

## 2011 Manion Lecture

Canada School of Public Service, National Arts Centre, Ottawa, Ontario, Canada

2 June 2011

### ***Achieving Results in the Context of Fiscal Restraint: Real-Time Lessons from the British Experience***

**Sir Gus O'Donnell**

#### **Introduction**

1. The Canadian fiscal retrenchment of the 1990s has been seen by many in the UK as a model for how to cut a deficit with minimum pain. In this lecture I want to look first at the **economics**, to compare and contrast the UK and Canadian situations. I will argue that, for various reasons, the UK in the 2010s faces a tougher challenge than Canada did in the 1990s, to pull itself out of a more vulnerable position, but that a credible consolidation is crucial to minimise risks to the UK economy.
2. Then I want to consider the **political economy** of how to make the difficult choices needed to achieve fiscal consolidation with minimum pain. This is an area where we have studied the Canadian experience and have learned from it. No doubt you can tell me if we have drawn the right conclusions.
3. Finally, I would like to share with you how we are **implementing** our deficit reduction plans in ways designed to achieve *better* with less – and the particular challenges faced by the UK Civil Service.

#### **The Economics**

##### **The Canadian and UK contexts**

4. The UK now is, of course, not Canada in 1996.<sup>1</sup> There are, however, some strong similarities. Both countries experienced a long period of growth interrupted by a sharp recession. This led to an increase in deficits and debt which eventually

---

<sup>1</sup> As noted, for example, recently by M Mendelson, Caledon Institute of Social Policy, 'The UK in 2011 is not Canada in 1996', May 2011.

reached levels which were unsustainable. The scale of the fiscal task is larger for the UK in terms of deficits: our deficit peaked at 11% GDP while Canada's was significantly less.<sup>2</sup> However the Canadian net debt ratio peaked at 71% in 1995, exactly the same level as the UK's is forecast to hit in 2013-14.

5. Given these similarities, the success of the Canadian Government in tackling its deficit and turning round an unsustainable rise in public debt, helps to show that the adjustment the UK now has to make can be done. But the differences are also instructive. Arguably, they suggest that the UK faces a tougher and more urgent challenge to consolidate its public finances, given its weaker starting position and the size of its financial sector.
6. The recession in the UK was deeper than that in Canada – we had a cumulative GDP loss of 6 percentage points reflecting our large exposure, both in GDP and revenue terms, to the financial sector. This meant we started the fiscal retrenchment with a large output gap - estimated at 4% of GDP in 2011 by the new independent Office for Budget Responsibility (OBR), whose forecasts assume a significant loss of capacity in the UK economy following the financial crisis. We are also, however, suffering from higher than expected inflation, in part caused by increases in global commodity prices and a decline in our exchange rate.
7. The monetary policy environment is also different, with UK monetary policy conditions currently very expansionary.
8. The pace at which any country, particularly open economies like Canada and the UK, comes out of recession will depend importantly on the level of growth in their key export markets. Canada was lucky in that in the US – the destination of the vast majority of your exports – growth was very strong. As the Caledon Institute of Social Policy puts it, “American consumers generously substituted for Canadian consumers”. Overall, Canadian exports grew by around 9% a year while the OBR is predicting growth in UK exports at around 6% per year from 2011 to 2015.<sup>3</sup> This is

---

<sup>2</sup> Note that the figures used by M Mendelson, which come from the Canadian Department of Finance, and those in various IMF publications, use somewhat different definitions. The IMF figures suggest the Canadian deficit peaked at 9.1% in 1992 but was down to 5.3% by 1995.

<sup>3</sup> Net trade growth is predicted to account for about a quarter of overall growth, while in Canada its contribution was over one third.

despite expecting euroarea GDP to grow at only 1.5 to 2% over the same period, as the UK picks up market share following the depreciation of sterling [Slide 1].

9. There is one further final important difference between the Canadian and UK contexts, which suggests that the need for the UK to act decisively now is greater even than Canada's was: the UK's fiscal challenge is set against the background of the most serious global financial crisis since the Great Depression. The legacy of that crisis is weighing on global growth prospects. And in that context, the UK's unsustainable fiscal position is a key economic vulnerability, exacerbated by the interaction between the fiscal position and the UK's large financial sector [Slide 2]. As the International Monetary Fund (IMF) has noted: 'any renewed turbulence in sovereign debt markets could trigger an adverse feedback loop between sovereign debt markets and the financial sector, inflicting major damage on the recovery'.<sup>4</sup>
  
10. That makes the need for credible consolidation in the UK all the more urgent. The difficulties of some countries in the eurozone – for example Ireland – illustrate both how turbulent current conditions are in financial markets, and how damaging contagion between the sovereign and the financial sector can be.

### **Achieving Fiscal Consolidation**

11. So much for the background: what has actually been achieved? In Canada a deficit of 3.7% GDP in 1995-96 was turned into a surplus of 0.3% GDP in 1998-99 and surpluses continued until 2008-09. The OECD regard this as a clear example of a successful, sustained fiscal consolidation, in a study of 24 OECD countries over the last 30 years.<sup>5</sup> The structural fiscal tightening, as estimated by the IMF, was of the order of 8.3% GDP over 5 years, from a structural deficit of 7.4% in 1992 to a structural surplus of 0.9% in 1997. At the same time monetary policy was loosened considerably, growth averaged 2.8% and inflation was low (1.5%).
  
12. In the UK, of course, we do not yet know how our economy will evolve. One of the first acts of the Coalition Government was to set up a new independent body, the Office for Budget Responsibility, headed by Robert Chote, with the task of providing

---

<sup>4</sup> World Economic Outlook, IMF, October 2010

<sup>5</sup> GUICHARD et al 2007

independent and authoritative analysis of the UK's public finances based on their own macroeconomic forecasts. As the IMF and the OECD have noted, the creation of the OBR helps to bring independent judgement to the forecasts on which UK fiscal policy is based, and so improve the credibility of the consolidation plan as a whole.

13. So, using the OBR forecast we can at least look at how the fiscal consolidation might work out. The Government's "fiscal mandate" – its rules, if you like – is "to achieve cyclically adjusted current balance by the end of the rolling 5 year forecast period" (2015-16). There is also a supplementary target for debt: that the net debt/GDP ratio should be falling by 2015-16. These targets reflect the exceptional environment in which the Government must address the fiscal challenge. They are designed to ensure that fiscal consolidation is delivered over a realistic and credible timescale. The OBR calculates the likelihood of the Government achieving its mandate given the forecast for the economy and its spending and tax policies. Their most recent assessment is that there is a greater than 50% probability of meeting both deficit and debt targets under current policy.
14. If these plans are delivered successfully, the structural tightening will end up being around 8.4%, much the same as Canada, but over 6 years not 5. Over the period 2011-2015, GDP growth and inflation are both forecast to average around 2.5%.
15. **Slide 3** compares the Canadian and UK experiences – on deficits and debt. It compares the actual experience of Canada with the OBR's forecasts for the UK. If the OBR is correct, the slide implies really quite similar results.
16. **Slide 4** takes the same approach to comparing structural tightening. Again there is a considerable degree of similarity. It also shows that the UK's fiscal consolidation is broadly a straight line, with a slightly faster pace in the earlier years (years 5 to 7 in the chart), reflecting its weaker starting position on the deficit and the potentially more vulnerable position of the economy. Of course, this chart must come with a large health warning as, in my experience, the process of cyclical adjustment is far from an exact science.
17. Finally on the economics, it is worth pointing out that, because of the financial problems in some eurozone countries, the cost of government borrowing has increased dramatically in some countries with large deficits [**Slide 5**]. This is a crucial factor in fiscal consolidations. If you can persuade the markets you have a

credible deficit reduction plan your borrowing costs should decline, and, as you reduce the level of debt, you pay less out in interest helping reduce deficits further. The so-called debt dynamics can create vicious or virtuous cycles. In Canada, reductions in interest rates, created a virtuous cycle.

18. In the UK, as the slide shows, we have avoided the high interest rates faced by many other high deficit countries, and the vicious circle they can generate. That may in part be thanks to the credible plan for consolidation the new Government sought to put in place. It is crucial that those long-term interest rates remain low, both to help ensure continued economic growth and for the consolidation plan to be successful in cutting borrowing.

### **The UK's Prospects**

19. It is of course early days yet in the UK's economic recovery and fiscal consolidation. But there is some early evidence of success.

20. As I noted, long-term interest rates remain low. Despite the size of the deficit, UK gilt yields remain close to German levels. Since the General Election and the announcement of the plan to accelerate the reduction in the deficit, the spread of UK gilts over German bunds has narrowed by around 70 basis points, while Spanish bonds spreads have increased by around 100 basis points.

21. Manufacturing and export performance has been good, suggesting that some of the rebalancing towards exports and investment that the UK economy needs has begun. Net trade contributed 1.7 percentage points to GDP growth in the first quarter, driven by continued export strength and a fall in imports. This represents the strongest contribution from net trade to growth on record. Exports grew strongly in the quarter (by 3.7 per cent), reflecting the strength seen in recent private survey data. Manufacturing output grew by 1.1 per cent in the first quarter and is now 4.7 per cent higher than this time last year.

22. And the deficit has begun to fall, with tax receipts recovering. In fact borrowing has come in £10bn lower than expected – at £139bn for 2010-11 compared to the £149bn forecast in the June Budget last year.

23. Finally, it is also very interesting to compare and contrast *current* Canadian plans with the UK plans to reduce our deficits following the most recent recession. Both the UK and Canadian Governments are trying to consolidate when our export partners' growth is far from certain. A lot is said about the strong opportunities in Asia: the UK's goods exports to China have risen more than 80% over the past two years. But we start from a low base: we export more to Ireland than we do to Brazil, Russia, India and China combined. A booming German economy is helping: exports have risen almost 30% over the past two years. But other parts of Europe are struggling. And, just as Canada needs a strong US economy, the UK needs a strong eurozone. Neither seems certain at the moment.

### **Supporting Growth**

24. Given the scale of the challenge it faces, it is vital that the UK Government learns the lessons of past fiscal consolidations as regards the effect of a different mix of tax increases and spending cuts on growth. On the basis of OECD and IMF research the Coalition Government decided on a mix of roughly three quarters spending cuts and one quarter tax increases. [Slide 6](#) compares the Canadian mix and the planned UK mix. As you will notice, they are remarkably similar.<sup>6</sup>

25. It is also important to ensure that the precise *form* of tax and spending changes not only reflect political priorities but also improved supply-side performance. This is particularly true in areas like welfare reform where the emphasis in the UK has been on changes aimed at improving incentives to work.

26. In addition, the Coalition Government has launched its 'Plan for Growth', working closely with businesses to undertake a fundamental assessment of what every part of Government is doing to support the conditions for private sector growth. The first phase reported alongside the Budget, and announced new supply-side reforms in areas such as planning. The next stage will report in the autumn, examining new issues and new sectors, including infrastructure, the rural economy, mid-sized businesses and opening up data held by the public sector.

---

<sup>6</sup> See, for example, OECD Economic Outlook No81, June 2007 and OECD Economic Survey: UK 2011, OECD March 2011.

27. One interesting innovation in the supply-side reforms, has been a return to the particularly difficult challenge of deregulation, but using a new approach. This has taken the form of a 'Red Tape Challenge', which is using crowd-sourcing techniques to give a voice to those who are seldom heard – such as small businesses and independent entrepreneurs – to understand from them about the obstacles to growth.

## Political Economy

### Making Difficult Decisions

28. Jocelyne Bourgon, who as you know was the Secretary to the Cabinet in Canada during its period of fiscal consolidation, had emphasised to many of us in the UK at a timely lecture at the Institute for Government that it was vital to think carefully about how you reached decisions on fiscal consolidation.<sup>7</sup> This was necessary to keep the Government united and to keep public support for difficult decisions. It was a considerable challenge as not only was the UK contemplating a very large fiscal consolidation but, from May 2010, we were operating with the first Coalition Government since the Second World War. To help meet these challenges, two vital pieces of ministerial machinery were created: the 'Quad' and the 'Star Chamber'.

29. The 'Quad' was a regular meeting of a core group of four ministers: the Prime Minister and Chancellor (Conservative) and the Deputy Prime Minister and Chief Secretary to the Treasury (Liberal Democrat). They considered the most important choices, inviting other Ministers in on occasion. This was vital in reaching consensus in the centre among the key ministers in both parties of the coalition. It was particularly useful in deciding important reforms to welfare spending, which form a major part of the overall consolidation. The 'Quad's key recommendations were then ratified by the full Cabinet.

30. The Public Expenditure Committee – colloquially known as the 'Star Chamber' – played a number of important roles. It was chaired by the Chancellor, balanced on the other side of the Coalition by the Chief Secretary to the Treasury. First, by bringing in a few other key senior members of the Government, it ensured that the Spending Review was not seen by Departments as a closed process, and strengthened the Treasury's mandate. It allowed the Treasury to test out some key

---

<sup>7</sup> Institute for Government, 12 May 2009

judgements and rely on the support of the group in Cabinet discussions, especially on difficult cross-cutting issues like how to allocate the capital budget on a zero-based, cross departmental basis.

31. Second, it added important and powerful incentives. It provided a 'carrot' for Departments to come to an early agreement with the Treasury: there was a promise of a place on the Committee for Ministers who did. It also provided an extra 'stick', as it was to be the ultimate arbiter if a Department disagreed with the Treasury. The Committee was unlikely to give a Department a better deal, thereby adding to the pressure. Unsurprisingly no Department actually ended up going to the 'Star Chamber' – suggesting that the threat of that particular 'stick' was a powerful one – and instead it was able to focus on cross-Departmental matters such as capital allocations.
  
32. It is worth drawing some parallels with Jocelyne Bourgon's conclusions, many of which have proved very relevant to the UK's experience.
  - a. First, **speed is important**. It is preferable to move expeditiously. The Coalition Government completed the Spending Review process by October last year, less than six months after coming to power. This avoided lengthy uncertainty and allowed us to move to implementation quickly.
  
  - b. Second, **prudence is important**. In Canada this was achieved through lower-than-average fiscal hypotheses, the creation of a contingency reserve and the elimination of policy reserves for funding new initiatives. In the UK, the Government set a clear and measurable fiscal mandate (eradicating the structural current deficit over five years) based on a cyclically-adjusted aggregate to allow flexibility at a time of economic uncertainty; set the path of fiscal consolidation in the Emergency Budget to meet the fiscal mandate a year early (i.e. in 2014-15); and asked the newly created independent Office for Budget Responsibility to assess publicly on whether the mandate is likely to be achieved. The caution is important in ensuring the Government's strategy remains on track.
  
  - c. Third, **scale is important**. Scale makes possible reforms that alone would not be politically feasible. The public judgement about the merit of the approach in Canada hinged on the relative fairness of the proposal among regions,



groups, income levels and so forth – balancing single interests against the collective interest. In the UK, public spending is forecast to fall as a share of GDP by 6.1 percentage points. In this context there was a general recognition that not everybody could be a winner. Indeed the motto used by the Coalition Government throughout was “we’re all in this together” – encouraging a general recognition that no area was exempt. And polling suggests that most people in the UK accept that some level of spending reduction is necessary. So there was widespread acceptance that the Spending Review would be tough, but that it must also be fair. So the Spending Review prioritised areas with benefits to a particularly broad sweep of society: those that promoted growth like transport; education and health spending; and fairness and social mobility, providing sustained routes out of poverty for the poorest. It is also interesting to note that the Government decided to keep to its target of spending 0.7% of Gross National Income (GNI) on foreign aid.

- d. Fourth, **eliminating a sizable deficit is a societal project not a normal budget exercise.** This suggested a more open and inclusive approach, one that engaged the whole of government and the public. The Coalition Government made a point of consulting widely. Not just between Departments, using the ‘Quad’ and the ‘Star Chamber’ as I’ve already described, but also beyond: the Government set up a ‘Spending Challenge’ website which invited public sector workers and the public to suggest money-saving ideas, and over 100,000 suggestions were submitted. And Ministers held roundtable discussions with experts and held regional events to listen to people’s views. The Spending Review in October announced specific suggestions that would be taken forward from these consultations: including on procurement (such as greater centralisation of commonly used goods); reducing unnecessary publications in government and the health service; and standardising government travel policies in line with industry best practice.
- e. Fifth, **luck plays a role, but it does not last forever.** External conditions were favourable in Canada but the reforms appear to have been sustainable subsequently. As I’ve already discussed, the UK cannot rely on external conditions being as favourable as they were for Canada, but a significant part of its spending plans have been directed towards promoting long-term economic growth – including high value transport, maintenance and

investment – introducing structural reforms to enable a private sector led recovery and building a low carbon economy.

- f. **Most importantly for the UK: it can be done.** It is possible to make choices in a principled and defensible way for citizens and public servants. You achieved it in Canada, so why shouldn't we?

## Deciding Priorities

33. The Coalition Government started with the objective of eliminating the structural current deficit by 2014-15, which meant getting the actual deficit down from 11% GDP (in 2009-10) to 1.1% in 2015-16. The decision process worked broadly as follows:
  - a. **An initial package of savings** to cut costs by £6.2bn in 2010/11 was announced almost immediately by the Coalition Government, to take early action to reduce the deficit. This was achieved largely by a Civil Service recruitment freeze and moratoria on new ICT, marketing and consultancy spend.
  - b. The 2010 Budget then announced that there would be a two year **pay freeze across the whole public sector from 2011/12**, saving £3.3bn annually by 2014/15.
  - c. As set out above, some critical decisions on **welfare reform** were made early in the process. The 2010 Budget had already announced measures worth £11bn a year by 2014-15, including switching to CPI for indexation of benefits and pensions and reforms to Housing Benefit and tax credits. In addition, the Spending Review was explicit about the benefits of protecting essential spending on public services by taking further tough decisions on welfare. The Spending Review therefore introduced a wide range of further reforms worth £7bn a year by 2014-15, including capping household benefit payments and withdrawing Child Benefit payments from higher income families. As noted earlier, the 'Quad' was key to making these difficult decisions, ensuring greater protection for Departmental budgets through the ensuing Spending Review process.

- d. There was also a desire to protect the most growth-enhancing **capital spending**. Indeed, in the Spending Review, the Government agreed £2 billion more capital spending than it had originally set out in its Budget plans. This was a conscious decision to support growth but it was accompanied by a requirement to scrutinise, and potentially re-prioritise, investment plans. This included a fundamental review of all capital spending plans across Government – including no fewer than 250 different projects and programmes. Projects were assessed on an economic cost benefit analysis and spending prioritised on those areas that provided the greatest economic return. This process was facilitated by the ‘Star Chamber’.
- e. The next decision was to reduce every department’s **administration budget** by at least one third, to be achieved through efficiency savings.
- f. Given the deficit target and all the above changes, all that remained was to **decide on political spending priorities**. The Coalition Government wanted to protect health spending, large parts of education and overseas aid. Defence and security had its own strategic review because it needed to manage some long-term pressures which required strategic decisions. Health was particularly difficult given the demographic and ageing pressures we all face. They ended up with a small (0.4%) real increase, but this contrasts with the average rises over decades being 4% per year, so it still requires tough choices. Similarly the schools budget was given a 0.1% real increase per year as this was a clear political priority. One other important aspect was an attempt to decentralise power by removing ring fences on spending devolved to Local Authorities: in total over 90 separate core grants were reduced to fewer than 10, with more than £4 billion rolled into formula grant. The deal was less money overall, but more freedom over how to spend it.

# Implementation

## The Role of the Civil Service

34. What is the role of the Civil Service in cutting the deficit and supporting growth? The context for this is a Government which believes strongly in a clear vision for delivering public services, based on four core principles that underpin all of its existing and future reforms:
- a. First, choice – giving people direct control over services;
  - b. Second, decentralisation – devolving power to the lowest possible level;
  - c. Third, diversity of provision – establishing the principle that public services should be open to a range of providers competing to offer a better service;
  - d. And fourth, fairness – ensuring fair access, funding and competition.

## Cutting the costs

35. The challenge for the Civil Service is how to achieve better outcomes with fewer resources. The result of the Coalition Government's first Spending Review was, for most departments, at least a one third cut in administration budgets. This means achieving better internal efficiency at the same time as coming up with innovative, less resource-intensive but more effective ways of achieving the Government's aims.
36. The UK Government is keen to move away from the traditional tools of legislation, regulation and taxation - which can be expensive to design, implement and defend in court; they can also impose burdens on businesses and wider society. Part of this new approach is to try to develop and apply lessons from behavioural economics and behavioural science to public policy making: designing policy that reflects how people really behave, not how they are assumed to behave.
37. To help take this forward in the UK we have set up a Behavioural Insights Team in the Cabinet Office. I personally chair the Steering Board which sets the team's agenda. It is made up of a small group of civil servants working with special advisers, but it is very outward-looking - drawing on academic and empirical evidence from the world's leading behavioural economists and behavioural scientists. It is still early days, but in **Annex A** there are some interesting examples where these approaches are starting to show results.

38. Transparency is another way of achieving “better for less”. The UK Government actually has a long record of increasing transparency but, over the past year, has opened up in an unprecedented way. This began with the publication of all Government expenditure over £25,000. All Government Departments have published their Business Plans for the year ahead, which will be measureable against their actual performance. The Government also plans to publish all Government contracts to make it easier for SMEs to bid for Government work.
39. By releasing data into the public domain, the aim is to allow individuals to be able to use data however they wish to draw their own conclusions on the way Government operates, incentivising efficiency through accountability. But this goes beyond accountability: the aim is also to also create opportunities for others to develop services and tools that create value for both our economy and our society. Transparency can be a key driver of economic growth, stimulating innovation in industry, especially in the research, media and technology sectors, opening up new information marketplaces in our public services and supporting productivity in all aspects of enterprise.
40. For example, using data released by the Department for Transport, online maps have been developed which show exactly where cycling casualties and fatalities have taken place. On the streets of London, for example, they allow cyclists to identify whether particular crossings are relatively dangerous or safe. These maps have not been produced by the UK Government – they are generated by cycle user groups who want to help other cyclists avoid or take extra care in certain accident blackspots: but their work was only possible because of the release of Government held data.
41. There is, as ever, a need to strive for improved efficiency. UK Government Departments have traditionally operated in a semi-autonomous way, largely taking responsibility for managing their own personnel and infrastructure. The Coalition Government has instigated a “tight-loose” model of governance: taking control tightly into the centre where a challenge function is needed to drive efficiency; but adopting a ‘loose’ approach where the Government wants to encourage autonomy and a freedom to innovate. Examples of the ‘tight’ approach include the moratoria put in place on the use of consultants and on marketing expenditure. A new Chief

Operating Office for Government leads on this agenda, reporting directly to me and to the Minister for the Cabinet Office, Francis Maude, who is the political force behind reforms to ICT, workforce issues and procurement.

42. The 'loose' approach makes up a core element of the Coalition Government's vision: that public services should, where appropriate, be open to a range of providers competing to offer a better service. Part of this vision is about getting providers from other sectors to deliver public services. For example, the new Work Programme entails a tendering exercise where private and voluntary sector providers are bidding for contracts to help unemployed and inactive benefit claimants into sustained jobs. These are 'payment by results' contracts. To get the full payment, providers must ensure people not only re-enter the labour market, but remain there for up to two and a quarter years.
43. There is also a concerted movement away from a binary choice in the public sector between in-house provision and outsourced delivery. An example we are working on is mutuals, an innovative hybrid which offers a particularly interesting range of benefits. There are various different sorts of structure but all will offer staff an ownership stake and real influence in the way the organisation is run. Some will decide to involve a private sector partner to access private capital and expertise. And in some cases the Government will retain an ownership stake. The idea is to combine the best of the public service ethos with the benefits of a market incentive.
44. At the same time as implementing these new ways of working, the Civil Service in the UK is taking its necessary, but tough, share of the responsibility. Since last year the Civil Service has seen pay freezes; workforce reductions; recruitment freezes; reforms to redundancy payments; and pension reforms are in the pipeline. And there have been redundancies.
45. Total Civil Service employment at the end of December 2010 was 470,000 (FTE). This was a decrease of 8,000 (1.7%) over the previous quarter and a decrease of 28,000 (5.6%) over the previous 12 months. At the same time, employment figures are starting to rise in the private sector (by 400,000 over the 12 months to December). This represents the largest annual decrease seen over the last fifty years – and takes the total size of the Civil Service to its lowest since World War II. Civil Service numbers also fell further in the six months to December 2010 than during any other six month period back to 1999.

46. Once again, it is interesting to observe that the projected changes in public sector employment in the UK over the next five years mirror very closely the experience in Canada during the years of fiscal consolidation between 1994 and 1999. [\[Slide 7\]](#)
47. What is interesting to note in Canada's experience is that the % reduction in public sector employment is quite significantly less than the % reduction in Civil Service employment: at around 7.5% compared to around 20% for the Canadian public service. This shows the efforts made to prioritise those working at the "front line" of public service delivery. And we are looking to do the same in the UK: administrative budgets in the UK are taking some of the largest percentage reductions. That will mean that the reduction in size of the Civil Service is likely to be greater than the overall reduction in employment in the general government sector (which has 5½ million staff compared to the ½ million in the Civil Service, and which the OBR project will reduce in size by 310,000 or around 5 ½ per cent over the period 2011-12 to 2014-15).
48. Different countries are tackling the problem of achieving these necessary savings in different ways. In Ireland, for example, the emphasis is on nominal wage cuts rather than redundancies. In the UK we have a pay freeze but have also frozen recruitment and had redundancy programmes across the Civil Service.

### **Implications for the Civil Service**

49. These new ways of doing business are asking new questions of the Civil Service, and it will be important to ensure that we have the right skills and capabilities in place to provide the answers.
50. First, we have to **strengthen our leadership**. Whether developed from inside or recruited from outside, it will be essential to nurture a pool of leadership talent which can take the Civil Service through the challenges of the coming years. Motivating staff during a period of cutbacks and pay freezes is much harder than when pay and spending are increasing.

51. Second, as an organisation we have to learn to be **more innovative and creative** in our thinking. We need to be able to solve policy problems laterally without needlessly reaching for the 'usual suspects' i.e. spending, regulation and legislation.
52. Third, there is a specific set of skills the Civil Service will need to build on to deliver the Coalition Government's vision for public services. We need to deepen **our understanding of markets and quasi-markets**; and we need to get better at commissioning and at managing contracts, so that we can become more canny and agile in integrating with new sectors.
53. Fourth, we need to **increase the productivity** of all civil servants. Evidence from the private sector increasingly shows that workforces with high engagement are more productive. We have recently started exploring this in the UK Civil Service through our annual Civil Service People Survey, which started in 2009 and has a sample size of over 300,000 per annum. We measure engagement as the emotional response our employees have towards their organisation, by asking if they are proud to be part of their Department or Agency and whether they are motivated to help it succeed. These questions are set out on the right hand side of this slide [[Slide 8](#)]. The results of the 2010 survey – as shown in this chart – are interesting. despite the 2010 survey being carried out after the start of a two-year pay freeze, new redundancy terms, announcements of proposals for changing pension arrangements and the beginning of 30% cuts in administration budgets, the benchmark engagement index fell by only two percentage point from 58% in 2009 to 56% in 2010 while a number of organisations even saw some clear improvements in their engagement scores.
54. The results of the survey also help us to identify the key drivers of engagement [[Slide 9](#)]. This slide sets out the 9 'drivers' most strongly associated with engagement scores, with the strongest on the left hand side. This helps us to focus in on the areas where improvements in the Civil Service should help to drive engagement and, in turn, enhance productivity. The evidence from this slide points to a real need to focus on 'Leadership and Managing Change' – the strongest single driver of engagement, and one where our results are not sufficiently good.
55. Learning and Development – the fourth strongest driver – is another area where we need to focus action. Between 2009 and 2010 the benchmark dropped by 7 percentage points to 43%.



56. Given the uncertainties about the size of cuts departments would be facing in 2010 and 2011, one unsurprising result was a reduction in spending on learning and development. People were reluctant to be away from their offices when big changes might be made, and declining resource may also make staff feel under pressure to focus solely on front-line delivery rather than activity that could provide performance improvement. Budget holders were also reluctant to commit to new professional training programmes without clarity about the funding available and changes to potential need following workforce reductions.

57. We know that by buying learning and development together as a Civil Service (rather than separately by Department) we can achieve efficiencies. But there is more to this than saving money. We must take account of the latest evidence on the way that people learn and, in line with the highest performing organisations, move away from our traditional reliance on expensive classroom-based training towards e-learning and on the job experience. It also means a strong focus on the core skills people need to do their job and ensuring that individuals have the opportunity to learn directly from senior colleagues who have personal experience of the challenges and opportunities they face. To help us achieve this we have recently launched Civil Service Learning – which pools departmental budgets and will provide core learning in the required areas.

### **Is the Civil Service up to the challenge?**

58. There are good reasons to believe that the Civil Service can rise to the challenges it is facing at the moment.

59. The first is that, so far, the signs are that we can continue to **attract the brightest and best** to the UK Civil Service: particularly among university graduates. Last year 22,000 graduates registered an interest for just over 600 jobs in the Civil Service 'Fast Stream'. And we have also proved to be an attractive prospect for senior private sector executives. As part of the drive to increase diversity for many years we have been trying to attract private sector people to apply for more senior jobs in the Civil Service. Almost one in four (23%) of our Senior Civil Service was recruited directly from outside the Civil Service. Of our current Directors General – equivalent to assistant deputy ministers in Canada - 42% were appointed from outside, an increase from 25% in 2003. It will be a challenge to keep up this percentage given

the continuing need to exercise restraint in the pay for senior roles across the public sector.

60. The second is that we have a strong base to build from in terms of our **capabilities**. Our Capability Review Programme has driven improvements in departmental capability ensuring departments are better placed to meet today's delivery challenges and be ready for tomorrow's.

61. Third, we are a **more professional** organisation than ever before. We recognise that the Civil Service suffered a skills gap, particularly in the professions: HR, Finance and Project Management. We decided to develop more talent within – for example, by introducing new graduate entry routes – and in the meantime plugged the gap with external appointments. This is working. Every department now has a qualified finance director, 28 of the top 41 HR leaders are qualified either Chartered Members or Chartered Fellows of the Chartered Institute of Personnel and Development (CIPD) – only 3 were recruited externally in the last 3 years. We have doubled the number of professional statisticians (1500) and tripled the number of economists (1500) in the Civil Service since the mid-90s. We are now bringing in senior business leaders to act as Non Executive Directors on Departmental Boards, which will help us focus on how best to get commercial sector skills into departments.

62. And we are also **more diverse**, in terms of private and public sector backgrounds, in terms of ethnicity and in terms of gender, throughout the organisation and right the way to the top. Half of the Permanent Secretaries (Deputy Minister equivalents) in charge of major domestic departments are women and on current trends half of the Senior Civil Service will be women by 2020 – far ahead of the UK private sector.

## Conclusion

63. These changes are vital if we are to meet the new challenges. But in one area we have not changed at all: that is in terms of our values of honesty, objectivity, integrity and impartiality.

64. When I became Cabinet Secretary I urged all civil servants to fuse these four traditional values with what I call my four 'Ps': Pride, Passion, Pace and Professionalism. Just over 150 years ago, Northcote and Trevelyan thought the Civil

Service values, and the principle of fair and open competition, were so important that they should be enshrined in primary legislation. Last year, with all party support, this was finally achieved: perhaps not the best example of pace! But it was an important and symbolic recognition of the importance of a strong, independent Civil Service.

65. In these difficult times we need to retain the public sector ethos, shared as much in Canada as in the UK, which has helped our two organisations to be held in such high standing around the world. If we can combine the best of the past with a more dynamic approach to risk taking and innovation, I am sure we can both enhance the already high reputation of our respective public sectors.

Thank you.

## Annex A

### Examples of Early Work by the UK Government's 'Behavioural Insights Team'

1. **Increasing tax income.** In the UK over 1 million people fail to return their self-assessment on time. The Government has trialled whether changing the letters from HM Revenue and Customs could boost the swift payment of taxes. We found that merely pointing out in the letters that most people in a local area have already paid boosted repayment of unpaid self-assessment taxes due from around 50% to 72%
2. **Shifting to more cost-effective spending.** Another key strand is shifting spending from expensive and not always effective conventional policies to behaviourally inspired, more cost effective approaches. This is potentially a very long list, but to give some examples:
  - i. *Preventative measures in health* – for example, gradually reducing salt content in food. Our estimate is that the voluntary agreement just agreed with the food industry will save about 4,000 lives a year. It also has the potential to be in effect within months, in contrast to the possible 3 years or more if a regulatory route had been pursued.
  - ii. *Organ donation.* England currently has an opt-in system to organ donation in which results in only 27% of citizens being on the NHS Organ Donor Register despite the fact that surveys show that 65% of citizens would be willing to donate an organ. So the Government will be trialling a system of 'prompted choice' in England in 2011, which has already been successfully applied to organ donation registration systems in several US states. We will introduce it onto the online application form for renewing and applying for driving licenses and if it proves effective could be extended to other registration routes.
  - iii. *Reducing Did Not Attend (DNA) rates.* The UK Government is applying behavioural insights to NHS appointments to try to reduce the number of DNAs e.g. by requiring a patient to repeat back the time and date of their appointment when they phone for a GP appointment. The trials are registering a DNA reduction compared to the previous months and the same

time one year previously of 18%. However, these results are currently provisional, and will need to be properly verified in due course.

3. **Boosting growth.** Another strand of the behavioural insight work is helping consumers save money and boost growth rates by addressing behaviourally-rooted 'errors' in consumer behaviour. This was the focus of the Consumer Empowerment Strategy, including the 'mydata' programme. The mydata programme will enable individual consumers in the UK to access data which are currently held about them by businesses. Over 20 of our leading businesses, covering financial services, retail, utilities, telecoms and online platforms, have agreed to work with us on this. The applications are potentially limitless – for example, they may enable individual consumers to identify which of the 12 million mobile phone contracts is the best for them (based on their past 12 months of usage). By helping individuals access their own data we believe a market in useful apps and websites can be stimulated – able to analyse consumers' data for them, to make choosing the best deal easier.
  
4. **Subjective Wellbeing.** The UK Government is not just looking at how policy development can be different, we are also exploring how we measure the difference these policies are making to citizen's lives. Of course, GDP tells an important story of how a society is doing, but it doesn't tell the complete story. Last November the Prime Minister made clear that the Coalition Government wants to measure progress in the UK not just by how the economy is growing but by how the lives of individuals are improving. Speaking last November, the PM invited the National Statistician to lead a national debate, to understand better what people consider important in their lives, and to collect new measures of subjective wellbeing. The debate generated considerable interest, with 22,000 taking part on-line. The Office for National Statistics has started to collect data on subjective well-being from 200,000 people across the country. Final results will be available from summer next year. This information will enable policy makers to improve the way they take account of well-being in policy design. The Cabinet Secretary is overseeing work across Government to ensure departments are best placed to make use of this information.