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Speech to CBI Public Services Summit

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Good morning, and thank you for attending this, the third CBI public services summit.

We meet at what I call a burning platform moment for the public sector.

The state of our public finances is, as everyone knows, in a serious mess and deteriorating fast.

The big question is whether we are going to seize the opportunities created by the crisis, and drive through necessary reforms that would have been politically just too difficult to pull off in calmer times.

Or instead will we be content to drift on what is plainly an unsustainable course – one that leads to the risk of high long-term interest rates and economic stagnation in the short term, and crushing liabilities for future generations of taxpayers in the long term?

The case for bold public services reform has never been clearer. And if not now, when?

Let's start with the big picture. The UK faces a fiscal deficit this year on a scale which has never been experienced before in peacetime.

The bulk of this deficit is structural in nature, which means that it won't simply disappear when the economy starts to recover. On the Treasury's own forecasts, it will be eight years before the Budget is back in balance.

That's two full parliaments of fiscal austerity.

What's to be done?

One thing is clear. Rapid moves to cut spending or raise taxes would be a big mistake -- the economy is still much too weak for strong medicine. As evidence of what not to do, you only have to look back to Japan in the mid-1990s, when a sudden fit of fiscal austerity led the government to push up taxes too early, and sent the country spinning back into recession.

But that's not a reason for sitting around and doing nothing.

Everyone understands that sooner or later, things are going to have to change. Either public spending will have to go down, or taxes go up – or quite probably both. The investors who are going to be asked to buy a mountain of government securities in the next few years in order to finance the deficit need to be confident that the government is going to get a grip on the public finances – otherwise they will demand higher long-term interest rates in return for their money.

Businesses that need to take long-term investment decisions will be similarly cautious until they have a better idea of which way the wind is going to blow.

So the politicians need to give much clearer indications of how they plan to shrink the deficit, and to set out a credible pathway back to sustainable public finances.

That means taking tough decisions now.

Last week, the Office for National Statistics published an important analysis of how productivity in the public services had changed in the ten years to 2007.

As you may imagine, coming up with a sensible answer involves a lot of complex measurement. If you just took the crude numbers, you would conclude that – for example – a reduction in classroom sizes would represent a fall in the productivity of teachers, which would plainly be daft.

To get round this, the statisticians have adjusted their measures to take into account increased quality of service in the health and education sectors. After allowing for this, they conclude that total productivity across the piece fell by just over 3 per cent in the ten years, an annual average of 0.3 per cent.

That may not sound like much. But increased competition, together with improvements in technology and work processes, have transformed the productivity of the UK's businesses over that same period of time. While the public sector number was falling by 3.2 per cent, productivity in the market sector rose by nearly a quarter.

If the public sector had matched the private sector's productivity performance over that period, then we could now have 11 per cent more public services for the same money.

In adult social care, prisoner rehabilitation, welfare to work programmes and across all our public services, we could be getting more if greater efforts had been made to drive through reforms and efficiencies in the years of public spending growth.

While our politicians debate the merits or otherwise of ten per cent cuts in services, think what could be done with 11 per cent increases.

We have to be realistic, though. Public sector monopolies can simply never match the productivity performance of competitive private industry.

But the figures do point to what has to happen over the next few years.

We've seen an enormous increase both in the pace of public spending and in the number of public sector jobs.

Now the emphasis has to change. We have to start squeezing more out of all this extra capacity – finding better ways of giving citizens services of the quality and breadth they have a right to expect. Whether it's in health, education, transport infrastructure or whatever.

That in turn means radical changes in the way that our public services are delivered. And it means big changes, too, in the way that public money is managed and disbursed.

Cuts simply handed down from the centre, salami style, cannot improve efficiency in the way that is required. We need a new emphasis on value for money throughout the process, with managers at all levels empowered to change their way of working in order to deliver more with less.

We need more market testing, and much more engagement with the private and voluntary sectors in the delivery of our public services.

Fair competition between these providers is the single best tool policymakers have at their disposal for controlling costs and increasing quality.

We badly need this tool to be used more effectively. We cannot allow the reforms that bring about more and better use of competition to stall. A cabinet member recently said that public service reform is like a shark: if it stops moving, it dies. We fear things aren't going swimmingly for the shark right now.

Some parts of the public sector have grasped that things need to change. The Department of Work and Pensions' 'right to bid' policy means any provider can approach it and pitch to win business. The Department of Health's 'any willing provider' policy has similar intentions.

The Ministry of Justice has announced that two of its poorly performing prisons are to be market tested, and the success the private sector has had in building and managing prisons should be remembered here. Its performance in cutting costs and improving standards offers lessons to other departments.

There are clear financial benefits to subjecting existing provision to competition. Academic studies find that the typical cost savings from competitive tendering to be between ten and thirty per cent, including when the in-house team won the bid. This comes with no adverse effect on service quality, and, if done well, can be used to improve it.

Many local authorities are making progress, and the CBI is working with the Local Government Association to improve commissioning and make better use of public service markets.

Glasgow City Council has signed a pioneering joint venture which sees it hand over operational control of its day-to-day services to a private firm and make considerable savings and service improvements as a result, while Essex and Barnet councils are looking at large-scale outsourcing to help meet their efficiency targets.

Across government at all levels, the shared services agenda must be pursued with a fresh vigour. It makes no sense that so many parts of the public sector are clinging on to their own back office administrative functions when pooling resources and creating economies of scale could greatly enhance efficiency and offer service improvements.

There are major human resources issues as well. Performance could be enhanced with greater devolution of accountability to front-line managers. Public sector

absence must be cut, and better use made of performance-related pay and incentives.

The public sector's commissioning skills must be improved if we are to get the best of what competition and contestability can deliver for taxpayers and public service users alike.

The biggest single HR issue is that of public sector pensions. These are in need of immediate, drastic and permanent reform.

We should not accept a situation where nine in ten public sector workers have a defined benefit pension scheme when this is the case for only one in ten private sector employers.

The private sector has had to face up to what its pension commitments will cost, and has made huge efforts to put its own house in order. The government must do the same for its employees.

According to an analysis in the *Economist* magazine this week, there were in 2007 just 2.7m private sector employees in defined benefit schemes, of which 1.3m were in schemes that were still open to new recruits.

By contrast there were 5.2m active members in the public sector, overwhelmingly in DB-type schemes that remained open.

And remember that public sector workers make up only a fifth of total employment.

The cost to future taxpayers of the resulting liabilities is unimaginably large. A report last week from the think tank Policy Exchange put the amount of unfunded pension obligations to public sector staff at well over £1,000 billion, equivalent to more than three quarters of national income.

Sooner or later, this problem will have to be tackled. And if not now, when? Given the current state of our public finances, political expediency can be the only reason for delay.

Pensions throw up a specific problem when public sector staff transfer to the private sector under contract.

Put simply, public sector providers bidding to win work do not have to take account the true costs of the generous final salary provision their employees receive. Instead, they just take account of their own direct costs in their bids, which are only small proportion of the total liability.

Private sector providers do not have this luxury, and so some must price as much as 60 per cent of their overall payroll for pensions costs into their contract to cover potential liabilities.

This can have the twin effect of making public sector bids look cheaper than they really are and of discouraging many would-be bidders from entering public services markets.

Today, we have published a report that looks in more detail at this issue and offers practical solutions that will really make a difference. The current situation is threatening to let new providers' role in improving public services stagnate at the very moment when their potential to raise productivity and improve quality is so badly needed.

Where proper reforms have been made, their success is plain to see. But these have often been small steps when responding to the pressures of increased demand, changing demographics and fewer resources needs giant leaps.

In the 2009 CBI Public Services Survey, published this week, only three per cent of firms said they thought there would be any significant public service reforms between now and the general election. Ninety-four per cent said there would be none.

It would be deeply regrettable if this were to come to pass. So, I'd like to conclude by making a three-fold challenge to policymakers.

First, be honest. People have to know what services cost and how much – or how little – is in the kitty. We cannot quickly escape the fiscal handcuffs we are in, no matter how hard we struggle, and so must function within them and learn lessons for when economic growth returns.

George Osborne made a sensible contribution to this debate with his article in the *Times* yesterday.

Second, be bold. Look for radical and innovative ways to ensure that cuts in spending don't have to mean cuts in services. Tear up the rule book. Do not be afraid to take risks.

Third, don't go it alone. Only by working together and using the expertise and experience that new and existing providers from all sectors can offer can the challenge be met.

It is vital that business plays a prominent role in this debate. As taxpayers and service users, we will be demanding customers. We will be vocal in support for those who act, but speak out against those who do not.

Thank you for listening, and I'm sure Ruby McGregor-Smith from MITIE and other members of the CBI Public Services Strategy Board here today will be able to tell us what they are doing on the ground to deliver more for less.

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