

Radical Britain

## The unlikely revolutionary

David Cameron's Britain has embarked on the toughest fiscal tightening and most drastic decentralisation of any big, rich country. The stakes are high. So are the risks

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ALEXIS DE TOCQUEVILLE'S chronicles of the Anglo-Saxon world did not stop with America. On a tour of Britain, he was taken with its liberal vigour, decentralised government and "spirit of association". It came as a relief from the stultifying uniformity that he knew at home in France.

Under Gordon Brown Britain arguably became Europe's truly Napoleonic state, the real home of *dirigisme*. More of its public spending now comes from central government than in any OECD country bar New Zealand. Its local government is weaker than nearly any comparable country, including France. The state finances and provides most health care. It bossily decrees where schools can be opened, and how they must be run. Then there is the sheer size of the beast: on OECD figures, public spending made up 51% of GDP in 2009, putting Britain into the same league as continental countries that deplore Anglo-Saxon *laissez-faire*.

It would have been understandable, if not forgivable, had David Cameron ducked a showdown with Leviathan. The Conservative prime minister failed to win May's general election outright and governs precariously in coalition with the Liberal Democrats. Yet as it approaches its 100th day, the government is turning out to be searingly ambitious in taming the state. It wants to cut public spending more steeply than almost anyone expected. And it intends to make sure that whatever state is left is more local, flexible and responsive to the people who pay for it.

The first of these missions is the more obviously radical, out of necessity. The government inherited an economy only starting to climb out of a ruinous recession that had been among the deepest in the G7 and had lasted the longest. Even that tentative upturn relied on unparalleled looseness in fiscal and monetary policy. A debt-laden economy emerging from a banking crisis looked vulnerable to a Japanese-style "lost decade" of faltering recovery.

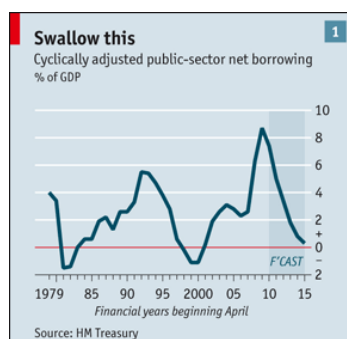
Even worse was the budgetary mess the new government inherited. Labour ran a deficit even during the boom years, and stuck to its expansive three-year spending plans after recession hit. Fiscal stimulus on top of this took the deficit to a record high of 11% of GDP in 2009-10; the IMF forecast in May that it would be the biggest this year among G20 economies. Whoever won the election would sooner or later have to slash the deficit.

The new government decided to do it sooner. After a few days in office, George Osborne, the Conservative chancellor of the exchequer, announced cuts to take effect in 2010-11. His coalition partners, the Liberal Democrats, had opposed an early start during the campaign. But against the background of Greece's sovereign-debt crisis, they agreed to endorse them.

These first cuts trimmed the deficit by only £6 billion (\$9.4 billion), or 0.4% of GDP. But they showed the new government meant business. They also hinted at the pain that lay ahead: spending cuts equal to less than 1% of total expenditure involved reductions of over 5% for some departments. The National Health Service, which makes up nearly a fifth of total spending, was to be "ring-fenced" for a full parliament, and defence and schools protected in the first year. Overseas aid would rise until it reached 0.7% of GDP in 2013.

The budget on June 22nd set out fuller plans through to 2014-15. Mr Osborne was surprisingly bold in two ways. He decided to clip the deficit at a brisk pace. And he plumped for doing it mainly through spending cuts.

Mr Osborne plans to get the job essentially done by 2014-15. If all goes to plan, the deficit will fall from 11% of GDP in 2009-10 to 2.1% in 2014-15. The structural deficit, which strips out the effects of the economic cycle, will drop from 8.7% of GDP to 0.8% (see chart). On a similar basis, the government will by then be running a small surplus on the current budget, which excludes net investment (due to be slashed anyway over the next couple of years). This is a much faster retrenchment than the previous Labour government envisaged. It planned to return the cyclically-adjusted current budget to balance in 2016-17. Labour's fiscal consolidation would have amounted to 4% of GDP by 2014-15; Mr Osborne is aiming at 6.3%.



The fiscal squeeze in Britain is less intense than in some smaller European economies, such as Greece. But it is much the biggest and fastest among the G7 economies. The retrenchment planned by America and Japan, the two big economies running deficits comparable to Britain's, is nowhere near as significant, says Ben Broadbent, an economist at Goldman Sachs, a bank.

Mr Osborne has also nailed his radical colours to the mast by relying on spending cuts for three-quarters of the squeeze by 2014-15, leaving relatively little work for tax rises. In the ten biggest consolidations among rich countries from the late 1970s to the mid-2000s, just two countries—Canada in the 1990s and Ireland in the 1980s—leaned more heavily on spending cuts, according to a study by the OECD in 2007.

### Daring or daredevil?

If boldness is the test, then the strategy for cutting the deficit cannot be faulted. But though fortune may favour the brave, it can trip up the headstrong. Debate rages—not only in Britain—over whether it makes economic sense to tighten fiscal policy so much, so fast. And austerity plans may not be achievable without ripping vital public services to shreds.

The independent Office for Budget Responsibility (OBR), which now oversees Treasury forecasts, delivered an encouraging verdict in June on the probable economic impact of the budget. Though it trimmed GDP growth forecasts made on the basis of Labour's policies, from 1.3% to 1.2% in 2010 and from 2.6% to 2.3% in 2011, the downward adjustment was surprisingly small given Mr Osborne's accelerated fiscal consolidation.

By moving decisively the government has gained credibility with investors worried about Britain's huge deficit, and yields on government debt have fallen. Moreover, growth was surprisingly strong in the second quarter of this year, with GDP rising by 1.1% compared with its level in the first three months. The worry, however, is that firms and households burdened by debt are in no mood to invest or spend more, and the extra budgetary restraint could choke off recovery. Confidence indicators for both businesses and consumers have dropped since the budget, spurring fears of a double-dip recession.

In its quarterly take on the economy on August 11th, the Bank of England lowered its growth forecast, but still expects a respectable recovery. Presenting its *Inflation Report*, Mervyn King, the bank's governor, played down the importance of Mr Osborne's extra austerity in the downward revision to growth. The government thinks its harsh fiscal policies will permit more monetary balm, whether through resuming the policy of quantitative easing or keeping interest rates lower for longer. Judging by this week's report, the central bank is in no mood to tighten policy and takes the view that the rise in inflation will eventually be doused by spare capacity.

Even if loose monetary policy can ensure recovery in the teeth of fiscal consolidation, the Treasury's spending plans may simply not be feasible. With interest payments rising because of huge borrowing, and the NHS ring-fenced from real cuts, the departments responsible for other public services face cuts of 25% by 2014-15. If defence and schools are to be spared such harsh treatment—by limiting cuts to 10%, say—the others face a real squeeze of 33%.

Cuts on this scale would be fiercer than any since the second world war. The precise allocation will be announced on October 20th, and ministers will be at each other's throats until then. The row over defence has been especially fierce: a document leaked this month suggested that all three armed forces would shrink dramatically, the RAF to its smallest for a century.

One way to alleviate the squeeze on public services is to intensify it on the welfare budget, which accounts for 28% of all spending. In June Mr Osborne announced savings of £11 billion by 2014-15 (half of it from switching the inflation measure used to uprate benefits). If the government were able to save an additional £14 billion on welfare, unprotected departmental budgets could fall by only 20%, calculates Rowena Crawford of the Institute for Fiscal Studies (IFS), a think-tank.

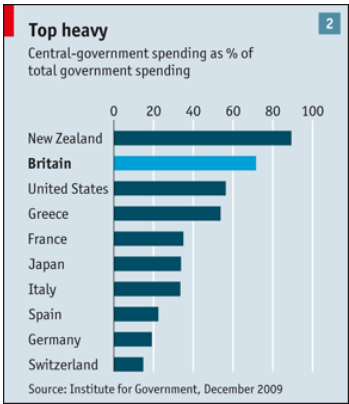
But there are limits, it seems, to the new government's radicalism. It could raise close to £10 billion by 2014-15 by means-testing payments such as child benefit that go to the better off as well as the poor and by scrapping winter-fuel payments and free bus travel for people over 60 (pensioners are anyway gaining from more generous uprating of the basic pension). Or if it dropped ring-fencing of the NHS and postponed its commitment to meet the overseas-aid target, that would reduce overall departmental cuts to 14%, according to the IFS. Both, however, would mean reneging on election pledges.

And this highlights a big concern about the coalition's fiscal plans: they may be both too bold and too timid. On the economic front, it would be wise to have a plan B in case Keynesian fears about overstringent cuts turn out to be right. And as to spending, a government that preaches radicalism should be ready to tear up election pledges that make little sense.

The centrifuge

There is more to Mr Cameron's radical vision than number-crunching. The other part of this revolution is an agenda for devolving power from the centre.

Britain is one of the most centralised countries in the rich world (see chart 2). The central planning that made sense when it was fighting for survival in the second world war was giddily retained in peacetime. Many European countries, traumatised by defeat or collaboration, remade their states from first principles, often pushing power away from the tainted centre. In Britain, victory sanctified and strengthened Westminster and Whitehall.



Then came Margaret Thatcher, who centralised the country still more politically in order to emancipate it economically. Tony Blair went further, micro-managing public services from the centre through performance targets. When he eventually recanted, his political stock was too low for him to get far. His successor, Mr Brown, was an unenthusiastic devolver, at best.

But decentralisation has now found a home. Blairite reforms, such as state-funded but self-run "foundation" hospitals and "academy" schools, appeal to an ancient Tory reverence for the local, the small and the independent. Giving power away was the theme of the Conservatives' manifesto for this year's general election. It flopped politically. Many Tories think they would have won a majority in Parliament with a more bread-and-butter campaign.

But that indecisive result has helped the centrifugal cause. Mr Cameron was able to forge a coalition with the Lib Dems precisely because both parties saw the state as overcentralised and overbearing. When they hammered out a joint programme for government, the main theme other than austerity was decentralisation. Three areas are in for particularly deep change: education, policing and health care.

In an approach partly inherited from Labour, the new government aims to allow parents more choice in their children's education. Existing schools are encouraged to switch to academy status, and newly created "free schools", set up and run by not-for-profit businesses, charities, faith groups, universities, private schools or parents themselves, will be in operation. These will be able to set pay and conditions for staff, deviate from the national curriculum, decide the length of school days and terms, and so forth. The state will pay for premises and provide funding per pupil; poorer children will attract more, so that schools are keen to take them on.

Opponents fret that school quality will vary and middle-class students will benefit most. They complain that supply-side reforms are sucking money from the physical upgrade of existing schools. Even reformers have quibbles. The ban on school providers making a profit seems politically motivated. The education secretary is ultimately to decide which new schools are approved, which seems unlocalist.

Still, the injection of choice and competition into an unusually rigid school system could transform it. Schools will compete for pupils, not the other way around. So far around 160 schools have applied to become academies, and there have been over 60 bids to set up new free schools. The

numbers may well increase as the policies take hold.

Of all the public services, the police have until now been least exposed to people power. Chief constables are essentially accountable to home secretaries. The public complain that officers sit at their desks rather than patrolling trouble spots, direct victims to support phone lines rather than going after offenders, and show a particular indifference to the supposedly low-level blight of anti-social behaviour.

Quis custodiet?

The government's answer to all this is directly elected "police and crime commissioners" for every constabulary in England and Wales (bar London, where an elected mayor effectively exercises democratic oversight already). Starting in 2012 they will determine priorities for their local force, appoint and remove chief constables and set the budget. The police authorities that purportedly hold constabularies to account now will be scrapped.

Civil libertarians worry that elections will lead to populism in policing. But the commissioners will not be able to create new offences or relax basic rules of conduct for officers. A more likely outcome is that even a democratic mandate will not be enough for commissioners to prevail over police chiefs, most of whom loathe the idea of taking orders from outsiders.

As radical as free schools or police commissioners, but less trailed than either, is the government's plan for the NHS. Mr Cameron promised obliquely to "trust the professionals". This has turned out to mean something profound. General practitioners (GPs), grouped in consortia, are to commission most secondary care. Strategic health authorities and primary-care trusts, which currently do that job, will be ditched, and patients will have greater freedom to choose their GP. The aim is efficiency as well as flexibility: GPs will be given incentives to keep their patients away from costly and unnecessary hospital care.

This may be the riskiest of all the coalition's plans to shake up the public sector. GP "fund-holding" was pioneered by John Major's Conservative government, but it was voluntary. Many family doctors lack the desire or the aptitude to manage large budgets. The stakes are enormous: commissioning involves most of the NHS's roughly £100 billion annual budget in England. It is also another wrenching reform to the NHS, and comes from a party that deplored such disruptions under Labour.

The government's drive to give power away does not stop at these three public services. Welfare is also being overhauled: paying firms and charities to help the unemployed into work will continue, and a fundamental benefits reform is mooted. There will be more elected mayors, fewer MPs and more citizen initiatives. The government will help to train and fund community organisers. And, in a *glasnost* to complement the *perestroika* of decentralisation, more data is being put online.



Where does this radicalism come from? Ruddy-faced and shire-bred, Mr Cameron looks and sounds like the stolid, middle-of-the-road High Tory he is often thought to be. Part of the answer lies in the company he keeps. Among the most evangelical of the Tocquevillian Tories is Steve Hilton, Mr Cameron's strategist. A former advertising man who grew intrigued by the potential of businesses and other non-state organisations to bring about social change, he joined his old friend's campaign to remake the Conservative Party.

Mr Hilton works closely with Oliver Letwin, a cabinet-office minister no less eager to strip power from the centre. Downing Street's policy unit is run by James O'Shaughnessy, who came up with much of what is now the new schools policy in his previous life as a think-tanker. His colleague, Rohan Silva, is perhaps the most ardent centrifugalist of the policy advisers. In opposition Mr Hilton, Mr O'Shaughnessy and Mr Silva travelled the world (and especially America) to study decentralised government and social innovation in action (see [article](#)). The fruits of this shuttle wonkery are strewn through the coalition's programme.

There are, of course, problems with the programme. Many of the boldest ideas have not been adequately tested. The Tories' faith that civil society can take on the burdens of the state may be more touching than realistic. And even if the policies are sound, resistance to them will be ferocious. Britons dislike public services that vary in quality according to a "postcode lottery". Unions will test the government's resolve. Many civil servants will fight the transfer of power from Whitehall.

Giving up power also means different things to different parts of the coalition. David Miliband, the favourite to become the next leader of the Labour Party, once spoke of "double devolution". Power, he said, should be given from central to local government, and where possible from government of any kind to ordinary people. The Tories are keen on the second half of this transfer; the Lib Dems prefer the first (and have a strong presence on many local councils). This could cause clashes. There is also a difference of emphasis between those Tories who yearn to shrink the state, such as Mr Osborne, and those focused on decentralising it, such as Mr Hilton. Reform often costs money in the short run.

Yet with all these caveats, the new government's vision of a looser state, and its determination to reform virtually all the public services at once, is boldly outlined. Add in the even more daring plan to cut the fiscal deficit, and Britain is in for a breathless and convulsive few years. Now and then, British elections are epochal, setting the tone for other countries, too. One such took place in 1945, when the modern welfare state got going. Another, in 1979, loosed Margaret Thatcher on a waiting world. By producing a ruling coalition that is as radical in redefining government as it is in cutting it, the election of 2010 may prove another turning point.