

Executive summary

The UK's current model of government is failing and unsustainable.

Over the past 150 years, politicians have taken over many aspects of our lives that were previously the responsibility of families, civil society and local government, and centralised them in the hands of a small number of ministers and civil servants.

This huge growth in government has been associated with demonstrably poor outcomes and public services, often falling behind international best practice:

- **In managing the public finances** politicians have run deficits in 52 of the last 60 years; the official national debt (at £80,000 per family) is historically unprecedented after a long period of peace and the state has made huge future commitments in unfunded health and pension liabilities
- **In health** the UK ranks 20th out of 24 OECD countries on cancer survival rates and 24th out of 30 countries on the 'efficiency' of the health system
- **In education** 40 per cent of pupils do not get the accepted minimum standard of GCSE grades A* to C in English and Maths by age 16. More shockingly, 90 per cent of those who don't reach this basic standard by 16 don't achieve it by age 19
- **In social outcomes** there are 3.3 million UK households with at least one member aged 16 to 64 where no-one is currently working. This equates to 6 million people living in workless households (4.5 million people of working age and 1.5 million children)
- **In regulating the economy** politicians have raised costs and restricted opportunity. Land use planning regulations, for example, have raised house prices by as much as 40 per cent above what they would be under a more liberal regime
- **In political terms** there is now widespread disillusionment with the current model of government. In May 2014, a ComRes poll posed the question: "Do you trust government?" 20% said they did, whilst 9% didn't know. An overwhelming 71% said they didn't trust government

The most important reasons for these failures of central government are: complexity, over-centralisation, monopoly and bad management. Together these have taken power away from end users of services – making government unresponsive to the wants and needs of individuals and inflexible to changing technologies and demography.

Achieving effective government to meet the challenges of today and the future therefore requires politicians to be bold enough to completely re-think the scope of the state and how its functions are delivered and managed.

The Paragon Initiative is a major new five-year project. It will be the largest body of research ever undertaken by the IEA.

The aim is to assess in detail the current problems we face across all major government functions. It will be highly critical of the performance of government, because unless politicians acknowledge the poor outcomes and understand their underlying causes, no action will be taken to deliver the significant changes required.

The Initiative will determine the fundamental reforms that are needed to the way we are governed to solve these problems, and produce a roadmap towards a world where people have more control over their own lives and politicians are able to concentrate more effectively on the core functions of government.

The end point will be a series of research papers which, taken together, will outline:

- what the core business of central government should be;
- how these core functions should be managed;
- which non-core functions can be better managed by civil society, voluntary organisations or local government;
- how effective government can be maintained

The growth of government in the UK

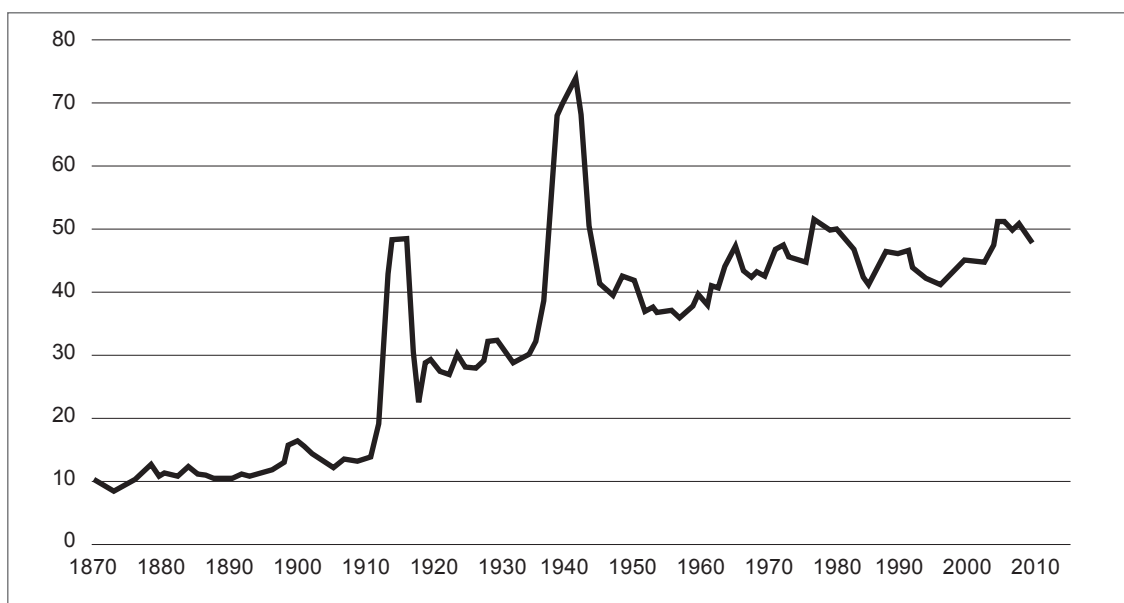
The current model of government in the UK is failing, unsustainable and inefficient. It urgently needs reform.

The size, scope and intrusiveness of the state has increased beyond recognition in the last century. Politicians and civil servants now control how nearly half of the nation's income is spent, are responsible for the funding and delivery of personal services such as healthcare, education and welfare, and determine many aspects of how we live our lives through excessive regulation.

Politicians control a greater proportion of national income

Government has increased its spending from around 10 per cent of GDP at the beginning of the 20th century to 47 per cent in 2014, reducing the proportion of income individuals get to spend for themselves.¹ Despite talk of the coalition government 'slashing' spending, government expenditure as a proportion of GDP at factor cost in 2014 was higher than in any year between 1947 and 1979 – the supposed post-war big government era.

Figure 1: General government expenditure as a proportion of GDP at factor cost



Source: Smith (2007; 2015)

Politicians now control the funding of important personal services

“Until August 1914 a sensible, law-abiding Englishman could pass through life and hardly notice the existence of the state”
A J P Taylor.²

Before World War I, governments already had some responsibilities that were beginning to undermine what we now call civil society institutions – friendly societies, charities and churches. Since then, politicians in successive governments have taken over the responsibility for funding many vital functions. To see the extent of this change: government spending on health, education and ‘social protection’ has increased from 11.5 per cent of government expenditure at the start of the 20th century to 63.2 per cent today.³ Without a radical overhaul, the change in demographics will result in unsustainably high levels of expenditure in these areas.

Politicians now control the provision and management of many services

In 1900, just 5.9 per cent of overall employment was in the public sector. Now it is 17.6 per cent (5.4 million). A further 1.3 million people were employed in outsourced sectors in 2010.⁴

Not content with just funding them, in the UK many services are now centralised and managed by politicians and civil servants as near-monopolies. It need not be this way. In many other countries civil society has a great deal more autonomy in delivering public services (even where funding is granted by governments), meaning government providers have not crowded out private organisations to the same extent. For example, the independent private sector, including not-for-profits, accounts for a third of all hospital beds in France and half in Germany.⁵

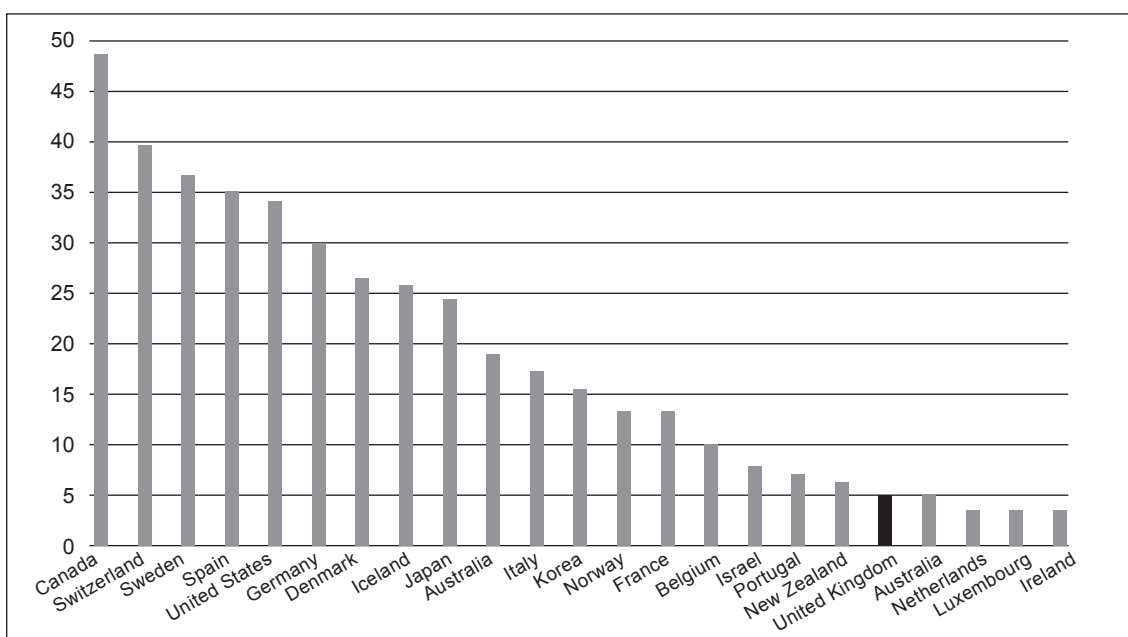
Too much political power is centralised in Westminster

“The biggest problem with government today is that the people making the decisions are too far from the people affected by them”
Steve Hilton.⁶

A strong culture of local government developed in 19th century Britain, with politicians with substantial powers trying to serve the different needs of their local communities. Many of these responsibilities have since been taken away from the local level, reducing accountability.

Even in the 1920s and 1930s local government accounted for 45 per cent of total government spending compared with only 25 per cent today. Less than 5 per cent of overall government tax revenue is now raised at a sub-central level.⁷ The UK is one of the most centralised states in the developed world. In effect, local government is just a branch office of central government. This is not to mention centralisation from the UK nation state to the European Union.

Figure 2: Sub-central tax revenue as a proportion of total government tax revenue.



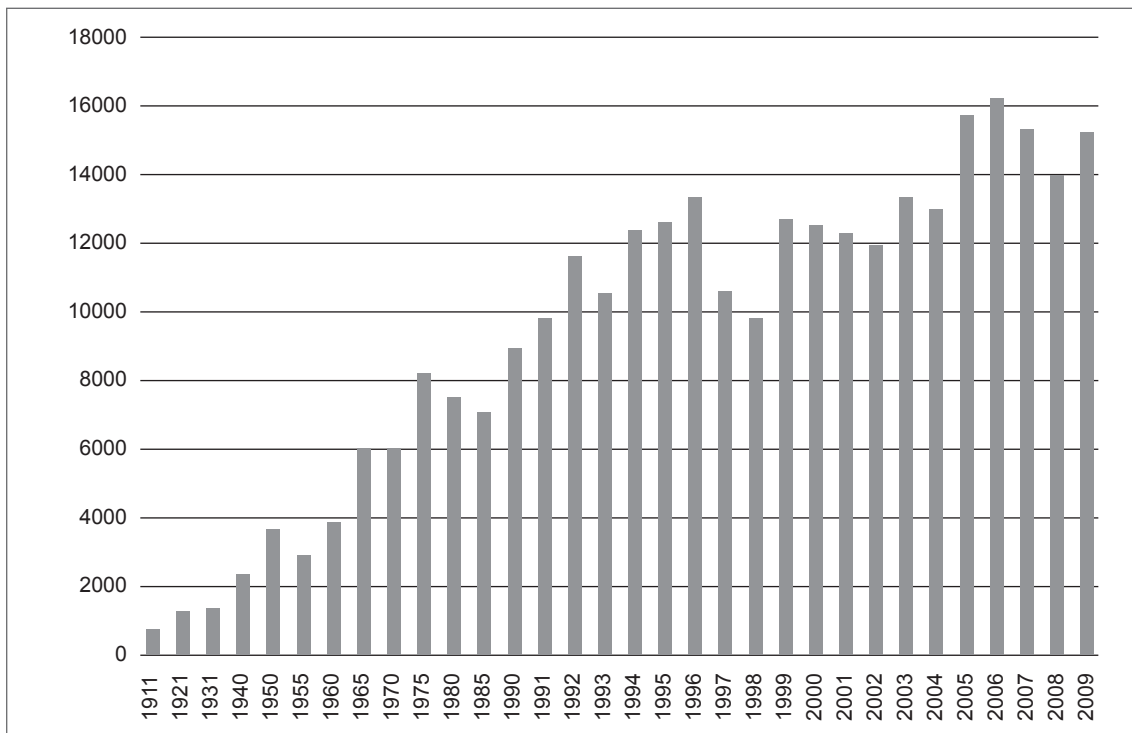
Source: OECD (2013)

Politicians now control many aspects of our lives through regulation

The state now regulates many aspects of our lives – employment relationships, environmental issues, consumer activity, childcare and lifestyles. The number of pages of legislation passed per year has increased by a factor of 20 over the past century. The high costs of regulation are a particular burden on small businesses and consumers, and they limit the freedom of individuals and businesses significantly.

The sheer volume of state activity encourages vested interests to lobby the government for special privileges and favours which enhance their interests. Bizarrely, the government itself funds many of those lobby groups.⁸

Figure 3: Pages of Acts and Statutory Instruments (1911 to 2009)⁹



Source: Annual volumes of Acts and SIs published by TSO

Outcomes of management by politicians and civil servants

The performance of politicians and civil servants should be judged by outcomes. As the examples below demonstrate, our current model of government is failing, with poor performance endemic in many departments and with many other unintended consequences of government activity.

Poor financial management

Politicians have not been prudent managers of the public finances. High levels of state spending have resulted in high levels of taxation and increased borrowing:

- The government has spent more than its revenue in 52 out of the last 60 years – with a deficit of £89.2 billion in the last year and a forecast £69.5 billion for this.¹⁰
- As a result official government debt now stands at £1.5 trillion. If off-balance-sheet finances and future liabilities, such as pensions and PFIs, were included, the national debt would probably stand at five times the official figure.
- Interest on debt will cost £46 billion this year, which is more than the cost of public order and safety.
- Without policy change, the promises government has made on health and pensions will impose an unsustainable burden on future generations.¹¹

Mediocre educational performance

Despite higher than average levels of spending on education, the UK's performance relative to that of other countries is mediocre:¹²

- 20 per cent of school leavers are functionally illiterate despite the UK's very high secondary school graduation rate.¹³
- 40 per cent of pupils do not get the accepted minimum standard of GCSE grades A* to C in English and Maths by age 16. More shockingly, 90 per cent of those who don't reach this basic standard by 16, don't achieve it by age 19.¹⁴
- The UK performs particularly poorly in terms of outcomes for 'disadvantaged socioeconomic groups'.¹⁵

Poor quality healthcare

If the NHS were an airline “planes would fall out of the sky all the time”
*Sir Robert Francis QC, Chairman of the Stafford Hospital Inquiry.*¹⁹

The NHS does not do well, on an international basis, when it comes to health care outcomes:

- The NHS is ranked 20th out of 24 OECD countries for five-year mortality rates for patients with breast, cervical and colorectal cancer.¹⁶
- Figures on mortality amenable to healthcare suggest the UK could avoid 14 deaths per 100,000 people if it rose to the standards of the social health insurance systems of continental Europe.¹⁷
- The Keogh, Francis and Kings Fund reports all highlight severe problems in the NHS – *30,000 unnecessary deaths, dirty wards, and uncaring nursing with patients left to suffer, hungry, thirsty and in pain.*
- An independent assessment of the ‘efficiency’ of our health system – a measure of how well inputs are used to improve health outcomes – ranks the UK 24th out of 30 countries.¹⁸

The welfare system creates dependence

A responsible society looks after the disadvantaged. However, instead of helping people to participate, our model of welfare has had the unintended consequence of making many dependent on taxpayer generosity, and does not look after them well:

- Centralised welfare provision is not responsive to different circumstances and needs; means-tested welfare interacts with the tax system to create marginal tax rates as high as 80 per cent – deterring progression in work and human capital formation.
- There are 3.3 million working-age UK households where no-one is currently working. This equates to 6 million people (including 1.5 million children).²⁰
- 13 per cent of children live in workless households. In 2011 it was estimated nearly 30 per cent of children lived in households with nobody in full-time work.²¹
- The UK has one of the highest rates in Europe of children living in single-parent families. Being in a non-working single parent family significantly increases the chances of growing up in poverty.²²

Excessive legislation and regulation increase costs and unemployment

Excessive legislation and regulation raise business costs, and reduce wages and innovation:

- The British Chamber of Commerce has estimated that additional employment regulations imposed by the Coalition will have cost businesses £23bn in the last four years of the 2010-2015 Parliament.
- Planning controls significantly increase UK housing costs. Comparison with similar countries suggests that land-use planning and related regulations have increased housing costs by up to 40 per cent. This especially affects the least well-off and the younger generations.²³
- Energy policies raise fuel bills unnecessarily; childcare regulations raise childcare costs; and food prices are raised by the Common Agricultural Policy and bio-fuels mandates at the EU level.
- Regulators and governments fail too. The banking crisis was a clear example of this, with certain interventions exacerbating moral hazard.²⁴

Low public sector productivity makes services expensive

The performance of public service productivity has been extremely poor, and this results in high costs of provision.

- Between 1997 and 2012 public sector productivity performance improved by only 3.7 per cent. By contrast, the private service sector between 1997 and 2012 improved productivity by 25 per cent.²⁵
- A series of reports commissioned by the Centre for Policy Studies undertaken by NERA in 1996 assessed the performance of 33 major companies privatised between 1984 and 1991. It found substantial improvements in productivity, leading to lower prices for consumers (domestic gas prices fell by nearly 25 per cent; airport charges by nearly 10 per cent; industrial gas prices by nearly 40 per cent; and telecom prices by 40 per cent) and large increases in financial flows to the Treasury.

The fundamental causes of failure

The causes of these failures are multi-faceted. Politicians have made many attempts to reform the delivery and management of public services over the years. But these attempts have been doomed because many of the broadest fundamental causes of failure have been ignored.

Complex functions with competing objectives

The range of activities the UK government engages in is extraordinarily diverse – making the government like an unwieldy conglomerate. What's more, some of the specific services government provides – like healthcare – are themselves extraordinarily complex. This makes government overall difficult for individuals or bodies to manage coherently, particularly given that government policies in different areas often have directly conflicting objectives.

Over-centralisation of power

An over-centralisation of power in Westminster prevents experimentation, and proper democratic or even direct accountability to end users of services. Providers of services and local government are unable to tailor their activities to meet the differing wants and needs of individuals, families or localities.

Monopoly kills innovation

In a range of areas, including the most important services, the UK government has a virtual monopoly on provision. Monopolies on this scale lack external performance comparisons, and a lack of competition means there is no threat of customer loss or bankruptcy. It's these rigours which drive innovation, continual improvement in management techniques and ultimately cost reduction for companies in the market sector.

The fact that these monopolies are guaranteed state funds and privileges also creates significant barriers to entry for potential competitors. This prevents entrepreneurial activity and the process of new entry and creative destruction which characterises dynamic market processes. This is particularly damaging given both the new opportunities presented by technological change, and the new challenges posed by ageing populations. Without flexibility in public service delivery, dealing with these issues effectively will be difficult to achieve.

These problems are exacerbated because there is little understanding amongst the British population about the relative performance of our government services. Very few people have experience of public services in other countries.

Without competition or the demand from end users for improvement, organisations become self-serving, inward-looking and bureaucratic. The opportunity to elect a new government every 5 years, meanwhile, does not create the same degree of accountability or pressure for change as the ability for individuals to take their custom elsewhere.

Innovation in healthcare is possible: Senior staff of the Virginia Mason Hospital visit Toyota in Japan each year for inspiration on how to improve safety and productivity. In 1994, after a patient died through being given a wrong injection, the hospital decided to admit all its mistakes – providing the necessary information to improve systems. The outcome: a 74 per cent reduction in the hospital's liability insurance premium and the number of complaints and lawsuits falling by 75 per cent.

Poorly qualified management and a culture of inertia

A successful organisation – a business, school or charity – will have a leader who is an experienced manager, and has an in-depth knowledge of its customers, services, systems and staff. The leader will often be long-serving, which provides stability so staff know the organisation's aims and culture, and what is expected of them.

Ministers and civil servants do not match this profile. They often lack this experience, and in the case of ministers and permanent secretaries often change their jobs so often that they have no time to gain it, or to be held accountable for their policies or performance. The Department for Transport had three permanent secretaries in the 2010-2015 Parliament, for example. The former Labour politician John Reid held seven Cabinet positions in eight years between 1999 and 2007.

The culture of the civil service has proven a major obstacle to reform too. The Civil Service Reform Plan described the culture as “cautious and slow moving, focused on process and not outcomes, bureaucratic, hierarchical and change resistant.” Top management imbued with this culture cannot be expected to bring about the radical changes that are needed.

Vested interests and lobby groups

The sheer volume of state activity encourages vested interests to lobby the government for special privileges and favours. This can sometimes be overt – see, for example, various subsidies (the recently announced tax credits for films and favours given to the energy sector). Often though vested interests obtain favours from politicians purely as a result of politicians' desires to win elections. How else can one explain the insulation of

a growing pensioner population from significant public spending restraint, or a continued failure of governments to liberalise planning laws?

The expansion of government, and hence its complexity, also occurs because new interventions are nowadays promised on the basis of 'the rich' paying for them, despite the fact that our tax base is already 'dangerously narrow', according to the Institute for Fiscal Studies. Indirect taxes and stealth taxes are used to create the illusion that many taxpayers are getting good value for money from public services.

The Paragon Initiative

The Paragon Initiative is a major five-year project being undertaken by the Institute of Economic Affairs.

It starts from the premise that the current framework of UK government fails to facilitate the conditions for a prosperous population with high living standards, high quality public services and good social outcomes.

Achieving effective government to meet the challenges of today and the future therefore requires politicians to be bold enough to completely re-think the scope of the state and how its functions are delivered and managed.

The Paragon Initiative aims to determine the fundamental changes that are needed to the way we are governed, and to propose a vision so that we operate in a world where people have greater control over their lives and politicians are able to govern effectively.

The Initiative will:

1. Review every major current function of government, examining the problems and failures of current government activity.
2. Draw on international best practice and acknowledge future challenges to outline effective alternative means of the function being delivered, whether that be within the public sector or otherwise.
3. Outline practical steps to get closer to the ideal means of delivering the function. Where appropriate, this will include pilot schemes for testing and evaluation.
4. Develop a constitutional framework, to ensure that well-functioning government will be maintained after the reforms are implemented, beyond the reach of vested interests.
5. Propose a new approach for politicians to manage effectively the operations which constitute the core business of government.

The endpoint will be a series of research papers which, taken together, will outline:

- what the core business of central government should be;
- how these core functions should be managed;
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Endnotes

1. National Income accounting is largely a post-war development and earlier measures are to some degree speculative. Even in more recent years conventions have changed frequently (most recently in 2014 when, for example, income from prostitution and illegal drugs was added to GDP), as have methods of data collection and the speed of release of data. What counts as government spending has also changed. The figures in the chart use measures of government spending and GDP which allow consistent historical comparisons (general government expenditure and GDP at factor cost) and are generally regarded as the best way to measure the share of government spending over long periods of time. The figures here come from Smith (2007) and Smith (2015).
2. From Taylor (1965) p.1.
3. Data taken from Davies (unpublished) and HMT (2015a).
4. Data taken from Davies (unpublished) and ONS (2014a), with calculations on outsourced industries estimated from data in Oxford Economics (2012) in line with methodology of Bourne (2011).
5. Data taken from Niemietz (2015).
6. From Hilton (2015) p.48.
7. Data taken from Davies (unpublished) and OECD (2013).
8. For a full exposition of this phenomenon, read Snowden (2012).
9. Figures for Statutory Instruments were only available up until 2009, though there is some evidence that the number of pages of Public and General Acts fell after 2009.
10. These figures are taken from HMT (2015b).
11. See the briefing paper produced by Booth and Bourne (2014).
12. In the PISA (Programme for International Student Assessment) outcomes for mathematics and reading, the UK performs around the average within the 34 OECD countries, although above the average in science.
13. See Bartholomew (2015).
14. Speech given by government minister Matthew Hancock in 2014: <https://www.gov.uk/government/speeches/maths-and-english-provision-in-post-16-education>
15. See analysis of OECD (2012).
16. Details can be found in Niemietz (2014).
17. See Niemietz (2015).
18. See Niemietz (2014).
19. Quotation, as widely reported, for example: <http://www.independent.co.uk/life-style/health-and-families/health-news/if-the-nhs-were-an-airline-planes-would-fall-out-of-the-sky-all-the-time-says-mid-staffs-inquiry-chairman-9436811.html>
20. See ONS (2014b)
21. See Niemietz (2012).

22. Ibid.

23. See Hilber and Vermeulen (2012) and Niemietz (2012).

24. There are too many examples of regulatory failure to discuss in this short paper. However, the banking crisis is clearly the worst example of legislative regulatory failure developed by politicians and implemented by regulatory agencies. The introduction of compulsory deposit insurance and state regulation of bank capital helped to crowd out the diverse range of institutions, such as building societies and trustee savings banks, which used to provide different levels of security for customers and compete with the riskier commercial banks. The moral hazard created by these interventions contributed to the banking crisis, exacerbated by the tri-partite system and the creation of the Financial Services Authority. The National Audit Office estimates that, even now – almost seven years after the crash, total outstanding support to the sector is as high as £122 billion or almost 7 per cent of GDP (though this is expected to continue falling).

25. See ONS (2015a) and ONS (2015b).

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