

How Not to Spend Public Money

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CHECK AGAINST DELIVERY

I want to talk to you today about how **not** to spend public money.

This isn't a question of how *much* money the government should spend. I have already said that we will share the proceeds of growth between increased spending on public services and a reduction in taxation and borrowing.

Instead it's a question of *how* that money should be spent.

You may not have noticed, but last week the Chancellor published the interim report of his Comprehensive Spending Review.

This report was first announced with a fanfare by the Prime Minister in his Party Conference speech last year. He described it as “a vital foundation stone” of future spending plans – an assessment of how money had been spent over the last ten years and an analysis of where savings could be made. It was also the Prime Minister's way of keeping an eye on what the Chancellor was up to.

What began with a fanfare was finally published on Thursday with barely a murmur. It is an empty document that entirely fails to look at existing spending patterns, examine the long term pressures on government resources or suggest significant savings. And the Chancellor used an obscure parliamentary procedure to slip it out with minimal chance for MPs to question him about it or hold him to account.

It was a giant missed opportunity. The Prime Minister was right when he announced all this. Before government spending to the end of *this* decade is finalised, we need a thorough and serious review of public spending over the *last* decade.

This must go beyond the tired critique that Labour are simply incapable of spending money well – or the narrow ideological argument that public spending is always an inherently bad thing.

Of course, Conservatives are sceptical of calls for more government intervention. We believe in sharing responsibility between government, communities, and individuals, and we look for ways to enable people to do more for themselves.

But the next Conservative Government will spend very large sums of taxpayers' money on public services. So it should. Well-funded public services like education are important not just to our social welfare but to our ability to compete in the global economy.

Given that, the question we need to answer is this: how can we spend that money better than it's been spent since 1997?

We have to begin with an understanding of how this Chancellor could have spent so much and achieved so little.

The facts are depressing for any taxpayer.

Labour has spent four trillion pounds over the last nine years. Spending in real terms will, by 2008, have risen by 40%. The share of the nation's income consumed by the state has risen by a staggering 5 percentage points to 42% of GDP. We will bring that share down.

After just two years of sticking to tight Conservative spending plans, Gordon Brown swapped prudence for promiscuity.

And, of course, taxes have risen dramatically to pay for that spending and are to set to rise still further – making our economy steadily less competitive in a more and more competitive world.

What has been achieved with all that money?

Instead of the stale argument about exactly how many extra doctors have, or have not, been employed or whether or not this extra hospital would or would not have been built, let's focus on the outcomes.

The Chancellor and others point to falling mortality rates in the health service or improved exam results in the education system as evidence that all that extra public money has delivered results.

What they fail to do is look at the trends.

Take health care. Mortality rates from diseases have been improving for decades in all developed countries. But as the OECD noted last year “the effect of higher spending [on these rates] is less clear: premature cancer deaths, and heart and circulatory diseases have continued to decline, but not faster than during the 1990s”.

The same is true in education. The Education Select Committee has pointed out that the *increase* in the proportion of children achieving five good GCSE grades was exactly the same in the five years from 1998, when education spending rose by a third in real terms, as it was in the five years before 1998 when real spending hardly rose at all. In the words of this all-party Committee “the Government needs to take great care in making claims about the efficiency of increased investment in education in increasing levels of achievement which the evidence cannot be proved to support”.

The Chancellor’s own spending guru, Sir Derek Wanless, summed it up recently when he said “less has been achieved than might have been achieved ... the money could have been better spent”.

The current Chief Secretary to the Treasury, Stephen Timms, was more blunt: “a great deal has been spent but not a lot has been achieved” he said somewhat candidly.

How could the money be better spent? How could more be achieved?

First, the main agent for controlling expenditure in Whitehall is not doing its job. The Treasury is broken and needs to be fixed.

The regime which this Chancellor dismantled was long-established and relatively simple. The Treasury’s job was to keep a tight grip on the purse strings and force spending departments to justify any claims on the money they spent. It was not itself a spending department and - although the Chancellor, as a senior member of the government, played a leading role in

shaping government policy – the Treasury did not try to dictate exactly how every single pound should be spent across Whitehall.

That has changed with this Chancellor.

For a start, the Treasury has become one of the larger spending departments. Gordon Brown has added to his empire the administration of Tax Credits, Child Benefit and Child Trust Funds – which together cost an annual sum of over £20 billion. There is no logical reason why these in-work benefits and universal child benefits should not be administered in the same department as all the other benefits.

This empire-building has come at a price. For if another government department had experienced the problems of fraud, error and overpayment in the tax credit system that are costing the taxpayer close to £2 billion a year, then the Treasury would have subjected them to very vigorous scrutiny and forced changes to the policy. That has not happened because the Treasury itself is the culprit. The gamekeeper has become one of the poachers.

Something even more significant has also changed on this Chancellor's watch. The Treasury now tries to set the direction of other departments and then dictate exactly how every pound is spent in meeting those objectives. The device used is the Public Service Agreement (or PSA).

The PSA system was set up in a huge hurry at the time of the first so-called Comprehensive Spending Review in 1998. At the centre of each PSA would be practical targets designed to drive improvements in the public services. Departments that failed to meet the targets would be severely penalised. The whole thing was intended to convey a business-like approach that would reassure the public that New Labour could achieve value for money in its spending.

In fact it resulted in the opposite. At the outset, a staggering 700 PSA targets were imposed by the Chancellor, far too many to be monitored and all too often in conflict with each other. Each target then spawned dozens more micro-targets within departments. But having so many targets is effectively the same as having no targets at all.

There have been attempts since to refine and reduce the number of targets, but this has often simply added to the confusion. For example, the Home

Office alone has now had over 100 different targets imposed on it by the Treasury. When John Reid says it is “not fit for purpose” it is not clear if the government knows what that purpose should be.

Not only are there too many targets, but the targets themselves are often vague, unmeasurable or in some cases simply impossible to deliver. For example, the Treasury’s own PSAs include the so-called Objective 5 to deliver “increased global prosperity and social justice” – something which a British Chancellor alone cannot deliver and so, while being a perfectly admirable aspiration, does not belong in the Treasury’s list of tightly drawn objectives.

And, fatally, the mechanisms for holding departments and individuals accountable to their PSA targets have never operated.

The assessments of whether a target has been met are laughable. The Treasury has apparently “met early” the target of improving the cost-effectiveness of public services, even though public sector productivity has slumped, and is “on course” to increase the productivity of the whole economy, even though whole-economy productivity growth has slumped. It comes as no surprise that the judge in both cases was the Treasury itself. The Home Office is “ahead” of its target for “improvement in the level of public confidence in criminal justice system”. That will be news to the public.

In 2002 the Chancellor had to admit that one of the key elements of the PSA system was being dropped. Departments that failed to meet their PSAs would not be penalised. So there is now no price attached to failure. For example, the government has missed by a wide margin its targets on reducing truancy – truancy has actually risen. So what has it done? Spent more money on tackling truancy. In other words the people who failed to deliver on the PSA target were rewarded with more resources, exactly the opposite of what was intended. That is what might at best be called a perverse incentive.

And that, of course, is one of the broader problems with using centrally set targets as the primary tool to improve performance in the public sector. They can all too easily create perverse incentives that distort behaviour. This is known as Goodhart’s law, and has happened most notably in the National Health Service, where waiting time targets have led to clinicians

processing the easier operations first or moving people and on trolleys from one part of an A&E department to another to avoid missing targets.

The result is, as the chief economist at the Chartered Institute of Personnel and Development put it recently: the Chancellor's "preferred brand of top-down, target-focused management of the public services has failed to make the most of the billions of pounds of extra investment he provided".

We need a completely different approach from the current Chancellor's empire-building and micromanagement.

The Treasury should focus on its primary responsibility of exercising a tight rein on public expenditure. It will need to do that if we are to achieve our goal of sharing the proceeds of growth so that the share of national income consumed by government falls over an economic cycle.

We should look hard at removing the spending responsibilities which the Treasury has accumulated under Gordon Brown for in-work and universal child benefits. Otherwise, who guards the guardian? The only caveat is that we must make sure that this can be done without adding further to the chaos of the administration of tax credits.

The Public Service Agreement apparatus is the expression of Gordon Brown's centralization. It needs to be replaced with something much simpler and much much more decentralized.

There may be a limited role for targets in public services as a means of setting basic minimum standards of delivery. But those targets should be clear, precise and measurable, and the individuals responsible for achieving those targets should be held accountable.

In short, the Treasury in a Conservative government would be there to ensure that value for money for taxpayers was being achieved. The micromanagement and empire building would stop. It would do less but do it better.

For we understand that improvements in public services cannot be driven by diktat from the centre. If running a government based on centrally-set targets was the root to success then the Soviet Union would still be with us.

That brings me to the second part of the answer to the question: How could the money be better spent?

Government needs to avoid what I would call ‘producer capture’.

The state is by far the largest employer in the country – and is getting larger. In 1997 5.2 million people worked for the government; today 5.9 million do. The independent thinktank, Reform, estimates that only a quarter of this total increase has been in frontline service delivery posts - the rest have been additional administrative staff.

Public sector workers do a difficult job often in challenging circumstances. Indeed we rely on the judgment of public servants in some of the most difficult and important moments in our lives. It is right that the Government, as their employer, looks after their well-being. We want the next Conservative Government to lead by example with modern, progressive employment practices that increase the productivity of the public services.

But we should never make the mistake of thinking that public services should primarily be run for those who work in them – the producers. The focus must always be on the users of those services – the patient or the parent – and the taxpayer who pays for them. Otherwise unproductive practices spring up, complacency develops in the system and the quality of services deteriorates. In the end, that not only harms the users. It is frustrating and demoralizing to work in an unproductive environment.

This is not easy to avoid. The instinct of every large bureaucracy is to protect its own, and for the politicians who lead it to become captured by the interests of the producers. That is what has happened to this Government and this Chancellor.

Look at the new GP and Consultants contracts he approved. Large pay increases have been awarded without securing, in return, substantive improvements in performance. In the words of Sir Derek Wanless, this has meant that the “money is not there to be spent on other things”.

Look at the government’s decision to abandon reforms that would put public sector pensions on a fairer, more affordable and more sustainable footing.

Look above all at the Warwick Agreement. Drawn up by senior members of the government and the public sector unions at Warwick University in July 2004, the agreement secured the political support of the unions in the run up to the election in return for major concessions. These included an extension of protection for striking workers, funding for a union academy, government support for the EU Agency Workers Directive and – perhaps most significantly – a commitment that the bulk of NHS services would be directly provided.

The Warwick Agreement is the perfect example of producer capture: a government that should be focusing on improving outcomes for the users of public services instead making concessions to the producer unions that undermine those improvements.

It will be interesting to see what happens when those same public sector unions are given a third of the total votes in the forthcoming contest for the next Labour leader.

But a Government that was really interested in delivering value for taxpayer money and improving public services would not have negotiated the Warwick Agreement.

The next Conservative Government does not regard the deal done on public sector pensions, for example, as binding. We will focus first on the interests of the users of public services and the taxpayers who pay for them.

That brings me directly onto the third and final part of the answer to the question: how could the money be better spent?

In 2001 Gordon Brown said: “I am going to insist that any additional resources must be matched by reforms so that we get the best value for money. There is not going to be one penny more until we get the changes”.

If only he had meant what he said. But sadly the Chancellor has been the principal roadblock to the very public service reforms he promised.

He crippled Foundation Hospitals at birth by severely restricting their financial independence.

He claims to support the recent education reforms, but I suspect his close adviser Ed Balls signaled the Chancellor's real views when he told the New Statesman magazine that he "sees no desire for schools to set themselves up as independent trusts".

These manoeuvres are not just for short-term political advantage within the Labour Party. They stem from deeply held beliefs.

In a speech entirely devoted to the question of private delivery of public services, given to the Social Market Foundation in 2003, Gordon Brown argued that public services like the health service had to be not just paid for by the state but delivered by the state too. In his words, "equality of access can best be guaranteed not just by public funding of health care but by public provision."

The significance of that statement only becomes clear when you apply it to current issues. In a publicly paid for and publicly provided NHS you could not have independently run NHS Treatment Centres, even though they now treat up to eight times as many cataract operations a day than the NHS has traditionally managed. City Academies, which encourage private involvement in the management of schools, are also an anathema to that philosophy.

I suppose it's possible that the Chancellor has changed his views since 2003, but you've got to say that this is unlikely. This is not a man known for his flexibility of thinking. Indeed last month he appointed as Chair of his Council of Economic Advisers Dan Corry who believes that "there are some areas in which, even if there is a view that the private sector could do things a bit better, we do not want them".

So it will be left to the next Conservative Government to build on the modest public service reforms forced through by Tony Blair, often now only with our support.

The central challenge of all public service reform is this: how do you provide incentives to improve in what is in effect a monopoly?

As we have seen, the Chancellor thinks the answer lies in centrally-set targets. I believe that the answer lies in a totally different approach - choice and contestability.

Government has three roles in the delivery of public services.

It provides the money to pay for public services through general taxation.

It ensures the services are provided.

And it also acts as the regulator of those services.

Choice and contestability help make sure that these three roles are as distinct as possible.

Choice so that we have public services which have to put the interests of their users, like parents and patients first.

Contestability so that poor performance is vulnerable to someone else coming in and doing better.

What does this mean in practice?

It means first of all explicitly acknowledging and applauding the role of public funding. The British people are very attached to taxpayer funded health care and education that is free at the point of use. So am I. As Nigel Lawson put it: the NHS is the closest thing the British people have to a national religion.

But it also means understanding that not every doctor or nurse has to be employed by the government. Labour has set an arbitrary limit of 15% of the amount of NHS care that can be provided by independent providers. I don't believe that such an arbitrary limit should exist at all.

We should let choice and contestability do their work. Professionals need to be trusted to get on with the job, and as part of that, be made accountable to parents and patients rather than to bureaucracies and Ministerial dictat.

And let us have genuinely independent regulation of those services – so that the providers do not judge their own performance. This is particularly important in public services which cannot be independently provided, like the police. The key to improving performance there is to beef up the independent regulation through, for example, elected police authorities.

I acknowledge the role of the ethic of public service. But in the end improvements in the performance of public services means changing the behaviour of those who work in them, and to change behaviour you have to change the incentives. You have to expose people to consequences of failure and the rewards of success.

That does not happen enough in the public sector.

Take the fact that 70% of non-PFI government procurement projects are delivered late and 73% are delivered over budget. Why?

Well, the greatest moment in the lifetime of a government project is when it is announced. That is when the Minister can stand in front of the empty site and get the kudos for saying that a hospital will be built there. The whole incentive structure encourages the benefits have often been overestimated, the costs underestimated and risks ignored. Yet no one is held accountable because no one cares. The Minister has probably moved to another department. The civil servants are thinking about the next announcement.

This culture has to change if we are to get better value for money for the taxpayer. Those charged with the delivery of public services should have more professional freedom, and then held accountable. They will - as part of a new Conservative approach.

An approach that focuses the Treasury on public spending control, so that it does less and does it better.

The era of the expanding Treasury empire is over.

An approach that understands that improvements to our public services will never be delivered by central government targets.

An approach that avoids the hazards of producer capture.

An approach that recognises that improvement will only come with reform, and that reform must be about choice and contestability.

An approach that delivers real value for money for the taxpayer and better public services for all.