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# Taming Leviathan

A special report on the future of the state | March 19th 2011

# Taming Leviathan

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A list of sources is at

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The state almost everywhere is big, inefficient and broke. It needn't be, says John Micklethwait

THE argument sounds familiar. The disruptive reforms that have so changed the private sector should now be let loose on the public sector. The relationship between government and civil society has been that between master and servant; instead, it should be a partnership, with the state creating the right environment for companies and charities to do more of its work. The conclusion: "We are in a transition from a big state to a small state, and from a small society to a big society."

A Republican presidential candidate in America? David Cameron rallying Britain's Tories? Neither: the speaker is supposedly China's most highly regarded bureaucrat. Last year Ma Hong won the country's national award for government innovation—a great coup for her department, which is trying to get more non-governmental organisations (NGOs) to take over parts of welfare, health and education services in the city of Shenzhen, just across the border from Hong Kong.

The award partly reflects the whirl of activity that is Ms Ma. She has dismantled most of the controls on local NGOs: rather than be sponsored by some government department, all they have to do is register with her. She began in 2004 with industrial associations, but has extended the net to

include independent charities. Almost 4,000 "social groups" are now registered—nearly double the number in 2002, when they were all tied to the state.

Over the past five years Ms Ma has paid out 400m yuan (\$57m) to the NGOs for social work, mainly to do with the elderly. The groups are evaluated by third parties on things like their corporate governance: the higher their rating, the more money she trusts them with. She provides training in social work and tax advice. She would like donations to more NGOs to be tax-deductible, as in the West.

Ms Ma has studied what works elsewhere. In Hong Kong, where she trained in 2005, some 90% of social work is done by NGOs, paid for by the state. Like many Chinese bureaucrats, she also admires Singapore—especially its balance between easy registration for NGOs and stern punishment if they underperform. She wants her social groups to become the engines of Chinese society "just as private companies are in the economy".

Even allowing for Ms Ma's dynamism, there was, as so often in China, a message implied in her award. The country's rulers are acutely aware that their government does not serve ordinary Chinese well. Back in 2007 the five-yearly Congress of

▶ the Communist Party embraced “scientific development” to create “a harmonious society”. Shenzhen is supposed to be the showcase for a new public sector, just as it showed the rest of the country how to embrace capitalism 30 years ago. The city has classified some 280 government functions as “social” ones, which means they can be contracted out to Ms Ma’s NGOs.

It is not hard to poke holes in China’s version of the Big Society, as we shall see later in this special report. But there is plainly a drive to make government work a little more like the private sector. “Just as a human has two legs, China has a very long economic one and a very short social one,” observes Ms Ma. “They should be of equal length.”

Many Western politicians feel the same way about their own bloated and inefficient governments. The immediate problem is the financial crisis: governments have had to spend furiously, both to prop up their banks and ward off a depression. With the average gross debt burden in OECD countries just over 100% of GDP and sovereign-debt markets fearful of another Greece or Ireland, every government, even America’s, is under pressure to produce a credible plan to shrink its deficit.

### What is government for?

Costly though it has been, the financial crisis has merely brought forward a fiscal reckoning. In most of the rich world ageing populations have been driving up the cost of public health care and state pensions. Emerging countries that are becoming richer, such as China and India, are now wondering what sort of state they need to meet their citizens’ demands for better schools, health care and infrastructure.

Indeed, the fiery argument about capitalism prompted by the credit crunch has obscured a nascent, and much broader, debate about the nature of government. The future of the state is likely to dominate politics for the next decade at least. How can government be made more efficient? What should it do and not do? To whom should it answer? Ms Ma is one voice in this, but so are the anti-tax tea-party activists in America, French workers protesting against later retirement and British parents trying to set up independent schools with state money.

This special report’s central argument is that Leviathan can be made far more efficient. The state has woefully lagged behind the private sector. Catching up is not just a case of nuts-and-bolts productivity improvements but of liberal principle: too often an institution that, at least in a de-

### It can’t go on

Government\* spending, % of GDP

	1870	1913	1920	1937	1960	1980	1990	2000	2005	2009
Austria	10.5	17.0	14.7	20.6	35.7	48.1	38.6	52.1	50.2	52.3
Belgium	na	13.8	22.1	21.8	30.3	58.6	54.8	49.1	52.0	54.0
Britain	9.4	12.7	26.2	30.0	32.2	43.0	39.9	36.6	40.6	47.2
Canada	na	na	16.7	25.0	28.6	38.8	46.0	40.6	39.2	43.8
France	12.6	17.0	27.6	29.0	34.6	46.1	49.8	51.6	53.4	56.0
Germany	10.0	14.8	25.0	34.1	32.4	47.9	45.1	45.1	46.8	47.6
Italy	13.7	17.1	30.1	31.1	30.1	42.1	53.4	46.2	48.2	51.9
Japan	8.8	8.3	14.8	25.4	17.5	32.0	31.3	37.3	34.2	39.7
Netherlands	9.1	9.0	13.5	19.0	33.7	55.8	54.1	44.2	44.8	50.0
Spain	na	11.0	8.3	13.2	18.8	32.2	42.0	39.1	38.4	45.8
Sweden	5.7	10.4	10.9	16.5	31.0	60.1	59.1	52.7	51.8	52.7
Switzerland	16.5	14.0	17.0	24.1	17.2	32.8	33.5	33.7	37.3	36.7
United States	7.3	7.5	12.1	19.7	27.0	31.4	33.3	32.8	36.1	42.2
<b>Average</b>	<b>10.4</b>	<b>12.7</b>	<b>18.4</b>	<b>23.8</b>	<b>28.4</b>	<b>43.8</b>	<b>44.7</b>	<b>43.2</b>	<b>44.1</b>	<b>47.7</b>

Sources: Vito Tanzi and Ludger Schuknecht; IMF; OECD

\*1870-1937 central government, 1960-2009 general government

mocracy, was supposed to be the people’s servant has become their master.

But nobody should expect that to be easy. The vested interests opposing change are huge: the state’s growth has been encouraged by the right as well as the left, by favour-seeking companies as well as public-sector unions, by voters as well as bureaucrats. Indeed, given the pressures for ever larger government, many reformers feel they will have to work hard just to keep it at its present size.

Government has always tended to expand (see table 1), and people have always fretted about it. In 1888 a French economist, Pierre Paul Leroy-Beaulieu, calculated that a share of 12-13% of GDP (just above the Western average then) was the sustainable limit for a modern state. By 1960 sprawling welfare states had pushed the average in the rich world to 28% (see chart 2), enough to convince Friedrich Hayek that “the deliberately organised forces of society [ie, government regulation]” might “destroy those spontaneous forces which have made advance possible.” Yet the next quarter-century saw another surge, pushed mainly by transfer payments and subsidies ostensibly aimed at the poor but often of most benefit to the middle classes.

This sparked a counterblast to halt Leviathan, led by Ronald Reagan and Margaret Thatcher. By the 1990s many people thought that global capitalism would stop the state’s advance. This was the decade, after all, when Bill Clinton and other leaders declared the end of big government; when left-wingers claimed (inaccurately) that half the world’s biggest economies

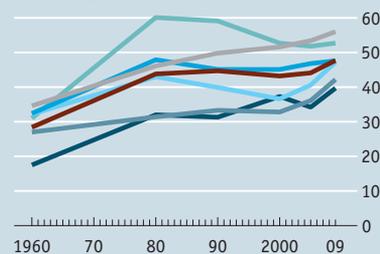
were multinational firms; when the emerging world was embracing the Washington consensus of deregulation: and when industrial policy mainly meant hanging on to golden shares in privatised companies. A special report in this newspaper, published in 1997, examined the then fashionable idea that the state was withering away. Its author, Clive Crook, now at the *Financial Times*, argued that it was not.

He has been proved right several times over. In continental Europe, where the state’s share of the economy was already pretty big, it has not risen that much. However, in America a Republican, George Bush, pushed up spending more than any president since Lyndon Johnson. In Britain New Labour became even less parsimonious: the state’s share of GDP rose from un- ▶▶

### Onwards, ever upwards

Government spending, % of GDP

France Sweden Germany  
Britain United States  
Japan  
Average\*



Sources: Vito Tanzi and Ludger Schuknecht; IMF; OECD

\*Average of 13 countries in table 1

der 37% in 2000 to 44% in 2007; with the British economy struggling, it then jumped to 51% in 2010.

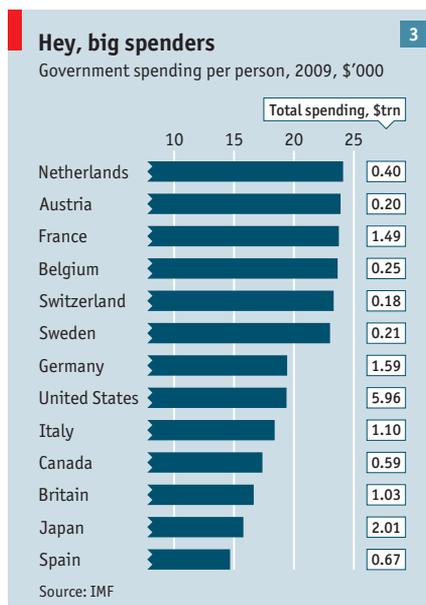
Share of GDP is not the only way to measure state power. "Big governance" can be just as costly to an economy as big government. Some 1,000 pages of federal regulations were added each year Mr Bush was in office. A quarter of a million Americans have jobs devising and implementing federal rules. The European Union has also produced a thicket of red tape. Some are prompted by the left (diversity, health and safety), others by the right (closed-circuit cameras, the war on drugs).

Or look at the state's role in business. In the 1990s privatisation seemed to have settled that argument. Now state capitalism has returned, sometimes accidentally (several banks have become government-controlled) but often intentionally. Many of the new industrial champions of the emerging world are state-owned, and industrial policy is no longer a rude expression even in Anglo-Saxon countries.

There is a belief in boardrooms and among America's tax-cutting right that a monstrous, ever-growing state is the creature of make-work bureaucrats and leftist politicians, and sometimes that is true. But often the beast is responding to popular demand. Globalisation, for instance, has increased many people's reliance on the state: greater job insecurity among the middle classes has increased the calls for bigger safety nets, and the greater inequality that comes with bigger markets has made voters keener on redistribution. Or look at the threat of terrorism, to which the knee-jerk response on America's right was to build up the government in Washington. As Stephen Walt, a professor at Harvard, puts it, "when September 11th happened, nobody rang Bill Gates or the Open Society Institute."

### The next battle

The recent advance of government is once again prompting a fightback. The Republicans' victory in the 2010 mid-term elections was hailed as a return to small-government conservatism. Bruised rather than reinforced by his huge health-care reform, Mr Obama is limping back to the centre, suddenly promising businesspeople that he will rein in regulation. In Britain Mr Cameron's government is pushing ahead with reforms that will slim some departments by a fifth. And even in big government's continental European core, private-sector workers are reacting with fury to the perks their public-sector coun-



ins enjoy at their expense. The German Language Society's word of the year for 2010 was *Wutbürger* (irate citizen).

But will this fury stop Leviathan's advance? Some scepticism is in order. None of the continental European government-slashers is really trying to change the structure of the state. Mr Cameron's attempt offers a better chance of genuine radicalism, though even his savagery will take back the size of Britain's state only to its level in 2008. The tea-party Republicans seem to be all milk and no caffeine: their first budget proposal did not touch defence or the three great entitlement programmes, Medicare, Medicaid and Social Security. Like the apocryphal sign at a tea-party rally last year, warning government to keep its "hands off my Medicare", they are refusing to confront reality.

Nor is it just spineless politicians who are at fault. A lot of economic theorists have predicted an ever larger state since Adolph Wagner linked its growth to industrialisation in the 19th century. The Baumol cost effect is often cited. In the 1960s William Baumol and William Bowen used the example of classical music to show that some activities are not susceptible to improvements in labour productivity. You still need the same number of musicians to play a Beethoven symphony as you did in the 19th century, even though real wages for musicians have risen since then. Larry Summers, Mr Obama's main economic adviser till the end of 2010, argues that the goods governments buy, especially health care and education, have proved much

more resistant to productivity enhancements than the rest of the economy. Since the 1970s real wages in America have risen tenfold if you measure them against the cost of televisions; set against the cost of health care, they have gone down.

Mr Summers expects that trend to continue. An ageing population will need ever more health services provided by the state. Better education means longer school years, smaller classes and more after-school activities, all of which cost more. Greater inequality will mean greater redistribution. In Italy and France cash social transfers alone take up 19% of GDP. The pressure to spend more is continuous, Mr Summers points out, whereas things that reduce the size of government tend to produce one-off savings: the end of the cold war, for instance, took a slice out of defence spending, but that was it.

Mr Summers has a lot of history on his side. This special report takes a more optimistic view. To start with, it is not inevitable that spending will keep on going up. Countries such as Canada and Sweden have reduced public spending when they had to. Moreover, some governments are massively more efficient than others, and there are huge gains to be achieved merely by bad governments copying what good governments do—such as planning ahead, backing winners and rewarding people for doing the right thing. With a smaller central core and much more competition for the provision of services, most governments could do the same for much less.

Most of this special report will focus on that overdue reorganisation. A second set of reforms, for which there is still less political appetite at the moment, would retarget government spending—especially adjusting social transfers (a category that in America's national accounts rose from 8% of GDP in 1970 to 16% in 2009). Benefits that have become middle-class boondoggles should be redirected at the poor.

Not all of history is on the pessimists' side. Fifty years ago companies seemed to be getting bigger and bigger. Business has since changed shape dramatically. The state can catch up by doing many of the same things business did to transform itself, not least bringing in competition and rethinking what it should do itself and what it should contract out to others. And the state, too, has changed shape in the past. In 19th century Britain, for instance, liberal reformers dismantled the patronage state of rotten boroughs and bought offices, building up a professional civil service. Government got leaner and much

► more efficient. It can surely do so again.

Second, even if Mr Summers is right that the state is unlikely to shrink, there is still a vast amount of work to be done to make it deliver more for the same money and become much more accountable. The ramifications are huge—for people, the economy and society.

### Reasons to change

On a personal level, the state matters because it has a big impact on people's lives. As Geoff Mulgan observes in his excellent book on the state, "Good and Bad Power", the quality of the state you live in will do more to determine your well-being than natural resources, culture or religion. In the surveys that measure people's happiness, decent government is as important as education, income and health (all of which are

themselves dependent on government).

To business, government can make an enormous difference. Most obviously, if the state accounts for half the economy then improving any part of that will create better conditions for growth. Even if government were to cost the same but produce more (better-educated workers, decent health care, roads without holes, simpler regulation), the effect on private-sector productivity would be electric.

For society, the debate about the state matters because liberalism is on trial. "The challenge of Western democracy is always presented as one to do with transparency and accountability," reflects Tony Blair, who served as Britain's prime minister for ten years. "In fact it is really a challenge of efficacy. Our politicians on the whole are not corrupt. But they are not delivering the

services people want. The emerging world is deciding what sort of government it wants. It looks at us and sees a system that costs a lot and does not deliver enough." Another prominent Western politician goes further, seeing government as an increasing problem for the West too. "If it carries on as it is, eventually our own voters may also be more tempted by 'something that makes the trains run on time'."

A host of books have recently been singing the praises of China's authoritarian approach. This special report will look at that model, but it will focus on the rich world, where most of the problems and solutions are to be found. No place better illustrates the troubles of the public sector than California, the American state that has become synonymous with private-sector ingenuity. ■

## California reelin'

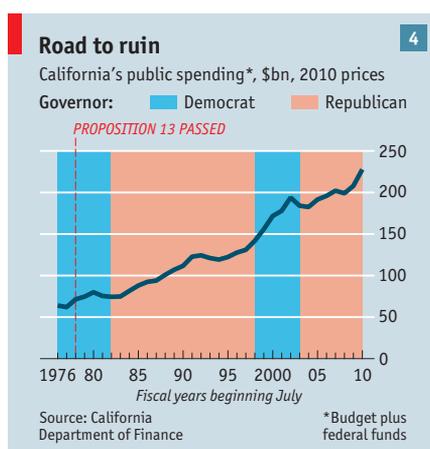
Lessons from a place that combines most of the shortcomings of the modern Western state

**D**ON NOVEY does not look like a typical Californian entrepreneur. The grandfatherly, fedora-wearing conservative began his career as a correctional officer at Folsom State prison in the 1970s. But he helped build one of the Golden State's largest industries.

Thirty years ago, when Mr Novey became president of the California Correctional Peace Officers Association (CCPOA), only 2,600 members walked what he calls "the toughest beat in the state", and there were only 36,000 inmates in California's prisons. Now, as Barry Krisberg of Berkeley Law School points out, some 170,000 people are locked up there, and CCPOA has 31,000 members. From the air California can look like an archipelago of prisons.

Mr Novey made CCPOA a dominant force in state politics, and not just by dishing out political contributions in Sacramento, the state capital. He shrewdly formed an "iron triangle" with Republican lawmakers and prison-builders. And he gave it a cause: tougher sentencing for criminals. CCPOA sponsored the "three strikes" law, mandating life imprisonment for three serious felonies, and helped set up victims' rights groups.

By the time Mr Novey gave up the CCPOA's presidency in 2002, the state had built 21 new prisons. Some guards now earn more than \$100,000 a year (with



overtime). Mr Novey negotiated pensions of up to 90% of salary, with retirement starting as early as 50. To many of his members Mr Novey remains a hero—a man who provided good jobs and made them safer. And the taxpayer footed the bill.

Jerry Brown, the Democrat who was recently elected governor, faces a deficit of around \$25 billion this year—bigger than the total budget in 1975. That was the year when Mr Brown in his younger "Governor Moonbeam" phase first ran the state. Back then California's government was widely admired for its highways and its universities, and also as a font of political ideas

both on the right (Reaganism) and the left (environmentalism). Now the roads and colleges are crumbling, even though total government spending in the state will reach \$230 billion this year (see chart 4). Californian politicians get some of the lowest ratings in the country. Like a paranoid movie star, the state has kept on grasping at miracle cures—from Proposition 13, the tax-cutting ballot initiative, in 1978 to the election of Arnold Schwarzenegger, the cyborg-ex-machina, in 2003.

California is now widely studied as an example of what to avoid. Why is the home of Apple and Google so useless when it comes to running school districts or budgeting, and why have so many clever people settled for such a bad deal? Such questions are worth asking because what happens in California, which is famously like America, only more so, tends to happen elsewhere. And indeed a list of its ailments applies to a greater or lesser extent throughout the Western world.

### • A messy structure of government.

Look at an administrative map of California and you might assume that a child had scrawled over the design. It is a muddle of thousands of overlapping counties, cities and districts. Beverly Hills and West Hollywood sit in the middle of Los Angeles but are separate cities. The LA school district has 687,000 pupils, but there are 23 others ►►

▶ with 20 pupils or fewer. Often voters have little idea what their officials do for their money. Last year the residents of Bell, a poor Latino city of 38,000 people, found their city manager was paid \$788,000 and their police chief \$457,000 a year.

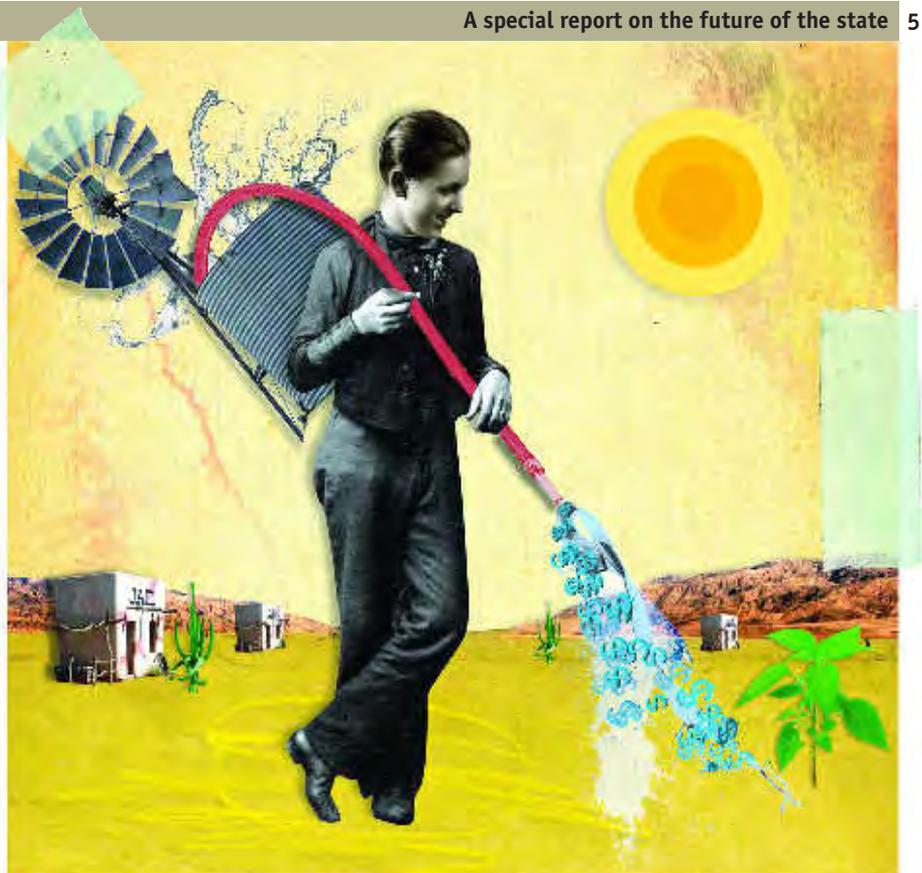
In Sacramento things are no clearer. Thanks to various voters' initiatives, as much as 75% of the budget is outside Mr Brown's control. Proposition 13, which halved and capped property taxes, forced the state to bail out local government. A chunk of the state's own money comes from the federal government. So cash for health, schools, welfare and much else sloshes backwards and forwards between Sacramento, Washington and various Californian cities. That makes it impossible to hold any Californian politician fully accountable for any part of government.

Some of this stems from specifically Californian afflictions, especially the ballot initiatives. But overlapping areas of responsibility are common throughout the West. In Australia, for instance, the federal government runs primary health care but the states run hospitals. In most European countries taxes are raised centrally but tend to be spent by local or regional government. The European Union increasingly plays the same role that Washington does in America, adding another layer of rules and mandates.

• **Out of date.** The most recent full redesign of California's government was in 1879, when the state had only 865,000 people; now it has 37m, and a single state Senate seat represents more people than the whole Senate did then. As California's pre-eminent historian, Kevin Starr, observes, "it is not surprising that an organisation set up to look after fewer than a million people should have a collective political nervous breakdown when it governs something almost 40 times that size."

The same argument could be applied to the United States as a whole. Its constitution was designed for a country of 13 states and 4m people, when things like religious tolerance, the right to form militias and preventing people trying to become king mattered a lot. The Founding Fathers had no plans to bring either North Dakota or California into their union, nor could they imagine the ramifications of those two states both having the same voting weight in the Senate even though California's population is 57 times bigger.

In Europe, thanks in part to two world wars, the state has been redesigned more recently, though many antiquated structures—such as Britain's House of Lords—



have survived. Many of these oddities work well in practice, and Americans revere their constitution. But structure matters. It is hard to think of any successful commercial outfit that has stuck to the same organisational design for 23 years, let alone 230.

• **Too much power for vested interests.** In "The Logic of Collective Action" (1965), Mancur Olson argued that rational individuals will work hard in a group with a selective aim reserved for its members (prison guards banding together to press for higher wages, for instance); they will expend less energy to push for public goods whose benefits are widely shared. Once entrenched, an interest group is extremely hard to shift. Its members have much to gain by fighting to retain their particular privileges, and would-be reformers have to take on disproportionately large costs to push for a vaguer public good. Californians have moaned about their prison guards' perks for a while, yet have only recently plucked up the political will to do anything about them.

In rich countries no group has illustrated Olson's work more clearly than farmers. In California's Central Valley you can watch Californian tax dollars evaporating before your eyes as farmers guzzle most of the state's precious water to cultivate crops that were never meant to grow in a desert. In the European Union two-fifths of the budget still goes to agriculture. In Poland farmers are exempt from income tax. Just as with the prison guards, the subsidies

keep flowing to farmers largely because of conservative politicians. Although the greediest public-sector unions are firmly allied with the left (see box on next page), the supposedly low-tax right also lavishes money on its own priorities. The new Republican leadership in Washington started its search for waste in the foreign-aid budget by trying to get the biggest recipient of American largesse, Israel, moved to the Pentagon's budget.

Interest groups work especially well in systems like America's where money needs to be raised and where party primaries matter. A Republican politician describes how the gun lobby works. If a Republican congressman signs up to the National Rifle Association's agenda, he gets a little money and some organisational help from vocal supporters. If he does not, the NRA will put a lot of resources behind his opponent in the primary. Going with the NRA is thus a lot easier. Many Democrats would say exactly the same about the teachers' unions and education reform. Opposing them is not worth the hassle.

Olson's theory also helps explain why broad-based lobbying by big business has given way to narrower special interests. Fifty years ago California was run by a business elite, keen to keep taxes down and infrastructure spending up but with a broad interest in the well-being of the state. Since then Californian businesspeople have discovered that targeted lobbying can do a lot for their specific business. That ▶▶

▶ has made it harder to get commercial interests to support projects of general benefit such as transport in the Bay area. It has also brought about an increase in regulation as individual businesses have lobbied for rule changes that create barriers to entry for other firms.

• **Ever more rules and taxes.** A study last year by the Pacific Research Institute said California had the fourth-largest government of all American states, with state and local spending equal to 18.3% of its gross state product. Texas, a state with which

California is often compared, chewed up just 12.1% of GSP. It also looked at tax structures, and on that count California came 45th out of 50 states, with its steep income tax being especially damaging. Its tax system has been a mess ever since the dotcom boom when it relied too heavily on capital-gains taxes. As taxpayers have got crosser, the state has tried to tax them as sneakily as possible while adding tax breaks for favoured lobbies.

This points to two endemic problems with government throughout the West.

The narrow one is that tax systems are in need of reform. America's tax code has grown from 1.4m words in 2001 to 3.8m in 2010. Members of the European Union, too, have made their tax systems increasingly complicated—with the heroic exception of flat-tax Estonia. Most economists think taxes should be shifted towards consumption and away from income and investment. But whatever the system, it should be easy to understand.

The broader problem is the growing thicket of regulation—of which taxes are ▶▶

## Enemies of progress

The biggest barrier to public-sector reform are the unions

**I**F JIMMY HOFFA were reincarnated as a modern trade unionist, he would probably represent civil servants. When Hoffa's Teamsters were in their prime in 1960, only one in ten American government workers belonged to a union; now 36% do. In 2009 the number of unionists in America's public sector passed that of their brethren in the private sector. In continental Europe most civil servants belong to unions, though these generally straddle the private sector as well. In Britain more than half of public-sector workers but only about 15% of private-sector ones are unionised.

There are three reasons for the public-sector unions' clout. First, they can shut things down without suffering much in the way of consequences. Second, they are mostly bright and well-educated. There are some Luddites left, such as Bob Crow of London's perennially striking Tube drivers. But it is much harder to argue with Randi Weingarten, the articulate head of the American Federation of Teachers. Most workers in the public sector are women, and many of them are professional types. A quarter of America's public-sector workers have a university degree. Officers of the British Medical Association (which represents doctors) and America's National Education Association (the biggest teachers' union) often appear on the news as experts on health and education rather than as representatives of interest groups.

Third, they now dominate left-of-centre politics. Some of their ties go back a long way. Britain's Labour Party, as its

name implies, has long been associated with trade unionism. Its current leader, Ed Miliband, owes his position to votes from public-sector unions. Spain's prime minister still likes to brandish his union card. In America the links have become more explicit. Between 1989 and 2004 the biggest spender in federal elections was the American Federation of State, County and Municipal Employees, and \$39.4m of the \$40m it shelled out over that period went to Democrats. One in ten of the delegates at the 2008 Democratic National Convention in Denver was a teacher.

At the state level their influence can be even more fearsome. Mark Baldassare of the Public Policy Institute of California points out that much of the state's budget is patrolled by unions. The teachers' unions keep an eye on schools, the CCPWA on prisons and a variety of labour groups on health care. It was the big public-sector unions which squashed the 2005 reforms proposed by Arnold Schwarzenegger, then California's governor.

In many rich countries average wages in the state sector are higher than in the private one. But the real gains come in benefits and work practices. Politicians have repeatedly "backloaded" public-sector pay deals, keeping the pay increases modest but adding to holidays and especially pensions that are already generous.

Many Germans were horrified to discover that the EU rescue package for Greece last year helped to bail out public-sector workers who could retire in their mid-50s on almost full pay. One scam in American cities has been to link pensions

to employees' earnings in their final year, rather than average earnings over a longer period. Naturally the subway drivers or policemen concerned put in heroic overtime in that final year.

Reform has been vigorously opposed, perhaps most egregiously in education, where charter schools, vouchers, academies and merit pay all faced drawn-out battles. Even though there is plenty of evidence that the quality of the teachers is the most important variable, teachers' unions have fought against getting rid of bad ones and promoting good ones.

As the cost to everyone else (in terms of higher taxes and sloppier services) has become clearer, politicians have begun to clamp down. In Wisconsin the unions have rallied thousands of supporters against Scott Walker, the hardline Republican governor. But many within the public sector suffer under the current system too.

John Donahue at Harvard's Kennedy School points out that the egalitarian culture in Western civil services suits those who want to stay put but is bad for high achievers. Heads of departments often get only two or three times the average pay. As Mr Donahue observes, the only American public-sector workers who earn well above \$250,000 a year are university sports coaches and the president of the United States. Hank Paulson took a 99.5% pay cut when he left Goldman Sachs to become America's treasury secretary. Bankers' fat pay packets have attracted much criticism, but a public-sector system that does not reward high achievers may be a much bigger problem for America.

merely the most onerous part. Many of the new laws that have been passed in both Europe and America have admirable aims: better health care, cleaner air, less discrimination against minorities. But as Philip Howard of Common Good points out, they are amazingly cumbersome—Mr Obama's health bill was over 2,000 pages long—and once on the statute book, they seldom come off again. One solution is to follow Texas's example and let legislatures meet only occasionally. Another would be to introduce sunset clauses so that all regulations automatically expire after a while.

• **The politics of gridlock.** Sixty years ago California's politics were rather cosy. In the early 1950s Pat Brown, Jerry's father, who was then the Democratic attorney-general, used to share a car from Sacramento to San Francisco on Fridays with Earl Warren, the Republican governor. This year Jerry Brown in his inauguration speech described politics as a primordial battle between "Modocians" and "Alamedans" (Modoc being a rural, conservative Republican county and Alameda a liberal enclave east of San Francisco).

It is fashionable to blame this animosity on the internet and on partisan media channels such as Fox News. But it often has structural causes, such as gerrymandering. California has tended to choose centrists—liberal Republicans or conservative Democrats—in statewide elections, but the legislature's electoral boundaries have been drawn to produce the biggest number of safe seats. That means primaries are the only real test for most politicians. Here reform may at last be on the way: Mr Schwarzenegger managed to force through an initiative that handed over redistricting to an independent commission.

But at a national level it will be a long time before America has a sensible debate about its budget deficit. George Lodge, a Harvard Business School professor who ran as a Republican against Ted Kennedy in Massachusetts in 1962, argues that many Western countries are now conducting a dialogue of the deaf. Conservatives want to talk about the "macro" vision (a smaller state) but not the "micro" specifics (the unpopular cuts to achieve that). Leftists want to talk about specific micro programmes they want to build up without ever discussing the macro bill for all of them.

• **Towards the older middle.** Given the fury from the left about bankers and from the right about welfare spongers, you would expect all that extra government spending to have been swallowed by either end of the income spectrum. In fact in

California, as in most of the West, the cash has flowed mostly towards those with middle incomes and the old.

Both the rich and the poor do relatively badly out of government. The rich pay for most of it. In California the top 1% by income accounted for 43% of income-tax revenues in 2008 and the top 5% paid 64%. In America as a whole the top 1% paid 38% of federal income taxes and the top 5% paid 58%; their respective shares of national income were 20% and 38%. The wealthy pay the lion's share in most European countries too. Getting the rich to cough up so much might be a desirable social goal in a time of great inequality, but it is hard to claim that they are not paying their share.

The poor pay virtually no income taxes, and many countries, especially in Europe, have a problem with entrenched welfare dependency. Britain, for instance, has a quarter of a million households in which no one has ever held a formal job. But overall it is not clear that the poor benefit from government transfers and benefits as much as you might expect. In America two-fifths of all "social payments" are made by the private sector through employers' pension contributions and health plans—both spurred on by tax breaks that go mainly to middle-income Americans.

When you look at overall public spending, the gap widens. Middle-income Californians go to better schools than poor ones do. Their streets often have more policing. They are far more likely to go to a publicly financed university, to claim mortgage relief on their home, to own a farm that collects subsidies or to attend a ballet supported by public funds. Europe is different only in that it subsidises the middle classes less through tax breaks and more through "universal" benefits—things like free bus passes for the old—which often started out being targeted at the poorest

but are now given out to all.

That points to another distortion, which is generational. A large number of welfare payments and social transfers are now aimed at the elderly. The huge baby-boom generation that is just about to retire will make these even more expensive. In Christopher Buckley's political satire, "Boomsday", America's young eventually start bribing their self-indulgent parents to end their lives early. In his interesting book "The Pinch", David Willetts eschews that solution for Britain's baby-boom generation, but calculates that it will take out nearly 20% more from the system than it has put in. The first budget of the new Tory government, in which Mr Willetts is a minister, still directed money disproportionately towards the old.

Across the rich world, politicians keep on pushing money towards the middle class and the old because that is where elections are decided. People aged 65 and older still account for only 13% of America's population, but they made up over a fifth of its electorate in 2010. No group is better organised: the AARP (formerly the American Association of Retired Persons) has 40m members.

• **The secession of the successful.** Hollywood, Silicon Valley or any of the other places where successful Californians gather show a profound contempt for their government. At the most extreme, such people have walled themselves off in gated communities, with their own security, health services and even schools. Their main relationship with the state, at least as they see it, is to write a cheque for their taxes—and their only interest in it is that the cheque be as small as possible. Philanthropy continues, but remarkably little goes into beautifying their environment (Silicon Valley is the ugliest industrial cluster imaginable).

Similar complaints can be heard in other centres of elitism: Wall Street does not do much about the Bronx, and the City of London usually ignores the East End. Both globalisation and the internet have increased this sense of separation. Companies with strong local links have been swallowed up by larger groups. Wells Fargo used to be a powerful force in San Francisco and Security Pacific in Los Angeles; both are now part of bigger empires. The Indian tycoons in Palo Alto feel closer to Bangalore than they do to Bakersfield (and so do many of their American colleagues).

This secession has an effect on government. It makes capital, as well as businesses and talented people, more footloose, so it becomes harder to raise taxes overtly. ▶▶



▶ Worst of all, the secession of the successful means that the most talented brains are largely left out of the mix. One leading California Democrat describes the list of businesspeople prepared to run a public commission as “painfully short”.

• **You, yes you, are to blame.** California is interesting for one final reason. Throughout most of the West, people are in denial about the consequences of wanting both more government and lower taxes. In Cali-

fornia ballot initiatives have actually given voters a direct say. Generally they have made government worse, protecting bits of spending yet refusing to pay for it. Having voted for Mr Schwarzenegger in 2003, they deserted him the moment he tried to introduce structural reforms in 2005.

Interviewed shortly before his exit at the start of this year, the gubernator had two thoughts. One was that his successor would find reform easier because the sys-

tem is more manifestly bust now than it was in 2003 (and Mr Brown is certainly having a go). The other is that Californians are still determined to get something for nothing. “People here are addicted to improving their lifestyle. They want more and more from their government.”

Is there a better way? Many of those who used to see the future in the Golden State now prefer to look across the Pacific—towards emerging Asia. ■

## Go East, young bureaucrat

Emerging Asia can teach the West a lot about government

WHEN people talk about Singapore’s education miracle, they normally think of rows of clever young mathematicians. The hair-design and beauty-therapy training centres at the Institute of Technical Education (ITE) are rather different. The walls are covered with pouting models, L’Oréal adverts and television screens. There is a fully fitted-out spa and a hair-dressing salon. It all seems rather more “Sex and the City” than Asian values, though the manicurists, pedicurists, cosmetologists and hairdressers toil diligently.

Asked whether he wants to go to university, the holy grail of most Asian families, a young barber called Noel replies that he would rather open a hairdressing salon. Mei Lien wants to set up her own beauty salon; Shuner would like to work in hotels abroad.

Until recently ITE—dubbed “It’s The End” by ambitious middle-class parents—was the dark side of Singaporean education. The city state streams pupils rigorously and is unashamedly elitist: one school claims to send more students to Ivy League universities than any other secondary school in the world. But such a system also produces losers—and many of the bottom third who do not make it to university come to ITE.

Since the 1990s the government has worked hard to change ITE’s image. It has not only spent a lot of money on new facilities and better teachers but also put a great deal of thought into it, scouring the West for best practice in vocational training. And it has encouraged students who are used to failure to take pride in their work. That has involved discipline (a list displays the names of class-shirkers) but also fun outside the classroom: ITE has sports

teams and concerts just like any university.

This attention to detail has paid off. Many of the graduates have to compete with cheap migrant workers, especially in service jobs, but most of them are snapped up quickly. The hairdressers and beauty therapists are off to the new casinos, or “integrated resorts”, as they are prudishly known. Singapore, already near the top of most educational league tables, has created yet another centre of excellence that is beginning to attract foreign visitors.

Singapore is important to any study of government just now, both in the West and in Asia. That is partly because it does some things very well, in much the same way that some Scandinavian countries excel in certain fields. But it is also because there is an emerging theory about a superior Asian model of government, put forward by both despairing Western businesspeople and hubristic Asian chroniclers. Simplified somewhat, it comes in four parts.

First, Singapore is good at government (which is largely true). Second, the secret of its success lies in an Asian mixture of authoritarian values and state-directed capitalism (largely myth). Third, China is trying to copy Singapore (certainly true). Last, China’s government is already more efficient than the decadent West (mostly rubbish, see next section).

### Fact or fiction?

For all the insults hurled at “Disneyland with the death penalty” (to use William Gibson’s gibe), Singapore provides better schools and hospitals and safer streets than most Western countries—and all with a state that consumes only 19% of GDP. Yes, that proportion is understated because it does not include the other fingers the gov-



ernment has in the economic pie, such as its huge landholdings, the Central Provident Fund (a mandatory savings scheme) and Temasek (a government-linked investment company). Yes, it is easier to serve 5m people on a tiny island than 309m Americans on a vast landmass. Yes, it has relied on immigration, which is now creating strains (and will be the main topic in the next election). And yes, Singapore’s bureaucrats can make mistakes, such as letting an Islamic terrorist escape in 2008. But its government does pretty well.

The Chinese are fascinated by it. “There is good social order in Singapore,” Deng Xiaoping observed in 1992. “We should draw from their experience, and do even better than them.” It sends streams of bureaucrats to visit Singapore. One of the first things that Xi Jinping did after being anointed in 2010 as China’s next leader was to drop in (again) on Lee Kuan Yew, Singapore’s minister-mentor, who ran the ▶▶

# Favelous

Sometimes the best ideas for government are the simplest

▶ island from 1959 to 1990, and his son, Lee Hsien Loong, who has been prime minister since 2004. The Chinese are looking at other places, too—most obviously Hong Kong, another small-government haven. But it is hard to think of any rich-country leader whom China treats with as much respect as the older Mr Lee.

So what lessons are the Chinese learning? There is an odd imbalance between the things that Singapore and others make so much noise about and the reasons why the place works. In particular, the “Asian values” bits of Singapore—its authoritarianism and its industrial policy—that the Chinese seem to find especially congenial are less vital to its success than two more humdrum virtues: a good civil service and a competitively small state.

## The island that Lee built

Singapore is certainly a fairly stern place. It has been run by the People’s Action Party for half a century. The older Mr Lee, a Cambridge-educated lawyer who was originally seen as a bit of a left-winger, set up a parliamentary system in which it has proved curiously difficult for the opposition to do well. From 1966 to 1981 Mr Lee’s PAP won all the seats. It has opened up a bit, and in the most recent election in 2006 it won only 66% of the votes and 82 of the 84 seats. The media, and particularly the internet, have also got a little freer.

The Singaporeans argue that they have the perfect compromise between accountability and efficiency. Their politicians are regularly tested in elections and have to make themselves available to their constituents; but since the government knows it is likely to win, it can take a long view. Fixing things like ITE takes time. “Our strength is that we are able to think strategically and look ahead,” says the prime minister. “If the government changed every five years it would be harder.”

There is more truth in this than Western liberals would like to admit. Not many people in Washington are thinking beyond the 2012 presidential election. It is sometimes argued that an American administration operates strategically for only around six months, at the beginning of its second year—after it has got its staff confirmed by the Senate and before the mid-term campaign begins.

Yet even assuming that voters are happy to swap a little more efficiency for less democracy, Singapore still seems a difficult model to follow. Not only is it manageably small, but balancing authoritarianism and accountability comes down largely to per-

**H**ELIÓPOLIS sounds a rather futuristic place. In fact São Paulo’s biggest favela (slum) crams some 200,000 people into a small area just below a road called the Street of Tears. Despite its obvious poverty, it seems fairly law-abiding. Even though they don’t pay taxes, the cafés enforce a 2009 smoking ban. A gym full of predictably skilful football players has plaques celebrating its two most famous visitors: Zinedine Zidane, of Real Madrid fame, and Luiz Inácio Lula da Silva, Brazil’s president from 2002 to 2010.

Lula remains a folk hero. Posters from the election last year show him endorsing his less charismatic successor, Dilma Rousseff. The other thing that rallied Heliópolis to Ms Rousseff’s cause was the (unfounded) rumour that her opponent was going to scrap Bolsa Família, Brazil’s conditional cash-transfer programme. It works because it is simple: poor families get cash if they send their children to school and take them for health checks.

Outside a crèche stand three claimants, all migrants from the north-east. Maria Lucineide has three children, Márcia four and Maria Lúcia five, entitling them to 66-112 reais (\$40-68) a month, but Maria Lúcia’s children skipped school and now she gets nothing.

## A nudge in the right direction

The money from Bolsa Família goes on small luxuries—sweets or snazzier sneakers. But it is enough to make a difference. “If you don’t go to school, you are going to be a nobody,” Maria Lucineide lectures her children. “And it will also mean that we can’t buy the things that you like.” Asked for their views on the state, the

three mothers, who missed out on education themselves, give an answer you would rarely hear in the rich world: “Government is wonderful.”

Bolsa Família goes to 13m families, around one in four. It has had a fairly dramatic effect on poverty and inequality. Marcelo Neri, a Brazilian economist, attributes 17% of the narrowing in inequality since 2001 to the programme: pensions and other welfare payments had a similar effect, but at a massively higher cost. He thinks it should be extended to students to improve their grades as well. It also counts as a form of affirmative action, since a disproportionate amount goes to blacker Brazilians.

It is not universally popular. Snooty Paulistas whinge about the “Bolsa Miséria” going to the undeserving poor. And it may work better in the countryside than the cities. Jonathan Hannay, who has worked with Brazilian street children for 17 years, thinks that Bolsa, which has absorbed other social programmes, has reduced their impact significantly.

Against that, Bolsa Família is very cheap, costing only about 0.4% of GDP. And it is a paragon of efficiency when set beside the rest of the Brazilian state, which although of first-world size (eating up 40.9% of GDP in 2008) delivers third-world services, such as a legal system that cannot enforce contracts. Much of this is down to the perks of public-sector unions. Teachers have the right not to turn up to work for a set number of days a year—and enjoy some of the world’s cushiest pensions. Ms Rousseff has pledged reform, but half the country’s civil servants are members of her party.

sonal skills (and even the opposition admits that the two Lees have been extremely good at it). More generally, Singapore’s success as a planning state has a lot to do with the sort of people who run it.

One thing that stands out in Singapore is the quality of its civil service. Unlike the egalitarian Western public sector, Singapore follows an elitist model, paying those at the top \$2m a year or more. It spots talented youngsters early, lures them with scholarships and keeps investing in them. People who don’t make the grade are pushed out quickly.

Sitting around a table with its 30-something mandarins is more like meeting junior partners at Goldman Sachs or McKinsey than the cast of “Yes, Minister”. The

person on your left is on secondment at a big oil company; on your right sits a woman who between spells at the finance and defence ministries has picked up degrees from the London School of Economics, Cambridge and Stanford. High-fliers pop in and out of the Civil Service College for more training; the prime minister has written case studies for them. But it is not a closed shop. Talent from the private sector is recruited into both the civil service and politics. The current education minister used to be a surgeon.

Western civil services often have pretty good people at the top, but in Singapore meritocracy reigns all the way down the system. Teachers, for instance, need to have finished in the top third of their class ▶▶

▶ (as they do in Finland and South Korea, which also shine in the education rankings). Headmasters are often appointed in their 30s and rewarded with merit pay if they do well but moved on quickly if their schools underperform. Tests are endemic.

How much strategic intervention takes place in the economy? The Lees have dabbled in industrial policy, betting first on manufacturing and then on services. Temasek manages a portfolio of S\$190 billion (\$150 billion). The country is now trying to push into creative industries, with limited success thus far, as ministers admit.

These attempts at *dirigisme* have made Singapore a more reserved, less entrepreneurial place than Hong Kong with its feverish *laissez-faire*. It certainly has far fewer larger-than-life billionaires. But it is hard to hail Singapore as a success of top-down economic management in the way some Chinese seem to think. Indeed, the core of Singapore's success—its ability to attract foreign multinationals—owes far more to *laissez-faire* than to industrial policy.

### Come in, the water's lovely

Rather than seeing foreign investment as a way to steal technology or to build up strategic industries, as China often does, Singapore has followed an open-door policy, building an environment where businesses want to be. The central message has remained much the same for decades: come to us and you will get excellent infrastructure, a well-educated workforce, open trade routes, the rule of law and low taxes.

In other words, Singapore's competitive advantage has been good, cheap government. It has worked hard to keep its state small; even education consumes only 3.3% of GDP. But the real savings come from keeping down social transfers and es-

pecially from not indulging the middle class. The older Mr Lee thinks the West's mistake has been to set up "all you can eat" welfare states: because everything at the buffet is free, it is consumed voraciously.

Singapore's approach, by contrast, is for the government to provide people with assets that allow them to look after themselves. Good education for all is one big part of it. The other mainstay is the Central Provident Fund. A fifth of everybody's salary goes into their account at the CPF, with the employer contributing another 15.5%. That provides Singaporeans with the capital to pay for their own housing, pensions and health care and their children's tertiary education.

There is a small safety net to cover the very poor and the very sick. But people are expected to look after their parents and pay for government services, making co-payments for health care. The older Mr Lee especially dislikes free universal benefits.

Once you have given a subsidy, he says, it is always hard to withdraw it. He is convinced that if you want to help people, it is better to give them cash rather than provide a service, whose value nobody understands. China, he thinks, will eventually follow Singapore's model.

But arguably the place that should be learning most from Singapore is the West. For all the talk about Asian values, Singapore is a pretty Western place. Its model, such as it is, combines elements of Victorian self-reliance and American management theory. The West could take in a lot of both without sacrificing any liberty. Why not sack poor teachers or pay good civil servants more? And do Western welfare states have to be quite so buffet-like?

By the same token, Singapore's government could surely relax its grip somewhat without sacrificing efficiency. That might help it find a little more of the entrepreneurial vim it craves. ■



## A work in progress

China's government is much less impressive than many Westerners believe

IF THERE was one thing that the world's tycoons agreed on at this year's World Economic Forum in Davos, it was that the Chinese state is a paragon of efficiency—especially compared with the doltish, venal clowns in Washington and Brussels. "Beijing really gets things done," sighed one American chief executive. "Their government people are so much smarter: it's terrifying," enthused one of the world's richest

men. The chalets resounded with stories of contracts rapidly signed, roads speedily built and young engineers designing brilliant cars and software programs.

There is indeed much to admire about parts of the Chinese government. Over the past 30 years the regime has overseen perhaps the biggest increase in economic well-being ever, with several hundred million people moving into the middle class

(even if the state had previously been the main thing that held them back). China is led by a group of people who take government enormously seriously.

For all this, there is something of a Potemkin village about the Chinese state. It is, after all, not terribly hard for a dictatorship to build roads and railways faster than a democracy can. Multinational companies and the educated middle classes are doing ▶▶

well from the state, but the poorer majority in this ever more unequal country get a raw deal. And even if some of its leaders are trying to move closer to Singapore's model, there are countless stronger forces pushing in the opposite direction.

Begin with the part of the Chinese state that is winning most praise abroad at the moment: education. In the recent rankings of school students by the OECD's Programme for International Student Assessment (PISA), Shanghai hurtled to the top in mathematics, science and reading, ahead of more than 60 other countries. China is also being cited as the coming force in universities. The number of higher-education institutions has more than doubled in the past decade, from 1,022 to 2,263. The number of students enrolled in degree courses has risen from 1m in 1997 to 5m.

Behind this gleaming façade, however, not everything is what it seems. The new universities are real enough, though they remain middle-class bastions: very few of China's poorer citizens get a look-in. But China's schools are not as uniformly good as Shanghai's miraculous PISA performance suggests. Investment remains low, even by developing-country standards. As far back as 1993 the state pledged to spend 4% of GDP on education: in 2006 the figure was still 2%, and the 4% target was put back first to 2010 and now to 2012. *China Youth Daily*, an organ of the Communist Youth League, has observed that China spends five times more on wining and dining local-government officials than it does on educating children up to 16.

The schools in the countryside are particularly bad. The recent abolition of fees has meant that more pupils now attend them, but it has also prompted local governments to cut back on full-time teachers. In the cities more money is spent, though it still usually takes a backhander to get a child into a good school. And many of the poorest children in the cities miss out on public education of any sort.

One example of this is indirectly provided by Shenzhen's new civil society: a school for the children of migrant factory workers set up by the Ciwei Philanthropy Institute. The school buzzes with endeavour. It looks after 132 children who cannot go to the city's schools because their parents, many of whom work for a nearby nuclear plant, are from out of town. That might seem fair enough for the children of temporary workers, but virtually all the pupils at this school were born in Shenzhen and have lived there all their lives. They are part of a permanent majority. Out

of Shenzhen's population of more than 14m people, only 2.5m are residents.

These "black" workers and their children are not entitled to health care, education or pensions in the city because their *hukou* (residence registration) is elsewhere. In theory you can transfer your *hukou* from one place to another. With enough documentation, any child under 15 should be able to get free education in Shenzhen. But it is a fiendishly complicated and corrupt business, and many migrants don't have the right papers. Some leave their children behind; others cough up for the 70 or so rudimentary private schools in the city. That saves Shenzhen's mainly middle-class residents and the foreign companies based there a lot of taxes, but it also creates an almost apartheid-like class system.

Much of the rest of Chinese local government is similarly skewed against the agrarian poor. Most of the main Chinese taxes go to Beijing; the central government then sends some money back to the provinces, and from there it trickles down

through the prefectures to the lower levels of local government that are responsible for basic services. Chinese cities make ends meet through land-grabs. Property on the edge of town is bought, using compulsory-purchase orders that seldom pay the landowners properly, and then sold to developers, who sell on the houses they build to the richer urban middle classes. *Caixin*, a magazine, reported recently that revenue from land-rights sales made up 46% of all local-government revenue. That hardly seems sustainable.

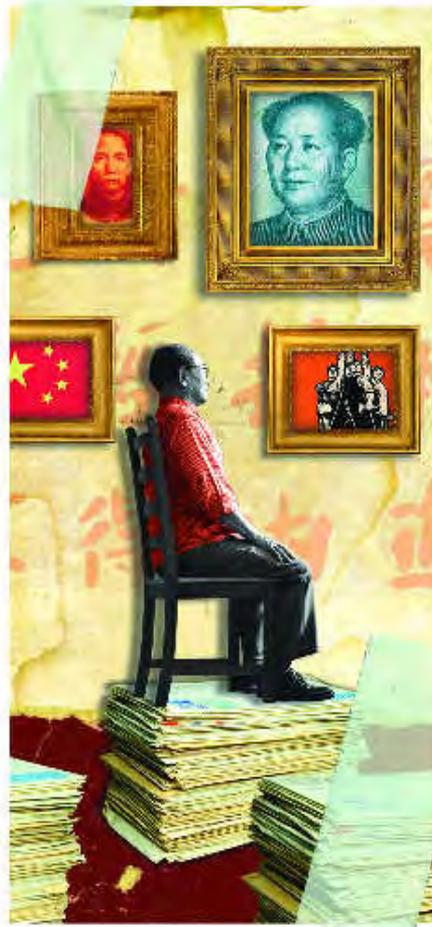
### The perils of making a fuss

Many people are angry about the quality of public services, as Yang Jianchang has found. He is in charge of the Luohu District Office of Market Supervision (Industrial and Commercial Bureau), which deals with counterfeiting; musty signs outline the penalties for producing fake Hermès bags. But Mr Yang, a deputy in Shenzhen's Municipal People's Congress, is best known for being China's most accountable representative.

In 2005 he took the unusual step of opening a separate personal office. People and mail flooded in, mostly complaining about the government. Over the past five years he has taken up 3,000 cases on behalf of some 20,000 people. He has been threatened and roughed up; his health is poor. Some of the villains and bureaucrats whom he pursued—for instance, for selling unsafe food—have gone to prison. Many more have not (thanks to the intervention of what people in Shenzhen describe as "powerful interests"), but he has usually caused enough fuss for them to stop whatever they were up to.

Mr Yang is a proud party man: his office is adorned with pictures of him in his uniform and with citations from various Communist dignitaries. You might imagine that a regime on an anti-corruption drive might embrace this example of accountable government. But last October the National People's Congress passed a law in effect banning deputies from setting up personal offices. The law applies across the country, and it seems to have been drawn up to stop people like Mr Yang. He has closed his personal office but mail continues to flood in, most of it by recorded delivery, so people know he has got it and will send it on to the right bureaucrat.

All this points to the sheer unresponsiveness of much of China's government. It may be fairly easy for the boss of a large Western multinational to see a senior state official, but for a Chinese citizen merely



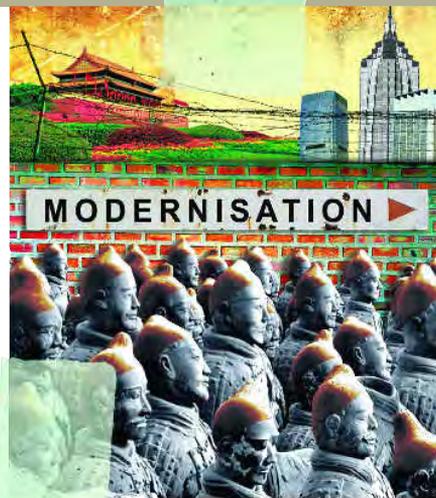
▶ getting a few minutes with a lowly bureaucrat is an ordeal: he needs to fight his way past several offices, guards and indifferent assistants intended to keep him out.

And the local satraps are not that much more responsive to Beijing either. The central government has the clout to compel bureaucrats to act quickly on issues of national importance such as foreign investment or responding to emergencies like the SARS epidemic; but on plenty of other issues the local government ignores them.

For the clever young technocrats at the top, the medium-term prospects for the Chinese state must be quite frightening. The country needs to find a more secure way of financing local government. It must improve its current rudimentary health-care coverage, not least to cope with the ageing population that is the legacy of its one-child policy. Above all there are the demands of its increasingly affluent citizens. Most of them are well over half-way towards the income level of around \$12,000 a year (at purchasing-power parity) which elsewhere in emerging Asia, notably Taiwan and South Korea, resulted in demands for greater political freedom and proper government services.

### A long, hard march

During Wen Jiabao's much commented-on visit to Shenzhen last year when the city was celebrating its 30th anniversary as a special economic zone, he tried to alert his party to the perils of its position. "If there is no guarantee of reform of the political system," the prime minister said, "then results obtained from the reform of the economic system may be lost, and the goal of modernisation cannot be achieved."



By Chinese standards Shenzhen's "small government, big society" programme is fairly dramatic. The city has eliminated a third of its departments and scrapped a jobs-for-life pledge for newly hired bureaucrats; and through Ma Hong's office, it is trying to outsource work to NGOs. Sunny Lee, the founder of the Ciwei school, points out that until recently it would have been unthinkable for a non-party member like him to set up a school. He talks about Shenzhen being "an El Dorado for NGOs". Billboards around the city proclaim: "Civil Society: Grow Together".

But it is slow work. Although some departments have been amalgamated, the main bureaucrats have all kept their jobs, leading to an abundance of deputy directors (which also makes dealing with Beijing difficult). The structure is still complicated: technically only 40,000 people work for the city (teachers, for instance, are separate). Li Luoli of the China Society of Economic Reform points out that the local ministries and developers have been able to ignore Beijing because there is no specific local body behind political reform. A report on how to improve the local people's congress has been shelved, and talk of an

anti-corruption commission has faded.

There is also a deeper cultural problem. Most reformers want to devolve power, but for a government that likes to control things this is hard to accept. The reformers have not been helped by the financial crisis. The failures of Western capitalism have put a spring in the step of the state-owned enterprises, and of state-directed capitalism in general. Shenzhen's reformers hail Hong Kong as a place where NGOs do a lot of the state's work, but most of Hong Kong's civil society is rooted in religion. The Chinese government is unlikely to let churches run schools; indeed, elsewhere in the country Catholic priests have been stopped from setting up networks of parishioners to check on old people, for fear that they might start proselytising.

China may aspire to the efficiency of Singapore and Hong Kong, but it is nervous about the idea of a small state. This hesitancy seems to go right to the top. Even though Mr Wen called on Shenzhen to lead the way to reform, Hu Jintao, China's president, who visited the city a couple of weeks later, did not reiterate the point.

The pressure from below will not go away. Mr Yang's office may have gone, but online forums now catalogue the country's bureaucratic disasters, even if they rarely name the guilty parties. Eventually the regime in Beijing will have to embrace government reform with the same gusto as economic reform under Deng.

Until then, whatever Davos man thinks, China will not provide many lessons in government for the rest of the world. If the West wants to improve the way it runs its affairs, it would do better to look to technology and management. ■

## The gods that have failed—so far

Could technology and good management bring the public-sector up to scratch?

ASKED to talk about how technology affects productivity, Peter Thiel, the venture capitalist who backed Facebook, draws a simple graph on his whiteboard: input on the y axis, output on the x axis. He then dabs on two blobs. The private sector goes in the bottom right (you put in relatively little and get out a lot); government goes in the top left: a lot of input and very little output.

Mr Thiel, a prominent libertarian, may be unsympathetic to the public sector, but

his chart is not a bad guide to the past 40 years or so. Productivity in government is difficult to measure and statisticians have generally stopped trying to come up with precise figures. But such numbers as there are all point in the same direction. With a few small exceptions, government lags behind the private sector.

Two closely related things have transformed the private sector since 1970. The more obvious one is technology: think what ATMs did for banking. But manage-

ment ideas—everything from profit-related pay to lean manufacturing—have arguably done even more to raise productivity. Toyota spent less on computers and robots than General Motors did; it won by outmanaging its rival.

The public sector has certainly dabbled in both these things. From Berlin to Bangkok, every big consultancy has a thriving public-sector practice. Many of the ghastliest examples of management-speak come from the public sector. And some of the ▶▶



▶ biggest disasters in public spending have involved technology, such as the attempt to link up Britain's health records nationwide. But neither has really changed government profoundly.

The pessimistic explanation is that they never will: there are good reasons why the public sector will always be resistant to change. Optimists have to make the case that "this time will be different," which is harder. But just this once it could be true.

### Government is different

Begin with the depressingly long list of reasons to be pessimistic. The most fundamental one remains the Baumol effect: labour-intensive services, such as nursing and teaching, have thus far proved as immune to productivity-enhancing technology as string quartets.

Another cause for pessimism is that government does not respond to normal pressures. Most obviously, there is rarely the threat of bankruptcy. Indeed, most of the examples of efficient government involve warfare or other crises.

The idea that business skills do not translate to politics would seem to be borne out by the string of businesspeople who have failed to make much of a mark in government. Silvio Berlusconi has achieved a lot less as Italy's prime minister than he did in business. A more successful transplant from the media industry, Michael Bloomberg, the mayor of New York, says he had not realised how different running a city would be: "People are motivated by different things and you face a much more intrusive press. You cannot pay good staff a lot of money... In business you experiment and you back the projects that win. The healthy bits get the money, and the unhealthy bits wither. In government the unhealthy bits get all the attention because they have the fiercest defenders."

There are even ideological reasons why liberals in particular should want to keep

the state relatively inefficient. Joseph Nye, a former dean of Harvard's Kennedy School and author of a book on power, says that Americans do not really want their state to work too well: "There is something special about government. It has coercive power, so it is essential that you have a healthy scepticism of it."

So why should this time be different? The immediate reason is that in many countries the state is now so bloated that, even without changing the basic structure of government, it could be made much more efficient.

In the short term, assuming a recovering economy, government can surely be slimmed relatively painlessly—if only because it has grown so fat. The howls across Europe about unprecedented budget crises ignore three things. First, Sweden and Canada have chopped their public sectors after financial crises and lived to tell the tale (albeit against a much more clement global economic backdrop). Second, most European countries need to do no more than reduce government spending to its level of three or four years ago. And third, many of the cuts are tiny by private-sector standards. At a private dinner in Paris recently a group of French businesspeople listened politely to a politician moaning about his department having to reduce its costs by 5%, until one of the private-sector bosses pointed out that he had knocked out a fifth of his costs in a little over two years. The politician shut up.

People can argue over the respective virtues of making across-the-board cuts or targeting particular departments (they usually do a bit of both), but managerially speaking it is not a tough ask. Reforming American defence procurement does not require structural change, just making use of the Pentagon's clout with suppliers. A recent study by the National Audit Office showed that Britain's National Health Service (NHS) could save £500m (well over

\$800m) a year by bundling its buying power; there is no need for hospital trusts to buy 21 different forms of A4 file paper and 652 different kinds of surgical gloves.

In the longer term, though, two sorts of opportunities present themselves: changing what the state does; and changing its structure. The first set tends to be administratively (fairly) simple but politically hard. For instance, getting rid of industrial and agricultural subsidies makes sense, but politicians cling to them. Even bigger potential "quick wins", though ones fraught with political difficulty, are to be found in pensions. Switching state employees from defined-benefit to defined-contribution plans and raising their retirement ages to prevailing private-sector levels would save most governments a fortune—but not as much as upping the age at which everyone starts receiving their state pension.

When Bismarck introduced the world's first state pension system in 1889, he set the retirement age at 70, some 25 years beyond the average Prussian's life expectancy, so it did not cost much to run. When America brought in its Social Security system in 1935, average life expectancy was only 62. In the OECD countries men on average now live to 76 and women to 82. In most rich countries raising the pension age to, say, 70 by 2025, and thereafter linking it to life expectancy (which keeps on increasing), would go a long way towards reducing the government's structural deficit.

In America Social Security is known as the "third rail" of politics: state pensions electrocute any politician who touches them. But the case for increasing retirement ages is overwhelming. It also begins to open the door to a proper debate about social transfers, including things like means-tested benefits. That argument will be much easier to make if the second set of opportunities to do with updating the structure of the state has been grasped.

On this score, unlike on benefits and ▶▶

# Patient, heal thyself

A bottom-up approach to the biggest problem in government

transfers, almost everyone agrees what needs to be done. Britain's Tony Blair puts it this way: "The modern Western state was created in the era of mass production and command and control, where governments told you what to do and provided everything. Modern life is about choice—and the state, even if it pays for something, should not be the only choice." He argues that creating "a post-bureaucratic state", with a small centre and a multitude of public and private providers, should be a particular cause for the centre-left to embrace. "In every other walk of life a citizen gets services from bodies that are anxious for their business. We have to open up the state to transparency and competition, or else anyone who is rich enough will pay to opt out."

Mr Blair has no truck with the idea that the public sector is bound to keep growing. The key, he thinks, lies in breaking the state down into innovative smaller units, like charter schools in America and academies in Britain. "As more and more choices are made by consumers, not politicians, we will shrink the state," he predicts.

As is his wont, Mr Blair tends to be more messianic about this than most politicians. But to see how such ideas might work, consider two changes in the car industry. First, in the era of mass production Ford did not just make its own steel; it also owned the fields on which grazed the sheep whose wool went into the covers of its car seats. Now it contracts out much of this, even though its name remains on the car. Second, in the 1970s there was a big gap between the quality of the output and the efficiency of, say, Japanese carmakers and their American peers. Now competition has minimised that advantage (and no longer always in favour of the Japanese).

## Don't do it yourself

For its part, the public sector in many countries still wants to do everything itself. Surprisingly, America, the country that has preached the Washington consensus of privatisation to the world, still owns a lot of its railways, ports and water systems; it also makes less use of for-profit schools than does Sweden. And if Britain's gargantuan NHS were to contract out as much of its business as the French and Dutch health services do, it would be a lot more efficient. The District of Columbia has shown how much can be saved by outsourcing: it has reduced its e-mail costs by 80% and its video-hosting costs by 90% by moving them to Google and YouTube respectively.

The huge variance in performance be-

IN ANY discussion about the role of the state, one subject soon dwarfs all others: health care. McKinsey points out that American spending on this has grown at an annual lick of 4.9% over the past 40 years, whereas GDP per person has grown by just 2.1%. Pessimists are convinced nothing can be done to restrain it. A refreshingly different perspective is provided by Sir John Oldham, a British doctor who is clinical lead for productivity in the National Health Service.

His view of what he calls the coming tsunami is as pessimistic as anybody's. Health costs, he points out, are determined by long-term conditions—things like diabetes, heart disease, obesity and lung disease, which are usually linked to lifestyle and diet. Some 15m Britons suffer from such conditions, which take up 70% of "bed days" in hospitals.

The numbers of cases in other countries are equally worrying. They explain why America, which currently spends 16% of its GDP on health care (see chart 5), is theoretically on track to spend 100% of its GDP on health care by 2065, followed soon by Japan. China too has seen a huge rise in such conditions. They are no longer diseases of the old: in America, says Sir John, the Facebook generation is picking them up so rapidly that it might be the

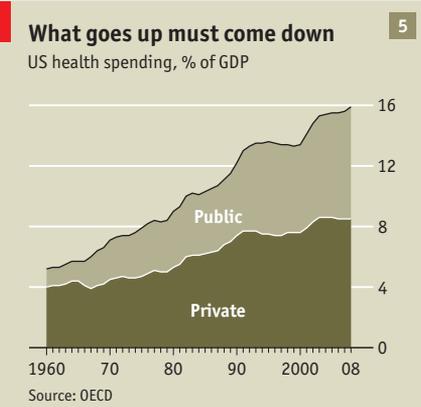
first not to live longer than its parents. But they are still mainly diseases of the poor, who live less healthy lives, smoking more, drinking more and consuming more salt and trans fats in processed food.

A hard-hearted economist might spot potential savings (especially on pensions) from people dying younger. But even he would be disappointed: any such savings would be wiped out by the adverse effect of such diseases on the productivity of the working-age population. One obvious way to alleviate this problem is to tax the things that are causing it: when governments are having to strengthen their ambulances to cope with heavier patients, it is time for a levy on cheeseburgers. But Sir John reckons that getting patients to help manage their illnesses might be even more promising.

Technology is starting to make this vastly easier. Futurists dream of small gadgets roaming people's bodies and reporting their findings to computers, but lower-tech versions of this already exist. In one pilot scheme in Britain's Stoke-on-Trent patients use fairly basic methods to record their own weight, cholesterol, blood pressure and so on every week and text the result to a computer, which tells them what to do about them.

This can be economically attractive, because the most expensive things in health care tend to be unscheduled visits to hospital. But it also improves people's health. A patient is always around to monitor himself, and he will be highly motivated. A big study by the Cochrane Institute showed that among people who managed their own anticoagulant treatment, repeat blood clots declined by half; deaths from clots also fell.

Sir John suggests that the NHS should set up an incentive scheme for its workers to lead healthier lives that would create rewards (or, as he likes to call them, "care miles"). That would set a good example. But for the biggest employer in the country it could also save a lot of money.



tween different bits of the public sector that do the same thing is shocking. Sweden spends half as much on health care per person as America does, yet Swedes live longer. Research on degree courses at public universities shows that some Western countries spend 30% above the average on a degree whereas others remain 70% below it, says Lenny Mendonca, a public-sector expert at McKinsey. "In anything even

resembling a free market, many of the best-performing public institutions would have wiped out all the others," he adds.

Variance within countries is harder for public-sector unions and other local vested interests to ignore. Sir John Oldham, an expert in health productivity, points to two similar adjacent areas in southern England where "unscheduled admissions" to hospitals (ie, the expensive sort) vary by a fac- ▶▶

► tor of eight; in another there is a 13-fold difference in the number of hospital referrals from similar doctors' practices.

By reducing these variances, quality would be improved and a huge amount of cash could be saved. Sir John has calculated that if every NHS organisation in Britain currently operating at costs one standard deviation above the mean were to improve its performance to the mean level, the NHS would save somewhere close to the £15 billion it is supposed to find over the next five years.

It is about care as well as costs. The McKinsey Global Institute points out that at some American hospitals nurses spend under 40% of their time with patients. Naming and shaming is one way of getting better results. Sweden's health registries, a much-cited example, provide statistics on the performance of individual hospitals. The fear of coming out badly in a national league table is a powerful incentive to try harder. A study by the Boston Consulting Group found that Sweden's National Cataract Register not only reduced the severity of astigmatism resulting from eye surgery but also narrowed the variance between the best and worst hospitals by half.

### Just wait till they find out

With such examples in mind, some argue that government reform will be akin to a popular revolution, driven by the spread of information. Just as American motorists, resigned to cars that broke down, rapidly ditched Detroit's products once they found they could buy cars that worked, so American parents will no longer tolerate the excuses of the teachers' unions when they discover that children get a much better and cheaper education elsewhere.

There is something in this. Few politicians now question the need to publish school-performance tables, despite the furious fusillades from the unions when they were introduced. One education minister argues that the most powerful force in school reform now is the OECD's international PISA ranking (see chart 6). "Waiting for Superman", a documentary by Davis Guggenheim, the director who made "An Inconvenient Truth", but this time attacking America's teachers' unions rather than climate-change deniers, was a big hit. As charter schools and the like outperform their peers, there is pressure to break up the old fiefs and introduce competition.

Clayton Christensen of the Harvard Business School, perhaps the world's most respected writer on innovation, thinks the public sector will be upset by what he calls

"mutants"—new organisms spinning out of it. He points to the success of Guaranteach, an online store of teaching videos set up by two former teachers in 2008, and other similar outfits.

A new wave of frugal innovation coming from emerging markets will also make an impact on the public sector. South Korea is a leader in education testing. India is taking a dramatically different approach to health care. It has found a way to reduce the cost of heart operations by setting up huge hospitals that can reap economies of scale. It is already cheaper for Westerners to fly to India as health tourists than to have treatment at home.

Many think the web will shift the balance of power between the public sector and its clients. Worried about your child's school? You can join a discussion group on Facebook. Furious with the American government? You can see how much it is costing you at [mygovcost.org](http://mygovcost.org). Fed up with Britain's lousy roads? Go to [fixmystreet.org](http://fixmystreet.org). Don Tapscott, one of the cleverer cybergurus and co-author of "Macrowikinomics", points to the rise of "prosumers": rather than merely accepting what the government offers, citizens will shape new services as they appear. Places like the District of Columbia and Canada's province of New Brunswick have been pioneers, spurred on by a new generation of younger, more web-savvy civil servants. Even health care—the field most resistant to change—could be turned upside down (see box, previous page).

So a bottom-up revolution is under way. But for all the obvious reasons, it is advancing more slowly than it did in the private sector. For instance, a recent survey by the *New York Times* of failed schools in eight American states that were bad enough to get federal turnaround money showed that 44% of the schools' principals had kept their jobs. Resources are another problem: there are fewer computers in the public sector than in the private because many government departments still do not distinguish capital budgets from operating ones.

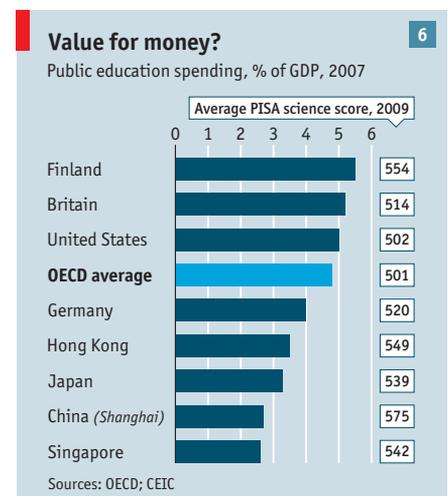
Mr Christensen thinks one of the main problems is the lack of a common language. As a young academic he was able to persuade Intel to change course by telling its bosses that the sort of disruptive change that had happened in steel (the arrival of cheap mini-mills) would also happen in chipmaking. Yet when he goes to health-care conferences, he says, nobody uses the same terminology. Doctors, insurers, hospitals and politicians all talk about com-

pletely different things: "The only people who could really bang heads together would be the federal government."

Indeed, for all the evidence of mounting pressure from below, a command-and-control organisation will change only when the top wants it to do so. And here most Western countries have something in common with China: leaders are scared. Some attempts to institutionalise innovation have been made. Geoff Mulgan points out that America has committed \$650m to a schools-innovation fund; Britain has allocated £200m to health. Barack Obama has appointed Vivek Kundra, the man who led the District of Columbia's technology drive, as America's first chief information officer. Mr Kundra has already saved \$3 billion by culling programmes.

Yet the same Mr Obama has recently delivered a budget to Congress that does nothing to reform entitlements. It is not just the threats from vested interests that inhibit progress. Mr Mulgan explains that the first wave of privatising governments in the 1980s and 1990s often did badly at the ballot box. Voters could not see enough change to justify the aggravation. And sometimes restructuring was done in several phases, so it was not clear who was responsible for the good things.

The recent economic crisis has changed minds. There now seems to be far greater acceptance that government is broken, and voters are more prepared to give their leaders leeway to mend it. Even if the debate has barely begun to tackle benefits and social transfers, that still gives politicians an opportunity. In various American states governors have seized it. But on a national scale nobody has grabbed it with more gusto than an Old Etonian Tory. ■



# Big society

Radical ideas from a fusty old island

FOR all its pomp and tradition, Britain has played an outsized role in promoting radical thought about the state. In the 19th century it championed modernisation, with the same liberal Victorians who campaigned for free trade (and set up this newspaper) also dismantling the courtly system under which posts in government were sold off or given to political allies. The Northcote-Trevelyan report of 1854 led to the creation of a politically neutral civil service, with appointments made on merit. Liberals prided themselves on the leanness of a state that ruled India with a few thousand bureaucrats. John Stuart Mill, himself a civil servant, famously defined this minimalism: “The only purpose for which power can be rightfully exercised over any member of a civilised community, against his will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant.”

Yet as the 19th century wore on, “New Liberals”, including Mill himself, began to question the morality of the “night-watchman state”. How could liberty flourish when so many people lived in misery and ignorance? Reforming governments introduced compulsory education, laws to regulate safety at work, tax-funded libraries and welfare—all robustly condemned by Herbert Spencer in his libertarian bible, “The Man versus the State” (1884). But the intellectual traffic was mainly towards more intervention, with socialists (Karl Marx and Friedrich Engels were based in London) and then Fabians taking New Liberal arguments to the extreme. A more active state became the answer.

Britain continued in that vein for most of the 20th century, with the Depression only increasing anti-market sentiment. In 1938 an ambitious young right-wing MP surveyed the British economy: “The weakness of partial planning seems to me to arise from the incomplete and limited application of the principles of planning. The lesson of these errors, which I regard as errors of limitation, is not that we should retreat. On the contrary, we must advance, more rapidly and still further, upon the road of conscious regulation.” Harold Macmillan went on to become a post-war Conservative prime minister, which

shows how far the centre had shifted.

Gradually, however, an anti-state right began to emerge. In 1960 Friedrich Hayek wrote “The Constitution of Liberty”, partly in response to what he saw in Britain. In 1978 another young Tory with a Macmillanish pedigree, William Waldegrave, took a very different line in “The Binding of Leviathan”: “No one knows how to run bureaucracies. Bureaucracies are increasing. No wonder the public thinks something is wrong.” In 1979 Margaret Thatcher hurled herself at these bureaucracies—and a new creed, very different from Fabianism, rippled out across the world.



Now the promise of renewed radicalism is in the air. David Cameron’s coalition government of Conservatives and Liberal Democrats is pursuing the most daring course in the rich world. That judgment is based on two things: the severity of its spending cuts (many departments are being slimmed by a fifth) and the fact that it is trying to change the structure of the state.

The spending cuts currently dominate the British media. Manchester is in turmoil because it will be reduced to only one public lavatory. The Tories are plainly taking an economic gamble by tightening fiscal policy so fast, but seem less fixated on the overall size of the state than Mrs Thatcher was. For political reasons they left health care, perhaps the most wasteful part of the British state, out of the cuts. One senior Tory thinks you cannot reduce state spending

below around 40% of GDP, or the politics will turn against you.

The bolder reforms, championed by Mr Cameron’s main domestic adviser, Steve Hilton, are centred on structure. They are hidden behind a confusing slogan that the Tories adopted to make themselves sound cuddlier: “The Big Society”. It brings together three things: pluralism, localism and voluntarism.

## How to get there

To promote pluralism, the Tories aim to build the “post-bureaucratic state” that Tony Blair wanted (they even use the same phrase). Haunted by the idea that Mr Blair did not move fast enough, they are rushing to hand over many more state services to outside providers. They have opened the doors to Swedish-style free schools set up by parents, and they want more parts of welfare to be delivered by outsiders, paid by results. They have also announced the biggest shake-up in the history of the health service by shifting spending power to groups of general practitioners, who will buy in services from both public and private hospitals.

Haste has caused problems. Whereas the education reforms follow on neatly from the academies that Mr Blair set up, the changes in the health service, introduced with little prior warning, come just as the system is adapting to the previous round of reforms. Oddly for a party that believes in the free market, the Tories have rejected for-profit providers for some services, notably education.

Even so, pluralism could lead to a much smaller civil service than anyone thinks. “Once you start letting people compete, it is incredible how few people you need in the centre,” says one of Britain’s most senior mandarins. And, since the change is technocratic not political (the state, after all, is still paying), it will be difficult for a future Labour government to reverse.

Handing over control of schools to parents and medicine to local doctors also fits in with localism. The Tories want more cities to have elected police chiefs and, eventually, elected mayors, like London’s Boris Johnson. They are providing reams of information to make government more

transparent; a new crime map of Britain's streets crashed on its launch day because so many people wanted to see it. Combined with pluralism, this amounts to a substantial attack on the centralised state. For instance, Suffolk County Council hopes to knock a third off its budget of £500m by becoming a "virtual" authority that outsources all but a handful of its services to social enterprises or companies.

This localism is somewhat marred by the Tories' deep distrust of local government. Handing over schools to local associations risks creating bodies that can be taken over by teachers' unions, as in America. Lord Adonis, a Blairite who now heads the Institute for Government, a think-tank, argues that the Tories should also have given more power to elected local mayors, especially in the 14 big cities where one in three Britons live. Apparently Tory and Liberal-Democrat local councillors took against this.

#### Volunteer, or else

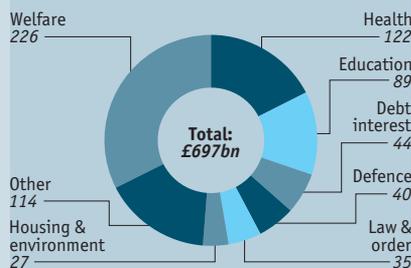
Volunteerism, the idea of Burkean small platoons taking on the functions of the state, is the trickiest part. On paper, this is a big idea. The people around Mr Cameron argue that just reducing the supply of government won't wean people off the state; you also have to reduce the demand for it. That persistent demand, after all, has been the main reason for sprawling government from California to Cardiff.

In practice, however, the idea has flaws. Running your local library sounds attractive, but most people lack the time and expertise required, and there is not a lot of money around to help them (thanks to the spending cuts). Britons seem to band to-

### State of play

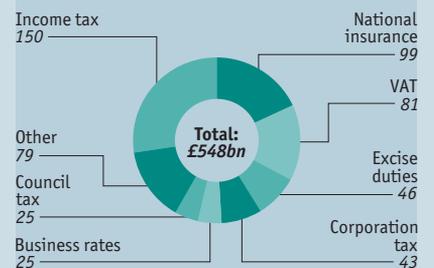
Britain's government, 2010-11\* estimate, £bn

#### Spending



Source: HM Treasury

#### Receipts



\*Fiscal year beginning April

gether of their own accord only when they want to oppose something—such as the government's plans to sell off the nation's forests, which they halted.

To be fair to the Tories, the Big Society is not their only scheme to reduce demand for government. Their welfare reforms are based on moving poorer Britons away from dependence on the state. A lot of state spending is "avoidable", argues one insider: if you can get people into jobs, strengthen families, stop teenagers getting pregnant and teach children early, you will save a fortune a decade hence. Just two particularly troublesome families have cost British taxpayers £37m over three generations.

The Cameroonians are also trying to do something about the tangle of regulation that costs the British economy around 10-12% of GDP. A neat scheme whereby any new rule would have to show a net decrease in regulation was shelved after civil servants gamed the system. One of Mr Cameron's advisers, Oliver Letwin, is now

working on another plan. But not all the regulation is domestic. A British Chambers of Commerce study of 144 new rules in 1998-2010 put the total cost at £88 billion, of which two-thirds was attributable to European Union legislation.

Implementation is crucial: unless reform of the state is seen to be equitable and effective, citizens will not accept it. But with that huge caveat, two things stand out. First, the government's breadth of ambition is impressive—even set against that of Mrs Thatcher, who did far less in her first year. And second, most other rich-world governments will have to do something similar soon. That is partly because of their fiscal situation: even America will have to start reconciling its revenues and its spending in the near future. And once you start to cut, you need to decide what should go and what should remain. Mr Cameron, for all his haste, is at the front of a great wave. In that, he resembles Mrs Thatcher—and those great reformers of the 19th century. ■

## Seize the moment

The prospects for reforming the state have improved, but it will be a long haul

HOW far and how fast could reform of the state go? For now that question seems fanciful, like asking how a man who has been getting fatter for decades would do in a marathon. Yet fatalism about an un-reformable state seems misguided.

To begin with, the patient is not in his current condition by design. In a forthcoming book about the role of the state, Vito Tanzi, an Italian-born economist, shows that it changed dramatically during the 20th century. Demands on it grew continu-

ously, and theories of what it might capably do expanded to meet those demands. What began as a "normative" state, designed to offset market failures and help the poor, broadened immensely to become an active redistributor of wealth and creator of universal public goods, hoovered up by the middle class in particular.

"If something cannot go on for ever", Herb Stein once pointed out, "it will stop." There are several reasons to think that some time soon—maybe next year, maybe

later this decade—the seemingly endless expansion of the state will begin to go into reverse. One is the political pressure from deficits. The shape of the state could be the main issue in America's presidential election next year. Even left-wing governments are increasingly looking at the spending side of the ledger.

Globalisation is another. Commerce has proved stickier than the proponents of borderless capitalism proclaimed in the 1990s, but it is less sticky than it was. The ►►

► mobility of talent, technology and capital surely puts some limit on governments' ability to keep on raising taxes. Government is becoming a more competitive business, not just in terms of lower spending but also in what it offers for the money.

Above all, the incremental benefits of ever bigger government, even assuming it was somehow affordable, become ever smaller. Decent-sized government can reduce inequality and poverty, but most of the evidence is that gargantuan government merely gets in the way of social progress. A state that takes up more than half the economy begins to deliver an ever worse deal to ever more people in the middle: the extra benefits become harder to detect, the extra costs harder to hide.

Guessing when this penny will eventually drop is a little like speculating when an investment bubble will burst or a dictator will fall. There are always reasons for delay but, once things begin to move, they do so quickly. A revolution in government would come in three stages.

The first, which this special report has concentrated on, might simply be described as good management. Purely by copying what other countries (or bits of their own system) do well, governments could save a huge amount of money. The path forward is pretty clear—towards a small central state buying in services from a variety of different providers. Technology could speed things up. A huge quantity of information about just how poorly bits of government are doing is becoming available—and, thanks to Facebook and other new media, shareable. Transparency will also affect demand. Too many voters are “Californians”: they think they can enjoy ever more services without paying for them. When they see the true cost of government, they may change their minds.

Within the public sector, mayors and senior civil servants could play a pre-eminent role. Not only do many public services, such as education and the police, work best at city level; cities are natural test-tubes for experimentation. In the urban West, mayors can still change things visibly: think of what Rudy Giuliani did for crime in New York. As for senior civil servants, most feel despised, underpaid and deeply frustrated. More than anybody else, they stand to gain from a world where government works.

Good management sounds a little worthy, but it could achieve a lot. Imagine, for instance, that Mr Cameron succeeds in creating a “post-bureaucratic” state in Britain. You might end up with a government that



delivered the same range of services—defence, justice, education, health care and so on—but consumed perhaps 40% of GDP, roughly ten points less than it does now.

Could it go further? The second stage is more difficult: limiting the scope of those services, especially the universal benefits enjoyed by most Western voters. Social transfers have accounted for a large part of the growth in the state: they also explain why even a well-run version of Britain's all-you-can-eat “buffet” state would be twice the size of Singapore's. Unless Western governments start to reform entitlements, the state will swell again in line with their ageing populations.

Some universal benefits can be trimmed across the board. State pension ages, for instance, are on the rise. But governments also need to start redirecting social programmes at the truly needy.

Persuading middle-class voters to give up their perks will be extremely hard. One possible avenue is to hand them greater control over their own benefits, perhaps by switching pay-as-you-go systems to individual savings accounts (like Singapore's Central Provident Fund). That has not had

much success yet—in part because most people, especially the young, are in the dark about how much the current system is really costing them. Tax simplification would help. A bipartisan commission on fiscal reform last year said that if the American government abolished all tax breaks (including middle-class ones like mortgage-interest relief), it could reduce the top individual tax rate from 35% to 23% and still generate \$80 billion more revenue. Again, limiting benefits will be a colossal struggle.

### Rules not OK

The final stage—untangling the web of rules—would on the face of it be less controversial. Everybody agrees that there are too many regulations. But in practice it could be the most fiddly to sort out. The European Parliament does not cost much to run, but it litters the continent with expensive rules. One in five American workers needs a licence to do his job. Sunset clauses to make laws expire in the absence of political reapproval would help.

This special report has tried to be pragmatic, focusing on what works. At the moment it is hard to see that society would gain much from even larger government, and easy to spot the gains in productivity, efficiency and personal freedom that would come from smaller government. States exist not only to lead society towards common goals; they must also provide people with the liberty to live their own lives. Over the past century government has moved too far towards the former. Now is the time to turn the dial back. Nothing would add more to the sum of human happiness in the West than a smaller, better state. ■

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