, the taxpayer. My predecessor, Lord Turnbull set up the Shareholder Executive (SHEX) which took on the role of shareholder which the public sector traditionally managed so badly. My idea would be to extend the remit of SHEX to cover these new areas.

WHY CHANGE WILL NOT HAPPEN

POLICY OVERLOAD AND CONSTITUTIONAL INERTIA

Many feared that coalition government would be insipid: a lowest common denominator approach. Yet the opposite has happened. This government is attempting radical reform of numerous areas: health, welfare, education and constitutional reform. In the latter case, they

have had a referendum on the Alternative Vote, and have agreed to one on Scottish independence. They attempted to reform the House of Lords, but as with our voting system, it seems we will end up with the status quo. This is despite widespread agreement that the Lords does need to be reformed; and despite serious biases in the operation of our voting system, including unequal sized constituencies.

This is an interesting paradox: a coalition has been able to reform policies in, for example, higher education funding and welfare that are very controversial and do not have all-party support. Yet changes to the way we are governed have made very little progress. The checks and balances appear to be much stronger in the area of governance change than they are with regard to policies. This is normal, with many democratic political systems requiring super majorities for "constitutional" changes. This equilibrium appears to be very stable, and has not been overturned by the arrival of a coalition government. So predicting 'no change' in the constitutional dimension looks a safe bet. Constitutional hysteresis is here to stay, certainly in areas like House of Lords reform, party financing, and boundary changes. Yet we have made significant strides on devolution. It would be worth studying why progress has been so patchy. (This is definitely a job for Robert and the Constitution unit!) In other areas radical change is generated by the existence of a burning platform. You might have thought the decline in trust and membership of political parties and the increasing disengagement of younger people from politics, with many not even bothering to vote, might have created such a platform for constitutional change. Record debt and deficits have certainly created the platform for radical changes in 'policy' space in many euro area countries. In cases like Italy there has been a desire to 'depoliticise' policy making and put power in the hands of 'independent' bodies. But this process has its disadvantages as well. The Italians initially welcomed the 'technocrat' Mario Monti, rather than the larger than life Berlusconi. But after Monti had introduced some mild, but painful, reforms, he was unsuccessful in the last election. To maintain their effectiveness it seems that technocrats need to steer clear of the political stage.

Coalition Dynamics

I expect the period of 'policy overload' to come to an end soon. The coalition is rightly in its implementation phase and should be wary of announcing even more radical change. In addition, as we enter the second half of this, first ever, fixed Parliament, the two governing parties are increasingly going to have their eyes on the finishing line on 7 May 2015. At that point they have both said they want to appeal to the voters as distinct parties with different manifestos. They will also both have their versions of the successes and failures of the last 5 years. No doubt each party will want credit for the former and blame their coalition partner for the latter. As the process of 'party differentiation' accelerates, the scope for radical new policies diminishes. The point is that it is entirely predictable that the coalition parties will increasingly differentiate their products in the next few years. It is not a sign of any particular failure.

Conclusion

As an optimist, I like to look more at opportunities than challenges. We have many policies that can be improved. We can change our policy processes to stop new, bad policies and start getting rid of the worst ones. We must strive to find ways to change the way we do politics that would encourage more people to engage and improve the quality of government decision making. Unfortunately, we suffer from strong policy and constitutional hysteresis. We are in a bad place, but it is a stable, bad place. I hope to spend my time as a Visiting Professor at UCL working on how to overcome this hysteresis. Step one is to show that a better future is possible. We can build a better state, with a smarter bureaucracy that will support a more vibrant private sector: a society with greater wellbeing and less inequality in wellbeing. A better politics for a better Britain.

Thank you.