

## **With the reduction in State aid is it time for the good Samaritan to fill the gap?**

The Second Zephyr Lecture, given by Warwick Lightfoot, 22 February 2011

---

There is no better audience to deliver a lecture to on the role of philanthropy in modern society than the Sovereign Military Order of Malta. As a large Catholic international organisation, the Order plays a significant part in delivering important humanitarian and medical services in many countries. Here in London the Order is associated with a private hospital which applies its profits to help fund a hospice. The Order is of course, part of the wider, charitable and alms giving tradition of the Universal Church. It is a very rich history and certainly in this country its interruption, as a result of the King Henry VIII's suppression of the monasteries in the 1530s, set off among Protestant reformers, a debate about the 'commonweal'. It was the first proper discussion of the role of government and of private charity in relieving hardship in modern history. Although historians of the welfare state trace its first origins to the Elizabethan Poor Laws passed at the start of the 17th century, their context can properly be located in a protracted debate that was largely ignited by the ending of the range of welfare services that Catholic monastic institutions provided. So a series of debates and lectures sponsored by a Catholic Order is as good a place as any to explore the role of charity and philanthropy in the context of a changing welfare state.

### **Charity and philanthropy**

Charity, philanthropy and volunteering are all good things. They result in all sorts of worthwhile activities taking place that enhance the well being of many individuals and contribute to the collective welfare of our community. Above all charitable giving and volunteering is good for those who do it. People get a huge amount of satisfaction from founding, contributing to, paying for and volunteering to help philanthropic organisations. The sociology of giving is complex, but one of its clear conclusions is the benefit that the giver obtains from the transaction. For that reason alone it should be encouraged. Indeed Adam Smith noted charity generates positive externalities since others naturally sympathize with benevolent actions.

### **Private property, freedom and charity**

Significant and large scale philanthropy can only take place in free societies where people can enjoy the private possession of property and where there is a liberal policy regime that enables people to dispose of their assets and use them as they please.

Philanthropy has the capacity to go against the flow. To stand out against official opinion and to nurture unorthodox initiatives. It offers plurality of judgement and provision. It offers the opportunity to innovate, to experiment and to challenge received opinion and judgement. It offers diversity and experiment. Voluntary initiative also offers examples of quality and excellence.

### **To what extent can philanthropy replace the welfare state?**

What scope does philanthropy offer as a substitute or replacement for the principal services provided by the welfare state? This is a big question. Any attempt to answer it goes to the heart of why we have a welfare state and why we use collective action and taxation to provide so many services. The heart of collective action in a modern state is an agenda of redistribution and the correction of market failures that would result in the under provision of many goods and services or alternatively provision that could more efficiently be made through some non-market arrangement. In many areas such as health care it relates to the limitations that private insurance markets exhibit.

Redistribution has two dimensions to it. The redistribution of money and resources from better off households to less well off households and the redistribution from households in general to households in particular circumstance, for example from the childless to those with children, from people of working age to older people or from the fit and healthy to the sick and disabled.

A significant dispersion of income is inevitable in a market economy. There has to be a measure of redistribution of income to ensure reasonable levels of economic welfare for households in the bottom three deciles of the earnings distribution. This not only raises the overall level of economic welfare, but probably contributes to the effective functioning of market economies. In 2008-09 the original income of households in the top quintile of the income distribution was £73,800 on average compared to £5,000 for the bottom fifth. The richest received an income fifteen times greater than the bottom fifth. After taking account of taxes and benefits the ratio between the top and bottom was reduced to four to one - £53,900 compared to £13,600. Only collective action by the state can carry out the kind of correction needed.

The growth in state spending that took ratios of government expenditure from about 12 per cent of national income before 1914 to around a third of national income in the 1960s was accompanied by huge improvements in a whole range of social indicators and evidence that if anything advanced economies improved their capacity to expand output in a sustainable way, compared to the position in the second half of the 19<sup>th</sup> century. So what by historical standards is a large state appears to offer genuine benefits in terms both of social outcomes and economic performance.

The question is at what point does the cost of public expenditure exceeds its benefits. I have offered an answer to that question in my recent book *Sorry, We Have No Money- Britain's Economic Problem*, and my conclusion is that it is about 35 per cent of national income. I quite accept that there is a debate to be had about that level. Although for the purposes of this lecture that need not detain us. That level of spending – whatever it is - where collective action is necessary, because of the dispersion of earnings in a free economy and market failure, in my judgement, has to be filled by state expenditure financed by taxation.

Philanthropy and volunteering will not provide the resources systematically to provide for the relief of poverty, the smoothing of income over the life cycle and the collective provision of services. This should be no surprise. Collective provision is required because of the limitations that arise out of individual initiative, the costs and benefits that are not properly captured by market prices and the whole issue of the free rider problem. Where people effectively say: hang on there is a limit to what I am going to do, because others are not pulling their weight and what is more it will make no difference to me if I take a back seat?

That is why as community we have collectively to take action. We compel people to pay taxes so that money can be spent on things and on individuals who need it. Voluntary and philanthropic action would not generate resources on a sufficient scale and certainly would not do so in a way that would make systematic and comprehensive provision possible.

For example, the hospice movement is hugely impressive, but it is underfunded. It is not able to offer a comprehensive service. In many respects it illustrates how a hugely valuable initiative cannot offer systematic provision without the help of the state. Likewise with the arts. There are many rich people who like the arts and support them generously. Whether we would get sufficient private support for say *The Place* school of dance and choreography and its experimental workshops is not clear. Much of its work is experimental, half worked up and not to everybody's taste. Yet out of that institution comes choreography that is clearly popular and worthwhile. In my judgement the part of the 1940s welfare state that has been an unqualified success has been the Arts Council, whose first chairman was Lord Keynes.

The significant absence of state funding does not as some people believe offer opportunities for voluntary and charitable initiative to come forward. There is a view that state funding simply crowds out private initiative. I am not so sure. The state under-funds long-term residential care and personal care for older people. Yet you do not see a flourishing charitable sector offering such care to people on a reliable and affordable basis on any scale. Although, you do see of course examples of excellence from the sector such as the Abbey field homes, but they are not cheap. Instead what we see is poor quality of provision combined with costly bills for many households.

### **Does all collectively funded public provision have to be directly provided by the State?**

Does all collectively funded public service have to be delivered through state and public sector bodies? The answer is plainly no. There is a lot of scope for the state to fund voluntary and charitable organisations. For many years following the 1944 Education Act many pupils received their secondary education from so called direct grant schools. Many local authorities pay voluntary organisations to provide services that they need such as legal and other advice services, day centres and luncheon clubs, and care services directed at particular and distinctive local communities.

Local authorities have in many respects led the way in working with charitable organisations to provide services through the voluntary and third sector. There has in fact been a long tradition of this sort of collaboration in London. It is a tradition that goes right back to the London County Council, is embedded in many London boroughs that are used to working with organisations such boys' clubs.

Education, youth services, health care and social care do not have to be provided through monolithic central government or local authority bodies. My own borough has benefitted immensely from its long standing relationship with a large, vibrant and diverse voluntary sector. There is no doubt that voluntary organisations can bring real flair and imagination to doing things that health and local authorities have not always shown when doing the same things.

### **The need for diversity in health provision**

The changes being made in the health service offer a genuine opportunity for the voluntary sector to come forward to provide services. The UK has a distinctive form of health provision: publicly funded, free at the point of use and largely directly provided by the NHS itself on the District General Hospital model. There are other ways of having the state fund health care, with the care itself being delivered in different ways. It is not clear to me that very large district general hospitals are the best way of offering hospital care. More community based settings may well be better and it is not clear that some sort of national policy on patient-to-in-hospital bed number is necessarily the optimal way of obtaining the practical clinical care that patients need. This is particularly the case in relation to older patients, with chronic conditions. The Ombudsman's recent report on NHS care of the elderly and Ms. Eva Figes's article in the *Financial Times* describing her period in a geriatric ward illustrate the way that the present arrangements are seriously deficient. Moreover, a sustained and significant increase in resources has made little impact on care for older people that have been the Cinderella of the NHS since it was founded in 1948. Since the foundation of the NHS there have been vested interests in it that give priority to acute medicine at the expense of other important forms of care such as mental health and the care of older people. In fact it was these vested clinical interests that Cecily Saunders had to challenge.

The Prime Minister has made it clear that new health care commissioning proposal is central to his vision about the Big Society. Part of it is putting the professionals directly in charge of deciding what kind of service they think is needed. And giving them the money to commission or purchase it on behalf of their patients. Charitable organisations and not for profit organisations should have an opportunity to offer alternative provision that represents an improvement on the quality of care currently being offered by the NHS.

### **The need to establish and maintain effective control over health costs**

The challenge for the Prime Minister will be to ensure that this immense structural change that I broadly support enables the government to retain effective control over the cost of health in England. Traditionally the NHS had a strict command and control over health care spending that was by international standards extremely efficient. There was comprehensive health care free at the point of use, comparable morbidity and mortality outcomes to other advanced economies with services costing roughly a third less than the OECD average. In terms of cost versus outcome it was extremely impressive. Although there were issues of patient choice, waiting time and quality of care. We now spend much more on health and although there has been some progress on waiting times and the range of interventions has expanded, quality of care has weakened and most of the increased resources have been absorbed by higher staff costs led by increased pay for hospital consultants and GPs. American experience shows that doctors and hospitals will raise costs unless there is a proper framework for the regulation of their profession. There is an extensive economic literature on that demonstrates the need to regulate doctors. The UK has no modern tradition of doing so. Private practice here is expensive, has a long history of debateable clinical governance and offers many illustrations of the sort of matters that the economic literature that I have just referred to is concerned about. The medical profession, moreover, since the time that Aneurin Bevan 'filled the doctors' mouths with gold', has been skilled at extracting significant economic rents out of the taxpayer and patients. It is not an accident that we now have to best paid public health doctors in the world.

So far, moreover, in the discussion that has taken place about competition in health provision there has been shyness about any discussion of price competition. I would like to think that there is scope for the voluntary sector to provide health care services on the model of the Mayo Clinic in the US. It provides excellent clinical care and it controls its costs. A genuine element of contestability will help to contain costs.

### **Do voluntary organisations do it cheaper?**

Voluntary organisations in principle can provide high quality services on a cheaper cost base than central government or local authority provided services, given present nation pay bargaining arrangements. In both the NHS and local government there are national terms and conditions that make their employment costs higher. The latest available data from the ONS suggest that public sector earnings are about 13 per cent higher than private sector earnings. In addition public sector pensions are more generous than normal private sector occupational pensions.

The voluntary sector does not have to pay public sector terms and conditions. It cannot avoid regulation that the government chooses to impose on all providers of services. Long term residential care offers a good example. The state chronically under funds long term care. Local authorities use their monopoly power to drive unit costs down, while providers of care have faced rising costs arising out of an ambitious regulation agenda. The result is that good and responsible providers of care have abandoned the market leaving some indifferent providers to carry on with substandard care but higher occupancy rates.

The challenge the voluntary sector has is that when it has contracted for services in the past, it has too often seen it as an opportunity to replicate the costs of the public service rather than a serious exercise in providing services differently and with a lower cost.

### **The voluntary sector and inefficiency?**

There is also a further issue about charitable and voluntary sector costs that cannot be ducked. In many voluntary organisations and particularly in some of the larger national charities that often have distinguished histories and are held in great public affection, there is a fundamental efficiency and productivity problem. It is often a matter of straight forward management discipline and concerns things such as the culture of attendance, sickness and general time keeping. Practices that would not be accepted in the public service are tolerated in parts of the voluntary sector.

The key efficiency challenge for non-market organisations such as public sector agencies is that there is no incentive to appropriate a profit. In the absence of a profit there is no individual claimant available to appropriate internal incentives. There are several non market failures that can be identified as potential sources of inefficiency. Among them are internalities and private goals. Monitoring of goals is removed from the market and is dependent on the self-discipline of those running the organisation. Goals other than maximising the cost effectiveness of the organisation may be chosen. There can be redundant and rising costs where output is difficult to measure and monitoring costs may be defective and there can be a tendency for real costs to rise over time. This affects both the public sector and the charitable sector as well even where it receives no public funding.

We can all think of charitable institutions where the core charitable goal has been displaced. We can all think of examples where there is rent seeking. Resources allocated to the person in charge of the charity- the director of a day centre whose office is the biggest room on the premises. In many respects Trollope's fictional creation The Warden exemplifies this. If Trollope offers fiction, then the Chairman's own home offers a concrete example of set of almshouses where the biggest building is the master's lodging. I am sure we can all think of examples of befuddled trustees failing to achieve or secure the core interests of their charity as they hand its assets over to a larger organisation principally interested in the value of its property holdings rather than its fundamental objective.

Adam Smith who was a greater supporter of charitable giving was critical of institutions with big endowments that could live comfortable lives. And his experience of Balliol College Oxford gave him a particular distaste generously endowed educational institutions. In Book V of The Wealth of Nations, Smith comments on the low quality of teaching and the meagre intellectual activity of English universities compared to their counterparts in 18<sup>th</sup> century Scotland. Smith attributes this both to the rich endowments of the colleges at Oxford and Cambridge, which made the income of the professors independent of their ability to attract students; and to the fact that distinguished scholars could make an even more comfortable living as ministers in the then hugely endowed established Church of England that in Smith's day luxuriated in the sobriquet 'moribund Church'.

### **The financial challenge we all face**

In recent years charities have seen their incomes fall. The latest available figures from the Charity Commission indicate that they have a total income of £52 billion a year, roughly 3.5 per cent of GDP. About a quarter of charities receive public sector funding and the National Council for Voluntary Organisations estimates that just over a third of voluntary organisations receive public sector support that totalled £12.8 billion or 2 per cent of public expenditure in 2008. It is not surprising that charities saw their incomes fall over the last few years given that GDP fell 6.5 per cent and private sector output dropped by almost 11 per cent. And there is a sustained squeeze in living standards as a result of higher commodity prices and a lower exchange rate.

This time last year the Treasury believed that the trend rate of economic growth was 2.75 per cent. In June 2010 the new Office for Budget Responsibility in its pre-budget assessment ahead of the Emergency Budget revised it down to just over 2 per cent. The Institute for Fiscal Studies in its Green Budget estimates that the trend rate of growth is 1.75 per cent. The IMF estimates that to bring the UK's public finances to a position where public debt is on a sustainable footing would require a fiscal adjustment of 8.75 per cent of GDP. We face a public sector that is going to be very constrained for many years. The emergence of China and India and other dynamic emergent economies means that advanced economies will face intense competition. Relative growth in living standards will be very different over the coming decades from the period when the contours of the modern industrial economy took shape in the 1820s. There will be a fundamental shift of wealth and power to the east and with it a process that will move wages towards a greater degree of equality between the two.

### **Developing, expanding and improving the services that we will need**

Our challenge is to reduce spending and to take costs out of the public sector, so that we can afford to pay for and develop the public services that we need. That means more realistic and affordable levels of public sector pay and pension arrangements. I believe the philanthropic and voluntary sector has a significant part to play in this process. It will lead to a less monolithic structure of public service provision. There will be more diversity and less uniformity. This cannot be done if the Government maintains the present degree of national policy guidance and local policy prescription that has been in place for forty years. So the challenge for the voluntary sector is to compete on price and realistic and affordable costs. The challenge for the Prime Minister and his ministers is to be more realistic about policy guidance and the regulations that it imposes on all providers of public services so that more organisations can come forward and help to provide a public service so that there is greater plurality of provision as well as a more realistic cost base. The public services that we want and need are possible. We can afford them and with reform and greater involvement of the voluntary and charitable sector, we can also develop and improve them.

---

*Warwick Lightfoot is a former London Mayoral candidate, special adviser to the Chancellor 1989-1992, and author of the recently published 'Sorry, we have no money – Britain's economic problem. He is also an elected councillor in the Royal Borough of Kensington and Chelsea, where he is Cabinet member for Finance.*