

# REFORM

*Reform* is an independent, non-party think tank whose mission is to set out a better way to deliver public services and economic prosperity.

We believe that by liberalising the public sector, breaking monopoly and extending choice, high quality services can be made available for everyone.

Our vision is of a Britain with 21st Century healthcare, high standards in schools, a modern and efficient transport system, safe streets, and a free, dynamic and competitive economy.

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# MANIFESTO FOR REFORM

## Preface

Since *Reform* was launched three years ago we have concentrated on four key policy areas: the economy generally (with special reference to the performance of the public sector and taxation), healthcare, education and crime. Our Manifesto reflects this focus. However it also touches on welfare and transport policy; these are the subjects of major new research projects which we are currently initiating. The Manifesto is supported by a detailed briefing document, with which it should be read.

We owe no allegiance to any political party. Our wish is to persuade politicians and governments – however they are constituted – that real public sector reform is the right thing to do. We believe that, by choosing reform instead of ever higher public spending, Britain can have lower taxes *and* better public services. This Manifesto sets out that case.

## Britain needs reform

Britain is a great country. We are one of the wealthiest nations in the world. Our living standards are high and have risen significantly over the past two decades. We have transformed ourselves from an economy in deep malaise in the 1970s to one that can compete on the global stage. Between 1979 and 2003 our GDP per capita overtook that of France, Germany, Italy and Japan.<sup>1</sup>

We have at last secured monetary stability, with inflation and interest rates at historic lows. We have had 50 quarters of continuous growth – the longest period of sustained growth for 200 years.<sup>2</sup> We have a record number of people in work and much lower unemployment than most other EU countries. Between 1985 and 2003 our unemployment rate fell below that in Australia, Canada, France, Japan, and the USA.<sup>3</sup>

The UK was the second largest recipient of foreign investment in 2003, behind the USA.<sup>4</sup> We were the second largest outward investor in the world.<sup>5</sup> The City of London remains one of the world's two leading financial centres.

Yet we are a nation facing significant problems. Against a background of increasing global competition, Britain's national productivity performance is relatively poor. Our regulatory burden is increasing. Taxes are rising to their highest level for 25 years. We have a welfare system under which dependency on the State is increasing. And we have amongst the worst public services of our peer group countries:

- **Education** – there remain very significant weaknesses in Britain's educational achievement at both primary and secondary level. Poor levels of achievement and the lack of opportunities for vocational education create the skills gap which is a major factor in Britain's weak productivity growth. Falling examination standards have lowered the expectations of teachers and pupils and given a false impression of improved performance.
- **Healthcare** – it was once believed that the NHS was the finest healthcare system in the world. Today few would make that claim. The performance of the NHS – ranked 18th out of 19 developed countries studied in a recent survey – is simply not good enough for a country of Britain's wealth.<sup>6</sup> British-style waiting lists are unknown in countries such as France and Germany, and while the longest NHS waits are being eliminated, average waits are little changed. Even if the NHS' key health target for 2008 is achieved – that patients should wait no more than 18 weeks between attending a GP and hospital treatment – the NHS would still be at the limits of international acceptability, and outcomes are relatively poor.
- **Crime** – under the impact of tougher sentencing policy, crime has been falling since the early 1990s, with the rate of fall slowing since the beginning of this decade. But it remains at extremely high levels compared to previous years and to other countries. Recorded crime is ten times higher than in the 1950s and is higher than in any country in the EU15 except for Sweden. The Prime Minister's Strategy Unit has described the level of crime in England as a "weakness" in comparison to other developed countries.<sup>7</sup> Prisons are overcrowded and the penal system fails to rehabilitate criminals. Three quarters of young male prisoners are reconvicted within two years.<sup>8</sup>

- **Transport** – Britain has amongst the most congested roads in Europe, and British commuters face the longest journeys to work. The attempt to focus transport policy and resources on rail rather than roads was doomed to failure, since 93 per cent of journeys are by road. While the historic decline in rail use has been reversed since privatisation, the effective renationalisation of the railways has seen costs explode.

## Spending without reform

The problems of poor productivity, rising taxation and public sector failure are inextricably linked. The successful aspects of Britain's economic performance today can be traced back to the liberalising industrial and labour market reforms of the 1980s. By contrast the structure of the public sector remains essentially faithful to its design in the 1940s. For successive decades the same remedy, to a greater or lesser extent, has been chosen to improve public services: higher spending and tightened central control.

Between 1999-00 and 2007-08 government spending on the public sector will increase by 40 per cent in real terms. But this spending will be on almost wholly unreformed services. While reform has been debated and in some cases implemented at the margin, in practice the Government has, like its predecessors, sought to wring improvements from monopolistic national services through the apparatus of central direction – targets, national standards and political pressure – rather than through consumer choice and accountability.

The UK now spends more on education and health than the EU15 average. The costs of those services are approaching the costs of equivalent private sector provision. The total cost of primary and secondary education, including expenditure by the national and local bureaucracies, amounted to over £5,000 per pupil in 2002-03, and is likely to rise to over £7,000 by 2007-08.<sup>11</sup> The average cost of an independent day school place in 2003 was £6,150.<sup>12</sup> Spending on the NHS per household has now reached over £3,000, the price of many private family health insurance products. Yet quality is still far below Continental or private sector levels.

While standards are little improved, costs have increased enormously. Without reform, today's funding increase is tomorrow's cost increase. Rising costs mean that services need more resources just to stand still. In coming years, when spending increases on public services will slow, rising costs will put many services under strain. The current course is unsustainable.

The increase in public spending has led to a substantial growth in public sector employment, reversing the historic trend. From 7.4 million in 1979, total public sector employment fell to just below 5 million in 1998. It has subsequently risen to 5.5 million. As a result, since 1998 the number of public sector jobs has increased three times as quickly as those in the private sector.<sup>9</sup> Most of the new public sector jobs are not frontline staff. Between 1997 and 2003, only a quarter of all new public sector jobs were doctors, nurses, teachers or police officers.<sup>10</sup>

The Government has planned year-on-year rises in taxation to fund its spending increases. Most of the tax rises will take place in the next Parliament and will lift the tax burden, by the end of the Parliament, to its highest level for 25 years. Higher taxation and spending will harm productivity in two ways: an incentive effect, as taxes blunt and distort incentives, and a resource effect, as resources are transferred

from a private sector with higher productivity to a public sector with productivity that is lower and in some cases actually falling in absolute terms. The government sector (excluding social security benefits) accounts for a fifth of GDP, a greater share than manufacturing. Poor public sector performance is a drag on the performance of the whole economy.

## **Failing the poorest in society**

The failure to improve services affects both individuals and society. The fact that only two-fifths of 16 year-olds achieve good GCSEs in english, maths and science is a blight on their chances of leading a fulfilled life and on their hopes of prospering in employment. The fact that Britain's healthcare, crime and transport systems are amongst the worst in the developed world means that individuals have a lower quality of life and that society is less prosperous and secure.

But public services and welfare programmes fail most severely those for whom they were ostensibly designed. The least well off in society experience the highest levels of crime, the poorest healthcare and the worst schools. Those with greater means can afford housing in areas with better schools and services. Meanwhile the wealthiest in society – the top 10 per cent – opt out altogether, taking out private health insurance and sending their children to independent schools. The central purpose of the welfare state, to equalise entitlement to essential services, has never been fulfilled. As Professor Julian Le Grand – now a senior adviser to the Prime Minister – has argued: “the strategy of equality through public provision has failed”.

In addition, current tax levels are particularly onerous for people on low incomes. Higher levels of state benefits are no substitute for greater freedom to make their own decisions. For people on low incomes, an effective 40 per cent tax burden leaves little room for anything beyond essential day to day spending. After a decade of economic growth, the choices and opportunities for the poorest third of households are still desperately limited, and welfare dependency is increasing. 30 million people in the UK now receive at least one social security benefit and a third of households depend on the State for at least half of their income.<sup>13</sup>

## **End of the “cradle to grave” welfare state**

The terms of the welfare bargain have already been drastically revised. A number of separate policy decisions are coming together to close the era of the “cradle to grave” welfare state. People are already expected to contribute to their higher education. In older age care services have to be paid for, and the state pension is likely to provide a minimum at best. Under 35s are a crossover generation who are paying the cost of the welfare state without being able to expect many of the benefits.

In the more flexible global labour market people need to invest more in their own skills. In the past there was lifetime tenure with employers making decisions on investment in human capital. Now people have to change careers and invest in new skills. Income has both to meet day to day living standards and stretch to personal investment in marketable skills.

Many more people are now working in smaller firms where they have to take direct responsibility for the firm's survival and growth. In a knowledge based economy the initiative and commitment of these individuals are crucial. The economy is no longer machine paced but relies on the willingness of many individuals to take responsibility.

While the State can provide help for individuals in times of need, it cannot provide security over a lifetime. The cost of higher universal benefits, before or after retirement, would drive the tax burden even higher. People cannot be expected to provide for themselves if they are funding the cost of welfarism and unreformed services through higher taxes.

## The problem is the system

The failure of ever higher spending to improve public services has shown that the real problem is the system. In services such as health and education, government acts as both monopoly funder *and* provider of services. Managers look to government for their lead rather than to consumers. Central targets, national standards and their associated bureaucracy – which have made public services increasingly unsatisfying places in which to work – are integral to the current structure of these services. Only at the margins, for example in the NHS and prisons, have new types of providers been introduced. In services like policing, where government has also intensified its direction of local activity, choice and diversity of provision do not apply. Here, the problem has been that services are not properly accountable for their performance.

The 1940s consensus that public ownership and management of industry was the best way to secure prosperity and employment eventually expired, although not before entire industrial sectors were lost from Britain's shores. The other part of that consensus – that public ownership and management is the best way to secure equitable access to services – has endured for longer. But as society becomes increasingly consumerist; as tolerance of poor services lessens and spending ever more is seen to fail, the historic welfare settlement is breaking down.

The Britain onto which the welfare state was launched in the middle of the last century was a country which we would barely recognise today. People queued patiently for food and gratefully for healthcare. Today people's expectations of service are rising, and their willingness to accept their lot without complaint or to put up with substandard service is falling. These changing expectations are fuelled by the public's experience of services which are not provided by government. Technological revolution and rapidly rising levels of disposable income have created a new nation of empowered consumers who expect to make choices, whether it is over their mobile phone, their holiday or their car. As Alan Milburn observed: "We are in a consumer age whether people like it or not".

For too long the debate about public services has been polarised, with the public being told that the choice is between the status quo of state monopoly and the absence of government support. This is a false choice. Reform is not about withdrawing the State or privatising public services. It is about changing the nature of the State's intervention to match its competencies. The proper role of government is to ensure that everyone has access to essential services, regardless of their means. There is no intrinsic reason why government should also own and run those services itself, as many of our peer group countries – often with a greater commitment to social justice than our own – demonstrate:

- In the Netherlands, 70 per cent of children attend independent schools funded by the State.

- In France, one third of hospitals are non-state owned and in Germany the proportion is 50 per cent. Both countries deliver higher quality healthcare more equitably than is the case in Britain, not relying on waiting lists to regulate demand.

These systems simply do not recognise the ideological apartheid between public and private provision which has pervaded Britain since Bevan legislated for the “extinction” of local hospitals.

## Reform works

One element of the story of the last five years points the way forward. Where reform has been tried, it has transformed services at little extra cost. The introduction of choice for heart patients waiting for longer than six months for operations has almost eliminated the waiting list.<sup>14</sup> New forms of NHS provision funded by the taxpayer and run by the independent sector have achieved outputs eight times as high as their counterparts run in the public sector.<sup>15</sup> Schools with control over their admissions – at both ends of the ability range – have added more value to their pupils’ learning than traditional comprehensives.<sup>16</sup> Private prisons have outperformed those in the public sector.<sup>17</sup>

Some of these reforms have caused disruption, as work patterns and traditionally structured services face uncomfortable challenges. But the test of success must be whether reforms deliver better outcomes for the patient and the pupil, and better value for the taxpayer. Structural reforms will endure, to the benefit of the professional as much as the consumer. They are significantly different to the incessant re-organisations which fall short of structural change and disturb life for professionals without delivering real benefits.

The right course for the next government will be to learn from where successful reform has been introduced and extend it throughout the public sector. The wrong course would be to regress to the solutions of spending and central direction which for decades have failed to deliver.

## The challenge of global competition

As Gordon Brown has said, “No country can take its future prosperity for granted.”<sup>18</sup> The Government itself has pointed out that global activity is shifting in favour of the developing world.<sup>19</sup> China and India will account for about 25 per cent of world output in real terms by 2015. Increasing competition and the pace of technology mean that business resources can and will be moved across borders to the most productive location. Successful economies will need to be in the forefront of research and innovation to move into high value-added, technology-driven areas which add to growth. China and India already produce 4 million graduates every year – including 125,000 computer science graduates, compared to just 5,000 in Britain.<sup>20</sup>

The need for Britain to secure and enhance its competitive advantages has never been greater. But in every important respect in this regard we are either standing still or moving in the wrong direction. In both spending and taxation levels we have moved towards the EU15 average in the last five years. The strong fiscal position achieved by the end of the 1990s – based on fiscal restraint and partly on one-off gains in revenue such as privatisation, North Sea oil receipts and the peace dividend – has been squandered.

A new competitiveness agenda urgently needs to focus on five key areas:

- A relentless drive to raise education standards and skills.
- A step change in public sector performance to raise productivity.
- A radically improved transport infrastructure.
- A significant reduction in the burden of regulation.
- The restoration of globally competitive levels of taxation.

None of this, however, will be achieved by tinkering with public services. Real reform means addressing the structural causes of public sector failure:

- The growth in the size and role of government.
- The monopolistic nature of public services.
- The absence of consumer choice and competition.
- The absence of proper accountability.

The increasing use of targets; political interference by politicians; “centralisation”; increases in bureaucracy – these are all consequences of the design fault at the heart of public services. They are symptoms. Political solutions which aim to “slash targets”, “cut back bureaucracy” or “put control in the hands of professionals” are programmed to fail because they are palliatives. The bottom line of real reform is:

- **Politicians must remove themselves from the day-to-day running of services while managers are made accountable for performance.** Ministers are attempting to do the impossible: run what is effectively a £500 billion conglomerate with 5.5 million employees. The model of the Bank of England reform is one that should be extended to the public services.
- **Public sector monopolies must be opened up fully and the consumer given choice.** Providers will be incentivised by competition to be efficient, services will cost less and the consumer will get more. Dynamic and innovative health and schools sectors will add to the country’s economic growth rather than dragging on it. Transferring government spending power to consumers, supporting those whose ability to make choices is restricted by their income, will give the poorest in society access to high quality services for the first time.
- **Co-payment must be introduced** to enhance funding of services, make them more responsive to users, and moderate demand.
- **Public spending increases must be brought back below the trend rate of growth** to allow for significant and permanent reductions in taxation and permit personal provision.

## Four major policy solutions

In our Manifesto Briefing we set out a range of policy ideas covering higher education, prisons, transport and welfare. But we propose four major policy solutions to translate our reform principles into action:

- **Universal school choice** – school funding would follow parental choice and allow children to be sent to a state or independent school, topping up the fees if they so choose. At present funding per pupil only covers running costs and excludes funding for investment. By including capital costs, good schools would get the funds to expand and new schools could open. Central control, targets and intervention would be eliminated. Head teachers would have the freedom to run their schools as they see fit.
- **21st century healthcare** – government would become the guarantor of care rather than its monopoly supplier. Patients would be funded – either through the tax system or by way of universal insurance – to purchase healthcare from providers of their choice. The State would guarantee levels of health provision, including for the poorest in society, and patients could opt to spend more on certain services.
- **Accountable policing** – the police would be made accountable for their performance, either through a national or local mechanism. A new economic regulator would ensure value for money. Extra resources for the police would be conditional on these reforms.
- **A new Growth Rule** – for the next two parliaments the trend growth rate of departmental spending should be at least 2 per cent lower than the trend growth rate of GDP. This would reduce risk to economic growth, create room for tax reductions so as to promote private saving and ensure fairer treatment of the younger generation. Together with the reform programme to ensure improved value, and simplification of taxes, the current overall tax burden on individuals of 36 per cent could be reduced significantly in as little as five years.

## A new vision for Britain

Old dogmas have trapped politicians into defending a status quo that is failing. The Left seeks to defend public provision of services in the genuine but profoundly mistaken belief that to do so will preserve equity. It justifies reform at the margin only so as to minimise public flight to private provision. The Right flirts with privatisation and encourages people to opt-out of public provision, while believing that it can manage the remaining public sector better, minimising its cost.

Both approaches have failed. Both have the effect of preserving an apartheid between the public and private sector, and both would leave much of the public sector unreformed. We need a new approach with a higher purpose: to break down the barriers between private and public provision and extend opportunity to all, regardless of means.

The challenge of rapidly accelerating global competition makes it imperative that Britain changes course. We cannot expect to maintain our living standards unless we can compete through low taxes, world class skill levels and high productivity. But the growth of State dependency and the fact that the poorest in society experience

the worst public services also gives us powerful moral cause to challenge a system designed in the last century.

Real reform of the public sector would mean improved services and lower taxes. It would mean a better life for the professionals who run services, freeing them from political interference. And it would create a more equitable society, where for the first time the many would be empowered with the kind of choices that are currently available only to the few. The time for a new approach is long overdue.

## Notes

- 1 Current prices and current PPPs, \$US – OECD Annual National Accounts 1970-2003.
- 2 Q3 1992 to Q4 2004 – ONS, National Accounts Main Aggregates.
- 3 *OECD Economic Outlook*, June 2004.
- 4 *Overseas Direct Investment – UK Trade and Investment*, quoting from *World Investment Report 2004*, UNCTAD.
- 5 *ibid.*
- 6 Nolte, E. and McKee, M., Measuring the health of nations: analysis of mortality amenable to health care, *British Medical Journal*, 15 November 2003.
- 7 *Strategic Audit – discussion document*, Strategy Unit, 2003.
- 8 *Prison Statistics 2002*, Home Office, 2003.
- 9 *Jobs in the Public Sector Mid-2003*, Office for National Statistics, May 2004.
- 10 *Reform* bulletin, 14 July 2004.
- 11 *Real education reform*, *Reform*, 2003; Blackwell, N., *Better schools and hospitals - why parent and patient choice will work*, Centre for Policy Studies, 2004.
- 12 *Independent Schools Management Survey 2004*, haysmacintyre, 2004.
- 13 Crawford, C. and Shaw, J., *A Survey of the UK Benefit System*, Institute of Fiscal Studies, 2004; *Family Resources Survey 2002-03*, Department for Work and Pensions.
- 14 *Winning the War on Heart Disease*, NHS, 2004.
- 15 *Treatment Centres: Delivering Faster, Quality Care and Choice for NHS Patients*, Department for Health, 2005.
- 16 Attainment and Achievement Tables, Department for Education and Skills.
- 17 *The Operational Performance of PFI Prisons*, National Audit Office, June 2003.
- 18 Speech to the Enterprise Conference, 4 February 2005.
- 19 *Long Term Competitiveness*, Pre Budget Report, December 2004.
- 20 Gordon Brown, speech to the Enterprise Conference, 4 February 2005.

