

ECONOMIC POLICY AND TAXATION AFTER BLAIR

The first in the 'Life After Blair' public lecture series at the London School of Economics, given by the Rt Hon. Charles Clarke MP on Wednesday 7th February 2007, 7.15pm

Introduction

Throughout the 20th Century, economic policy and taxation were the electoral millstone which prevented Labour holding power other than intermittently.

Ramsay MacDonald, Philip Snowden and the Great Slump, Stafford Cripps and devaluation and austere rationing, Harold Wilson and devaluation, British Leyland and the 'industrial disease', Jim Callaghan and the Winter of Discontent, Denis Healey and the International Monetary Fund and 98% rates of marginal taxation are just some of the folk memories of Labour economic failure.

Each of these was used to great political effect by Labour's enemies - often dishonestly, but they successfully prevented the Labour Party from winning the sustained period in office which is necessary to build the kind of society which the Labour Party was founded to achieve and whose intellectual foundations the London School of Economics has played such a leading role in building.

Probably the greatest single achievement of Tony Blair and Gordon Brown has been to prove that Labour in office can successfully run the economy in a way which creates economic stability and growth with low inflation, high levels of employment and high levels of investment in public services.

The credit for this belongs to both Blair and Brown. Despite all of its tensions and difficulties, including serious differences about policy and approach, their relationship has included a single-minded joint determination, lasting until today from even before 1994, that neither of them would become symbols, like so many of their predecessors as Labour Prime Minister or Labour Chancellor, of economic failure.

They sought, and have accomplished, a fundamental and historic change in Labour's economic reputation so that Labour will for the future be seen as the Party of economic success and not economic failure.

This achievement happened for a number of reasons.

First and foremost was the determination to outlaw profligacy and economic incompetence. We saw that from the outset in the commitment to honour Conservative spending plans for the first two years of Labour Government, with the consequent arguments in which Brown and Blair stood together, often against many in the Labour Party, including some of the Shadow Cabinet and then Cabinet.

We saw it too in the intolerance of economically incompetent organisations, such as some local authorities and nationalised industries, and the consequent national government interventions, again often very controversially. This is also the reason why Blair and Brown have both consistently resisted steps to 'restore' greater power to trade unions, as is so persistently demanded.

The second reason was the then controversial but now consensual decision to give independence to the Bank of England, and the establishment of the necessary institutions and regimes to make that happen.

And the third technique, which the Chancellor developed, was the creation of a set of 'rules', such as the 'Golden Rule' and the 'Fiscal Rule', by which his actions would be constrained, and the conventional Labour 'blowing off course' be avoided.

None of these three approaches were easy to implement and carry through and some remain very contentious, certainly within the Labour Party. However I strongly supported and support all of them, since I believe that they were all central to the economic success which Labour has achieved in government and which is now so commonplace that the economic problems of the past seem almost entirely forgotten.

But that very success has of course changed the economic policy questions which now face Labour and the country. Labour no longer has to convince the country that we are capable of running the economy well.

We now face the higher test of proving that we can run an economy which competes with the best in a world at a time of unprecedented and accelerating changes in economic relations and productive enterprise - when other countries are adapting and competing even faster than ourselves.

Moreover we have to compete whilst there is growing concern about climate change and whilst in this country we are experiencing rapidly rising popular expectations of the Government's ability to secure high quality services.

And as we meet these new challenges on the basis of our strong record of achievement we know and understand that the prescriptions of the past will not serve for the future. And so it is important to re-evaluate some central economic policy questions. I could discuss a number of these this evening, including the relationship of the £ to other currencies, the machinery at the centre of government, investment in our infrastructure through public-private partnerships, and the level of public spending in different parts of the United Kingdom.

I will, however, leave these and other matters to another day and focus this evening on three subjects:- taxation, the encouragement of opportunity and enterprise, and raising the efficiency of the public sector.

I begin with taxation.

Taxation

For the last thirty years or so the level of taxation has been a dominant political concern in most countries. From the political right Ronald Reagan and Margaret Thatcher appeared conclusively to win the argument that there was a direct and inverse relationship between the propensity of a political party to raise taxes and its likelihood of being elected.

And of course the level of taxation, or at least of certain taxation rates, has been a potent political brew. So for example newspapers continue to campaign to reduce or

abolish particular taxes and the charge that taxes are being raised 'by stealth' is a serious one.

The Brown/Blair New Labour regime essentially accepted the Reagan/Thatcher hypothesis that those who raised tax would lose elections. As a result taxes on higher rates of income have not generally been increased and the tax base of VAT has not been broadened along the lines of many other European countries. More generally, discussion about the merits and demerits of particular taxation strategies has become almost frozen, perhaps mainly because of a media climate in which any proposal for change can be presented graphically in inaccurate terms.

The main, and important, exception to this understandable and in many ways laudable caution was the Chancellor's commendable decision in the last Parliament to raise National Insurance contributions. This was justified as a means of raising National Health Service levels of spending closer to that in the rest of Europe. There was little political opposition to the change and the Conservatives now go out of their way to claim that NHS spending, at this higher level, is safe in their hands.

This decision to raise National Insurance to pay for health, in an almost hypothecated way, is a good illustration of what I believe to be an important principle for social democrats, that taxation is a means and not an end.

In this case the tax increase was the means by which the collective good of high quality health services is better funded by the community as a whole. The same can of course be true for other community goods, such as defence, education or law and order.

Taxation can also of course be a means to stable Keynesian economic management, as fiscal controls are used to encourage high and stable employment, low interest rates and good growth. That is the basis of George Osborne's Tory Conference rebuff to his Conservative tax-cutting colleagues, when he stated that 'economic stability' would take priority over tax cuts - whatever one thinks of the sincerity with which that commitment was offered.

And taxation is of course used to promote overall social and economic policy goals, for example in reducing poverty or promoting marriage. It can be used to influence individual conduct, for example in encouraging saving or productive work or promoting more healthy or environmentally positive behaviour, through taxes on tobacco or Nigel Lawson's higher tax on leaded petrol.

In short taxation is an important means to economic and political ends. In my view it is now time for Labour to build upon its achievement of economic strength, and even more its reputation for economic competence, to consider evolving our tax strategies. This evening I suggest two significant areas where this could be done.

First we should shift decisively to attach tax revenues to those things that the public wants to spend money on. This means increasing the proportion of taxation which is hypothecated to a particular purpose such as health, green sustainability or particular infrastructure investments. The Treasury has conventionally rejected this proposal, including under this Government, on the fundamental grounds that it does not want any restrictions upon its freedom to act. I think that they do not give sufficient weight to the downside of that attitude, which is that the citizen does not feel any particular connection to or ownership of the way that their taxes are spent.

I think that the current welcome interest in 'green taxation' is a good example of the need for hypothecation. This seeks to change behaviour by increasing taxes upon environmental 'bads' and reducing taxation on environmental 'goods'. Those who oppose such tax changes, even if they are designed to be revenue-neutral, argue that it would be just another 'stealth tax' - a trick to swell the Treasury's coffers, but with no impact upon the environment.

I believe the reverse - that the public will accept green taxation if they can see that the benefits are genuine and will impact upon the lives of themselves and their families.

The letter to the Chancellor from the Environment Secretary, David Miliband, before last December's Pre-Budget Report made a number of specific suggestions, such as a landfill tax escalator, increased vehicle emission duty for high-emissions vehicles, fuel duty related to the price of oil, road user pricing, home energy efficiency improvements, air passenger duty, VAT for flights, enhanced capital allowances for anaerobic digestion in agriculture, fiscal instruments for energy efficiency, a start to the Environmental Transformation Fund as well as a variety of public sector procurement issues. Any or all of these could form part of a transparently hypothecated package to promote environmentally beneficial purposes such as higher quality and cheaper public transport, or supporting energy conservation.

In a similar way I hope that the Report of the Lyons Committee on local taxation will restore a far closer link between local political decisions and the level of local taxation. Local taxation and spending should be more closely related to each other. In addition local taxation could be raised, perhaps on the basis of a local referendum, for particular capital infrastructure projects. Or council tax increases above a certain level could be authorised only by local referenda, without the need for a central government cap.

I believe that the case for such hypothecation is very strong and the time has come to examine it seriously. It would make taxation more understandable, spending more accountable and would restore consideration of taxation to the centre of our national political life, where it belongs.

Second, we should accept that it is reasonable in some areas for the beneficiaries of public spending to make a greater contribution to the spending from which they benefit, in some proportion to the benefit received. That was the essence of the case for higher and more variable tuition fees, which initially was so strongly opposed by the Treasury and the Chancellor, but I am glad is now supported both by them and by the official Opposition. The fundamental reason why the otherwise attractive option of a graduate tax was not successful was that the Treasury refused to contemplate hypothecating revenue from such a tax to universities on any formula.

I believe that the taxation argument will become sharper over the coming period as resources from the Exchequer expand at a slower pace than in recent years and as the public spending pressures, highlighted most recently last week by the Institute for Fiscal Studies, begin to bite more deeply.

Even in the relatively well-favoured areas of education and health, it is difficult to imagine consistent annual public real spending increases of more than about 3%. Even if this is combined with the annual 3% efficiency savings proposed in last December's Pre-Budget Report I very much doubt that this will be enough to meet the likely increases in demand for spending in those areas. Nor do I believe that

there will be any real appetite to raise general levels of taxation to meet those demands. Indeed my own view is that such general increases would be difficult to justify.

However the drivers of increases in demand for education and health have real substance. For example the Chancellor announced just a few days ago that he intends to 'raise the school leaving age' to 18. The 'extended schools' programme already anticipates that schools are to be open for much longer hours, for example from breakfast to early evening, 50 weeks a year, seven days a week. And it is very good news that pre-school provision is being enormously expanded.

The health pressures are equally vital. People are living longer, new health treatments regularly become available which many believe should not be subject to a 'postcode lottery', and improved healthcare is leading more children to survive serious handicaps after birth.

All of these desirable changes, and many others across Government, will cost money to support. As I have just said I do not believe that over the coming decades the combination of Gershon-type efficiency gains and the likely levels of increased allocations from the Treasury are likely to meet public expectations, and the consequent political pressures.

The only way out of the dilemma which governments will therefore face is to permit some levels of charging, along the lines of university tuition fees. Such charging is certainly likely to raise important issues of fairness and possible social division as was the case for student fees. I believe that it is important, as we did successfully with student finance, for it to be a Labour government, committed to social justice, which faces up to the hard choices implicit in the policy options which any government will face, particularly as they are bound to run across the most important public services in this country, in some of which, such as dentistry, 'co-funding' is already becoming established.

But I believe that our starting point should be the need to raise the resources which are necessary to fund the growth which our public services need, without forcing individuals to choose private sector options to meet needs that they want to address but the public sector cannot meet.

So I believe that in the ways I suggest Labour should move forward from the positions which we have hitherto taken in both of these two areas - hypothecation and 'co-funding' of some public services. There are other important issues for both personal and corporate taxation, such as establishing a simple and intelligible system in place of the Byzantine structures which currently exist and are understood only by expensive tax lawyers, if that is not a tautology.

And of course there are other difficult taxation issues which will be better addressed in an environment where tax decisions are taken within a clear and open framework of the type which I describe.

I now turn to the second economic policy question I want to address this evening, the promotion of a society in which opportunity and enterprise flourish.

Opportunity and Enterprise

I believe that any impartial observer would be bound to conclude that this Government has made massive strides in building strong local economies throughout the country, reducing social exclusion for many sections of the population and promoting social justice. These values, which are at the core of the Labour Party's belief, are absolutely vital for a strong society.

That said, we need to acknowledge that mobility and opportunity have proved amongst the most intractable of problems for social democratic governments over the decades, partly because of the time taken for any change to have an impact and partly because of lack of confidence about the best path to follow.

For example, there are real issues, and there has been uncertainty, about the way in which we can ensure that maximising protection for those in work does not necessarily damage those who are out of work. That has been at the core of debate about the so-called 'European social model' and has given real concern to trade unions.

Similarly, for centuries many on the left have argued that opportunity is a zero-sum game. One person's wealth is another's poverty. One person's power is another's impotence. One person's chance is another's disadvantage. If you're going to make the poor richer you have to make the rich poorer.

One of the contributions of new Labour is to challenge assertions such as these. It does so by stating that a Labour government will seek to advance life chances and fight alienation for every individual, and not simply for those in work. That was the purpose of our social exclusion agenda and it is why we supported the case for flexibility of labour markets within an increasingly flexible economy.

It does so by asserting that whole society benefits from the success of individuals, organisations and communities within it and from the aspiration to success that goes with that.

I believe that the foundation of our future policy approach has to be the celebration of success. Any ambition to 'make the pips squeak' is outdated, wrong in theory and wrong in practice.

I suggest this evening that we need to use six main weapons if we are really to create greater opportunity and enterprise and to enable everyone to fulfil their aspirations.

These are:-

- the fight to reduce poverty, including the establishment of a socially just pensions system;
- the efforts to create universal and universally excellent childcare with support for parents;
- the determination to enable every child to start secondary school able to read and write well;
- the efforts to bring together the world of education and the world of work on the basis of a transformed agenda for skill development ;
- the continuous need to fight social exclusion and
- the constant struggle against discrimination on grounds of sex, race, sexual orientation or disability.

In each of these areas this Government has already made great achievements, with the minimum wage and more people in work, the Sure Start programme for under-5s, increased levels of attainment for 11 year olds, the beginning of extended and healthy schools, changes in examinations and curriculum, with a renewed commitment to skills for young people and greater involvement for employers in the education system and changes in the law to empower those who fight discrimination.

We should never forget that each of these advances was bitterly opposed by the Conservatives. It is vital that Labour continues and develops these programmes so that their principles are established irreversibly. Each of them illustrates the need for Labour to maintain a lengthy period in office.

Labour needs that time to continue to support families, in particular parents, in our poorest communities, both through the tax and benefit system and by direct services.

It needs the time to entrench a childcare system, based on Sure Start principles, which is universal and exists in every community and is not simply an extended pilot programme.

It needs the time to evolve the school curriculum to offer more variety in primary schools, including arts and sport, and in secondary schools following the principles set out in Mike Tomlinson's report and, above all, to put first the needs of every individual child, different and complicated as they are.

It needs the time to accelerate the engagement of employers, both private and public, with our education system, through basic support, the specialist schools and academies programme and strong joint work for skills and apprenticeships, particularly between employers and schools from 14 to 19.

And it needs the time to focus far more directly upon looked-after children and the children of those in prison from whom a disproportionate amount of crime hits our communities.

These are all long-term commitments and programmes which can only achieve lasting results from a long-term Labour government.

Legal remedies are still necessary for those who continue to suffer discrimination. But in the long-term an over-legalistic approach is not the most effective way to fight discrimination. We need businesses and public organisations, large and small, to celebrate the advantage which they enjoy from their diversity and positively promote that. Government must encourage that change of culture.

And a change of culture which promotes opportunity and enterprise will not be achieved by a flow of regulations and controls which require compliance but invite evasion.

It is partnership not compulsion which will promote high quality economic performance by large and small enterprises. Businesses which work with their local universities will grow productivity. Employers who commit to social partnership will, long-term, get the best from their workforce. Small firms which work with schools will recruit and develop the skilled employees they need.

The promotion of such partnerships and the encouragement of such success needs to be the core of a Labour government's approach. This is particularly challenging in the modern sharply competitive global economy with rapidly moving and often cynical finance capital forcing short-term change in every industry.

And for Labour a particularly important partnership is that with its affiliated trade unions. I believe that Labour in Government needs to try and repair its relations with the trade union movement. The 2004 Warwick agreement was a compromise between almost directly opposing analyses about the future of Labour, some looking to the past and others looking to the future.

We need now to begin discussions to conclude a new Warwick agreement which faces the challenges of the future, proper skill development for all employees, fair pension provision, flexible working arrangements for parents and other carers, joint commitment to promote environmentally sustainable practices at the workplace.

A Labour approach to building opportunity and enterprise through partnership and success, rather than coercion and regulation, will gain the support of the public.

But of course all of this will only cut any ice if the public accept that money raised in taxation is well spent and is delivering real results. That will be a constant source of political argument and indeed is so today. So I turn now to the means which we should consider to attack more directly the efficiency and productivity of our public sector.

Public sector efficiency

In addressing this aspect of economic policy, I cannot escape my personal history as I often have in mind the experience of my father who in the early 1960s was responsible for public spending at the Treasury and who as such played his part in devising the then innovatory PESC arrangements which have evolved into our current Comprehensive Spending Review process. On family holidays he used to rail against the profligacy of other Government departments, such as the Ministry of Transport's extravagance in providing more road signs than the intelligent motorist really needed!!

It seems to me that the key question here is how to drive efficiency and how to incentivise those individuals and organisations upon whom we depend to make this happen. The regime of targets and outcome tests which begun in the early to mid-1990s and which has now become very well-established has one immense achievement to its credit. It has placed efficiency and results at the centre of our modern public service culture.

This may seem self-evident but it most certainly did not use to be the case. Too many public servants did not have results and outcomes at the centre of their thinking, and too many were ready to look at the failures of others, or at global conditions, to justify their own lack of success. I believe that this cannot be said today and that this is a credit to this government and the approach which has consistently been followed. In consequence, however, the problem we face has changed.

Our problem today is that those who want to make a difference, and whose motivation, strength and commitment we need, are often not sure how best to go about making that happen. They have been confused by lack of consistency in

relation to some of the reform programmes which Government has put in place and sometimes they feel the impact of a series of regulatory regimes which seriously constrain their ability to make a difference. Moreover the system in which they operate does not necessarily place responsibility for finance and outcomes at the place where a real difference can be made.

I believe that it is time for the Government unequivocally to follow the model of those major corporations which decided 20 years ago that success came through small, slimmed down central functions, the devolution of power to far smaller business units and profit centres and the abolition of many of the conventional distinctions of hierarchy.

In public sector terms, I have previously called this approach one of 'social entrepreneurship' which sees the mobilisation of energy as essential, whether at the level of the individual or the organisation, for example a school or hospital.

This contrasts with the position of those I have described as the 'traditional Webbits' (and I hope I offer no offence to LSE in making this description) who essentially believe that the key to change driven from the centre is to establish the right framework of national law, administrative and professional practice and central leadership. They believe that fairness and equality can best be achieved by use of central regulation. They tend to distrust local or professional initiative on the grounds that it is likely that those who are already better placed will use that advantage to reinforce their position in a competitive way and so those who most need support will fail to receive it. This is the school of thought which has tended to oppose initiatives such as foundation hospitals and trust schools, because of fears of inequity.

Such analysts have believed that the 'social entrepreneurs' saw competition, rather than co-operation, as the normal relationship between schools or hospitals.

I believe that this fear is misplaced. It is essential to create institutions and individuals which encourage mobilisation and strong local leadership. I believe that organizations like specialist schools and foundation hospitals are the means to positive change and I do not accept that this needs to lead in practice to increasing inequality.

So I conclude that we should adopt a strategy of steadily seeking to free from the difficulties and constraints which they now experience schools, GP practices, hospitals, police stations, offender management services and the range of organisations which deliver real service to real people locally.

That means providing a budget for at least three years ahead on which they can rely and plan, without constant changes of funding formula.

It means ensuring the establishment of a living contract where the school or hospital receives payment in response to fulfilment of certain targets and ambitions, preferably agreed no more frequently than annually in a way which involves all state agencies and other stakeholders together.

It means ensuring that organisations receive 100% of any efficiency gains they generate, rather than having to pay half or more back to the Treasury.

It means encouraging the development of supplementary local income streams to increase resources.

It means aligning the performance incentives of organisations with the performance incentives of those who work for them, where possible devolving control of budgets to named individuals.

It means devolving to the lowest possible level human resource decisions, including the right to hire and fire and the setting of pay, on the basis of control of overall pay budgets rather than of employee numbers or rates of pay increase.

It means permitting organisations like schools and hospitals to own their own assets and borrow against those assets and appropriate income streams.

It means seeing the role of Government procurement as getting the best deal for a combination of literally millions of local purchase decisions by using Amazon-style techniques.

It means promoting leadership and encouraging local leaders to improve the public service for which they are responsible by all the means which they can bring to bear.

And I must add that what is true for the local public services, such as schools and hospital needs to be true for national and regional institutions too.

Bodies like the Higher Education Funding Council for England or the Highways Agency should be able to take their own decisions, including on human resources, on the basis of at least three year budgets, possibly including a control on total pay, without the need for constant reference back to the Cabinet Office or the Treasury.

I am of course aware that the programme of institutional freedoms which I have set out has enormous implications. It would have to be worked through carefully and systematically, since not all institutions could immediately be trusted to run themselves. A variety of audit and training processes would need to be put in place at different levels.

And I know that many will argue that this kind of programme and its associated bonfire of the regulations, would risk a loss of control which, might be costly and pose economic dangers.

This view had real substance in the past, and was indeed the reason for establishing many of the controls which we now have. However we are now ten years on and, by a variety of means, Labour has significantly improved the management of many of the organisations which gave rise to greatest concern previously.

I now therefore believe that, provided that such a change was made with prudence, greater freedom and more clearly devolved authority would strengthen local leadership, local responsibility and local accountability and thereby increase public sector efficiency.

We should set the expectation that over time every public service organisation would enjoy the freedoms I describe and we should move down that path with care and consideration and an atmosphere of regular review.

But the path should be clear and it should embrace the commitment of the literally millions of public service professionals who are committed to high quality public services and want to play their part in making that happen.

Though both the Treasury and the Cabinet Office are responsible for the cat's cradle of controls which now exists, and which should be dismantled, it is the lead from a Treasury committed to use our new-found economic strength to promote public service efficiency which will be so important.

I conclude this section on public sector efficiency by reference to pilots, the Public Sector Borrowing Requirement and the need to rationalise levels of Government in this country.

After nine years of government the need for pilots and new initiatives should be minimal. There certainly was a place for them, but now we should be in the mode of implementing carefully considered changes across the public service, and promoting change in mainstream ways of doing things. While there may be the need to phase in any change, for financial or other reasons, that should simply be a matter of timing rather than experimentation.

Now may also be the time to relax Public Spending Borrowing Requirement restrictions on local government and some other organisations. These were certainly necessary in 1997 but much less so now. It should be possible to find mechanisms, perhaps through an independent body such as that dealing with foundation hospitals, to permit at least some local authorities to borrow on the market against assured revenue streams such as housing and transport. This should be reviewed.

Finally I argue that it should be a central goal of economic policy at this time to simplify and rationalise the many levels of government in this country. From national government and its agencies of various kinds, most with some form of local presence, to the various agencies of regional government to the different varieties of local government across the country there are substantial overlaps and I believe significant scope for efficiencies. Such efficiencies can only be made by facing up to hard choices and this Chancellor has already taken very important steps in that direction. But there is more that can be done and more that needs to be done.

Conclusion

The economic record of this Prime Minister and Chancellor is brilliant, and should inspire faith in the capacity of committed politicians to make a real difference.

What I have said tonight does not seek in any way to undermine or belittle that achievement.

However, I really do believe that it is time to recognize that the achievement itself has changed the economic circumstances which Labour faces. The solution for 1994 to 1997 and the first years of Labour office are not the same solutions that we need for the next decade.

The particular proposals which I make this evening may or may not be worthy of support.

But I believe as deeply as I can that Labour cannot avoid discussion about the best path for the future. We must engage with it in the confidence that we are the political party best equipped to find the right answers.

I congratulate the London School of Economics on fulfilling its historic role and I hope that the discussion you have stimulated will carry on and increase in intensity.

END