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Living standards and public spending

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As Parliamentarians stagger towards summer recess, we find ourselves embroiled in a furious argument about the House of Lords.

In my two years in the Commons, I have discovered that the passionate intensity with which Parliament debates something is usually in inverse proportion to its importance to most members of the public.

Whatever reforms are made to this peculiarly British institution, I am pretty sure that none of them is going to have much impact on the health, happiness or prosperity of the British people in the next 50 years.

Fortunately, if you head outside Parliament, it is not hard to find people who are focusing on the things that really matter.

And the Resolution Foundation is one of the places where they gather.

It is difficult to overstate the importance of the work being done by the Foundation and its Commission on Living Standards. The publication of the Commission's report in the autumn will have huge influence right across the political spectrum, as we all try to grapple with one of the UK's most intractable problems that we face.

By exposing the stagnation of most people's wages in the decade that led up to the financial crash, you have challenged us all to re-examine our commitment to the Thatcher-Blair bargain that combined lightly regulated and moderately taxed free markets with steadily increasing spending on financial transfers and public services.

For those like me who are deeply committed to this model, that challenge was best expressed by Charles Moore, when, one year ago, he asked “is the Left right after all?”

He went on to explain the source of his doubts.

“People..have lost faith in the free-market, Western, democratic order. They ask the simple question, “What's in it for me?”, and they do not hear a good answer.”

Ed Miliband has made the plight of the ‘squeezed middle’ one of his main themes since he became leader of the Labour Party.

And I, for one, am glad that he can call on the intelligence and integrity of people like Andrew Adonis and Rachel Reeves – who spoke here a fortnight ago – to help him come up with answers to the problems he has described.

But it is my contention that politicians – of all parties – have barely begun to wrestle with the implications of the stagnation in living standards or confront the agonising choices that we will be forced to make in the decades to come.

In January, in my Macmillan Lecture, I argued that we needed a new national mission: to make Britain, and the British people, competitive once again.

Productivity and competitiveness are my lodestars because I am convinced that the only way that we can restore sustained improvement in living standards is if most working people in Britain can command high and steadily increasing wages in the market place.

It may be true that, for some, total household income has continued to grow because a previously unemployed partner has started work or one or both partners have increased the number of hours they work. And that's good news. I want people to have the opportunity to work more hours if they want.

It may also be true that increased financial transfers by government have helped many people on low pay enjoy rising incomes despite the stagnation in their wages. And I support the working tax credit and would like to see it continue.

But it seems obvious to me that neither of these trends can go on forever – and, even if they could, we should not want them to.

What will it do for the health and happiness of ourselves and our families if the only way to achieve a growing income is to work ever longer hours?

And which of us really believes that any government will be able to expand every year the amount of money it gives to those whose wages have stalled?

It is on the productivity of British workers and the competitiveness of our economy that we must focus if we want to help people get on and build better lives for themselves and their families.

Today I want to explore what this focus would mean in practice, and, in particular, what it implies for public spending.

For it is here that the toughest choices will be required.

The Comprehensive Spending Review in 2010 showed how a Government can use bold decisions about public spending to support its key priorities even at a time of austerity.

We cut spending on university teaching by 40% but protected the science budget and extended an offer of 15 hours a week of free childcare for 2 year olds from low income families.

This revealed a lot about our priorities and beliefs.

It showed that we believe the funding of a university education should reflect the fact that most graduates will benefit from higher incomes as a direct result.

That we recognise that scientific innovation is a vital source of future competitive advantage for the UK.

That we think the best way to help young children escape poverty is to make it easier for their parents to go out to work.

In the next three years, Britain will have to confront an even tougher set of fiscal challenges than those we have already surmounted.

Sluggish growth, and the fact that the financial crisis inflicted far greater damage on our economic potential than anyone thought, has put our target of eradicating the structural deficit by 2014/15 out of reach.

So we will have to make even harder choices.

What the governing parties propose for public spending – in future budgets and spending reviews as a coalition, and in our manifestos as independent parties – and how the Labour Party responds will reveal more about our respective priorities than all of next year's parliamentary debates put together.

The Coalition parties have already made two big decisions.

We have decided to try and eradicate the structural deficit by 2016/17.

And we have made clear that we will achieve this through further cuts in public spending not tax rises.

In so doing, we have asserted our shared conviction that government can't improve people's living standards by borrowing more or putting up their taxes.

And we are challenging the Labour Party to say how much more they will borrow and which taxes they will raise, if they disagree.

While the planned total of public spending reveals the Coalition parties' belief that Britain must not fall into a high-debt high-tax trap like France, it is the detailed spending plans that will make our priorities plain.

So I hope that Treasury ministers will not take it amiss, if I suggest four clear principles to guide the choices they make and help ensure that public spending is focused on improving the productivity of the British people and competitiveness of our economy.

First. Growth in public spending as a percentage of GDP should be restricted to those programmes with measurable impact on the productivity of working people and the competitiveness of the British economy.

Second. Spending on other priorities should be restrained so that spending on all of them combined is gradually falling as a percentage of GDP.

Third. Spending programmes that have enjoyed the most rapid growth in recent years and that do not contribute to improved productivity or competitiveness should be the first targets for substantial cuts.

Fourth. New public spending commitments should be ruled out altogether unless they can be funded entirely by diverting spending from other existing programmes.

These principles have controversial implications.

My fourth principle would imply that the Government is right to defer full implementation of Andrew Dilnot's solution to the future funding of social care until the next Comprehensive Spending Review.

And that it should only go ahead if sufficient savings can be achieved through the integration of health and social care (as suggested in last week's outstanding report by the IFS for the Nuffield Trust) or through changes to benefits for older people.

Like all MPs, I have constituents who are enraged by the fact that their elderly parents have to sell their home and spend all their life savings to pay for residential care in the final months of their lives.

And understandably so.

But I think it would be irresponsible for any government to suggest that the taxpayer should assume an additional unfunded burden worth 0.2% of GDP in 2021/22 (or roughly £3 billion in today's money) – and equally irresponsible to impose new taxes on hard-pressed working people to pay for it.

If we are to make the improvement of productivity and competitiveness our overwhelming priority, difficult decisions will have to be made and this is one of them.

My third principle would suggest that we should concentrate the next round of cuts on benefits and tax credits on which spending has ballooned in recent years and which don't help people improve their skills or get back into work.

Housing benefit has grown, in today's money, from £16 billion in 1996/97 to £22 billion in 2011/12.

Although it probably does help some people move to places where they are more likely to find jobs, I challenge anyone to show that this is the most cost-effective way to help people into work or to tackle our generational failure to provide enough affordable homes for our growing population.

Meanwhile, child tax credit has grown in today's money from £15 billion in 2004/05 to £22 billion in 2011/12.

And that comes on top of a child benefit bill of £12 billion before the recent restrictions on higher rate taxpayers.

While these transfers provide a vital boost for the incomes of many poorer families with children, unlike working tax credit on which we only spend £8 billion, child tax credits and child benefit do little to help parents get into work and nothing to incentivise them to take steps to improve their capacity to command a decent wage in future.

Given all that we now know about the crucial importance of children's early years in shaping their destiny, does anyone really believe that the best way of helping the next generation escape poverty and build better futures for themselves is to spend over £30 billion on financial transfers to their parents and only £5 billion on education for under-5s?

Spending on universal benefits for the elderly (the Winter Fuel Allowance, free prescriptions, free bus travel and free TV licenses for the over 75s) reached roughly £4 billion in 2010/11.

I know that this help is vitally important for many older people – and a step away from universal provision of these benefits after the next election would need to be handled very carefully as many members of this generation are admirably reluctant to make a fuss, even when they really need help.

But, does anyone here think it would be responsible for a country in our financial position to go on giving a free TV license to Michael Winner, free prescriptions to Lord Sugar and a winter fuel allowance to Sir Paul McCartney after 2015?

In his Budget statement, the Chancellor mooted a further £10.5 billion in cuts to welfare spending by 2016/17 as a way of moderating the cuts that would be required in government spending on public services.

As a percentage of GDP this is equivalent to £8.5 billion today.

I find it very revealing that the authors of last week's IFS report include this cut in the baseline of their calculations of different scenarios of NHS and social care funding.

Why? Because it's almost impossible to make the numbers stack up credibly in any other way.

If we are to achieve stability in our public finances AND make crucial investments in improving productivity and competitiveness, we must find a way to save at least £8.5 billion from the £145 billion we currently spend on benefits other than pensions.

And if we are going to protect spending on pensions – as I believe we should – equity between the generations requires that these cuts cannot only fall on students, adults of working age and families with young children.

The Prime Minister is right to fulfil his pledge to protect these benefits during this parliament. But I believe we need to acknowledge now that we will not be able to continue the protection of these other benefits for better off pensioners after 2015.

My second principle suggests that we should restrain the growth of public spending in areas, which do not contribute much to improved productivity or competitiveness.

Government in a civilised country like the UK has a range of responsibilities reflecting the range of values we cherish.

Our national security. The rule of law and the maintenance of good order. The prevention of disease and treatment for the sick. The beauty of our environment and the protection of our national heritage.

They are all important and some of them will require real spending increases as our economy returns to growth. But a government with ten priorities has no priorities.

I believe that we will need to increase spending on the NHS (at least to maintain its value in real terms and maybe by enough to keep spending constant as a percentage of GDP.)

But this means we will have to hold down spending on policing, defence, the prison service, the environment, agriculture and the arts so that the overall budget for government programmes that do not make a big contribution to the improvement of productivity and competitiveness gradually falls as a percentage of GDP.

Which brings us back to my first principle.

Politicians love to talk about spending more taxpayers' money on their favourite policies and programmes.

And I am not immune to that vice.

But as we go through the process of identifying areas where spending should increase, I hope we will keep at the front of our minds the genuine hardship that will be suffered by those who currently benefit from the programmes we will have to cut

And resolve to be even tougher, even more hard-headed, and even more exacting in our scrutiny of those who are bidding for more.

If we spray money unthinkingly at any halfway plausible education programme, infrastructure project or R&D scheme, we will waste money just as surely as the last Government did.

And we will have even less excuse, as they were governing in an age of plenty and we are not.

So how should we go about this crucial task?

I suggest that the Chancellor should ask every government department to identify those programmes that it believes can be justified as crucial to the long-term improvement of productivity and competitiveness and to submit detailed evidence of their actual or potential impact.

He should make it clear that in submitting a bid for more money the department is opening itself up to a disproportionate budget cut, if it fails to provide convincing evidence of existing programmes' positive impact on productivity and competitiveness.

Without this detailed scrutiny of costs and benefits, it is impossible to anticipate what mix of spending on education, childcare, employment support, infrastructure and R&D will deliver the greatest long term impact on the productivity of working people and the competitiveness of our economy.

Let me finish with a difficult test case, which provides a good example of the sort of tough-minded scrutiny that will be required.

I am sure that everyone here will agree that effective spending to help those least able to assume the responsibilities of parenthood do a better job of bringing up their children is essential.

Particularly for a government that wants to increase the productivity of the next generation of workers.

So many might think that Sure Start would be a good candidate for more money.

But I am afraid that would be to perpetuate the kind of lazy sentimentalism that has seen so much taxpayers' money wasted over the last decade.

The most recent evaluation of Sure Start noted that, despite costing £1,300 per child and £1.1 billion in total, "no differences emerged" between children who had attended Sure Start and those who hadn't on seven different measures of cognitive and social development.

The Chairman of the Public Accounts Committee, Margaret Hodge, herself a former Minister for Children, has said "we tried to do too many things on not enough money."

And Sure Start's former director Naomi Eisenstadt has said, "the core design principles of Sure Start were more to do with what government wanted public services to be… and not really based on evidence of interventions that had been tested through scientific methodologies."

If we are going to make any difference to the future productivity of working people and the competitiveness of our economy, we must abandon this soggy approach and demand that the childcare and child development programmes we invest in have a substantial and measurable impact.

Because that is the only way we can justify taking the money from hard-pressed taxpayers in the first place.

As I have set out today, the Coalition is going to be confronted with some very hard choices on public spending if we are going to achieve a decisive improvement in productivity and competitiveness and a reversal of recent trends in living standards.

In the last two years, Conservatives and Liberal Democrats have shown that we are willing and able to grit our teeth and take unpopular decisions in what we believe is the national interest.

And I am confident that together we have what it takes to rise to these new challenges.

The question I would leave you with is this.

Is the current leadership of the Labour Party willing and able to do the same?

We know what cuts Ed Miliband and Ed Balls oppose but very little about those they support.

We know what further spending they would like to see but very little about the taxes they would put up to make these pledges consistent with Alistair Darling's plan to deal with the structural deficit.

Talk is cheap.

But, as President Hollande is discovering, to govern is to choose.

I have set out here some of the painful choices that I believe are necessary.

If they want to earn the right to govern in the future, the two men running the Labour Party will someday soon have to do the same.

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