fair dos

The Smith Institute

The Smith Institute is an independent think tank that has been set up to look at issues which flow from the changing relationship between social values and economic imperatives.

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fair dos

2003

A series of four seminars on fairness and enterprise, organised by the Smith Institute in partnership with the Work Foundation and Scottish Power, held between **December 2002 and April 2003**

Edited by Hugo Foxwood

the work foundation

ScottishPower

THE SMITH INSTITUTE

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Contents

Preface

Wilf Stevenson

Director, Smith Institute

The Smith Institute is an independent think tank, which has been set up to undertake research and education in issues that flow from the changing relationship between social values and economic imperatives. In recent years, the institute has centred its work on the policy implications arising from the interactions of equality, enterprise and equity.

The government is pursuing the two broad aims of fairness and enterprise, but these two aims may not always fit harmoniously together. Conflict can arise, both at the level of general principle and in specific policy contexts such as employment regulation, company law, the level and incidence of taxation and the provision of public services.

At best, the "enterprise economy" may help to promote certain aspects of social inclusion by creating jobs and spreading wealth. At worst, the creation of an enterprise economy might prove to have an in-built tendency to exacerbate existing sources of inequality and social unfairness. There is certainly no guarantee that measures to promote enterprise will invariably serve well the cause of fairness.

The Smith Institute, in association with the Work Foundation, is delighted to be publishing this account of the discussions that took place during our seminar series on this topic. The main aim of the series was to clarify the principles upon which a strategy of enterprise and fairness might be based; and to determine what would be the principal components of such a strategy, particularly in relation to the responsibilities of individuals, government and business.

The first seminar provided an overview of the territory and of the broad dilemmas within it. The following three seminars dealt, in turn, with the specifics of fairness: for individuals, for corporations, and in the regulatory and taxation system.

The Smith Institute gratefully acknowledges the support of Scottish Power towards this publication and the associated seminar series.

Seminar 1

An overview of fairness and enterprise

A seminar held on
Tuesday 10 December 2002

Introduction

Wilf Stevenson
Director, Smith Institute

We are delighted to be launching this seminar series on fairness and enterprise, which we are doing in partnership with the Work Foundation. We are grateful indeed for their support over the development of this project and for the support from Scottish Power.

Rt. Hon. Gordon Brown MP
Chancellor of the Exchequer

It was this month five years ago that the Smith Institute first started running seminars. Over these five years, perhaps 100 seminars have been organised, either here or around the country – and particularly in the regions of the country. I do believe that the contribution the Smith Institute is making to the debate about the future of Britain and the future discussion of social and economic issues is outstanding.

I would like to thank on your behalf not only the trustees, for all that they have done, but Wilf Stevenson, who has been the director of the Smith Institute, Konrad, Natascha, James and others who have been working in the Smith Institute for everything they have done over these last five years. It is a tremendous achievement, with limited resources to have the limitless energy to be able to organise such important events.

The first book by Bob Reich that I came across was called *The Next American Frontier*. It was written in 1981 – 20 years ago. Consistently, since then, Robert has been posing this question to all of us: Is enterprise bought at the cost of fairness, and is fairness bought at the cost of enterprise, or is it possible to have a society that is both enterprising and fair? I believe that that is the challenge that the Smith Institute is addressing. It is also the challenge – and I am glad that Will Hutton is here – being looked at by the Work Foundation.

If it is the case, perhaps, that America has been enterprising without being fair – which is a debate that we can have – is it possible to argue that Europe has concentrated on social cohesion at the cost of having a strongly enterprising economy, in recent years? Can Britain, or can the rest of Europe with Britain, in the next 10 years have an economy that is enterprising with a society that is fair?

I believe that that is a huge challenge ahead of us, and I believe that that will inform the work of the next part of the Labour government.

A lot has happened since 1981. I remember standing as a candidate in 1983, and I said that "this constituency needs an MP of youth and fresh ideas", and then in 2001 I had to say “this constituency needs an MP of maturity and experience”!

Since the 1980s, Robert has continued to produce books that have been both challenging and path breaking. His most recent book that has been published in Britain is *The Future of Success*, where he takes what I think is an excellent and challenging view of the issues of work/life balance, and puts it entirely in this issue of enterprising and fair societies. He is now publishing a new book in Britain this month, which was published in America a few months ago. It is a series of his essays, entitled *I’ll Be Short*.

Throughout these 20 years, Robert has been posing these questions. It is a great pleasure for me to ask him to address you this morning. Robert, welcome to the UK, and thank you for all the work that you do.

Professor Robert B Reich

Florence Heller Graduate School, Brandeis University

Since I was last here at No 11 for the Smith Institute, the United States stock market gained and lost $7 trillion. Easy come, easy go.

There have been some other things that have happened over the last five years, but I do want to congratulate the chancellor and also many of you who are involved, directly or indirectly, in New Labour – and I mean this quite sincerely – for setting an example for the United States about what is possible and desirable. You have also set an example of the quality of public debate that is needed with regard to making a society both more equitable and more efficient.

I thought it would be useful to talk a little bit about what we have learned in the United States about labour markets, particularly with regard to these themes of fairness and efficiency, and to talk about the difference between what has happened in the recent recession compared with 1990/91. There was significant structural change in the US market over that time.

Comparison with 1990/91: unemployment and flexibility

In the recent recession, unemployment did not reach the same level it reached in 1990/91. The highest unemployment level we reached, as we measure unemployment in the United States, was about 6% – where it is right now – but in the last recession of 1990/91 unemployment reached 9% and 9.5% in certain places, and around the country in places like Los Angeles it was 10.5%.

Why is it that unemployment in this recent recession was so much lower, and can we say that that is an advance? Have we progressed in some sense? Is the structure of the labour market in the United States more equitable or fairer? What has changed in the interim, if we compare troughs of the business cycle?

I would say that what has happened, essentially, is that the labour market in the United States has become – to use an overused term – more flexible. Labour unions are simply less powerful than they were even 11 years ago. The percentage of the labour force in the private sector that is unionised in the United States is now below 10%. Twelve years ago, it was approximately 14%.

We see that the percentage of workers covered by the Fair Labour Standards Act continues to shrink. That is an Act requiring that workers work only 40 hours a week or, if they are working longer than that, then they get paid time-and-a-half for overtime.

The minimum wage in the United States, in real terms adjusted for inflation, continued to decline, even though we had a minimum wage increase in 1995. In many other ways – and I will not bore you with all the ways – the labour market in the United States became more flexible over the last 12 years than it had been, in all the ways we think of flexibility: the ability of employers to hire and fire workers, the ability of employers to set wages, the lack of regulation of the labour market, etc.

As I said, there seems to be some relationship between the flexibility of the labour market and a relatively lower level of unemployment when you have a trough in the business cycle. I might also add higher productivity. We see that in this recession productivity per worker has been higher than it was in the previous recession.

Does that mean that labour market flexibility is a good thing? On the surface, it would seem so. Again, if labour market flexibility means you have lower unemployment and higher productivity, that is great. Lower unemployment has some tremendous social benefits attached to it. It is one of the most important social policies. If you try to contrive a social policy that is going to train more people, reduce hardship, and make sure employers are doing their best to recruit people, you want low unemployment. But let me suggest to you that these statistics hide some very important and very troubling realities.

The hidden costs

Yes, we have higher productivity in this recession than in the last recession, but that higher productivity per person is largely a result of the fact that there are so many people who are not working, who have exited themselves from the labour market altogether, who do not even show up in the labour market survey. When asked: "Are you looking for a job?" they say: "No, we're not essentially looking for a job." This is particularly people over 50 years old.

The productivity per person left over in the labour market is much higher because they are doing much more work. They are working longer hours – that is another aspect of this new reality. We find that the working week at the end of the 1990s in the United States was considerably longer than it was at the start of the 1990s, and the average household was putting in seven weeks' more work. That is a huge increase in the amount of paid work, usually by both husband and wife.

Insecurity is now much greater. That can be seen in the levels of company lay-offs, where companies were basically saying to workers: "We don't need you any longer." Those increased substantially in 1991-93, and then did not decline even as the economy in the United States sped up. Labour market flexibility brings a great deal of labour market insecurity. People simply cannot count on the fact that they will have their jobs, even though their companies, at least in the late 1990s, were doing quite well. It goes without saying that, now we have another recession, labour market insecurity is much greater than it was.

I want to suggest to you that there are very substantial social costs that come with the increase in what we shall call labour market flexibility. America now has more flexible labour markets than we had even 12 years ago, which even then were highly flexible by European standards.

Comparison with Europe

I want to contrast this degree of labour market flexibility with what you have now in Europe, particularly on the Continent. In almost every dimension, you have a labour market that is far more rigid: unionisation, the ability of employers to hire and fire, the setting of wages, the regulation of labour markets; and I understand the euro countries now have six weeks' vacation. In the United States, the average duration of paid vacation is now two weeks, not six weeks. That is a substantial difference.

Regarding maternity or paternity leave in the United States, we do not have paid maternity leave. In fact, what we considered to be a great benefit, a great success, in the Clinton administration – after seven years of fighting – was to get 12 months of unpaid maternity leave. I can tell you, having administered that law, that almost no employee takes advantage of it, because it is unpaid and because many employees simply cannot bear the cost of unpaid leave.

I do not conclude from all of this that you have to have a trade-off. Obviously, structural unemployment on the Continent is much higher than it is in the UK, and certainly much higher than it is in the United States. The question to be addressed today is, it seems to me: Is there a way of combining the best of labour market so-called flexibility in the United States with the degree of stability and fairness and minimal social cost that you have in the UK or in Europe? What is the ideal mix of labour market flexibility on the one hand and fairness on the other hand?

Better ways to create flexibility

Already, here in Britain – and I wish we continued it in the United States – there is an understanding that investment in education and job skills, and continued investment in structural adjustment policies, make a big difference. They make the labour market work better and enable an economy to run at a much lower level of unemployment and not risk inflation.

Even five years ago, we talked about the importance of public investment in people. Let me go beyond that. Are there other means of gaining labour market flexibility that do not necessarily entail simply saying to employers: "You have a right to fire without severance; you have a right to set wages and unemployment insurance; and other regulatory mechanisms will be minimised"?

It is very important to think about other aspects of labour market flexibility. For example, geographic mobility – which can enable employees to find jobs, to commute to jobs, to get new jobs – is an aspect of labour market flexibility that, in my view, is often not discussed enough. What should be thought of as one aspect of labour market flexibility is a good system of public transit, a system that enables people to live closer to their work, or at least get to work or change jobs with less problem. Such a system is an aspect of enabling people to get jobs.

The same is true of small business training and of equity being available for formulating small business. Banking that is favourable to small business formation should also be considered an aspect of labour market flexibility. We have seen in the United States that many people would like to form their own businesses but simply cannot. Our equity markets, our capital markets, our lending markets are better than they were in terms of small business formation, but there are still a lot of impediments to small businesses getting going.

For instance, it is important to eliminate unnecessary certifications and licences and other barriers to people forming their own businesses, or, basically, to moving from one occupation to another occupation. That is another important aspect of labour market flexibility that is rarely discussed.

Lightening the burdens of change

Are there new forms of insurance that can soften the burdens of change for people? One of the problems that people in the United States have right now is that their earnings are subject to such extraordinary differences from one time period to another. It is not so much that they lose their job: they lose their earnings. One reason that unemployment is lower in this recent recession than it was in the previous recession is that so much pay is now variable. By variable pay, I simply mean that employers are tying a larger portion of the pay package to profitability than they were in the last recession.

This is good for employment; but it is bad for earnings security. It means that someone's earnings go up and down. What about thinking creatively about earnings insurance? It is possible, for example, to come up with a scheme in which employees might pay in in good years – in years when the economy is expanding, or when the employers themselves feel that they are doing very well, they could pay in. If ground is lost in a recession, if earnings decline, perhaps they could dip into the earnings insurance pool for a portion of the decline. They could then even out their earnings over time.

Is it possible to think about community insurance? Employers in the United States, due to our labour market flexibility, can and do fire people – and not just one person, or five people, but sometimes thousands of people who are located in the same geographic area. And so entire communities suffer the social consequences, including many retailers and small businesses. Can we think creatively about providing an entire community with some degree of insurance against that kind of instability, so that a community gets more community development funding, or more funding to strengthen the diversification of its labour market and its economic base?

Is it possible (and I raise these as questions) to have, for example, a set of mechanisms in place that might put a little bit of sand in the gears of capital – a set of circuit breakers? When a company or companies in an industry are about to lay off large numbers of people, instead of saying that you cannot lay off, would it be possible to soften that by saying, in effect, you may lay off as many people as you want, but only at a certain rate? In a given period of time, you cannot lay off more than, say, 10% of your labour force because the social consequences of rapid lay-offs of large numbers of people in a geographically contiguous area would be simply too great for society to bear.

I call this a circuit breaker, because it is analogous to what we have on the stock market. Sell-offs of a certain magnitude over a certain amount of time are thought to be simply too great, because they may cause the entire market to lose confidence. Can we think about the same kind of circuit breaker in terms of mass lay-offs?

Transfer taxes

And finally, can we revisit the issue of transfer taxes? When I talk about a transfer tax, I am talking about a very tiny tax, maybe 0.1%, on the transfer of equity. We have talked about this in the United States for years. The most recent Democratic secretary of the Treasury, Larry Summers, now president of Harvard, did a very elegant paper arguing for a transfer tax before he went into government. When we were in power, we used to have a great deal of fun – I say "fun" figuratively – about that. I would bring out Larry's paper and say to him: "This is a very good idea – you want to read this?"

A transfer tax would need to be both national and international, because we are talking about an international phenomenon: the very high-speed movement of capital that undermines the social contract in many countries, and undermines the financial and political integrity of many countries simply because "hot" capital can move so quickly. Can we think creatively about a transfer tax? It might simply slow down the movement of capital a little bit, so that these social costs can be avoided.

Conclusion

I raise all of these questions as policy alternatives that may enable us in Britain and in the United States to gain the benefits of labour market flexibility and low unemployment without inflation, but not suffer the same social costs in terms of instability and insecurity.

Can we think creatively, in other words, about increasing flexibility for people to get new jobs; or about providing earnings insurance, or slowing down the movement of capital, but not necessarily reducing the flexibility of labour markets?

I ask that as a question. I have every confidence that the chancellor and New Labour will, once again, really chart the course. I have no confidence at all that the Bush administration will do this – in fact, I have, unfortunately, every reason to believe that they will do nothing of the sort. So, once again, my speaking here is a way of congratulating all of you and urging you on to greater and even better innovation in public policy.

Will Hutton
Chief executive, The Work Foundation

Conceptions of fairness and efficiency

This conversation about fairness and efficiency is bedevilled by the sense – and there were traces of it in what Robert was saying – that there is one paradigm for fairness and another paradigm for efficiency and enterprise; that there is the economic, where you do things like having to lay off people at a fantastic rate, and there is the social, where the social cost needs to be mitigated.

I want to argue that, rather than thinking of two separate but interdependent spheres, we should think of a Venn diagram with two circles largely overlapping. There are large parts of what we consider to be enterprising that are impossible without some sense of fairness. I am going to argue that successful business organisations are successful organisations, and that that has been lost over the 1990s with the debate about enterprise. That is pointed to in substantive literature, both in economics and in the Business School literature to which I want to make some reference.

I also want to argue, on the fairness side, that we have got to reconsider social contracts and labour market regulation so that we start to recognise that elements of inequality may need to be built into our conceptions of fairness. Once you start reconceptualising both like that, a lot of this argument falls away and a new approach opens up.

Conceptions of enterprise in the 1990s

In the 1990s, the quintessential notion of enterprise was in some sense embodied by the venture capitalist who backed the inventor or businessman who had an idea. The idea is brought to market in an initial public offering. Lots of small firms are started, firms that embody ideas that increase the rate of technical progress and push out the frontiers of technological advance and productivity, and: hey presto!

Another 1990s conception of enterprise is that, given that all firms need to be profit maximising, the very best way to get enterprise is to align the interests of directors with those of shareholders. That was the doctrine of shareholder value, which saw the introduction of share options schemes to such a degree in the States and to a lesser extent in Britain.

But at the end of the 1990s – the beginning of next decade – we need to take a little step back. There were 3,500 initial public offerings between 1993 and 2000 on the New York Stock Exchange, and even before the stock market fall, when the Dow was around 10,000, only half of them by 2000 were trading above their initial offer price. Now it is much less. An enormous number – over two-thirds – have gone bust.

On the share options, I do not think many people are recognising the numbers – they are simply stunning. In 1990, directors of the Fortune 500 companies owned 2% of the trade equity in the States. In 2001, the figure had exploded to 13%. That 11% capitalisation transfer from the hands of institutional private shareholders to directors is one of the largest wealth transfers in history: $600 billion of those options were exercised over the 1990s. This was meant to produce an enormous increase in productivity.

In 2002, that theory has to be questioned. The official numbers in the States show only a modest increase in whole economy productivity in the second half of the decade compared with the first half, and there is a lively debate around them. Very many people know the work by Robert Gordon of the University Northwest, which challenges to what extent this is structural and not cyclical.

I do not want to get into that debate. I suspect that there is more structurally there than we recognise; and the productivity numbers are holding up rather well in this recession, as Robert pointed out. But what you cannot say is that an increase in productivity from around 1.5% per annum to rather more than 2% was worth that degree of wealth destruction. If you factor in the collapse of the telecoms and dot-com bubble, where the *Financial Times* estimates $1 trillion was lost in straight right-offs and losses; and if you factor in those IPOs I have just talked about, and all that venture capital money that went west for the very slight increase in productivity; then, even if you accept the numbers at their face value, all this places a question-mark over to what extent that conception of enterprise has really delivered the goods.

A different conception of enterprise

This is where I want to open up briefly a different conception of enterprise, a different conception of the firm. I borrow here from Edith Penrose, whose work includes *Theory of the Growth of the Firm.* At INSEAD, her successor as professor of organisational theory is a woman called Mary O'Sullivan, who is working with a chap called Bill Lazonick. I am also borrowing from some of the empirical work that has come out of that theoretical work: *Good to Great* by James Collins; and notably that great business book, *Built to Last*, by James Collins and Jerry Porras – which, by the way, is the best-selling business book in the States. It has sold over quarter of a million copies – that is as many as *The State We're In.*

What this stream of thinking argues is that you have to think of businesses as business organisations: organisations have very fundamental rules if they are to work as organisations. They have to have a sense of purpose. They have to have built into their processes notions of fairness and integrity, otherwise they just do not function as human organisations.

Some of the great business organisations have ceased to be so as a result of the 1990s. For instance, Boeing, which Porras and Collins talk about as a great organisation, has become less so as a result of the shareholder value revolution. It has been overtaken by Airbus and it has become a company that is dedicated to maximising shareholder value. It has lost its sense of core purpose; it is moving away from building great aeroplanes, which was William Boeing's conception of Boeing, and has gone into aviation. It is getting into the insurance business. It has left Seattle and migrated to Chicago. It is a kind of rent-seeking company, which has lost what its core purpose is about, and is losing its way as an organisation.

Organisations require to be well directed and well led. They require a high degree of what sociologists and some economists call social capital. If you are going to make good decisions as a board of directors, you have to have good information in your hands that you can trust. The people who are supplying that information to you have to have a very good sense of what the company is about. You, the directors, have to make smart and fast decisions about allocating resources to particular parts of the market. All this requires cohesion, a shared sense of purpose, and high levels of trust within the organisation. Those are brought about by values of fairness and integrity. It is not surprising that one of the best predictors of poor corporate performance is excessive chief executive pay.

A lot of work has been done in the States showing that, actually, the bigger the share options – the bigger the remuneration of the board – then the more likely that two, three, four, five years after that there is indifferent corporate performance. And there is a lot of work showing that the performance of merged companies after contested take-overs is extraordinarily indifferent. KPMG came up with some figures which I thought amazing: 85% of take-overs either add no value, or actually lose shareholder value – and they looked at over 600 in the period 1995-2000.

So, I want to argue the first point: that successful business organisations incorporate many of these notions of fairness into their processes, and when you neglect that you do not get much of a pay-off.

I want to move into the second sphere of this idea of the social contract. The question is: Does the social contract inhibit enterprise? Does the taxation, the regulation, the provision of public services, the minimisation of risk for ordinary people that is entailed by a social contract in some way inhibit the enterprise sector?

The Rawlsian social contract

Again, I borrow from the work of John Rawls and his famous difference principle. I do not want to do a piece about Rawlsian ideas here; it would take too long. I will assume that you all basically familiar with his thinking.

One of the difficulties with arguing for and against social contracts is a sense that they have to produce equality of outcomes. This difficulty is resolved once you start to recognise that, actually, fairness is not about everybody having to be equal, but about those who are rich, or have the opportunity to be rich, only being that rich to the degree that, if their roles were swapped with those of the poor, then they would recognise that their richness is benefitting the generality of people. Once you start entering that, you start to recognise that a degree of inequality is not only tolerable but justifiable, and may need to be lived with. Of course, it also puts a cap on the permitted degree of inequality.

This has very interesting implications for the trade unions and the labour market. When I spoke to the TUC general council a few months ago, I argued that unions have got to recognise that, if they want to bargain for the universe of people in a firm, then they must recognise that some of the people they are going to bargain for will need to have greater differentials than others, if those same people are going to consider the outcome fair.

Once you start thinking in these terms, then the sense of the two spheres being in tension all the time, and one being at the cost of the other, starts to fall away.

Enterprise and social justice in Europe

Half-a-dozen countries in western Europe have unemployment rates lower than the US. They are Austria, the Netherlands, Finland, Portugal, Sweden and Denmark. I think they have a better trade off than either the US or – at the other end of the scale – Germany. They have highly productive corporate sectors: their productivity, in output per man hour worked, is either equal to or greater than the States. Their unemployment is lower; and there is a greater degree of social cohesion. I would argue that that is because they have understood – and their structures incorporate the understanding – that there is not a tension between enterprise and social justice in the way that the Anglo-Saxon world sometimes thinks.

In Germany, where unemployment is highest and where the critique is levelled most aggressively, unemployment is, on a high/low base, close to 9%. That is compared with under 6% in the UK. I would argue that the Germans have tried to reproduce the success of the smaller European countries; or the smaller countries have been doing what the Germans do and doing it more successfully. This does not suddenly mean that the whole model is wrong.

Unemployment in Germany

When you start to unpick what's happening in Germany and, to a degree, in the French labour markets, you see how unfair some of the critique is: the critique that the German model shows the world of enterprise being obstructed by the world of social contract, social justice and fairness.

The German participation rates of the male labour force between 25 and 55 years old are broadly the same as in Britain, France and Italy, and, amazingly, the US. What is happening is that female participation in the labour market is much lower in Germany; and older workers and younger workers are not given the same kind of access as in the States and Britain. That has a lot to do with German social structures.

I argue in my book that one of the reasons why there has been an extraordinary rate of job generation in the States – 40 million jobs in the last 20 years, of which 39 million are women's jobs – is because feminism and the sexual revolution came to the US first. American structures have adapted to and accommodated women's demands over the labour market more quickly than in mainland Europe, which is still – particularly in Germany – fundamentally sexist. And that is a very important part of the labour market story in the stakeholder Rhineland countries, a point that is not usually put on the agenda.

Consider another aspect of the German-led labour market. If all the regulation and rigidity that Robert talked about were inhibiting job generation in Germany to the extent that some theorists argue, then you would expect, for example, to find higher unemployment among unskilled workers than among skilled workers. They would be unable to price themselves into work because of all charges on them, and all the inhibitions about sacking them, if the cycle turned down. Actually, Steve Nickell has shown that unemployment rates in Germany of skilled workers and unskilled workers are exactly the same.

Almost all the studies on it show the same thing. What you discover when you look at German unemployment is that, above anything else, it is about macroeconomic policy mistakes: the terms in which the East and West Germany merged; the terms in which Germany entered the eurozone; the way the automatic stabilisers have not been able to work in German fiscal policy; and, I would argue, the inability to introduce New Labour types of schemes in its labour market.

The incentives for job search in Germany are extraordinarily low; and the way the social insurance system works leads to a vicious circle because, as the numbers of unemployed rise, the pool of people who pay social insurance falls, and the social insurance rates rise. Thus you get a rather vicious effect in that employing people becomes more expensive, which exacerbates any economic downturn. Some of Robert's ideas would ease that.

So, the argument that Germany demonstrates that there is a tension between social justice and enterprise does not stand. The macroeconomic policy mistakes in Germany are as much to do with its own difficulties as with any endemic contention, if you like, between fairness and enterprise.

Conclusion

In conclusion, what does it mean? My contention is that ideas of fairness and integrity need to be incorporated into our conceptions of enterprise; and that we need to think about building and having structures that allow capitalists to build successful visionary business organisations. That value system is perfectly consistent with trying to build a Rawlsian social contract. They come from the same stem.

If that is right, then there is not a tension between social justice – fairness – and enterprise; they are informed by the same value system. It is possible to work towards a country with structures in which you build great companies with high value added, high levels of productivity, and in which you are also building a social contract with all that entails in equality of opportunity and risk sharing.

In policy terms, it is rather unheroic. The government has to do things like Gordon has already done to a degree in his Myner's review. That was a review looking at the relationship between institutional investors and pension funds and quoted companies, and examining to what extent one could improve relationships so that directors of companies had better communication with shareholders, and shareholders understood that the objective of a corporation was to build a sustainable organisation over time.

You start to get into rather unheroic fine print of trustee law or pension fund law: how companies are constituted; what the fine details are of corporate governance; what directors' responsibilities are; information and consultation procedures. That becomes the territory into which one moves, but the rewards from it are extraordinarily rich.

That is what we are trying to do at the Work Foundation, and this is our fundamental proposition: the values that inform the fair society people want in their home and their neighbourhood are exactly the same values that they want in the enterprise for which they work. And we believe that fairly run enterprises are highly productive enterprises.

We are currently conducting an enquiry into work enterprise as initiated by Pat Hewitt over at the DTI. We have six companies – Tesco, Astro Zenica, Microsoft, Lloyds TSB, Manpower and Eversheds – backing an enquiry that has tried to tease out these relationships between quality of working life, quality of leadership, the extent to which organisations are fairly run, and the consequent performance. What we are hoping to do in the course of the next year is prove robustly these points that I have tried to make today.

Wilf Stevenson
We have arrived at a very similar position from two quite different histories and backgrounds. The issues themselves are very clear: you can have a win/win if you can incorporate into your society a sense of social justice and fairness; and successful organisations will be, by nature, fair. But, obviously, there is a long way between aspiring to that and knowing how to achieve it.

Discussion

Ronnie Mercer, Group director (infrastructure), Scottish Power
We have half our business in the US and half in the UK. Robert's point on flexibility of labour intrigued me because I see it, as I go to both places.

The one word you never mentioned in your whole time was "pension", and yet it is the biggest blocker we have in the UK, especially from former nationalised companies, to getting any flexibility for people to move out to go to joint ventures or whatever. I wondered what your view of that was, as against what you see in the US?

Response: Professor Robert Reich
In the United States we have been moving very rapidly from what we call a "defined benefit" pension plan where, after staying with the company for 40 years, you got a fixed amount of money every month; to "defined contribution" plans, where employees and employers both put in some money but there was no guarantee of how much you would get per month when you retired; to the "employee-only defined contribution" plans that we have now. That means companies not putting in any money at all, but employees putting in tax-favoured pension money with the hope at the end that they will get whatever the stock market yields.

The net result of all that movement, from defined benefit through defined contribution to employee-only defined contribution, is that we have a whole generation of people who are now in their 50s. They are looking 10 years hence and do not have the personal savings; they do not have the company pension plan; they cannot rely on social security; and they are becoming understandably nervous. One of the great questions we are facing in the United States, from a macro standpoint, is whether consumer spending, particularly among this vast group of post-war baby boomers, will maintain itself – given the nervousness that everybody now feels about not having enough of a pension.

I am looking for a way of bridging the relatively higher level of generality that Will was bringing to the discussion – which I think is very important – with the micro questions that I think you are asking, namely: How can we provide more flexibility with regard to pension coverage, and yet at the same time generate not only economic security but a sense of collective well-being and social solidarity, and a sense that we are all in this together both at the enterprise level and at the national level?

It may be that the best mid-point (and I do not know where British pension law is on this) would be a defined contribution plan, but one in which the enterprise was also expected – or maybe by law required – to submit a certain amount, or a certain percentage of that contribution, per quarter or per month. Again, you can let me know if that is now the law. I simply do not know.

Ronnie Mercer
The point is that people do not want to leave their pension schemes, and that is the biggest blocker to flexibility in business administration.

Wilf Stevenson
How do you get the transferability across to other enterprises? Is that something that has come out of this?

Response: Professor Robert Reich
Yes, the defined contribution scheme we now have is purely portable and transferable. You are contributing not to a company pension scheme but to a pension plan that is fully portable.

Wilf Stevenson
I do not think Bob realises that this is currently a rather hot topic over here.

Response: Will Hutton
What you are discovering at Scottish Power, presumably because you have a defined *benefit* pension scheme, is that people are just hanging on to their jobs. They get to 45 and will not leave, and so you have got less turnover. The reason why they will not migrate is because anywhere else they would receive a defined *contribution* pension scheme. That is your problem.

Ronnie Mercer
Recently, we had part of the business deregulated. We realised we could not

live with the conditions we had inside the company, so we formed a joint venture with a contractor. It has been done now, after great pain, but it was because of the pension that both workforce and management did not want to go.

Response: Professor Robert Reich
I do not want to spend our valuable time on this one issue, but I do want to make sure I understand the situation here enough to be able to comment on a comparative basis.

If you had a portable defined contribution scheme, such that employer and employee were both contributing into a pension that could be taken from one employer to the next, would that alleviate your problem?

Ronnie Mercer
Yes.

Professor Julian Le Grand, Department of social policy, London School of Economics
I was interested in Robert's idea about earnings insurance and community insurance, but it did sound remarkably like a kind of Bismarkian system of social insurance, where you have earnings-related contributions and then you get benefits out, related to your earnings, when you are in trouble. Of course, the Bismarkian system of social insurance is used by Germany and various Continental European countries. I wondered how you thought these ideas of community insurance or earnings insurance would not suffer from the kind of problems that Will was alluding to with social insurance?

For example, if costs rise, then the burden on employers and employees rises, and the greater the number of problems you are trying to deal with. And there is the whole problem of high replacement rates discouraging job search and so on. So you end up with a trade-off at the end of the day between labour market flexibility and fairness.

Response: Professor Robert Reich
Well, there may be some trade-off at the end of the day, but let me make sure you understand the scheme that I am proposing.

In the United States we have a greater volatility of earnings than we have seen before. It is not a volatility of employment. More people are staying employed while their earnings go up and down; because of bonuses, because more and more of their earnings depend upon so-called voluntary overtime, because of profit-sharing schemes, and because commissions are now so dominant in certain fields as fundamental earnings streams. Whatever the reason, employers are tying employees' compensation to some measure of performance or profitability. That is good for employment, in that it steadies employment, but it does push a lot of the variability and a lot of the insecurity onto earnings itself.

So, the notion is not so much to impose a new insurance burden on employers and employees, but simply to even out that volatility of earnings. In years when your earnings increased by a certain amount, or were over a certain amount, then you would either automatically, or perhaps voluntarily, have an opportunity to pay into a scheme. Where your earnings dropped by a certain amount, you would have an opportunity to take money out. The money that you either put in or took out would compensate or would represent a portion of either your gain or your loss.

It need not be arranged so that it is an added burden on employers or employees. It could be arranged so that you were simply diversifying the risk of your earnings being as volatile as they otherwise were.

Professor Julian Le Grand
Would it be a funded scheme rather than a pay-as-you-go?

Response: Professor Robert Reich
It would be a funded scheme; it would not be pay-as-you-go. It would be funded so that you could even out the variability of the business cycle.

Professor Julian Le Grand
Would it be run by employers or would individuals have their own fund?

Response: Professor Robert Reich
I would prefer it to be on an individual basis, so that you maximise the flexibility for employers and employees. That means government would have

to be more directly involved. But it could be done in either way.

Professor Sheldon Leader, Department of law, University of Essex
One of the contrasts of emphasis between the two talks was that Bob's talk was essentially focusing on what society at large can do in the name of reaching this synthesis between fairness and enterprise; whereas Will gave us more of a picture inside the organisation as well. There is a real issue between the two, and I want to pose a couple of questions about that difference.

Will gave us a picture of overall organisational purpose and loyalty as being a very important part of what a successful organisational culture involves. One of the things that could pull against that is the fragmentation and the contractualising of the enterprise, such that the enterprise is often seen as an aggregate of smaller parts, each of which is there to make a profit and enters into contractual relations with the other. Bids are made and, if the bid is not interesting, you outsource. Before you know it, you have a network of contracts – some inside, some outside the enterprise. In one sense, that is in the name of an overall purpose but, in reality, the tug of war that goes on in these profit centres undermines a sense of organisational purpose.

The policy implications seem to me to be very strong. If you see that as a potential problem, you will be less willing to go down the route that we have of the fragmentation of the enterprise. The situation calls for some fairly new ways of looking at a whole network of laws that make this possible. So, I have two questions.

One is: would you agree, Will, that there is this potential tension between a successful organisational sense of purpose and what we have at the moment, which is this tendency to fragment the enterprise?

Then, secondly, Bob, would you see this as an issue for the United States? It talks about corporate governance, yet I do not see this portion of the debate figuring in American policy.

Wilf Stevenson
Of course, there are implications here for the public sector as well.

Response: Will Hutton

Yes, I think there is that tension. In a sense, part of my talk was precisely about it, and that is why I raised the Boeing/Airbus example. The Boeing subsidy is very similar to that of Airbus once you factor in export tax rebates and defence contracts, and Airbus's subsidy has been rolling back. I think that Boeing is, in your words, fragmenting as an enterprise. From the point of view of European industrial policy, the result is good for us Europeans. Airbus now has the longer order book in every category of aircraft; and it is Airbus that is going to develop this super jumbo. But, if I was an American, I would be mourning the diminution of what used to be one of the great pillars of American capitalism and the American economy. I think there are a lot of sectors where that is true.

On the other hand, information and communication technology is going to make organisations much more "porous", as I call it. Forming networks and partnerships is going to become part of the new way of doing organisations. So you have to distinguish contracting out or fragmentary forces that are malevolent from relationships that are more constructive and creative, enabling the organisation to get itself into purposeful networks. There has been very little good work done on distinguishing between the good and bad trends.

Response: Professor Robert Reich

In the US context, we are talking about different phenomena. On the one hand, there has been a vacillation back and forth, over time, between the conglomeration and, let us call it, "back to basics". In the 1980s, companies moved into vast conglomerates; and they did it in the 1960s. In the early 1990s, they started separating back to basics, which Wall Street liked better. In the late 1990s, we saw a lot of companies going back into conglomeration. This vacillation is very much a matter of what the fashions are at the time and where stockholders feel that they can see real value.

The inevitable back and forth between conglomeration and exposing where value centres are has to be separated from what Will referred to just now, and that is long-term structural shift towards a different kind of organisation. It is a shift away from a high-value, high-volume organisation in which people all understand that they are part of the same network, where there is a great deal of social capital and loyalty, towards an organisation which has almost no loyalty, where many people consider themselves free agents, and where there is a great deal of subcontracting – in fact many organisations that call themselves companies are now just collections of subcontracts.

That secular direction is not going to change very much, for companies are being pushed that way by technology and globalisation. There will be a loss in terms of social capital; but capital markets themselves are getting less and less patient. They are moving to very short-term assessments. We complained 10-15 years ago about how short term capital markets were; they are even shorter term these days. We have many shareholders who are shareholders for 15 minutes or for 30 seconds. In that kind of world, how can we realistically talk about developing the kind of social capital that we all think is very important for long-term productivity? I do not have a way out of that paradox.

Robert Peston, City editor, Sunday Telegraph
It seemed to me that you both, in different ways, were looking at the issue of boundaries between private and public, between government intervention and what's left to the markets. That boundary is moving, and it is quite interesting to try and work out where it is going to end.

One interesting area which Will referred to is the whole issue of executive pay. It has been acceptable for 20 years now for governments to criticise "might is right" by trade unions, but almost everywhere you look it is still unacceptable to criticise "might is right" as exercised by executives over boardroom pay. Yet, as Will points out, there is evidence that excessive pay is actually correlated with poor corporate performance, let alone economic performance.

Do you think that governments should be more involved in issues of boardroom pay, or do you think this is something that should be left purely to the owners of public companies – the shareholders?

Response: Professor Robert Reich
People are upset by many of the scandals we have seen, such as Enron, Global Crossing and WorldCom. And the colossal compensation for the former president of General Electric is something of a scandal in the American press,

even though he did a wonderful job in terms of shareholder value.

If one believes that capital markets are efficient and that oversight of companies is basically more efficiently done by the capital markets than by government, then you have to basically throw up your hands and say: let the market for corporate executives dictate, by supply and demand, whatever the executives' compensation is going to be.

And if you, basically, say: we, as public officials in the public sector, or we, as citizens, do not really know what executive pay should be and we are less able than the capital markets to judge that, then, again, you throw up your hands.

But if you do not believe that capital markets are all that efficient; if you believe there are profound agency problems, and that indeed executive compensation is being set by compensation committees that are appointed by chief executives; if you believe that excessive compensation demoralises employees, undermines productivity, and that it is demoralising to the country as a whole to have vast gaps between what the high and low are making; then there is a justification for some public guidance, if not tax policy, that goes after excessive compensation.

That was certainly the view that we had in the Clinton administration in 1992. In Bill Clinton's campaign, one of his promises was to make it impossible for companies to deduct executive compensation in excess of $1 million a year. When it came time to implement that provision, we decided – because we had so much very strong objection from the business community – that we would change it slightly. Thinking it was only a slight change, we said: Yes, companies can deduct any compensation over $1 million a year if the compensation is linked to company performance. Of course, we did not know we were opening up a can of worms.

What we should have said, if we were going to link it to any performance at all, was that the performance would have to be a trend line above the overall trend line index of Standard & Poor's, or whatever the Wall Street index was going to be. But simply to allow it to be performance-based, and then to have the extraordinary run-up in share prices that we had at the end of the 1990s, seemed to provide a public imprimatur of legitimacy on these exorbitant executive salaries. So we had a boomerang effect; it accomplished exactly the opposite of what we intended in 1992.

Wilf Stevenson
You could have tied it to them taking more holidays, I suppose, and that would have helped our tourism and solved our foot-and-mouth disease and all sorts of things!

Response: Will Hutton
I think the issue in the States particularly is share options. The remuneration ceiling has gone from something like 50:1, with 1 being the average blue-collar worker pay, to over 450:1, over the 1990s. That has been driven by share options more than anything else. The reasons are: firstly, shareholder value, and, secondly, the way they have been accounted for.

Until about six months ago, when Coca Cola began to account for it – and the remarkable number of 50 or 60 other Fortune 500 companies have followed suit – the idea was that you could give share options away; it was not even a contingent cost to be set against the profit and loss account. They were seen as a completely free ride. And there was no policing of the strike price. They were simply reissued and reissued, so it was an unbelievable gravy train. If you strip them out, the underlying executive pay has gone up but nothing like so excessively.

For me, that is the heart of it, and I would say that governments should take a close interest in it. It is of fundamental importance how share options are accounted for, how they are regulated, what their impact on earnings dilution is, and what their impact is on the shareholder value in a company. The Americans in particular, but the British to a degree, have been far too lax about it. That is my view.

Ruth Silver CBE, Principal, Lewisham College
I run a large college in the inner city in south-east London. It is a rehearsal studio for the government's policies on third-way education and training. I was interested in your comments about geographical mobility and how that might deal with some of our difficulties. There is an amazing movie in our cinemas at the moment called *Bowling for Columbine*, which shows how

geographical mobility attacks social justice in that a single black mum is bussed out to do a “new deal” type of programme and, of course, she is the mother of the child who kills another child in school. The mobility meant that the socially vulnerable people in our society are the ones who are bussed around the place and the unstable family life is attacked even further.

So, reassure me, please: can you give me some examples of geographical mobility that might help with our difficulty?

Chris Brown, Human resources development manager, Abbey National
This is a totally different question, but Bob may or may not know that Michael Porter, under the auspices of the DTI, is basically about to examine the state of British management. I am interested to know from Bob’s perspective whether there are lessons from across the Atlantic, within the concept of a social partnership, that we might learn from, to promote the idea of fairness and enterprise?

And I am interested in Will’s perspective as to whether he has got a crystal ball to know where the answers might lie in Michael Porter’s research.

Response: Will Hutton
I am uneasy about the notion that there is something about geographical mobility or excessive mobility that makes social exclusion worse. I guess I start from a place which is that, within the confines of reasonableness, it is good to travel, but I am going to leave Robert to unpick that one.

Denise Kingsmill CBE, Deputy chairman, Competition Commission
I have to say that in my study of women’s pay and performance the lack of mobility is one of the really significant factors, which accounted for a big gap between men’s pay and women’s pay. Women were unable to travel very great distances away from their home and maintain their caring responsibilities at home. This was a huge factor in perpetuating unequal pay.

Response: Will Hutton
Well, that is what I think, but I do no have a policy answer for it.

Attendee
Some US welfare schemes give people cars.

Response: Will Hutton
It is good that one's instinctive reactions are backed up by research, and that there are ideas about how to solve it.

On Michael Porter: I suspect, from what I know of his work, that he will say British managers are not noticeably worse than those in Europe and in the United States. Part of his evidence to that will be that British multinationals do quite well internationally. He will probably say that it is, rather, the British institutional structures that militate against some of the good things that managers need to do, and then you will see a familiar, Porteresque list of stuff. That is my expectation of the Porter review.

Response: Professor Robert Reich
With regard to geographical mobility, a positive trend in the United States is to do with land use planning. People are granted access to affordable housing near where they work, which is near transportation hubs, so they can get to work more quickly. You also have mixed-use zonings, so that it is possible to have places of work that are also places to live. All of that is encouraging. In Oregon and Maryland, we are seeing some real advances.

What is discouraging is that, in most states in the United States, we find more and more geographic segregation by income. We have entire communities that are either rich or middle class or working class or poor – and the poor are increasingly isolated. They have a harder time getting to where the jobs are, and the jobs are mostly in the suburbs. The response there, if not land use planning, is to provide better public transportation so that it is possible for poor people, who are otherwise locked away from where the rapid areas of job growth are, to get very easily to those jobs and then get back.

Those are the two directions we seem to be heading in. Of those two sets of public policies, the former is more promising. It is both enabling people to live closer to where they work and really pushing against the geographic segregation by income.

With regard to the very different question on Michael Porter's work and British management as opposed to American management: everything I have seen and read suggests that there has been a remarkable convergence over the past 10 years in management compensation, management training, management theory, management recruiting and patterns of management retention on both sides of the Atlantic.

An Anglo-Saxon model of management is emerging in which British management is becoming almost identical to American management. We tend to exaggerate the differences, but there is less and less difference. An American manager of a middle-size company is paid approximately the same as a British manager of a middle-size British company; and, indeed, capital markets are becoming so international that it is hard to tell, above middle-size companies, what is a British and what is an American company anyway.

But there is still a fundamental difference – although it is becoming less so – between the manager on the Continent and the Anglo-Saxon manager. The question that I doubt Michael Porter will get to – but I do not want in any way to be heard to disparage him – is whether the model of free agency, which increasingly is dominating the way in which managements and managers conceive of their careers, is itself flawed.

Managers are moving from company to company; they bring to a company a collection of general management ideas and experiences that are applicable to almost any setting; they are loose; they are consultants; they will stay in one place for three to five years and then move to some other place. That model is very flawed in terms of the social capital and relational capital, which are being undervalued and under-assessed by capital markets.

I would love to talk more about that, but that is a fundamental flaw in a larger, growing flaw. It leads to excessive corporate pay, because you have an increasingly very efficient market for a set of executives; and the supply is limited because compensation committees and other committees that are in charge of recruiting are looking at a fairly small group of people. As the competition intensifies for that relatively small group of people, then, obviously, pay accelerates – even if you did not have compensation committees that were wholly owned subsidiaries of the chief executive officers.

Wilf Stevenson

Thank you very much indeed. Our aim for this seminar was to try to sketch out the work that is to follow in the three successive seminars dealing with individuals, with corporations, and with the regulatory and tax structure. We have touched on all of these rather well this morning, and, indeed, I already have a list of things that will go into the final document. So, we will offer them to the Work Foundation to take forward as part of the outcome of their arrangements; and we will all take away from this a very invigorating discussion and debate, and a very useful opener for our series.

Seminar 2

The individual

A seminar held on
Tuesday 4 February 2003

Introduction

Wilf Stevenson
Director, Smith Institute

This is the second in our series on fairness and enterprise. Today, we are looking in a little bit more detail at how the education system operates for or against fairness and enterprise. Ruth Silver is going to lead on that. Then, John Kay will talk a little bit about the conundrum that seems to affect a lot of people who find that work is not that liberating since they seem to be always working and never have time for anything else. But there is, apparently, an economic reason for that, which John is going to give us.

Ruth Silver CBE

Principal, Lewisham College

I am speaking from experience in delivering some of these grand schemes that come out of central government and I want to chase Will Hutton's thread of the last seminar, which was on the notion of enterprise and social inclusion. I am not going to contradict him; in fact, I will go further: I would say that, in order to socially include certain groups, we need to be extremely enterprising and creative. And sometimes, some of the rules get in the way of that.

Let me say that I start from sharing the government's belief that it is possible for all our citizens to have access to the best job opportunities. I know that it costs a pile of money, but I believe it is worth it.

Further education: meeting the changing demands

In the world of further education, we have learned to understand demand-led models in a new way. This is not the "demand-led" that we are used to in education, which is about what students and potential students want, but rather about the demand from the world of work, from employers themselves. This is extremely radical in that in turns colleges – the institutions nearest the learners – absolutely inside out. And that, in itself, is extremely hard to do at this stage of development for further education.

Further education is the adaptive layer in the UK education system. It touches edges with everything: schools, the workplace, universities, and community and voluntary groups.

It is helpful to think of England's 450 colleges as mapped on a spectrum of work-relatedness. The sixth-form colleges, for example, start by preparing people for a job sometime in the future, probably post-university; whereas colleges like my own, a general further education college, have people coming in from work to up-skill themselves and people getting ready for work, either work rehearsing or work preparation.

A definition that is useful about our world is: if quality describes an organisation that is fit for purpose, then equality describes an organisation that is fit for context. For inner-city colleges like my own, serving a very needy community, that is an important definition. All colleges are rooted in their communities; so you will find, for example, the further education college in Newcastle concentrated on naval engineering apprenticeships. My own college concentrates on engineering and catering south of the river.

We have moved from a world of 20 years ago, when an army of white, young men were coming through our doors from the Gas Board and the BBC on day-release apprentice training, to now serving highly aspiring, multi-ethnic communities. It is a world that is caught between both No 10 and No 11 for policy interest and intent. Further education is under-understood, under-researched and undertheorised as part of the map of UK provision.

Lewisham College: pushing prosperity

Lewisham College is in south-east London; there are 15,000 students to serve from the 16th most needy community in the UK, a community on the threshold of change. Not only are we told that this is the case; these days, I believe it.

We are situated on the edge of the Thames Gateway, where there is enormous investment in new infrastructures, such as the Docklands Light Railway, and we are seven minutes from Canary Wharf. That location changes the destination of some of our learners because, for the first time in 25 years, there are real opportunities for jobs. The average age of our students is 29; 60% come from ethnic minorities; 52% are male; one-third study at level one; one-third at level two; and one-third at levels three and four. We see our task as a college to push prosperity.

Responding to government policy

As a sector, we are comfortable within the contemporary strands in government policy and practice. These are: the pursuit of excellence for all in our community; the preoccupation of modernity – technological advancement; and being world-class. We do believe that human capital yields economic and competitive advantage for the country, as well as for citizens themselves. When you have worked with poorer communities, you cannot not believe it when you see how lives are transformed by moving into employment.

The policy drivers that No 10 and No 11 visit on us are: social inclusion;

raising achievement; and the notion of a world-class economy. For us, these turn into provision in general education, in vocational education and on the employability agenda. I want to concentrate on the latter.

The strategic plan for my college talks about the 21st-century curriculum having seven models that need to be explored both at academic research level and also in practice. Very simply, they prepare learners in models that deliver classroom readiness, learning readiness, work readiness, job readiness, university readiness, role readiness and success readiness. We have far too many learners who get their piece of paper, go along for jobs, get the jobs, and then do not do well in them because we did not pay attention to that last model of success readiness.

There are three curriculum models in play in UK colleges at the moment and I want to concentrate on one, the Wildcat model, because it is the one that I think offers the most difference. I will leave a paper with the Smith Institute on the other one, which is really one that is absolutely employer-led at employer design and demand; and there is a third one that we are involved with, which is the Academy of Finance. That is a national academy movement to do with 16- to 19-year-olds, but it is not so relevant.

Wildcat to City Bound

Wildcat is a new model imported from New York, where it has been running for five years. In the UK, where it is called City Bound, it runs in only two places: an employment project in the community, and my own college.

City Bound is an employer demand-led model, but it is actually in the hands of the government. It came about after many 10 and 11 Downing Street discussions with chief executives of companies who were persuaded to put money in a pot to develop this model. The deal was simple. People on New Deal should be able to access jobs with prospects, and, once in the job, the trainees would be monitored to see whether or not they received advancement within one year. The jobs, of course, were with City firms. This was some three years ago, and we had many planning weekends away with ministers and civil servants designing the curriculum.

In the City Bound programme, qualifications are of secondary importance.

Employers do not care if people get a piece of paper, but they do care that people are job ready, that they can fit into the workplace and that they serve the business need. That was quite a challenge to the government's thinking about the unemployed.

The pilot programmes had to deliver administration skills, to the expertise of level three, and job skills. The nature of the job skills was and is unclear because they are defined by each employer, probably quite rightly, according to their own needs. But the key point of this was that it was a central government drive and it did not take account of how the long-term unemployed were underskilled, undersupported, undereducated and underconfident.

It is just typical that this very ambitious programme, which often graduates would have struggled with, was visited upon those who had been the most excluded and were the most needy. I do wonder sometimes about the British unconscious.

The challenges of implementing City Bound

The programme lasted 18 weeks, with monthly intakes into the college. Every month, we had a new bunch of New Dealers coming through our door, and, at this stage in the country's development, we got to the very long-term unemployed.

The New Deal programme one had been successful, and we had already got lots of people through New Deal and into jobs and further educational training. But the people we were working with presented us with some difficulties – not difficulties as learners, but difficulties learning this particular programme.

We then had to find employers. The chief executives had said they would be involved in this, but talking to very suburban directors of personnel made some of the translation very difficult. The chief executives thought it was a fabulous idea; but suburban housepersons had a very different idea about what proper behaviour was.

I sent a very senior, black manager to a very prestigious company and had a phone call to advise me that she should go on a telephone-answering course.

The cultural jar is really underestimated when you are working with employer-learners of this kind.

There were three phases:

- Phase one of the programme was skills development – personal and technical.
- Phase two was a rehearsal experience in a friendly local authority or public service organisation who did expect them to be learners and not know how to behave, and gave them support with that.
- Phase three was a placement in a big business.

The placing of a temporary member of staff in full-time employment was called "temp to perm". The deal was that when full-time jobs came up, they would go forward for the employer's first refusal. The measure of success was that the jobs had to pay above £15,000 a year. I do not know if you know how much teachers earn these days, but that is not a bad starting salary in the world of education. We all found that tough, the government included.

The student intake presented its challenges. The rawness of the staff in college was unbelievable; most of them had been in further education for a while, and their contact with employers was just moving students in for their scrutiny. The employer readiness that I have commented on was terrific at board level and not so terrific elsewhere.

The culture shock was enormous; and the systems in collision were unbelievable. For instance, the benefit regulations acted against the learners: in fact, employment services had to parachute advisers into the college where trainers could relay: "Because I am in work now, my benefit has been cut, my child welfare has been cut, my housing benefit has been cut – but I might not have a job after four weeks. What happens then?"

We are talking about an 18-week programme that was government-led, civil service-designed, college-brokered, employer-conscripted and American-supported – indeed, the Americans came over here. The students really rated the programme. With all the difficulties that they faced, they thought that it was fabulous – and you can understand what happened. They could see a transformed life for themselves. It was great fun. Not only did the college have to find employers to take the students, but also it had to buy them clothes to wear and have their hair done, because, after years on benefit, folks do not have a large wardrobe on which to call.

The fatal flaw

We had evaluated it as being worthwhile doing in the pilot phase, but it had one fatal flaw. It was absolutely dependent on the UK economy. Employers would take these learners as long as things were fine in the City, but the minute the economy altered, so did this programme. The good intentions went out of the window.

Another challenge we faced was the past reputation of New Deal, which carries terrible shadows with employers who understand it. On the whole, they did it because they had been involved in some of the connections here at 11 Downing Street. I said to Wilf, when I first met him, that there is a real British flaw in educational policy, its development change – they lob policies, projects and people at us while giving no time for the practitioners to prepare.

The same is going to happen with the higher education white paper, unless time is spent preparing the teachers for the new intake. I have watched this repeating error over a long time while working both as a civil servant and as a practitioner.

The other difficulty this country faces is that there is no tradition of intermediaries in the UK map of players. In America, there is not only an enormous group of them, but also there is heavy research on the role of intermediaries in social change. After a first encounter with them, I came back and asked for some research information on intermediaries in the UK, and there was none. Youth Aid were the only people who could give some hints. So, if you are looking for research agendas and models of development, I would suggest that you pay attention to those.

The conventions of bureaucracy in this country did get in the way, but worst was the unintended consequence of bureaucracy. For example, we could not send in for payment the list of learners who deserved payment until the list was complete, because the bureaucracy could not handle that. And sometimes it took a whole week to get all the people to register in from all the different work placements.

There was also a problem with the targets we had to meet. Eighty New Deal graduates came through this programme; 51 got jobs, but only eight counted towards our New Deal progression targets because only eight were employed with salaries over £15,000. The rest were £12,000, £14,000, so these were labelled failures because we did not make those high targets. I have to tell you that the 51 people are extremely happy to be in employment. To emphasise hitting targets may miss the point – another key challenge for all of us.

Recruitment was made difficult due to eligibility restrictions and the benefit system. When we recruited jointly with HSBC, we had over 300 applicants for some of these places; when we recruited just through the New Deal network we had eight, and we were not allowed then to do any more advertising for employers. The lone parents who came forward could not risk coming on the programme, because if they did so they would risk losing benefit – they could go back on benefit but not at the same levels. So you can see all the pulleys working against success in this programme.

Not only did individuals risk losing their benefit, but learning is a risk too. It was very difficult for some of them having been away from education for such a long time. They also risked disruption to their support systems. Grandmothers who looked after babies so that people could come to college could not always take them at 7am so the parent could be at work on time. The level of disappointment and loss of dignity at not being selected for a permanent post due to unsuitability was hard to bear, and really quite difficult to handle for the college.

Post-exit support

If they got jobs, then there were risks ahead. These students remained the most vulnerable at work, and we discovered that they needed post-exit support from the college. After a day's work, they would sneak into college saying: "Oh, my God, I made a mistake today, I did not do this, this and this right; can you please help me?" Employers would tell us they did not show enough initiative. We explored that and found that being good in poorer society on the whole means being quiet, and so they would go into work and be very good and very quiet, and be thought of as very boring and unsuitable.

So they had all of those workplace issues to face.

Successful inclusion needs to make a bigger difference than benefit itself does. The jump in income has to be higher. The candidates need a name of their own. “New Dealers” or “interns” does not really work. These are threshold employees who, if given the right support once they are there, will do very well.

Conclusion

You can see the policy tensions. We can widen participation to economic life, but we also widen participation into the instability of economic life for the most vulnerable members of our community. There is a tension in Whitehall between trust in educational organisations and the discretion most organisations need to serve learners with.

So, top action points for this to be a successful dual-focus programme would be:

- We must deal with the fatal flaw. Abraham Lincoln said: “If I had six hours to chop down a tree, I would spend the first four hours sharpening the axe.” We need to sharpen the axe of preparing the learners, the providers who train them, and the employers.
- We must develop an intermediary layer to intervene in social and learning matters; and we need to develop mezzanine floors of support for these trainees – a kind of mezzanine society, if you like.
- We must reform the financial support so that people do not lose their benefit all at once, and increase social support to make childcare, even when children are sick, more reliable.
- Similarly, New Dealers are, on the whole, the parents of our poorer children. So they need appropriate time off to spend with their family.
- We need to develop political patience, not pulling up the roots to keep seeing if the plant is taking.
- The key to all of this is making it worthwhile for employers. They have a business to run, and they have to make a profit for all their interests.

I know that, with the right support, we can empower the most vulnerable members in our community to participate safely in economic life.

Professor John Kay
Fellow, St John's College, Oxford

When Ruth was talking, I was wondering how my talk would fit in. In one sense, it does not fit in at all; but in another, it is the complement. Ruth talked about the problem of people who have few privileges and not enough work; the subject Wilf threw at me was people who have loads of privileges and too much work.

The problem that he posed for me was essentially the following. If we take an audience like this, which basically consists of highly qualified professionals doing jobs that are, in the main, in high demand, why is it that practically all of these people complain about how overworked they are? Rarely do people like these get together without complaining about overwork; indeed, because of overwork, rarely do they get together at all.

The rare sight of economists out of school is not a pretty one. I still have not forgotten the occasion on which I went with a group of economists up to Snowdonia so we could trek over mountains talking about post-neoclassical endogenous growth theory and all those other kinds of subjects.

After one of these walks, we went into a pub where there were not many people except us. The barman's jaw dropped further and further with disbelief until finally he could not contain himself any longer and said: "Why can you people not talk about something sensible?" Even worse are these kinds of events in the USA. I remember at Harvard, 20 years or so ago, playing a number of economists' party games. One of these key party games was the dollar bill auction.

The dollar bill auction

Let me tell you the rules of the dollar bill auction. You take out a dollar bill, and the rule is you have to bid in 3¢ increments. As in all auctions, whoever bids most gets the dollar bill, but, in this one, both the person who bids most and the person who bids second most have to pay.

You will see that where it truly gets pathological is at the point at which the bids are at, say, 96¢ and 99¢. You would think that surely no one would pay more than a dollar for a dollar bill, but the answer is that they will. If I have bid 99¢ and you have bid 96¢ then you quite quickly realise that, if you leave my bid alone, you will have to pay 96¢ and get nothing; whereas if you go up to $1.02, you might actually get the dollar, in which case you only lose 2¢.

There is no upper limit to the amount people will bid in this auction. Indeed, Martin Shubik, who invented the game, introduced a rule that the maximum anyone was allowed to bid was $50, just in order to prevent the thing getting out of control.

Why am I telling you this? Well, there is a real point. The phenomenon I described is that people do too much work in jobs that are in considerable demand. There are two simple explanations for this: one is that these people are dumb and they have got their work/life balance wrong; and the other is that they are smart and they know what they are doing – perhaps their jobs are actually great fun and a good deal more congenial than being at home talking, yet again, to their partner or looking after the children. There is, indeed, some truth in both these explanations.

But there are also truths in somewhat more complicated explanations – explanations to do with the ways in which people get trapped into something that they did not intend, and if they stood back from it would not intend. The dollar bill auction actually illustrates that kind of issue very well because the dollar bill auction is a stylised version of what is a very real game in life. It is a game that is played repeatedly on young professionals starting their careers.

The version of the dollar bill game which people play is as follows. I walk into the room with a group of new entrants and say: "I am the partner (or managing director or some other big cheese) in this firm, and one of you people down there is one day going to be like me. But it is only going to be one of you, and it will go to whoever works hardest and does best." You can quite easily see that that is a game that has exactly the dollar bill auction property.

The dollar bill auction is a peculiar kind of economic game because, in economist terms, it has no solution in terms of economist standard equilibrium concepts. If you get into the dollar bill auction game, you may be dragged into doing far more than the activity is worth.

On the other hand, if you want to stay out of the dollar bill game, then there would be a dollar that would be going for nothing. So there is, as it were, no sensible, rational way to behave in the dollar bill model. And that model actually has been used and is used in law firms, accounting firms and investment banks in a whole variety of activities, to extract more work from people than they would actually want to put in if they could stand back and think about it.

Rent sharing

The second reason for the problem we are describing is what is best described, again in economic jargon, as rent sharing. Successful professional service businesses earn what we call economic rents, and by that I mean that the organisation generates more than the sum of the contributions of its individual members. That is, in fact, essentially what we mean by a successful service organisation.

Now, in the commercial sector, these kinds of organisations typically pay out again most of the value that they add as organisations, and they pay a large proportion of that out again to their employees. So what you have is that rent, that pool of value added, in the organisation which needs to be shared among the members of the organisation.

It is quite easy to see that two things follow. First, the fewer people the pool is shared among, the larger it is for each of them; second, it means that people are paid more than what economists would call their marginal product – that is, people's earnings are more than the actual value of the margin of what it is people are providing.

That rent sharing phenomenon, as well, encourages these organisations to focus this pool of what they earn on fewer and fewer people working harder and harder.

The combined effect

Now – and this is the real killer, as it were, in all of this – you can see how the rent sharing aspect and the dollar bill auction aspect actually work together.

You define within the organisation the pool of people – the partners, the managing directors or whoever it might be – who actually share in the rents, and you put that up as the prizes in the dollar bill auction. That is the phenomenon that happened when you joined one of these firms and on day one you were told: "Work very hard and you will be like me."

Rent sharing and the dollar bill auction problem work together to create the phenomenon we all recognise, which is people who are the new joiners in these professional service organisations working ridiculously hard in the hope of obtaining prizes that only a fraction of them will get.

Hourly earnings

But that, of course, is not the end of the story. One has to think a little bit about earnings per hour. I have been explaining why earnings per hour are actually going to be more for successful people in these organisations than their work is actually worth, because of this rent sharing phenomenon.

Now, if you think about it for a moment, someone who earns £100 per hour – and £100 per hour is not a ridiculous figure for people in many of the businesses we are talking about – would earn £1 per minute after tax. Now £1 per minute after tax is actually quite a lot. It means that five minutes' work is enough to pay for the difference between going home by taxi and going home by tube. It means 15 minutes' work is enough to pay for a babysitter for an evening, and it means a day's work is enough to pay for a rather agreeable skiing holiday.

As we all know, or as economists have always explained, if you increase the amounts that people earn it has two effects on what they do. One is that it makes them better off, obviously enough, but also it increases their incentive to work more. That is why there is what we think of as a backwards-sloping supply curve of labour, in which the more you pay, the more work you get.

There is a further point in relation to that sum. I said that £100 an hour equated to £1 per minute after tax. Of course, that figure has gone up quite a lot. Twenty-five years ago, £100 per hour equated to 30p per minute after tax. It then more than doubled in 1979 to 70p, and in 1988 it went up to £1.

These reductions in marginal tax rates have had disproportionate effects on these net-of-tax earnings.

Interestingly, of course, that was exactly the effect they were intended to have. That was the point, we were told, of doing these things: it was giving people incentives to do more work. It should not be completely surprising to us that a little bit of that effect has actually occurred: it was meant to happen.

Folk theorem

There is a final economic story I would like to tell you about this. The kind of economists who do the game theory that led people to the dollar bill auction have something that they call the folk theorem. The folk theorem is really an economist's way of saying, rather pretentiously, that almost any pattern of behaviour within an organisation is likely to persist; and if it becomes culturally embedded in the organisation, then no individual movement away from it is likely to change it.

We work in organisations in which there are quite large pressures for people to adopt similar working habits and similar working behaviour. If that is the case, it is not at all unlikely that people will get locked into common patterns of behaviour that none of them individually would chose to engage in but, equally, which all of them as individuals are actually powerless to do anything about.

Conclusion

We have seen a variety of, as it were, pathological explanations of why it is we get the kind of behaviours we see: the dollar bill auction; the problem of rent sharing; the amount to which we have raised marginal earnings for these kinds of people, and the impact that tax has had on it, which is a more conventional economic story; and, finally, the folk theorem, which says that people get trapped into these kinds of behaviour.

It is worth saying that most of these kinds of behaviour are inefficient in the sense economists would normally interpret it. People are trapped into behaviour that they would not choose, either individually or collectively, if they had the option. Since that may conflict with what you would expect to hear from economists – which is that there are efficient market solutions to almost all of these problems – let me advertise a book, *The Truth About Markets* (published May 2003). It discusses many problems of that kind in modern economies.

So, this is inefficient in that kind of sense, but since we are at 11 Downing Street we perhaps ought to ask what should be done about it. The honest answer is that, as far as government policy is concerned, there is not very much that can be done about it. Indeed, the only thing in the account I gave on which government policy bears relatively directly is marginal tax rates, and I have not come here to suggest that marginal tax rates at the upper end of the distribution should be going up more.

There is not much government can do except – and you would perhaps expect me to say this – encourage economic education. If people understood better the kind of issues and problems that I have described, it might well be that they would get less drawn into them. Once you have learned about the dollar bill auction, it is still not entirely clear what you would do when you are faced with that kind of problem – but, at any rate, you are likely to know what is happening to you when it does happen.

Let me finally end on a personal note about this topic. Three years ago, I found myself trapped in an environment where clever people sat around all day being politely unpleasant to each other and stopping each other from doing anything, and then went home at the end of it to complain how hard they had been working. I came to the conclusion that this was not a great way of spending my time and my life, and I got out of it.

At the same time, I got ill, and that made me think about these kinds of things as well. I decided that, as someone who is in professional service activities, I would start asking myself the question every day: "Am I enjoying what I am doing right now, at this very moment?" If the answer to that question was "No", I would find a way of making for the door. That is the option that people who have the kind of professional skills we are describing do have. Rather few of them chose to exercise it, but certainly, from my own experience, I can greatly recommend the option.

Discussion

Attendee
I have come to believe that the way to happiness, like the way to economic growth and the way to increase productivity, is to get on with what you are doing. Do not work excessive hours, of course; but do not think that much about happiness itself. James Mill, John Stuart Mill's father, had an interesting version of the pleasure principle. For him, the important thing was to avoid misery and unhappiness, and he said he had never known people gain much enjoyment from just pursuing happiness the whole time.

Liz Hewitt, Director of corporate affairs, 3i Group
Two questions for Ruth. First, I am intrigued to know how you establish what employers are looking for when designing your courses. Second, you mention the role of intermediaries, and there being a shortage of intermediaries in the UK compared with the US. I am afraid, in my ignorance, I am not quite sure what role you see for intermediaries, or what type of intermediaries you mean.

Attendee
Ruth, what experience do academics in further education have of the world of enterprise-style work, and would more of it help this intermediation?

My comment to John is that the dollar bill auction is not an absolutely pure model, in the sense that within those structures there are run-off zones. Where it becomes apparent to the hierarchy that you are not going to make the dollar, you are offered a runner-up prize as a finance director or a lawyer in-house to a client company. That is institutionalised as a run-off, so you do not kill yourself trying to be the one partner.

Response: Ruth Silver CBE
What do employers want? That is a Holy Grail issue. It is a real problem, because when they get what they said they wanted, they are not always happy. The biggest clash comes along with value systems.

I referred earlier to the students coming from fairly rough backgrounds who tried very hard to be good, but were then seen as passive and lacking initiative. The unpacking of those issues is really a very skilled job, and one that we are not trained for. How my staff have approached the general problem is to treat employers as learners, and try to get under the skin of what is behind the competencies they describe.

There is now lots of talk about employability skills for the 21st century. No one really says what that is, and there is no research from universities on it – and I really make a plea for research. We have jumped at this rather quickly, but we are getting somewhere. We have learned that each employer wants something quite different, so you cannot run a general course; you have to run programmes that are absolutely tailor-made to employers.

Intermediaries are interesting. In America, they are actually businesses that are based on business models with boards. One of the key things to remember in New York is that you are only entitled to five years of benefits support in the whole of your employment career, so there is a clock ticking and they needed to build in provision for that.

Wildcat in New York bids for New York City projects, but it runs a business bidding for work and getting projects from the public and private sectors, and then works with the unemployed to deliver those projects. So it is making money and it is part of the enterprise culture. That becomes the seed corn for the learners to go on to further development, so there are all sorts of exit points for semi-skilled/skilled, blue-collar and white-collar workers. Intermediaries have a long tradition and are much valued in America.

Here in the UK, what we have are voluntary groups that have a very different social process and a different ideology to the work and enterprise culture.

Further education has little experience of current enterprise initiatives. On the whole, staff have come in from the world of work – but mostly in flight from the world of work. They are blue-collared themselves, in a lot of cases. We are trying to expose our own staff, and they come across bruises like the one I mentioned: a senior, black colleague being thought of as a clerk somewhere. But, actually, they like it once they are there, so we have been organising twinning and job swaps and what not; but there is much work to be done, and the old models do not work.

Response: Professor John Kay

We have this distinction in English between hedonism, which is the repetition of pleasurable actions, and happiness, which has a broader sense of fulfilment. Indeed, John Stuart Mill himself – presumably the greatest utilitarian of all – describes how, after a period of fairly acute depression, he came to realise that happiness was best pursued indirectly. I think that is right. The US constitution refers to "the pursuit of happiness" – which is a very odd phrase when one thinks about it – but, nevertheless, I think one can manage one's life/work balances better.

The last thing I want to do at this seminar is to get a blackboard and put up a bit of mathematics, but I can promise you that even if you modify the game so that there is a second prize of 50¢ that goes to the underbidder in the auction, it still has the same property that the pure dollar bill auction has. It is still a treadmill that we need to get off.

Professor Sheldon Leader, Department of law, University of Essex

I want to try and bring together what Professor Kay and Ms Silver were saying in two areas. One of the lessons of the dollar bill auction is about education; another is about personal understanding of what it is to have to cut your losses, perhaps at a fairly painful level at which you have already invested quite a lot in your career. You have to make that decision as to whether to keep on going.

I was wondering if this links up with the education point that Ms Silver was making about the importance of a programme that is training for what it is to be in a job. Perhaps we should train people to make that almost ethical decision about how you deal with yourself in such a situation?

But, in policy terms, along with that educational result, I wonder if one of the further lessons of the trap that Professor Kay has described is that, in framing employment law, we have to be much more sensitive to the penalties, such as being passed over for promotion, that people pay when they take time off, perhaps for family-related reasons.

It is easy enough to say you are not going to submit to any wage penalties, but it is much tougher to get a better view on what it is not to have suffered at all in your career for having made this move towards non-work concerns. Therefore, one of the further implications is that we have to toughen up the law in that area.

Bahram Bekhradnia, Director, Higher Education Policy Institute
I was very interested by the programme that Ruth described, but I wonder how generalisable that would be. It does seem very intensive, and if it is a pilot or experiment, then that implies it is going to be expanded and that it is generalisable. I just wonder whether you would like to comment on that?

Related to that, in this sort of thing are we not playing a zero-sum game? What we are doing is creating relative advantage for some who, admittedly, were very disadvantaged before, and it may be that creating a more level playing field is something worthwhile in its own right. But in advantaging some, we are relatively disadvantaging others who already are not very far off the bottom of the pile. Is there not an issue here?

The same goes in higher education, where there has been quite a lot of effort and concern with employability skills. But now we are beginning to understand that, in giving employability skills, what we are actually doing is enabling those who have them to compete for their first job against other graduates – but that is not doing very much to enhance the performance down the track of people in work.

Wilf Stevenson
John, Sheldon is pointing out that if we are going to be realistic about making sure that the run-off or the decision to leave the room is not going to be a penalty, then we ought to strengthen this question about how employers can penalise people by just not promoting or by sidelining them. Is that something your economist could live with?

Response: Professor John Kay
One could live with it, but one has to ask whether such a policy either will succeed or will be desirable. If one is very brutal about this, the whole success of capitalism has, in a way, depended on dollar bill auctions. It has depended on people putting in a great deal of effort into new experiments and new ventures, most of which did not succeed, in the generally naive hope that they

might have a chance of the rewards that would go to the few people who did succeed.

I am not sure that we could suppress the dollar bill auction problem in anything like a market economy; but if we were to suppress it, then we might, in important respects, destroy its vitality. Rather than devising public policies to deal with these kinds of issues, it is much better that we should further understand these mechanisms in ways that would enable us to make our own individual life/work choices in ways that genuinely reflect our individual preferences, and not feel ashamed at making whatever choice we do make.

Response: Ruth Silver CBE
I would agree with that, but I want to talk about the generalisability of these models. I am absolutely convinced it is generalisable, but not under current circumstances and systems. That is why I make the plea for really taking time to prepare and deliver something that will make a difference and give people choices. It is really about choosing to go in or out of an economic market when people want to. I do want to say that it is very hard for the haves to tell the have-nots not to want, and there is a bit of that around some of these projects.

Wilf Stevenson
I accept what you say about it being generalisable, but the level of intensity that you are putting into your people seems impossible for the system to cope with. And is there really going to be an equitable outcome?

Response: Ruth Silver CBE
I do not think the intensity would be impossible to cope with. In any case, the intensity was just part of the learning phase. And people other than teachers can do a lot of the work; hence my plea for intermediaries.

To make this on offer across the board will need a radical change in employers, in education, and in the players allowed to be involved in education. But that is what inclusion will take.

Simon Judge, Labour market division, Department for Work & Pensions
On the point about generalisability, there seems to me to be considerable

overlap with a programme we are launching at the moment called Ambition, which is rolling out across four sectors: retail, IT, construction and energy. It is very much employer-focused in the way you were describing, and very much trying to get people in at the £15,000/£20,000-level jobs, rather than basic, entry-level jobs.

I am still a bit confused on the intermediary point, because what you are describing seems quite similar to intermediate labour markets – which is the term we use here – of which there are quite a lot in the country, and also to social enterprises, which is a term perhaps used more in Scotland, where there seems to be rather more of them.

One I was hearing about a couple of months ago, for example, is a social enterprise which is replacing all 60,000 kitchens in the entire public sector housing stock in Glasgow. That is an awful lot, but they are doing it in a way that is very much supporting disadvantaged clients. So, there is actually quite a lot of activity going on in this sort of area. The trick is always to make sure that people get out and into a permanent job: that these intermediate labour markets are intermediate.

I think there is quite a lot of activity going on in this area; I am not quite sure what more you want.

Response: Ruth Silver CBE
No, there is not a lot of activity. There are one or two projects learning the lessons, and the issue is whether or not we have the courage to roll them out.

We are certainly learning, and when we started these projects four years ago there were none. I worked in Whitehall, so I know what it is like to think that an idea has come into fruition just because you have studied a policy. That is what I meant about the 10-year scale. But I am glad that the ones I have seen in Glasgow are very successful. And well done with Ambition.

Andy Russell, Company training development, Railtrack/Network Rail
I wonder if Ruth could say a little bit more about her last action point – how do you make these schemes worthwhile for employers?

Response: Ruth Silver CBE
I feel less sure about that bit because the transition to employment was a difficult one for the learners. They had come from an education where we believe people have a right to learn and to make mistakes, and can instantly get some support to do better. Employers do not quite have that consciousness, nor should they.

When I argue for this kind of mezzanine-floor experience, it is partly about allowing that learning to take place. The preoccupations of employers are different from the preoccupations of education, and that is why intermediaries have a better chance at success than we do.

I can do you the pitch that says: "Employ these people: they will not move around as much as graduates will; they will stay longer with the firm; they will be good employees." Actually, I do not feel good about saying things like that because I do not want them to be quite so deferential. Maybe our colleague from the DWP can add more to that. There is a kind of business case that has been made which gives me some cause for concern, because it is about breeding deference. That is not what our education does.

Matthew Trimming, Head of government affairs, EDS
I wanted to suggest for a second that the dollar bill auction – which is obviously a fascinating little model that I shall now quote at every dinner party without attribution – is a purely economic solution to describing a bunch of human social behaviours. I want to link that with your point about the only thing you could really do being perhaps to shift marginal tax rates at the top end. I wonder whether that is true.

That might be the case if you are simply looking for a pure economic solution, but surely one of the things that you could also look at in this context is the policy principle of flexibility. That could have equal benefit for people struggling to get into the labour market, as Ruth is talking about, and people who are in their heart of hearts desperate to get out of the labour market but are stuck on the treadmill. While no one expects any more to join a company and be there for life, much of the policy architecture both within an organisation and within government institutions perpetuates those sorts of behaviours.

Now, if Alan Leyton were here, he would say that everyone ought to go plural immediately. Of course, that is an extreme and untypical example, but within it there are some quite interesting concepts to think about to do with how you incentivise people.

Ruth made the point about failure being defined by not getting one job that did not pay you at least £15,000. However, success could be getting three jobs, for one-and-a-half days a week each, that added up to £12,000, and thereby not being trapped at the other end of the scale just thinking: "I have got to hang in there because I am shackled by my share options, and the whole market is under water," or whatever it happens to be. So, I would suggest that the policy principle of flexibility ought to be far more to the fore in both social and economic thinking.

Response: Professor John Kay
There is an important issue there. Clearly, one of the things that has happened in the labour market, generally defined, is a decrease in employment in the assembly line manufacturing process, to take the traditional extreme case. The assembly line process, by its nature, required everyone on it essentially to work the same hours at the same time.

The transition in employment is perhaps best illustrated by retailing. Retailing has moved from being forced to have that structure to one in which much larger retail units open much longer hours, and they can be manned or womanned by people who work flexible hours that suit their particular requirements, which may be either long or short hours.

One needs to ask whether a similar change is possible at the top end of the income and skill distribution. The requirement for people to work similar hours tends to remain in that kind of area; and it probably is not the case that two people doing 25 hours of work are as productive as one person doing 50 hours of work, or it is certainly not so clearly the case.

Now, there are obviously some areas, like parts of law and accountancy, for example, where the opportunities for flexibility are as great, but one of the reasons it has not happened in higher income and skill areas is that these traditional aspects of labour market structures continue to exist, and continue to exist for good reasons.

Response: Ruth Silver CBE
Our attempts to find flexible work for programmes like this have been difficult simply because of the rules and regulations of funding for colleges. There is less trust around and more accountability, and those both knock flexibility around a bit. Institutional flexibility would be superb, as would new definitions, but I understand the concern around the public purse and we have to live with that.

Wilf Stevenson
I sense we are probably coming to the end of this, but we have a trade unionist of some distinction in our audience. I was going to ask whether, having heard about the individual and about the educational process and about the employer's voice, we might get a trade union view.

Jim Mowatt, National secretary (manufacturing), T&G
I have found the analogy of the dollar bill auction very interesting. Perhaps we should say that often analogies are used by second-rate minds, so let me give you another analogy.

The dollar bill auction is not dissimilar to the Olympic Games. There comes a point when you are not going to get the gold medal, so when do you jack it in? We know some people do that: Ming Campbell, an Olympic runner, jacked it in, took a drop in status, and became a politician; I will not mention Jeffrey Archer. So there is an analogy there.

Ruth's experiment down in south-east London is raising the pool of human capital. There is nothing more dispiriting than being gulagged in unemployment, and you are transforming people into being economically active. Capitalism has got an enormous success rate in doing that.

If I can be personal: I used to work in the Singer sewing machine factory in Clydebank, when there were 17,000 of us in the one plant. No one works there any longer. If I may say so, as an admission of our own inadequacy, people like Gavin Laird and myself were arguing what welders should get paid if they were Catholics for working night shift on Easter Friday, whereas we should have been arguing about product development or markets. Some 17,000 jobs are now gone.

When I go back to Clydebank to maintain my accent, I discover there is a wondrous transformation, in people doing things you just could not believe. One of the reasons for that – and I am a beneficiary of it – is that the government had schemes that incentivised us into education. One route, of course, was adult residential education.

I think Ruth's City Bound is an exciting experiment, and I wish that unions were more involved in that sort of experiment of triggering people. We have not got a bad record of pushing people through the ranks in very small numbers, but we could always do more. As they say: "Ambition can soar, but it can also keep."

But there is no doubt that this is not about a zero-sum game, it is about raising the game completely. That is where you find the synthesis of the two contributions from John and Ruth this morning.

Seminar 3

The corporation

A seminar held on
Wednesday 5 March 2003

Introduction

Wilf Stevenson

Director, Smith Institute

Welcome to the third seminar in the series that we are presenting jointly with the Work Foundation and with the support of Scottish Power. We are grateful to both for all their support over the time we have been planning and developing this series.

We started just before Christmas with Will Hutton and Robert Reich, who gave an overview of fairness and enterprise, and the balance between them. We came to a view that a fair and enterprising policy implied a new reciprocity in the political settlement between society, government and corporates. In our second seminar, we looked at the individual and tested the Hutton hypothesis about reciprocity. But, today, we turn to "the corporation" and its role and responsibilities in a fair and enterprising culture.

David Pitt-Watson

Managing director, Hermes UK Focus Fund

I am very pleased to be addressing this audience because there is another side to my background: before I ran Hermes Focus Fund, I did, in fact, work for the Labour Party. I guess some of my friends on the Left still want some explanation as to how it is that you move from working for the Labour Party to working as an investment manager. Some of that, I hope, will come out in what I want to say today.

Ownership

My theme is really ownership and its effect on enterprise and fairness. The debate, over the past 100 years, between the Left and the Right has focused an awful lot on the issue of ownership. Those of us who have been in the Labour Party for many years will remember we went around carrying a card about how we were going to secure for the worker by hand or by brain the full fruits of their labour, on the basis of common ownership. That was something the Labour Party never had the will to do, and it was happily got rid of with New Labour. But that gave rise to the problem that, on the left of centre, we now do not want to talk about ownership, or talk about how ownership can be used to our advantage in thinking about how we promote the public interest.

I am going to talk, in the main, about publicly quoted companies, the world that I work in. I would, however, give two caveats before I start on those. Publicly quoted companies, obviously, are all the large multinationals that are based in the UK. I guess they employ between 5 million and 10 million people in the UK, and as many abroad. They are the ones on which people focus when they think about the private sector.

We have many different forms of ownership in this country. Just going through my own employment history: I have worked for partnerships; I have worked for co-operatives, and with Pauline I was on the Co-operative Commission, which is a retail co-operative; I have worked as a sole trader for myself; I have been a director of a company; I have been a shareholder of a company. There are all sorts of different ownership forms. I am just going to focus on public companies, which are not the whole world by a long way.

Nor in bringing back ownership into the debate am I trying to say that ownership is the only thing. In fact, it is clearly not. Anyone who has thought about the management of organisations can see that you have one form of ownership for companies or organisations where they are doing well, and a similar form of ownership where they are doing poorly.

As I mentioned, I was with Pauline on the Co-operative Commission, and before we started the Co-operative Commission there was some research done that looked at this organisation, with its fantastic ownership structure in theory, and considered how well it was performing. Unsurprisingly, its returns on capital were lower than some of its peers' in the retail sector and the financial sector. But if you talk to the trade unions, they would also say that the work relationships were better in some of the private companies than they were in the Co-op. If you looked at the changes in market share, it was pretty obvious that customers were voting with their feet for some of their competitors. And, indeed, it had reached the stage where, as part of a promotion, one of the biggest supermarkets was actually going to be giving more back into the community than the Co-op was.

I am pleased to say that some of the work that Pauline has been doing over the last three or four years has significantly reversed that trend. But it is not enough to have a good ownership structure. I would say to any policy makers: caveat structure. Beware of thinking you can solve many public policy problems by simply creating a structure and sending it off on its own.

I want to address four questions. The first question is: Who owns these public companies? Who owns BP and Vodafone and Six Continents and all these people in the press? I then want to ask the question: Given that we now know who owns them, are those companies run for their owners? That has always been a fundamental assumption on every side of the political spectrum and the economics department. I then want to ask the question: Insofar as they are not run for their owners, what would they look like if they were run for their owners? And what would that mean in terms of public policy and their delivery of public policy, and, therefore, what is the policy framework we need to have around these companies in order to make sure they are delivering for the public good? Perhaps we can go on, with Pauline, to talk about what the limits might be of the things that we can ask private companies to do.

So, who owns them? Are they run for the owners? If they were run for the owners, what would they do? And what is the proper public policy framework to have round them?

Who owns public companies?

The first question then is: Who owns these companies? I would guess there is hardly anyone in this room who does not have a pension or a life assurance policy. Over 60% of the shares in UK public companies are owned by pension funds, both domestic and foreign, and life assurance companies. The conclusion is simple: the beneficial owners of UK plc are you and me.

If I think about my fund, which is a very peculiar fund, it has a few hundred million and it manages the shares of other funds as well, but within the specific fund that I manage it is quite small. But 8 million people are beneficiaries of that fund. They are telecoms workers, railway workers, local government workers, and teachers in Ontario. The point I am making is this: the beneficial ownership of UK plc, and actually of US plc and much of the rest of the world plc, is vastly held through pension funds and life assurance companies.

I heard Brendan Barber speaking, who is taking over from John Monks as general secretary of the TUC, and he was saying to his audience: "Look, we have secured common ownership of the means of production. These companies should be run for us – we own them." And it is not just "we" white-collar, well-paid people who own them: it is railway workers, municipal workers, teachers in Ontario and public service workers in California – they are the ones who own companies.

Who owns public companies? We do.

Are public companies run for their owners?

So, then, the question is: Are these companies run for us? If we reflect on the way that the populace feels about the boardrooms and the operations of UK companies, do they believe those companies are run for us? Right now, in the UK, I think it is something less than 28% of people who believe that the chief executives of large UK public companies in general tell the truth. People have got to a situation where they believe that the companies that they beneficially own through pension funds, or through life assurance companies, are not run in their interest. Why is this?

A lot of it has to do with the system of ownership that we have in this country. In theory, that system of ownership should be terrific. An average pension fund has got an average liability time horizon of 25 years. Pension funds are clearly not short-term investors, nor are life assurance companies, and even most of the people in this room, whom I guess might even be above the average age for the adult population, would be looking at a considerable period of time before they need a return from their pension funds. These investments are long term.

Since there are millions and millions of people that these investments represent, they should have to be run in some way with regard to the public interests, since their beneficial owners are the public. Yet that does not happen. If you ask most chief executives of public companies, they will say: "When I meet my owners [meaning fund managers], they are very short term, they want to know what the news is for the next quarter."

What we have done through the pension funds industry, and for good reason, is to give to fund managers, who are essentially traders of shares, our rights of ownership over those companies. Their job has been likened to gin rummy capitalism. What they are trying to do is collect a set of cards for you of strong companies, and when those companies are overvalued they will sell them, and when they are undervalued they will buy them. They buy and sell mainly, since they own 70% of them, between each other, and that is the game they play – it is a game of gin rummy. A lot of people would argue it is pretty much a zero-sum game. We can debate whether that is true or not later.

But what no one is interested in is being the owner of your company, and, as a result, the people who manage these companies feel that they are under short-term pressure. They will say that they make decisions because they are under short-term pressure from their owners; they do all sorts of things, blaming it on the shareholders. Well, the shareholder is you and me. If we are going to try and change anything about this, the first thing we need to do is find a framework, a framework where you and me find some sort of voice to be able to tell the companies what it is that we want to happen.

If there is one important thing that we have done in the Focus Fund, it is that we have tried to re-establish the link of ownership. We have tried to say: "Look, if we invest in companies where there are real concerns about the management, and we change the management direction of those sorts of companies, then we can demonstrate that that adds value." Indeed, our returns would suggest that that could be done if you get the right group of people around.

The work that has been done by Paul Myners is absolutely radical in this regard because it is saying: "Look, we want you as fund managers to take on the role of owners." But let us be clear about this: there is an £8 billion industry out there called fund management and broking and all the things that have got to do with buying and selling of shares; I doubt that 0.5% of that figure is devoted towards being a good owner of shares. More than 99% is devoted to trading shares. That is done on your behalf, on my behalf, on the railway workers' behalf, and the postal workers' behalf, and we have to ask a question about that. If this is all being done on our behalf, what now do we want companies to do? If we, as a group, own these companies, what would we expect companies to do for us?

What if public companies were run for their owners?

I am convinced the number one thing I would like the companies to be is profitable. I am really keen, when I am a bit older and unable to earn a living, to have a pension. I have no interest whatsoever in any company that is not investing in order to turn £1 into something that is worth more than £1, and not to turn £1 into something that is worth less. That has to be an absolute fundamental duty over the long term of the companies that ask for my capital and have my beneficial ownership of their company.

I think what we have done, particularly on the left of centre, is to say that either you can make money or you can be good. It is just complete nonsense. Companies need to have regard for what it is that they are doing in society. They need to have regard because we live in a civic society, but, actually, they need to have regard because we live in a civic economy where you and me and everybody else own the companies. It cannot make any sense for me to have a pound's worth of pollution stolen out of one pocket, and a shilling put back in the other pocket in the private profit that I have got from the company.

If there is a second most important thing we have done at Hermes, it was writing a piece that, I was astonished, had never been written before I joined Hermes, a piece called *The Hermes Principles*. These are some very basic principles upon which we might expect that public companies would run themselves. Of course, it focuses on making sure that we are going to have surpluses in our pension funds – that is what I am there to do. But it also talks about how it is that that might be integrated into wider social responsibilities.

Be clear that *The Hermes Principles* does not say that public companies have got limitless social obligations. If we do that, we will kill the goose that lays the golden eggs. But public companies do live in a civic economy where they have millions upon millions of beneficial owners, and they cannot live within society without having proper regard for that.

The fact that they cannot be social services is quite interesting, because it means that there may be some areas where the atmosphere of the transaction, or the type of the transaction, may mean it is inappropriate for private companies to do. It would be useful for us across the political spectrum to start to have that debate about where are the limits and what are the sorts of factors. It would be useful not because we could draw out a strict line in the sand, but because we could ask at what point there would be an advantage for co-operatives, for example, to be carrying out productive services, rather than private companies carrying out those productive services.

It is because I believe in all those plurality of ownerships that I am also keen on working with Pauline on the Co-operative Commission, to try and make sure that co-operatives are, indeed, successful, because they too have an enormous amount that they can contribute.

So, who owns companies? We do. Do they act in our interest? We do not think that they do, and even if they did, certainly on the margin there are lots and lots of things that companies themselves would complain that we – or the people that we have delegated our powers to – are putting pressure on them to do. If you read *The Hermes Principles*, you will see how we can start to make some definition of what it is that we want public companies to do, and if we did that we would have a much more successful and productive economy. And, by the way, we would have a linkage between ourselves as owners and what companies were doing, and that is part and parcel of fairness. The fairness is that the managing director of a company, even if he gets paid a lot of money and works hard and has other privileges that go with that, does that for us. There is the deal. It is fair.

What is the proper public policy framework?

We can have more productive companies and we can have a fair ownership. There is then a question about the public policy framework that we put around this. The governance movement now has a history of 10 or 15 years, and some of its thinkers are now starting, interestingly, to address this in a way that goes beyond thinking about company law, or what might be the duty of this or that player.

One of the leading thinkers in the States on corporate governance, Steve Davies, has recently written an article called "The Civic Economy". He argues that we understand what the characteristics are of a civic society: you need to have democracy; you need to have the judiciary separate from the legislature; you need to have a free press; you need to have freedom of speech etc, etc. But why can we not try and define what those sorts of factors are for a civic economy? We need engaged shareholders; we need clear standards. We need an absolutely legitimate role for outside lobby groups, consumer groups, workers groups and environmental groups who know what companies are doing and are able to lobby them from outside, and so on and so forth.

Davies goes through what those characteristics might be in a world where we all commonly own these vast means of production. What is perhaps most interesting is that when he gets to the end, he asks about the government's role. The government's role in all of this need not be huge. There is an enormous amount that we can do on our own if we can start to define, within this system of ownership, what the responsibilities are of the people who are carrying out those tasks; and if we can have proper accountability between those layers of ownership: between you and your pension fund; between the pension fund and the fund manager; between the fund manager and company; and the company and the people that work within that company. We could do that without the government needing to enforce it, just as the government does not need to enforce a free press. It will be a free press. It does not cost the government a huge amount to enforce the separation of the judiciary and the legislature, it just needs to know that you do not allow those sorts of interventions to take place.

Although, as yet, there is a lot of debate to be had, it is a hugely interesting framework for us who know that business needs to be given the freedom to breath if it is going to be successful. It has to be innovative, and, therefore, we do not want to impose loads and loads of legislation upon it, but, at the same time, we do want business to be socially responsible, and not just privately responsible, in what it is doing.

To sum up: Who owns these companies? We do. Do they work in our interests? To a large degree they do, but to a large degree they do not as well – and no one believes that they do. Can we define what it is that we might want them to do? Yes, we can. Does the government need to legislate for this? No, but we do need to have a better understood system of rights and responsibilities of all those layers in the ownership structure that make sure the public companies work in our interests.

Efficiency and fairness

If we could achieve that, where might we get to? First of all, it would have a tangible effect on the growth and the wealth of the country. Every study that has been done of well-managed companies versus poorly managed companies suggests that there are significant differences in value between managing well and managing poorly, and that owners have got a huge role in that. That can be seen even in the results that we have produced in the companies in which we have invested.

As a comparison, think about a tenanted flat. After 20 years, is it worth more if it had a good owner, or is it worth more if it had an absentee landlord? Is the company likely to be worth more if it has a good owner, or is it likely to be worth more if it has an absentee owner? So, there is a tangible effect we can have on wealth, adding fractions of a per cent, perhaps, to the growth rate.

In addition, if we could be clear about what the rights and responsibilities are, then we automatically bring in a sense of fairness about what we are doing. As owners, we are delegating to boards of directors, both to run those companies and how to run them. Incidentally, I had a conversation this morning with a chief executive of an outstanding UK company, who said: "I read your principles and that is what we try and do, but it is not the way that people feel the pressures of the marketplace. They do not feel the pressures of the pension fund, they feel the pressures of a day trader."

So there are two advantages: efficiency and fairness. We can have both. We can also take a huge political step forward if the Left can start to define what it means by good business. With New Labour, we very sensibly abandoned the daft idea that if we were to nationalise everything we would have utopia.

But we need to go back again and ask: What is the proper ownership? What is the proper management that is actually going to deliver a successful economy? These are important questions to ask. If we did that, I believe that probably the majority of people who run British companies would actually see their views represented in that view, rather than in the ultra laissez-faire view that might have been popular 15 years ago. I fully believe that, and so there is a huge political advantage to this.

Then my final point, and the one on which I would hand over to Pauline, is: If we can define for ourselves what it is that we want these private companies, who are going to be paying our pensions in the future, to do, and what it is sensible for them to do as capitalist organisations, perhaps we can also have a debate about what it is sensible for them not to do.

Conclusion

So I have tried to answer four questions today:

- Who owns companies? We do.
- Do they act in our interest? We do not believe it.
- Could we manage to define what it is that we would like companies to do? We probably can if we think about it.
- Can we put a policy framework around that – a framework that is not restrictive but based on rights and responsibilities? I think we can.

This is an area of enormous richness for policy development, and one on which there can be a broad consensus between business people, the economy, investors and the government. I look forward to debating this with you.

Dame Pauline Green

Chief executive, Co-operative Union

I want to begin by endorsing and associating myself with two things in particular that David has said. First of all, I believe very much that the spectrum of ownership models that David articulated and outlined is appropriate and necessary. The model that I am here to represent is not right for every business, every product, or every service. There is a spectrum, and I certainly endorse it. I also have sympathy with much of David's hypothesis about the shareholder model. Some of what I have to say about the sector that I represent will have resonance with that.

The Rochdale pioneers

The Rochdale pioneers were an incredible group of Lancashire mill owners who are credited with formalising co-operative philosophy in the first half of the 19th century, a philosophy that then went on to sweep the world. No one could claim that those guys (because they were all guys) were lacking in enterprise or entrepreneurship; but yet anyone who has read *The Ragged Trousered Philanthropists*, or who knows the history of the period, will understand that the fundamental concern of the pioneers was that of fairness.

As a modern-day co-operator, I have often asked myself where those same pioneers would direct their common endeavours if they were to come back today. Of one thing I am absolutely sure: they would not open shops. However, the retail legacy of the pioneers is tremendous. Britain today has one of the highest-quality retail offers in the world, and much of the stimulus for the development of that modern-day retail offer lies with the philosophical and business challenge to the conventional enterprise of the day that was presented by the pioneers and their cohorts.

By the 1930s and 1940s, the pioneers' model had created one of the most powerful, independent, sustainable, effective, successful, member owned and member controlled organisations in the world. And at the heart of that challenge were two basic assumptions.

The first assumption was that by coming together in strength, they could assure a better service for themselves, their families and their communities.

It was not about profit maximisation; it was about multiple bottom lines.

The second assumption was that the fruits of their shared energy could provide for them an economic benefit as well, and that is the genesis of co-operation. Yet, here we are, at the third of these four seminars in this prestigious venue, 160 years on from the Rochdale pioneers, and we are asking the question as to whether fairness and enterprise can coexist.

Here we are, at the beginning of the 21st century, seeking ways of bridging the gap, the gulf between those two concepts that sometimes appear to be mutually exclusive. I want to argue that the mutual concept, the co-operative model, social enterprise – these names tend to be fashion-based but they are all part of the same spectrum – has a resonance in today's business environment, and, indeed, in the social environment, that it has not had for, perhaps, the past 60 or 70 years.

So, let us start by trying to answer the question: Where would the Rochdale pioneers focus their formidable talents today? I think today's pioneers would seek to work in those industries where trust and confidence among ordinary people was at a premium, and where it was patently failing.

They would look for initiatives in those areas where people going about their everyday lives had little choice, had limited opportunity to impact on decision making, were frustrated, and felt angry, cheated or impotent. Modern-day pioneers would look at where the public interest was not being best served by structures or bureaucracy or big business, whether national, regional or local, and whether in the hands of civil servants or private enterprise.

It is in these areas today that what we call the new wave, or second generation co-operatives, or social enterprises, are now coming to fruition. "Co-operation" is not the word of the moment – "social enterprise" is. However, the co-operative sector is the biggest part of the spectrum of social enterprise in terms of its economic muscle and influence.

Second generation co-operatives

So let me just give you a few examples of these second generation, new wave co-operatives. What I want to do is give you that grass roots sense of this sector of the economy and where it is headed at this moment.

One recent initiative, which has gained considerable public attention and profile, is in the conduct of our national sporting obsession – football. Football clubs are very big business and far removed from the genesis of the local club, in which local fans took a great interest and could directly engage with their team and their players through the activity of their supporters' organisations, or, simply, by being there, where it was happening, in a local environment.

Today, with many of the best-known clubs now super-businesses, there is very little space for the ordinary fan to engage with their club, except perhaps to buy a few shares by way of demonstrating their support and continuing commitment. But now there are over 70 football trusts, most of them industrial and provident societies, ie co-operatives. The fans themselves can now pool those few shares that they may have bought, or been given as presents, and end up with a substantial portion of the club's equity in common ownership.

So successful has this model become that many of the trusts, or the co-ops, now have directors on the boards of their clubs. Football fans are finding themselves in a co-operative that has restored to them some of that long-lost ability to engage, once more, with their beloved club. It is surreal for an organisation like mine, which was founded some 140 years ago and was the home of the traditional consumer co-op sector, that we are now getting phone calls from England's football fans asking how they should run their co-operative.

The model of the football trust, or the football co-op, which was originally launched in England, has now been taken north of the border and is being actively considered for rugby football as well. The government, realising its potential, has provided funding for technical and legal support through Supporters Direct. It is proving its worth and, in many localities, is being supported by the traditional consumer co-op sector with business skills, mentoring for the boards and management of the new co-operative, and, indeed, often by funding as well.

A spin-off from that new initiative is another proposal now being actively worked up called Employees Direct. Here, there is some resonance with what David was saying. Employees Direct focuses on the growing number of employees now engaging with their company through share ownership, maybe through share bonus schemes or all-employee share plans. Why not form an employee trust or co-operative created by pooled shares with the potential for the trust or co-op to have directors on the boards of major British companies, as a result of mutual management of a proportion of the company's equity? As a co-operator, I find that a delicious irony to contemplate.

Multi-stakeholder co-operatives

But perhaps some of the most exciting new developments are to be found in the spectrum of multi-stakeholder co-operatives now coming on stream. Multi-stakeholder co-operatives, where membership and boards of co-operatives are drawn from a range of stakeholders, particular employees, the service users or consumers, and the wider community, are relatively new in the United Kingdom, but they are used very widely, particularly in health and social care, in the rest of Europe, in the United States, Canada and Japan. They have been developed, in particular, to meet the need for an organisational model to deliver public sector services that reflects the public ownership of the service on a local level.

The aim of these models is to create more business-like and independent services, with a strong social value base and local accountability, balancing the interests of employees, users and other stakeholders. In other words, an independent, sustainable enterprise, combining public service ethos with business efficiency. The classic example of an employee led, multi-stakeholder organisation of this type are the leisure management, industrial and provident societies and trusts, of which Greenwich Leisure was the first and perhaps the best known. There are now 40 such multi-stakeholder enterprises that manage leisure services on behalf of local authorities across the country.

Over the last three to four years, that multi-stakeholder model has been extended to, for instance, residential care for older people, where the ownership of local facilities is vested in the local community in perpetuity, thereby keeping local facilities in the hands of local people for local people.

This is an area where I want to touch base with some of the things that David was saying. He said that what is missing is that sense of engagement by those who own the shares, the public who actually own the public companies and private companies. In the plc sector, there is, in fact, no sense of engagement and participation. Whereas that is one of the things that the co-operative and mutual model has as fundamental to its being.

I can tell you that there is nothing more energising than to see the impact of this self help model on the ground. One of the most powerful experiences I had very recently was to talk to a group of nearly 50 care workers from a residential care facility – 49 women and one man. I was talking to them about the challenges and opportunity that their facility becoming a co-operative would actually offer to them. At the beginning of that meeting, they began by quite aggressively asking: "What is the Co-op going to do for us? What is the Co-op going to do about our out-of-hours payments, our sleepovers, and some of the many other benefits that have long been negotiated and valuable to care workers?"

By the end of the evening, after an hour with a trainer from the Co-operative College, they realised that they actually constituted the Co-op. There was a buzz around the room as these women sat in very excited little clusters, talking about how they could change the shift patterns, how they could organise in partnership with the client group, and how they could simply do things better, if they were in control. It was immensely inspirational, and that is the difference. There you have empowerment of people on the ground.

That same model of multi-stakeholder co-operation on the ground is delivering not only in residential care, but also in childcare. And it can apply and is applied to a whole range of other public service provisions.

The crisis in the countryside means more and more local communities are deprived and disadvantaged. In response, village communities are buying out shops that are in danger of closing down. They are buying out transport facilities, garages, pubs; and recently two local breweries were bought out as local community co-operatives.

At the same time, a new service is being supported and provided for, creating new agricultural co-ops in Britain. I have been surprised how often I have heard on the BBC in recent weeks the most unlikely people talking about the need for co-operation in agriculture, and how successful it is in Europe, in the US, in Australia, in Canada and in New Zealand. And yet, in the UK, agricultural co-operatives are very limited. So, once again, there is a whole range of services which the farming and rural community could benefit from by coming together.

In utilities, in housing, in wind energy – to name but a few – the services of my organisation, which traditionally has been the body that registers, promotes and develops new models of co-operation, are registering new businesses and promoting yet more.

But the mutual and co-operative sector also presents challenges – it is no easy option. Not only does running a values led business with an active membership philosophy demand time, patience and energy, but also there are pitfalls en route. Believe you me, the co-operative sector knows about the pitfalls because we have been there and we have suffered them.

I know that David was talking at the opening of his speech about some of the disadvantages of the co-operative sector, and I do not run away from any of them. There have been difficulties, but, in a business that has been there for 160 years, I am sure you would expect that we have gone through cycles of success, through ups and downs. We certainly have experienced the pitfalls, but we are still here. That is a testament to the enduring qualities that underpin the model.

But our periods of greatest and most rapid decline and stress have occurred when we have lost sight either of our wider agenda, our social purpose, or where we have forgotten the value and importance of our membership. That we are currently enjoying something of a renaissance is due to the reinvigoration of the two underlying concepts of concern for self, for family, for community, and, second, the value of the engagement of our members.

Employees: engagement and ownership

There is one key stakeholder group who deserve special mention, and that is the employees. Why involve employees in membership? The benefits of staff participation and engagement are well documented. It is seen by many management theorists as being critical to successful service delivery. The principles underpin many of the currently quite extensive quality systems, including Investors in People, ISO 9000, the business and excellence model, process re-engineering etc. Consultation with staff is an integral part of the best-value regime for public sector service providers; and it is recognised by the government as being an essential ingredient in improved service performance.

Research carried out by Ownership Associates demonstrates that participation in an organisation brings much greater benefits to the organisation and its stakeholders than either financial reward or consultation. In fact, the best benefit is obtained when all three are active within an organisation. To be truly convincing, ownership, in our view, has to be part of the offer.

This is the critical point. While other systems provide consultation and engagement, they are management tools and can be perceived by staff to be such. Organisational managers put them in place, and organisational managers can withdraw them. The perception is that, if they wish, managers can ignore the results of consultation and use the tools simply to substantiate their own positions. And, to cynics, they represent no real shift in power.

Direct engagement with a board takes the process a significant step further. It provides the right to take part in decision making; and it can be the key to delivering genuine empowerment in practice. For us, that is actually what it is about – re-engaging with communities, active citizenship empowering people in practice, and all the benefits that accrue from that.

Conclusion
There is a strong message here to those who believe that using the language or wearing the clothes of mutuality will be enough. I would issue a very profound caution to those who believe that the lingering virtues of trust and honesty, which still cling to co-operative and mutual structures, will be enough to create success. You cannot create a mutual structure or a co-operative business unless you accept the whole concept and all the principles governing the sector. Critically, this includes membership participation and democracy. Is Network Rail a mutual? I do not think so.

We have a vested interest in the sector; we have a vested interest in ensuring that something calling itself a mutual is just that, because if it fails, then we take a direct hit on our sector's reputation. With the difficulties we have experienced, we, frankly, cannot afford that, so we have a vested interest in protecting the integrity of the mutual model.

In giving evidence recently to the Health Select Committee on foundation hospitals, I tried to make it clear that if the government is going down the road of mutuality in its proposals for foundation hospitals; and if its intention really is to empower and involve local communities in their local hospital provision; then it must accept all the principles of co-operation and mutuality: empowerment, engagement and democracy.

We believe the mutual or co-operative sector has a huge amount to offer, particularly in some of the service sectors, which currently are causes of distress, anxiety and tension – I will not use the word "crises". To a range of issues that confuse and frustrate ordinary people, our sector has those fundamental concepts to offer. Bring them together with those original principles of the Rochdale pioneers from 160 years ago, and we believe absolutely that fairness and enterprise in this context can and does succeed.

Discussion

John McFall MP
I was interested in David's point about the definition of good business and efficiency and fairness going hand in hand. My committee recently looked at the issue of split capital investment trusts, and we did not see any of those characteristics present in that. I do not want to talk about that particular issue, but about a by-product of that.

During my work, many fund managers and others in the investment industry came up to me and said: "We knew this was going on. We did not want anything to do with it. We have had a lifetime of experience in the industry and we are rather ashamed of what has happened." So, to me, that proved this disconnect element, that it is there in business; and it proved that the laissez-faire model is a model that exists at the moment and *caveat emptor* applies, as long as the consumer did not know what he or she was buying.

So, my question to David is: How do we change that? How do politicians engage with business to ensure that the rights and the responsibilities go along with innovation and a light regulation touch?

People I know in the City tell me that an Americanisation of culture has taken place – perhaps you would disagree. The attitude is: "What does it say that we cannot do? And if it explicitly says we cannot do something, then we can do everything else." We are getting ourselves headlong into trouble in that particular issue.

Response: David Pitt-Watson
The split capital scandal makes it absolutely clear that we do not have, in any sense, a definition of ownership that is being done for us. And you are right: people did know about it. I was not an expert on it, but I knew there was something that was going wrong there. Institutions did not typically put pension fund money into split caps, but, in a sense, that almost does not matter. We do not have a consensus of rights and responsibilities that flows from us, through pension funds, to fund managers, to companies.

You could say that maybe the FSA should have blown the whistle earlier on split cap because it was so well known. Your committee has done great work on all of this. There would have been something that we could have done there, but what I am arguing for is not just about passing a law on split capital. If you stop split capital trusts, there is something else that will bounce up.

We need, on the left of centre, to find a language that accepts what a good thing it is to be making a capital surplus and to be investing in projects that are highly profitable. But, at the same time, we need to say that there is a moral framework within which that takes place.

I have to say that we have also got the whole moral debate wrong. Anybody here who runs a company knows they have a culture within that company that can only be described in moral terms. If you think about organisational structures nowadays, people do not draw them as root structures any longer, except perhaps in the government. You think about them as the seven “S”s, and the superordinate goals, and the culture of your organisation, and how you bring people to a belief system that works.

It is absolutely central to economic production that we have morals in the way that we act together. The question is then: How do we establish these appropriate morals? I was talking to a friend only yesterday about a professional services company about to break away from its parent. It is big, it is about a $3 billion company, and we were talking about those companies where they have allowed their ethics to drift because they pushed too hard.

I was a partner in Deloitte’s for many years, and everyone knew that Andersen was a terrific company, a wonderful company, but it was pushing the ethics. You needed to perform if you were at Andersen in a way that you did not need to elsewhere. If it was going to happen anywhere, it was going to happen at Andersen; and, in fact, it happened at Andersen in Texas over Enron and the whole thing went down.

I would argue that we simply do not have this debate. I am not arguing for legislation or for any single silver-bullet solution to all of this. It is what you do on your committee. It is how we manage to create some sort of consensus of understanding of what these commonly owned companies are there to do, and, by the way, what they are not there to do.

There are senior business people in the audience here, and I think many of them would say: “We would love to have that debate, because we would like to stop having to respond to people that want to know what our profits are going to be in the next quarter because they are trying to trade our shares; we would like to start to talk about how it is we can deliver real value for people in 25 years through producing goods and services at low cost that people want, and producing a hell of a profit off that so that you can have a pension.” Split capital trust is nothing to do with that.

Mark Goyder, Director, Centre for Tomorrow’s Company
I was glad to hear the last intervention because I think it brought the balance back. “Fairness and enterprise” is the title we have, but the real debate that is being brought up here is leadership versus accountability. We heard a lot in both presentations about accountability, but you will not have a successful enterprise model unless you get the leadership bit right as well. The kind of leadership and the kind of moral frameworks that leaders set, which David was talking about, are crucial.

Incidentally, David, I fell out with your chief executive, Tony Watson, because, when I was last debating with him, I heard him say that the company is not a moral being, so I would like you to join me in trying to persuade Tony that you cannot think about companies without thinking about them as being a whole bundle of relationships. They are not just a bundle of transactions.

Companies are not democracies either, and my challenge to Pauline would be to say that companies are started by entrepreneurs. When they become established, the entrepreneur should not be lost but gives way to, we hope, a leadership that actually sustains entrepreneurial culture while laying those foundations.

We need to create a way to evaluate that. The Hermes principles are superb, but you need to have an evaluation framework, and this is where we get down to how the chief executive experiences the pressure of investors. Until we get a recognised evaluation framework which puts a value on how well companies are led, what kind of risks lie in the moral frameworks and foundations that have been laid or not laid by the company; until we get an evaluation framework to support those Hermes principles; then it seems to me we will not progress because, typically, what gets measured gets managed, although we all know that it gets manipulated as well.

That is why we are at a crucial time, and the Company Law Review is core to everything we are talking about. I currently do sittings with a group that is looking at the whole materiality issue within the Company Law Review, and I know it is going to be a radical change for boards when they have to sit down and say: “Right, we have to produce an operating and financial review that talks about the whole future performance of this business. We therefore have to report on the health of every relationship in this business and the risks that lie in all those relationships. We have to work out for ourselves what is material and what is not.” I would say to you that if we do this right, companies cannot be led and managed in the same way that they were led and managed in the past.

This is a terrific opportunity for the future. The other key bit to it is the work that we in Tomorrow’s Company are doing on the design of the investment system. We get at the leadership bit through the operating and financial review, which is the corporate response to the challenges we have heard. We get at the accountability bit through actually starting to influence the decision making chain of investors, by getting pension trustees to set different mandates, and so on. When those two meet in the middle, then there is some hope for Tomorrow’s Company.

Roger Lyons, General secretary, Amicus and MSF
One of the features of modern ownership is the globalisation development, certainly at European and, in some cases, at international level, and also the takeovers and restructuring. You can have different kinds of ownership, you can have different kinds of management, you can have different kinds of leadership, but when companies come together as part of the growth process then, if they are coming from different directions, they do not necessarily take the right direction.

A recent example, perhaps, was the Wellcome Foundation. It has disappeared now; the Trust is there, but it sold its shares and it is now Glaxo-Kline Beecham and that says enough, but there are many other companies of the same kind.

Virtually the only company not bidding for Safeway at the moment is John Lewis. It does not want to merge Waitrose because that would give it a headache in trying to rationalise the two different systems. There may be other reasons too, but if you have got these different systems of ownership, if you have got different types of leadership, then is it not, perhaps, fossilising the status quo to some extent? It makes it very difficult. You have got a system you think is a winner, but is it not being risked in restructuring, in taking over, in expanding? In other words, it would not be the expanding sector of the economy at home or abroad; it would be, to some extent, the status quo.

Liz Hewitt, Director (corporate affairs), 3i Group
I want to pick up a few points that David made. The first is to endorse his observation, which we would certainly share in the private company sector, the unquoted sector, that performance, good-quality profit performance, is often linked to good awareness of corporate social responsibility issues that seems to go hand in glove with what we would perceive as good-quality management.

But going back to the quoted market arena that you were focusing on, you talked about 60% of shareholders coming from pension funds and life companies, which struck me as the half-full/half-empty model. If you would take it to 50%, that would imply that 50% is, therefore, held directly by individuals, rather than by pension funds or life companies.

As a public company ourselves, the attendance at our annual general meeting, from a share register of about 40,000, varies between 50 and 100 shareholders. We know what drives the difference between 50 and 100: it is competing AGMs on the same day, and it is whether it is a central London or a West End or a City venue. It does concern us that so few shareholders, either institutional or retail, are sufficiently interested in the running and the operation of the business to take the opportunity that we put a lot of effort into creating for them to come and talk to us about the business and what we do.

My question then is, given that it is obviously very difficult for shareholders to engage in that way, what ideas or what sort of debate do you think we could have about how engagement could be more actively encouraged?

Ian Russell, Chief executive, Scottish Power
I am immediately conscious that there must be 30 people in this room who are not going to believe what I am going to say, based on David's earlier statistic of 28% of people not believing plc chief executives, but, notwithstanding that, I believe Mark Goyder hit the nail on the head that there needs to be a joining up of leadership and ownership style.

There is a lot of work being done in UK plcs right now to make sure that leadership moves on, and there are a lot of organisations represented in the room today who I think touch on that area. I would not underestimate the extent to which companies like ourselves, with 5 million customers and very much a community based organisation, are achieving a lot of the aims and goals that Pauline referred to earlier. The Rochdale ethos is alive and well in well-run British companies.

But the disconnect is how we, as individuals who have pensions and therefore are indirectly owners of these companies, connect through to that leadership model. I have no difficulty at all with the notion that the leadership model at Scottish Power is the right one, and I think we are driving forward very strongly. We have about 800 shareholders turn up to our AGM – that is more than 3i's 50-100, but, out of our half a million shareholders, it is still nevertheless a relatively small percentage, and most of our time with shareholders is spent with institutional shareholders like Hermes.

A lot of the focus is on what companies are doing; but there needs to be much more focus on what institutional shareholders are doing. What is the City doing? What is Wall Street doing, because 30% of our shares are held in America? What are institutional shareholders doing to better represent the views of the individual stakeholders, whether they are shareholders or whether they are community stakeholders? That half of the equation is not getting much airing. The City is a bit of a black box, frankly, to most people; a lot more spotlight should be focused on that half of the equation.

I deeply applaud the Hermes principles that David has put out. It is a very good leadership model. But the next step is delivering it, making it an integral part of the way institutional shareholders operate. So, I would be interested in a debate around that.

Response: Dame Pauline Green

When Mark was making his comments, he made a sort of side swipe at democracy – "democracy is all very well, but …" Let us be clear: co-operatives, mutuals, social enterprises need effective leadership as much as any other corporate style. It is critical to the regeneration of our model that we do have that leadership. But what must go with it, and here I take up the last comment in particular, is the whole issue of accountability. We have learned, over many years, that the way in which we engage with our members is not simply through an annual meeting, but through an active membership policy.

Now, that is fine when you are talking about members; it is slightly different in the sort of company that David has been talking about, where you are arm's length removed from the leadership of the company. But, for us, engagement does not just happen; you need an active engagement membership policy so that you are constantly in touch.

That is one of the reasons why there is a lot of democracy within the co-operative and mutual sector, and it costs. We have to accept that one of our multiple bottom lines is operating that sort of wider membership engagement policy. That has a cost to it, for sure, but it is vital for us.

For instance, in recent years, there have been a lot of new approaches to active membership policy, engaging around membership groups and stores. There are still 3,500 co-op stores around the UK, and many of them now are on a par with the best-quality offer in the country. That is a reflection of a reinvigorated membership style that has caused membership groups to pop up around stores engaging with the people.

Of course, it is much easier for us because we are locally based. One of the big dichotomies for co-operatives and mutuals is that they are inherently local, but, in today's trading environment, you need a national corporate identity and that presents some difficulties.

Co-operatives and mutuals are and must be independent, sustainable, successful businesses. They are not "not for profits". Therefore, leadership is critical. But that must go together with accountability, and you drive accountability by activating your membership.

Response: David Pitt-Watson

I absolutely completely agree with the mood of the questions, Ian's and Mark's in particular. We are moving towards the ability to be able to express some sort of consensus that is based on this ownership model that is absolutely of value, and that does take in leadership.

Ian is absolutely right. We have investigated companies and boards from here to the end of eternity, and the place we have got to start is that black box called the City. And, frankly, if only 28% of people believe chief executives, then fund managers would be lucky if they got half way there.

On Roger's point, I did a seminar to the INSEAD City Alumni Club in a debate with people from financial services, and, again, it was about the Hermes principles. I said: "I think mergers and acquisitions, and even hostile takeovers, provide a function, we need to allow those to happen, but 80% of them do not deliver value. We have had umpteen studies on this." I sat there and said: "Would you three people admit that 80% of the fees you receive is actually for something that is going to destroy value for the shareholders who are the pensioners? Can we please stop doing this because you are very clever, very productive people and you ought to be doing something?" There was silence in the hall, but no one even wanted to debate that.

We cannot criticise everything that goes on in the City, nor say that there should not be hostile takeovers – and the Left needs to understand that. But we do need to respond, and it is terribly important that it is done right. When there is evidence that the City is wrong, on split capital trusts or on too many takeovers or whatever, we try and mention as many of them as we can get into a 10-page document.

Ian was saying that, from time to time, Scottish Power will use the Hermes principles to go back to investors and say: "We are doing this – are you going to complain about it?" That is exactly what they are there for, so that traders cannot do the sort of things to Ian's share price that put him under pressure to do the wrong thing for us as pension holders.

Of course, Mark is right. You cannot ignore the leadership in all of this, nor can you ignore the fact that the leadership may want to be all over the place in the directions it is taking. You cannot make lots of things ultra vires for companies; they need to have that entrepreneurial spirit.

But, equally crucially, we need to have credible standards of what it is that they are doing, and I would refer back to the stuff that is being said by Steve Davies. He is saying: "What do we need for a civil economy? We need engaged shareholders; we need independent monitors of what it is that our companies are doing; we need credible standards of what their output is; and we need civil society organisations to be the market forces that then make sure that these companies are approaching themselves right."

That is a very interesting framework for an agenda that is entirely acceptable for good managers like Ian and his board, and the people that are delivering not only power to people to Scotland, but also pensions to me in 25 years' time. We can have a huge consensus on that if we can express it.

The final question was about AGMs. I am in favour of AGMs taking place but we have to be realistic. First of all, I do, from time to time, go to AGMs, but I do study my companies ever so closely and would expect to meet regularly with not only the chief executive and the chairman and the finance director, but also the non-executive directors of the company, so there probably is not a huge amount that is added for me by going to an AGM. It is, however, important that they take place, because it is an appropriate place for small shareholders and for retail shareholders to be.

But remember, I do not do what most fund managers do. Most fund managers trade shares. It is like there is a marathon going on that is about delivering power to people in Scotland and California. Fund managers are betting on how fast Scottish Power is going to run the next 400 metres. If Scottish Power starts to sprint the next 400 metres, beyond what it is possible for it to do in order to supposedly benefit its owners, then we have got a real problem, because it is not going to be there at the end of the marathon.

Clive Morton OBE, Centre for Tomorrow's Company
and managing director, Board Performance
I feel as if I have got a foot in both camps here. I work a lot with the corporate sector with boards, and I see precisely where you are coming

from David; and Pauline, I am a chairman of a NHS trust that has over this last weekend put in an application to become a foundation trust, with the interesting model of Greenwich Leisure being put in front of us, among others.

One of the areas David talked about, which I would like to get him to elaborate on, is that of corporate social responsibility. He said that companies do not have limitless social obligations and they cannot be social services. In essence, one can agree with that. However, research from Tomorrow's Company, and the research that I have done, shows that companies that work outside their boundaries in building trust and supporting projects, whether in the community or elsewhere, find an enormous payback. I have seen business development come from building that level of trust.

David seemed to imply that corporate social responsibility was a distraction from business, but, in my experience, it can help maximise shareholder returns. Shareholder value and social responsibility are not mutually exclusive.

John Sadler CBE
I am retired now but I was deputy chairman of John Lewis, so I am a great fan of mutuality, and I am also deputy chairman of British Telecom's pension scheme, which owns Hermes' Focus Fund, and I was amused that Mark did not refer to the owners there.

The fundamental problem with all these things is a matter of size and of trying to get the management and the owners' interest to coincide. We all know that, in the good old days of capitalism, they were the same people, but nowadays they are not, and have not been for a long time. The bigger the organisation gets, the more difficult it is to get a commonality of interest; and public choice theories indicate that people will behave, generally, to maximise their own personal interest.

Unfortunately, the problem does not go away with mutuality at all. The problems remain the same because the management has a tendency to further its own interests. That does not go away, in my view, by the publication of acres of print about corporate governance. It is basically a fundamental thing of getting the right people and getting a mechanism for changing them if they are not right. Those are the things we have to concentrate on.

No answers – but those seem to me the big questions:

• How do you get the right people to do what the owners want?
• How do you change them if they are failing?
• And how do you identify failure?

Professor Sheldon Leader, Department of law, University of Essex
I would like to address some of the more difficult questions about when principles begin to collide.

There seemed to be two strands to what David was talking about. The one is the need for stabilised, longer-term relationships in companies to avoid the problems of short-termism – a longer-term brief, in other words. But then that went alongside addressing another wider brief that includes or looks at a variety of interests that lie to one side of the core of what a company does. So, there is a wider brief and a longer-term brief.

An example that David mentioned was the trade-off between pollution and profit. Rightly so – it is a real dilemma. To what degree can we, as conscientious shareholders, allow polluting activities of our company, where the trade-off is the profit we put in our pockets?

If we are going to address it, though, it is not solved by just making the relationships more long term, but by widening the brief that the concerned shareholder can have, and, therefore, the company can have, and we run up against the problem of boundaries then that were raised a moment ago and possibly even company law. If your programme is going to work, it seems you are inviting us, maybe rightly so, to widen and not just lengthen the brief.

The other example that is very troubling for many people has to do with the closure or shrinkage of particular establishments in larger companies, where, again, the trade-off is between global profitability and an intense loss to the stakeholders involved when local establishments close. I would have thought that is in your brief, but, again, only by widening it, not just by lengthening it.

Response: Dame Pauline Green
John has made a very real case about the difficulties for mutuals on leadership and governance generally, about how you actually encourage good governance on mutual and co-operative boards. This is an area where we have lots of experience because there have been some very bad mutual and co-operative boards that have failed to take responsibility for their managers.

Of course, in the original format for co-operatives, the board of managers managed; now they employ professional management, and have for a long time. But the pendulum swung the other way, so that lay boards were completely unable to manage their professional managers because they simply did not have the skills. Now, the pendulum has swung back again, not to the other extreme but to somewhere in the middle, and we now have a very effective system of corporate governance.

When I look at what the government is proposing in changing governance structures, I am delighted to see that our code of best practice for the governance of our sector actually runs ahead of what the government is proposing now for companies generally. So, we have seen an improvement in the governance of our sector. We have this code of practice that we enforce annually and we report on internally, so there is peer pressure. We have seen governance standards improving from 68% implementation of our code of best practice to 82% and rising over the last five years.

So we feel we have some experience there and have got to grips with handling it. It is not perfect, by any means, and there will still be problem areas, but there is experience, breadth, depth and scope to the way in which we are now handling it. And I think we have a model that is transferable.

Wilf Stevenson
Does John Lewis comply?

Response: Dame Pauline Green
John Lewis is of, course, an employee owned business, so I was glad it was raised because my organisation now represents not only co-operatives, but employee owned and democratically owned businesses as well. John Lewis is not part of our membership, but certainly is part of our sector.

Response: David Pitt-Watson

On the question about the social responsibilities, we do need to get some sense of what the limits on those are. They do exist. On pollution, for example, we would say that companies should support voluntary and statutory measures that minimise the externalisation of costs to the detriment of society at large. Now, that is not the way that Exxon would feel about it when it is exploring for oil; but we would say that if you are going to damage the environment, it is appropriate for the oil industry to go and see the government and say: "Look, we need competitive market forces that stop us doing those sorts of things."

It is more tricky where you have got closures that need to take place, because there is a limit to the responsibilities that you can have to a workforce if they are not doing something that is productive in terms of a creation of value and a return on capital. Again, that is a tricky thing because it is the trade unions in this who have got two roles: they are the trustees of pension funds; and they also represent workers. They have a very difficult separation that they need to make because at times of closure there is a conflict. I would say that the conflicts are much less than people like to make them, but they do exist.

First of all, the British Telecom pension fund – I completely should have mentioned it. I am sure that is in my notes that I put down, because the only reason that Hermes has been able to take some of its more controversial stands is because of its ownership and because we have had the support of the British Telecom pension scheme trustees and, I have to say, the support of British Telecom. Those involved with this have shown a vast degree of integrity, they included people from a broad spectrum, and those associated with other political parties than myself, who say: "Look, we are just here trying to get capitalism to work."

I think John is right that the relationship between the owner and the board is ultimately about who is doing the job – that is the nexus of it. But there is a larger debate to be had, about the atmosphere in which we are having these discussions: what it is appropriate for people to do; what it is that they ought to be doing; what are the proper goals of companies; and who it is you are doing this for?

If you are going into work and you are wondering what shareholder value is, look at the person sitting opposite you on the train, think about what they want. I promise you they want long-term profitability; they really do. So this is not a social enterprise; it is about making profits; it is about doing it properly.

If I had a concluding thought, I could not agree more with Tomorrow's Company about the integrity of the culture. The culture of organisations cannot be separated from ethics; they are one and the same thing.

I think we have got stuck on the left of centre with the famous Roundhead/ Cavalier debate. I do not know how many of you have read *1066 and All That*, but in it there is a very clear description about the Roundheads and the Cavaliers. The Cavaliers were wrong but romantic, and, of course, the people on the streets of Seattle are wrong, but they are romantic. It would be nice if we could destroy global capitalism and all be rich and happy. Then there are the Roundheads, who are right but repulsive, and they, of course, are the people that are in the ultra laissez-faire camp.

We on the left of centre have allowed that debate to take place; and, of course, at the end of the day, people look at their pocketbook and say: "They may be repulsive, but, since they are right, I had better vote for them."

If you applied to the ownership structure the questions that Mark is raising about ethics within a company and leadership within a company, then we really could manage to get the best of both worlds. We can be right and we can be romantic, but we can only do that if we are confident about where we are debating and where we are not debating as well.

We need to fully recognise that companies are there to create a capital surplus, that they do that fundamentally by using ethics in all those sorts of ways, and they do it not for the Duke of Devonshire, or whoever is the wealthiest person in the country – they do it for us. So, my plea is that we can start to have a political debate that reflects on an economic debate where we can have the confidence to say: We can be right and we can be romantic as well.

Wilf Stevenson
David has given us a very fine finishing point on that. The issue he raised is really a question of how to take this debate forward, because there are clearly points that need to be resolved.

The chancellor is also on this agenda, and his speech to the Social Market Foundation a couple of weeks ago tried to set out the analysis of where the Left stood in relation to markets, the limits to where markets could operate in terms of social enterprise, and how that might be taken forward in the future.

We have obviously got a long way to go on this agenda, and we are very pleased to be part of that.

Seminar 4

Fair regulation and taxation

A seminar held on
Thursday 3 April 2003

Introduction

Wilf Stevenson

Director, Smith Institute

Welcome to the final seminar in what has been a very interesting and successful series on fairness and enterprise, which has been developed with the Work Foundation and with the support of Scottish Power. In this final session, we want to explore the place of regulation and taxation in the fairness and enterprise debate.

Rt. Hon. Patricia Hewitt MP
Secretary of state, Department of Trade & Industry

I am going to cheat a bit: I am going to talk about regulation rather than taxation; I will leave taxation to Edward.

We have an incredibly distinguished group of participants here, several of whom have told me that the entire series, of which this is the last seminar, has been very interesting and stimulating. I am delighted, although I have not managed to get to the earlier ones, to have the opportunity to participate this morning.

Many of you here have spent years thinking, researching and practising some of the very difficult issues concerned with regulation, so I start with some humility since I certainly do not pretend to share the expertise of many of you here this morning.

But what I will try and do this morning is just sketch out some of the issues that I think arise in trying to develop a coherent philosophy, a set of principles around which we can approach these regulatory issues. There is no doubt at all that this issue of regulation, or "red tape" in the headline phrase, is a source of considerable tension between government and the business community.

In any gathering of business people, it is easy for somebody to get a great round of applause by saying: "The best thing government could do for enterprise is just get out of the way, scrap the regulations – never mind introducing employment laws." When you have these smaller and more sensible gatherings, you then get into a much more intelligent discussion about the way in which regulation can actually help business, as well as – if you get it wrong – hinder it. Using regulation to achieve our objectives needs to be at the heart of our discussion here.

Historical context

In framing this discussion, it is quite useful to look back to the different phases of economic policy. For some decades after the Second World War, the emphasis in economic policy was very much on big government and big business, developing a long line of pre-war economic policy. That gave us a generation of state planning, of state ownership, and of state-owned or heavily regulated industries.

By the 1980s, the limits of that approach were all too clear. We entered a new phase when, indeed, government did see its job as simply getting out of the way, and that was the era of privatisation, of deregulation, and of cuts in public investment.

What is very clear now, as we enter a new, third phase, is that there are only diminishing returns to be had from government continuing to withdraw from economic activity. Indeed, if one looks at the railways, it is very clear that more rather than less public sector involvement is needed, if we are going to get desperately necessary investment and improvements in the transport system on which business, as well as individuals, depend.

Values

So, what we need to do, as we think about the appropriate relationship between government and enterprise, and the appropriate role of government in a very fast-changing and increasingly competitive economy, is to start from our values.

These are the values of equality and equal respect for every individual: the belief that everybody, whatever their background, in every part of our country, should have opportunities to contribute to wealth creation and share in its benefits; the belief that rights and responsibilities go together, that all of us do better where there is a powerful network of mutual relationships and responsibility; and the belief that those values apply just as much internationally as they do here at home.

It is that set of values that has to shape our approach in government to markets. Those who, in a sense, are still stuck in the neo-liberal paradigm, who say that all that government has to do is to get out of the way, really talk as if markets simply appeared from some cloudless, blue sky. They fail to appreciate that markets exist as social institutions shaped over many decades by government and other economic actors.

For instance, a labour market can operate with or without a minimum wage; it can operate with good standards of health and safety, or without them; it can operate with high standards of employment protection, or without them. Different labour markets reflect very different political and ethical values; and they produce very different results in people's lives and in business.

Equally, there is a world of difference between the system of company law and corporate law that protects monopolies and cosy cartels, and one that energetically protects new entrants and market challenges.

How we shape markets reflects those fundamental values but, of course, in shaping markets, we need to think about our commitment to participation in wealth creation and enterprise, as well as our belief in fairness and opportunity.

Competition

Let me apply that to some specific remarks. I want to talk a little bit about different kinds of markets, and let me start with product markets – markets for services and goods. Irwin Stelzer is not, on the whole, an ideological soul mate; none the less, I think he is absolutely right when he says that "competition in product markets is the deadly enemy of class rigidity".

Our commitment – and it is a pretty powerful commitment in our government – to intensely dynamic competitive markets actually reflects a belief that competition is the expression of meritocracy for business. We think it is good for business and enterprise as a whole, even though highly competitive markets that enable new entrants can be highly uncomfortable for specific individual businesses.

For instance, when I was minister for e-commerce, BT frequently complained about the extent of what they saw as excessive regulatory interference by OFTEL. The next conversation I would have with them would focus on the impossibility of entering the German market, and how much they wished they had OFTEL on their side in Germany. It depends, of course, whether you are the incumbent in the market or the new entrant. In this case, BT was the incumbent here and the market entrant abroad.

That example of telecommunications is a very good one of how, although the purpose of regulation in that kind of market is to create a competitive market, and thus as you get more competition in the market you withdraw from regulation, you may on the way need very tough and intrusive regulation. Indeed, David Edmonds of OFTEL described the "regulatory trench warfare" as he sought, through local loophole bundling, to enable new entrants and much greater competition.

So, that is one purpose of regulation within a market: simply to drive through competition to ensure access, in this case to networks. But let me take another example of where you can use regulation in quite a powerful way within product markets to drive up standards and innovation, and that is the particular example of environmental regulation.

Environmental objectives

There are various ways of achieving environmental objectives. Where we can do it, I think market instruments are likely to work best. The emissions trading scheme that we announced in the recent energy white paper is going to be a very powerful tool for shifting our energy system towards underpinning a low carbon economy.

There are other cases where voluntary agreements will do the business, like the voluntary agreements between the motor car manufacturers and the European Commission that are constantly driving down emission levels from new vehicles. They agree on the outcome, and then the companies are left, through technological innovation, to find the best, the cheapest, the most effective ways of reaching those goals.

There are other cases where you need classic regulation, and the Building Regulations are a very good example. We suffer in our country from building regulations – and, indeed, in many cases product standards – that over the years have been considerably lower and less demanding than those, for instance, in Scandinavia and other northern European economies.

The energy white paper gives a commitment to bring forward the review of building regulations and to drive up energy efficiency standards in new homes, and where there are refurbishments this will make a very real difference.

Again, what we have to do is to try to specify outcomes, and that, in turn, spurs innovation, which is the crucial issue that we need if we are to close the productivity gap with our key competitors.

Employment

Of course, markets for labour are completely different from markets for products and services, for the simple reason that they are about people and people's lives. So, again, we need to come back to values and goals.

Last year, in a joint paper with the Treasury and in some speeches, I set our goals for employment policy and particularly employment regulation. We want more people in work, and even though we have got far more people in work than we had in 1997 – more than in many other European Union countries – there is still a great deal more to do to draw into employment those who remain excluded.

We want more employment, but we also want better employment. And better employment means more productive employment as we improve people's skills, and as companies raise their own standards and generate higher profits and thereby higher wages. There can be tensions between those goals, and we should readily admit that – because we do not want to end up with the kind of insider/outsider labour market that we see operating in too many Continental countries.

When it came to the minimum wage, which is an interesting example, we had people telling us that the minimum wage would destroy job creation, that it would cost a million jobs. It did not do anything of the kind. It was very carefully designed. We used a social partnership process to set the level of the minimum wage.

Now that we have got rather better statistics, we discover that the minimum wage when it was originally established only covered a little over half the proportion of the workforce for whom it was originally intended and anticipated. That is why the Low Pay Commission has quite rightly come to the conclusion that we need above-average increases in the minimum wage for the next couple of years, in order that it should have its original effect.

But, of course, the fact that it was set so modestly at the outset has given us a very good opportunity to see whether or not it has cost jobs. Of course, as we all know, the minimum wage has been introduced in a period where we have increased, not decreased, the number of people in work by well over a million.

Work/family balance

Let me take another example: the new package on work and family balance which we are introducing from next Monday (7 April 2003). It is designed to help both employees and business deal with one of the largest causes of the growing levels of stress that people experience in the workplace, levels of stress that are highly damaging to business productivity as well as to individual wellbeing.

What we are trying to do with that package, which is, again, a very carefully designed regulatory package that has engaged the social partners all the way through, is to accelerate a process of culture change within organisations that is already taking place.

If we simply left it to the market, as it currently exists; if we simply left it to the voluntary activity of firms; then it would probably take about 20 years to get to where we want to be. The issue of enabling parents to balance earning a living and contributing to wealth creation, on the one hand, and bringing up their children and caring for elderly relatives, on the other, is too important to leave for another 20 years.

We have been going with the grain of changes that are already happening: businesses discovering that work/family policies are the best way to recruit and retain good people and raise their productivity levels. By going with that grain, we think we have shaped a package that will actually deliver that win/win solution that we want of being both good for individuals and families, and good for business.

Costs of regulation

Finally, let me say something about the cost of regulation because, in the headlines, we hear a great deal about the £20 billion – or whatever it is this week – cost of red tape. It is very important that we all understand what a nonsense that is.

For instance, the administrative burdens of implementing fair standards within the workplace come to about 1p per worker per week. The real costs come from increases in the wage bills to pay the minimum wage, and provided that we continue to design that carefully, so that wage rises for some workers are not paid for by others losing their jobs, then we can quite legitimately expect business to absorb those costs without damaging enterprise at all.

Equally, we get told that regulations are making it almost impossible to set up businesses, or grow the number of people in employment, and so on. However, the international benchmarks show that we consistently come out in the top three around the world in terms of being a good place to do business. If we look at the increase in the number of businesses established in the last five years, like the increase in the number of people in employment, it suggests that we are continuing to get the balance right.

Changing government culture

Having said that, it certainly is not perfect, and so we have paid a lot of attention in the last five years to putting in place what I would almost call "counter-cultural levers". The culture of government and of Whitehall undoubtedly is to regulate: you see a problem, you pass a law; you write a regulation. It is the response of, certainly, Labour politicians and of civil servants.

Having got the regulation, you then do incredibly detailed guidelines and all the rest of it to make sure you have covered every possible situation, and all too often we end up with the kind of gold plating that people complain about in relation to European laws.

We have the Better Regulation task force; we look at a proper regulatory impact assessment for every regulation; and we have the small business litmus test, where we actually test regulations for their impact on the small firms where it hits hardest. These are hugely important tools in making sure that we regulate only where the benefits justify the costs, and that we do it in the simplest and most cost-effective way.

We have also taken some real steps forward in introducing those same disciplines into Brussels. We are at a much earlier stage there, but we have got agreement on a better regulation action plan there too, and we have also, crucially, just won agreement that the new Competitiveness Council, for which we fought in the European Union, will now have a cross-cutting role looking at any regulation from any other council that could have an impact on competitiveness.

Conclusion

The first test case of that new approach will, indeed, be an environmental regulation – the new chemicals framework that the Environment Council is working on. That is a classic case of where the industry is absolutely clear that they need a new regulation. They want, among other things, not only to improve their own environmental standards, but to improve the image of the industry, which is not good and makes it very difficult to recruit good people.

But it is equally clear that if that regulation is badly designed, then half the chemical industry from Europe will simply move outside Europe. Then we would lose jobs and not get the benefits to the environment and to human health that the legislation is designed to get in the first place. That is where the Competitiveness Council will come in, not to oppose the environmental goals but to ensure that we achieve them in a way that is wholly consistent with our competitiveness.

I hope I have at least given us a framework for the discussion and set out some propositions that I am sure many of you will challenge and disagree with. I look forward to that.

Wilf Stevenson

Our first response to that is from an industrial perspective. Scottish Power is known for its corporate social responsibility and has been awarded Business in the Community Company of the Year this year for its positive impact on society; and it has come in the top 20% of the recently announced Corporate Responsibility Index.

Ian Russell

Chief executive, Scottish Power

When we came into the room and found it was quite cold here this morning, I was immediately drawn in two opposite directions. As the chief executive of an international power company, I thought it was a great shame that more effort was not going into heating the room, but having studied the secretary of state's white paper carefully, and noted the importance of energy efficiency, I applauded the chancellor's Presbyterian background. So there was an inevitable dilemma.

I would like to talk briefly about three things: firstly, the proposition that fairness and enterprise can co-exist, and the important role that regulation and taxation can play in that. Secondly, I would like to illustrate that with some examples from the energy industry, both in the US and in the UK. And, thirdly, as well as regulation and taxation, there are some other influences in this area which we can draw conclusions from.

Enterprise as a means to fairness

I would like to start by addressing the theme for the whole series of discussions which examines the question: Can fairness and enterprise coexist? My cautious answer is "Yes", but the answer depends crucially on the ability to distinguish between means and ends.

Now, to me, enterprise is a means to achieving a number of different ends; and it is up to society and government to say which ends it wants to achieve, one of which I believe is fairness. It is then the job of government, on behalf of society, to provide the incentives through taxation and regulation to ensure that enterprise delivers fairness across all stakeholder groups.

Let me give you a good example by looking at the government's white paper on energy policy, which the secretary of state has already referred to. Scottish Power welcomed the white paper, which contained a very clear objective or end, namely a low carbon economy. So the question becomes: Does enterprise provide a means to deliver fairly the low carbon economy that the government and society seeks? Again, I think, cautiously, the answer is "Yes".

The white paper provides a clear framework: government, regulators and the industry now need to work together to ensure that appropriate incentives are put in place through taxation and regulation to ensure that that aim of a low carbon economy is indeed delivered fairly.

Under the white paper, an example of good regulation that is already in place is the renewables obligation. In the US, where we have half of our business, we see the equivalent of that in the form of a taxation incentive to develop renewable power. Suffice it to say that these are exactly the sorts of incentive that enable business to work alongside government to achieve society's aims in a fair and enterprising way. I was struck by the secretary of state's remarks about specifying outcomes that encourage innovation and enterprise, and that seems to me to be at the heart of this.

So my first point is that fairness and enterprise can coexist, and that government has an important role to play in establishing appropriate regulation and taxation, to provide the incentives to ensure that enterprise delivers fairly across all stakeholder groups.

My second set of remarks relates to examples from the energy sector of regulatory incentives, which support the notion that fairness and enterprise can coexist.

US regulation

I have mentioned that half of our group exists in the US, and the states that we serve are regulated separately at a state level. It is a noisy, political and controversial atmosphere that is a long way, both in terms of distance and understanding, from the majority of our shareholders here in London. It is also very big. We serve some 750 communities in the US, including 30 Native American tribes and an area of over 130,000 square miles. The approach that US regulators take to incentivising good behaviour is informal.

Since we acquired our US business three years ago, we have greatly improved relationships with its regulators. I will give a couple of examples of what has contributed positively to that. A couple of years ago, in a survey of our communities, 63% of people that we serve in the US reported that they were satisfied with customer service, citing good customer service, involvement in the community, and our ability and readiness to fix problems as being some of the key issues that they looked for from an enterprise.

And, in a recent survey, our US business ranked top in the US for an improved utility business. We have seen direct influence of that customer opinion on our regulatory outcomes, thus emphasising the importance of fairness and good enterprise in the way in which customers influence the regulators.

UK regulation

By contrast with that informal approach, in the UK we have more detailed regulation, where often timing is the key, and, again, let me give you a couple of examples.

You may remember in 1998 Hurricane Boxer, as it was called, showed us that our network in the Scottish Borders needed to be reinforced to protect small, isolated farming communities from the hardship of losing power supply for a prolonged period of time. Over the last two years, after protracted regulatory and planning discussions, we have worked with these communities to regenerate the Borders' network through an £11 million investment.

Another example is the area of renewables. Society wants renewable energy. Government, through the white paper, has made clear targets for society's consumption of energy from renewable sources, but the network does not yet exist to deliver renewable power to consumers. So, what are we doing about it? We have two choices.

We can either anticipate that demand for renewable power, or we can wait until there is a shortage of the network capacity, and then respond. One of our key service territories is in mid-Wales, and just such a case in point has arisen there. The network needs to be strengthened to accommodate the future anticipated renewable demand in places around Aberystwyth. We are looking to strengthen it earlier, rather than restrict the development of wind power, which would frustrate developers and consumers alike.

Again, the issue is whether the enterprise takes the initiative, takes the investment risk on the understanding that the regulatory incentive will follow – whether enterprise moves ahead of the regulators, or waits for regulators to set the lead.

To conclude this second section of my remarks, the US examples which I have quoted say that if you maintain high levels of customer service and satisfaction, then the regulator may allow you to grow your business by increasing returns. That provides more resources to invest back into the communities and a virtuous circle ensues. In the UK, hitherto successful economic regulation needs to be expanded to keep pace with society's and government's aim in areas such as renewables.

The point in both cases is that whether it is the more informal US style, or the more detailed UK form, regulation and taxation have to line up with society's and government's aims if enterprise is to deliver the desired outcome fairly.

In the third part of my remarks, I would like to give you a few examples of where other stakeholders – the investment community, customers and employees – are incentivising enterprises to behave fairly.

Other stakeholders: investors, customers and employees

Both in the City and in Wall Street, institutions are quick to punish business that takes undue risks with the public trust, or breaks the rules in areas of governance, transparency, and corporate integrity. I am sure your list of examples is as long and as lucid as mine, but suffice it to say that, once an enterprise is found wanting in any of these areas, the financial community's retribution is as swift as the company's recovery is unlikely. The ever present notion of these penalties acts as a potent incentive to business.

With regard to customer incentives, we have a £20 million investment in what we call Rural Care, which was an incentive that began as a tree-felling exercise to reduce outages caused by trees bringing down power lines during severe storms.

We have roughly halved the disruptions caused to customers through storms, but importantly, along with felling trees, we have planted natural trees in their stead, and have often brought to the local communities a much better forestation through planting natural forests rather than commercial ones. So, they have the benefit of fewer power outages and a better environment. From our perspective, it is good business because it costs us less to repair storm-damaged lines.

Lastly, as far as employees are concerned, in 1996 we started, with the TUC, an organisation called Scottish Power Learning, which took our training facilities and made them available to society at large, including disadvantaged youngsters, particularly in the areas around Liverpool and Glasgow – two of our key service territories and two of the poorer areas of the UK.

Five thousand disadvantaged youngsters have gone through those training programmes over the last six years, and 70% have now gone into either work or further education. Seventy per cent is a statistic that compares quite favourably with the government's overall New Deal results.

These investor, customer and employee influences reinforce the framework provided by good regulation and taxation.

Conclusion

So, to sum up: first, a cautious "Yes" in answer to the question: Can fairness and enterprise coexist? Together with that, the government – through regulation and taxation – has an important role to play in encouraging enterprises, through incentives, to act fairly and evenly with all stakeholders.

Secondly, I have used examples to illustrate this in the context of energy regulation and taxation here in the UK and in the US; and, thirdly, I have also shown examples of incentives from other stakeholders, such as the investment community, customers and employees.

Finally, are there trends that suggest we are moving in the right direction? I think the answer is "Yes". The culture of greed and gain at all costs continues rapidly to demise. The investment community needs to understand that a focus on the short term does not necessarily mean long-term guaranteed returns.

Corporate social responsibility needs to become more widely recognised as a meaningful bottom-line advantage, and those of you who read the *Financial Times* on the way here today will have been delighted to see beyond all doubt that corporate social responsibility improves both economic value added and the market value – the share prices – of companies. That is a very important piece of research.

Customers and employers need to continue to be vocal, organised and well-represented in their calls for fairness across all stakeholders; and government should continue to demonstrate, with good regulation and taxation, that it is linked into these trends in society and in the investment community.

So, in conclusion, there are trends going in the right direction. And I am optimistic that, before too long, we will be able to answer the question "Can fairness and enterprise coexist?" with a stronger, more emphatic and less cautious "Yes".

Wilf Stevenson
We have started with regulation, then brought in a little bit of taxation from Ian, and now we are going to move a little bit further across the spectrum to taxation.

When we were setting up this seminar series, I was struck by the fact that I got three different responses to the question of what fair taxation was. Some felt that it was only fair if it was totally redistributive; others felt that it was only fair if it was utterly progressive; and an even stranger group said it was only fair, in a taxation sense, if it was so small as to be undetectable, and so large in its impact as to raise oodles of money.

Edward Troup
Simmons & Simmons

I have got the third of the three “R”s: revenue gathering.

Tax is different. To pick up Patricia Hewitt’s point: government cannot get out of the way when it comes to taxation. It is not something where we can say: no regulation, no taxation. We do need taxation. We do need to take money away, and taking money away from people is basically unfair. It is depriving them of what they have worked for, or earned in one way or another. To pick up one of Ian’s points: tax is a means, it is not an end in itself. It is a means of financing government, and we should always look at it like that.

The burden of tax regulation is one of the most frequently cited burdens of government regulation, but, equally, there seems to be inversely proportionately less done about trying to reduce it. I am going to talk about fairness in taxation and what we mean by it, and what the government should or should not be doing about it.

Fairness in taxation

Fairness in taxation is one of those propositions that, in a sense, fails the test of being a useful concept. The usefulness of a statement is generally indicated by whether it represents one of two potentially opposing points of view. Now, if you ask people: “Are you in favour of unfairness in taxation?”, they would undoubtedly say “No”. So, in a sense, have we got anything to argue about here?

We want fairness in taxation. If we mean by “fairness” that people in equivalent situations are treated in the same way, the apparent answer is indeed “Yes”. But if you ask British business: “Are you in favour of everybody being treated in the same way?”, quite a lot of British business would say: “No, we want to be treated better because we are in a slightly difficult position.”

Most lobby groups would be in favour of unfairness in this sense; and the chancellor has been particularly in favour of this sort of unfairness. The British film industry and smokers might both feel that they have been treated in a way that is not, on this test, fair.

So, we should be in favour of fairness, but we have to recognise that fairness, in the sense of equivalence of treatment between people in roughly the same position, is not something that everyone will actually agree to if you ask them the question.

Horizontal and vertical equity

But we also have to recognise that fairness can mean a different thing. Fairness, in the form I have just described it, is what the economists would call horizontal equity – trying to keep everybody at the same level in the same position. That means there must not be opportunities for tax avoidance or tax evasion.

But there is another kind of fairness, which is the kind of fairness that Wilf has just referred to, and this is what the economists would call vertical equity. This means that if you are further up the income or assets chain then you should pay more tax. This is linked, obviously, to the concept of redistribution, because if you tax people at the top more and people at the bottom less, you are effectively moving resources from top to bottom.

So "fairness" is actually a convenient word for politicians to blur these two concepts together; and it is convenient because it avoids using the word "redistribution". The chancellor has been very keen on fairness in taxation, but he has not explicitly distinguished between the fairness which we all sign up to when we are not wearing our lobby group hats – horizontal equity – and the vertical equity, which is effectively redistribution.

I am not going to talk about vertical equity because it is very much a political matter. It is, in a sense, the only end that you might identify for taxation – redistribution, moving income, moving assets down the wealth scale. By and large, it is only relevant to individuals, and the thrust of what we are discussing today is about businesses. It may be relevant as a concept to small businesses, which in many ways equate to individuals, but it is, by and large, something that is a political decision.

What we need to talk about in terms of fairness in taxation – how to achieve it and how to deal with regulatory burdens – is horizontal equity. How do we try to make sure that, by and large, to the extent to which the tax system interferes with business, horizontal equity is achieved? Taxation inevitably interferes with business, because you are taking 40% out of the economy, but how do we make sure it leads to horizontal equity?

The complexity of achieving horizontal equity

It is very difficult. We have to define equivalence of situations that may be subjective. That may be very difficult to determine, and it may change over time, or – and this is the more subtle and difficult point, which policy makers always fail to recognise – it may change in reaction to taxation itself. The mere act of taxing may change behaviour and may make what appeared initially to be equivalent situations different. I will give an example of that later.

Diversity of activity within the economy leads to complexity of taxation in trying to impose equivalence on people who we think are in the same position. We can end up creating rules in seeking to be fair which end up being unfair of themselves, simply because they are imposing a regulatory burden, or they are distorting behaviour – and that is the key paradox for the policy makers.

They want to be fair in taxation; they want to make sure that people in equivalent situations are taxed in the same way; but in so doing they may increase the regulation and create the complexity which becomes unfair of itself, and becomes the burden that businesses complain about.

Let me give you a couple of examples to illustrate how this works. Employee remuneration: businesses, in the absence of tax, will remunerate their employees in the most appropriate form. We want to tax that remuneration because we want to tax employees, so we tax cash salaries. Some businesses give their employees cars – they think it is a good perk. We do not think that those should go untaxed; equally, we are not going to tax an employee on the full value of a car just because his employer lets him use it. But if we do not, then, obviously, all employers will switch their remuneration strategies to give people cars rather than cash.

So we have to define some way of measuring the value of the use of a car that an employee has throughout the year. Now, those of you who are employers, or those of you who have worked in anything to do with the PAYE system, the benefits in kind system, will know quite how complicated the rules get.

The taxation system creates a regulatory burden on businesses and distortions of its own because we cannot create a company car system that absolutely captures the value to each employee. We have to make some stratification of the way in which we treat cars, and that itself leads to the sort of distortions you see in the ads in the papers which say: "Buy this car because the tax is cheaper."

Exactly the same sort of issues arise in relation to pensions. If an employer promises to give an employee a pension when he retires, we should not tax the employee there and then. We should not treat cash put aside for retirement in the same way as a salary. So we have to have some rules to ring-fence money put into pension funds.

What about the self-employed? The self-employed will complain unless we create some ring-fenced rules to allow them to put money aside. I know Patricia Hewitt is aware of the problems that this has created in the complexity of pension schemes. And, again, it is a good illustration of where seeking to be fair progressively, over a period of time, for the various groups who say: "We want to be treated equivalently to people who are in equivalent situations," has created a much wider unfairness and burdens on business, individuals and the economy.

So, the first of my two points is that we need to balance achieving fairness of tax treatment with avoiding the unfairness of complexity and regulation which comes from being, if you like, too fair. You can be too fair in tax.

Using tax breaks for economic intervention

The second point is that if we use, or try to use, the tax system to right wrongs, or to correct perceived economic failures, this creates a further and deliberate unfairness. This is the lobby-group point, and it is relevant to the film industry and, with respect, manufacturing.

Why do we need extra capital allowances? What happens? It goes against horizontal equity. We favour some businesses and activities by treating some tax payers better than others or, in the case of smokers, worse. Achieving fairness generally is difficult. Achieving fairness of this kind is absolutely impossible, and you only have to look at what has happened.

I am sorry to go on about the film industry, but it is an absolute disgrace what has happened in terms of tax reliefs to the film industry. Incidentally, the Conservatives were just as guilty of this; this is not a political point in any way. But the tax relief announced in 1997 said it would cost £15 million; it was widened to cost allegedly another £50 million in 2000; and in 2001 or 2002 it was stopped because abuse of it was costing £329 million.

This is what happens if you say: "Right, this group of people will pay less tax." Everybody piles into that group; they find ways, using accountants and lawyers, to take advantage of this hole which the government has cut in the tax system. It is dangerous to move away deliberately from fairness by saying: "If you fall within these written rules, then you do not pay tax, or you pay much less tax." And the rules are inevitably written by parliamentary draftsmen in their own arcane way. It is a recipe for disaster.

But it is worse than that. It is not just a matter of creating loss; it creates unintended consequences. It diverts activity. It cannot be targeted. It is abused. It creates "me toos"; it creates other groups of people who say: "Why have these people got it?" And, above all, it creates complexity of the tax system.

So, while it may be justified by some economic arguments – although I would dispute that, in virtually every case – it very rarely works and it creates its own, unintended unfairness.

This comes back to Patricia Hewitt's point about the unpleasantness of competition. Competition is unpleasant. The government has made the mistake too often of saying: "Yes, there is some unpleasant competition and we are going to use the tax system to rectify it."

Now, I do appreciate that there are some quite difficult political tensions here, because social issues clearly are a major factor. There is a need to do something about inner cities and disadvantaged areas; I do not think any of us would argue with that. However, my argument would question whether using the tax system to create its own deliberate unfairness is ever going to cure that.

I have talked about business taxation, but the logic behind what I have been talking about applies to all financial dealings between citizen and state: TV licences, road licences, council tax, etc. And some of these points also apply to payments the other way, such as benefits in tax credits. Abuse and complexity can apply just as much at that end as it can at the business tax end.

Conclusion
There are two points. One is that some unfairness in all taxes has to be tolerated because, if we try to be too fair, we actually create unfairnesses of itself. The second point is that the tax system is inherently unfair – we are taking money away from people – and we should not add to this by more deliberate unfairness in the name of economic intervention.

Business and government cannot have it both ways. Taxes are there to generate funds for government. If you want simplicity and efficiency, if you want light regulations, then some unfairness will follow. Governments should, clearly, never seek to be unfair, but they should not be too slavishly fair either.

Wilf Stevenson
Not to be political about it, but the starting points of those film tax abuses that Edward talked about were the 1990 summit on the film industry held by Mrs Thatcher, and the 1992 measures introduced by Norman Lamont.

It is difficult to get an exact sense of where the main debate goes, but what comes across very strongly is that you have to be clear about the outcomes you want from this, and what measures you are using to define the outcomes.

Discussion

John Pickering, Labour Finance Ministry Group
On the question of employment law, I help to run a global SME and we have no problem with English employment law. In fact, all our overseas employees are on contracts of employment governed by English law, and we find that very favourable. I am not saying this just because I am a loyal Labour Party person, but because it is good for business.

Secondly, as one of the architects of the telecom regulatory regime in the early 1980s, I would like to ask: What lessons do you think we have learned about utility regulation in the meantime, bearing in mind that we have a substantial management weakness, even insolvency, in rail, telecoms, energy and the Post Office?

My feeling is that the word “competitiveness” is a slogan that has not served us well. It can drive us too far down the road of “the market knows best”, and I really prefer some of the emphasis that we have in France and latterly in the US, where we talk more about the need to regulate so we have financially strong and viable companies.

With that emphasis in mind, I ask myself whether our rather macroeconomic regulators have been so realistic as to understand that necessity. After all, we are talking about the lights going out and rail accidents. All these big things cost us billions out of our own Treasury, and I wonder whether the subcontracting of the management interest out of the regulators has served the national purpose as well as we had hoped way back in the early 1980s.

George Kessler, Managing director, Kesslers International
I run a fairly small, 300-strong design and manufacturing business. I want to make a couple of points on regulation, first of all about the distraction that regulatory environments cause.

Ensuring that regulation is implemented is a major distraction on management time. Good firms – and Patricia is right – normally have implemented the type of environment that the regulation requires. But putting it into statute creates the need for documentation. And we also need to provide proof to avoid litigation. We are becoming an increasingly litigious society, apparently an import from the US.

The connection between regulation and education seems to be missed, in the sense that there is now an industry of educating industry about what the regulation means, before it, after it and also during it, as the law makes it clearer. Something needs to be done there to take that totally unnecessary cost out.

Mark Goyder, Director, Centre for Tomorrow's Company
I want to talk about an area of regulation where there has been a huge overreaction by government, and where there has been a tremendous departure from regulation by the values that Patricia Hewitt was talking about, to regulation by compliance.

I am talking, of course, about the US government, and particularly Sarbanes Oxley. That was a very interesting illustration of the pendulum effect, where business loses its licence to operate, and what you get instead of informal regulation is a heavy overreaction. As somebody pointed out to me, if you are a US chief executive and your accounts are in trouble, it is better to shoot your finance director because you will only get 12 years for that.

I am part of a group that the DTI has put together, looking at how the materiality concept is going to operate within the Company Law Review. Here we have a piece of regulation that is saying to business: "We are not going to tell you exactly how you are going to report. We are simply saying to you that society expects certain things from you, and shareholders in particular expect certain things from you, so that we can understand what you are doing and where you are going.

"But once we have set out that very broad framework, you are going to have to go through the rigorous effort of working out how you are going to describe what you are there for; how you are going to describe what you stand for; how you are going to describe your business model and your key relationships; and how you are going to account for your progress with real and tangible measures."

That is going to be extremely hard work for business, but it is the kind of hard work that is aligned with leading and governing a successful business anyway. I hope that we maintain this balance of flexibility and rigour, because it is an important model; and it is a model that I believe could do with some migration in the European context. It is a model where we actually do see values-led rather than compliance-led approaches, and it is something to cherish. I am really asking for affirmation from the speakers here that this is, perhaps, a good example of regulation and something to build on.

Response: Rt. Hon. Patricia Hewitt MP
I completely agree with what Mark has just said, and, of course, we are having some interesting discussions with the American administration at the moment about dealing with the extra-territoriality problems that rushed legislation has caused.

The first question was about what lessons we have learned on utility regulation. Let me single out a few. One is that it is much better to have a board than to have one regulator. Some of that very personalised regulatory conflict that developed in the 1980s between the regulator and the incumbent is very unhealthy. We are moving away from that as we get boards in place within the regulatory bodies.

Secondly, on the railways issue, we should keep it as simple as possible. The fragmentation of the railways industry with that particular model of privatisation was a disaster. We thought we could make it work; we could not. We are now having to reorganise the whole thing.

Thirdly and crucially: Do not blame regulators for lousy management decisions and poor corporate governance. There is a temptation sometimes to do that.

The Royal Mail situation, for instance, was, frankly, an example of a company that had been poorly run for a very long time and which had got into a cosy relationship – not with the regulator, because that is quite a recent development, but between management and the unions, where they simply went on putting up the wages in anticipation of productivity gains that generally never materialised.

Government colluded by simply continuing to put the prices up, because it was a system of back door taxation as well. The result was that eventually cost outstripped revenue and we got to the point of financial crisis.

That has now been changed. I think the regulatory framework there, although it is uncomfortable for the incumbent, is going to deliver. And it is starting to deliver, through greater competition and a better service for customers.

The Royal Mail is a very interesting model because we have got a publicly owned company within an increasingly competitive framework, and with a regulator in place. We are having to learn how to operate a new set of relationships that involves, for instance, the DTI having twin roles: one as guardian of the policy framework; the other as shareholder in the Royal Mail.

It is an unusual situation, and we have to be very careful about keeping the roles separate. My feeling is that we are doing it quite well. We have put new management into the Royal Mail and it is getting its act together; and as shareholder we are now stepping well back and not doing the kind of micro-management that used to go on in the past and which did not help the situation at all.

As far as energy regulation is concerned, the lights have not gone out in Britain. When we had a very bad storm last autumn, some companies coped very well. Generally, these were the companies that had done a lot of tree felling, but had also prepared for the storm and had got people on hand ready to deal with the problems. There were other companies that coped remarkably badly, so lessons are now being learned from that. The regulator, among others, will make sure the companies take the right action.

In California, there was a very sharp lesson of regulatory failure where the regulators were holding down retail prices, allowing wholesale prices to rise, and the whole thing just collapsed. There may also have been some market manipulation going on, but there was quite clearly a regulatory failure there. We have not had that.

Clearly, we cannot simply say: "It has not happened, so therefore it is never going to happen," particularly as we have become more dependent on imported energy. We think the regulator, government and the National Grid, the network operator, have got to work very closely together to ensure that, as far as humanly possible, we spot warning signals in the system, and take action that is needed to prevent either a regulatory failure or, for some other reason, a supply failure.

On George's point, I think there is a real problem here. I run a small office in my constituency. I have spent most of my working life running small organisations. Employment law, to take that example, is very complicated; and employment tribunals, which were envisaged originally as an informal system of sorting out problems that had not been sorted out in the workplace, have become a great lawyers' paradise. And the law has become very complicated through the development of case law as well as statute.

What do you do about this? Some people say: just sweep away employment protection. We are not going to do that because, though there are very good firms around who would go on treating people well in the absence of law, there are far too many who would not. There are real horror stories out there, so we have to have the law there to protect people against the bad bosses. The best approach, of course, is to get the disputes resolved within the workplace.

On the Continent, there is very expensive collective bargaining that happens through the collective bargaining system. In Britain we have much less of that tradition of collective bargaining. Even with our new employment relations law and a thousand new recognised union agreements, we still have a lot of the workforce who are not in a trade union, and so you do not get that process of the union and management sorting the thing out.

This is why, in the last employment law, we eventually introduced a very simple default procedure for resolving grievances and disciplinary issues inside the workplace, to try to reduce the number of cases coming from SMEs into tribunals. The cases impose not only costs on the SMEs but also quite substantial costs on the individual and the taxpayer. It is not a perfect solution, but it is what we are trying to do.

Response: Ian Russell
I have two brief responses to the comments that were made. At Scottish

Power, as a New York listed stock exchange business, we were delighted to discover that we were compliant with pretty much everything that needs to be done on Sarbanes Oxley. We just had to rearrange some of the paperwork and the processes to demonstrate the outcome. Given our already good British practices, I felt the regulatory burden of compliance was relatively light. But I would strongly agree with Mark's point about encouraging UK regulation to retain its flexibility.

The comments from Mr Pickering on the utilities were interesting. The last 10 years have, by and large, been very successful at driving inefficiencies out of utilities and lowering customer prices accordingly. There have been some failures – there always will be – but the last decade or so has been quite successful.

However, I think we are at a turning point. The Railtrack example and, to some extent, the storms in East Anglia in the autumn illustrated that in driving out inefficiencies we have also, to some extent, driven out investment. We have got efficient businesses that are world class and stand up very well by comparison with our peers. We should be proud of the UK utility industry. But we now need to turn the wick up on investment.

When we get to the periodic reviews in 2005, particularly for the infrastructure businesses, there is a need for investment, and that investment needs to be funded by equity. The big problem that the 1990s brought us, both as individuals and as companies, was that we all thought we could gear up to the hilt and it would all become wonderful; and the fact is, it is not. Infrastructure businesses need equity, and that, to me, is the key turning point we have reached.

Response: Edward Troup
This is slightly outside my area, but I think the recognition that there are areas where voluntary regulation is the best way forward is an acceptance of the fact that life and business are extremely complicated and you cannot legislate for everything.

Clearly, you cannot have voluntary taxation, you just do not get it. But if government is prepared to recognise that that there are areas that are very difficult, it effectively is confirming that point I made, which is that you do have to accept some unfairness. There are some areas which, in regulation, you can cover with value-led or voluntary regulation; in tax, you just have to say: "I am sorry, we are not going to deal with that."

Dr Hermann Hauser, Amadeus Capital Partners
I would like to make a point about the efficient use of tax money, because part of the fairness is also that the tax that we collect is used efficiently. Both Patricia Hewitt and Ian Russell have made the point about how important innovation is in this country. We all know that we have got outstanding universities producing excellent, innovative results but, unfortunately, these innovative results are rarely translated into a commercial success – or much less efficiently than they should be.

We also have a well-developed venture capital industry in this country, but it finds it very hard to invest in businesses that come out of universities because universities just do not know how to present these businesses to the venture capital community. This leads to a real gap, especially during the very early stages of seed financing. And it is partly because we do not train people at universities in how to write a business plan, or how to get their businesses into a shape whereby they can take full advantage of investment.

David Arculus, Chairman, Severn Trent, and Better Regulation task force
I have paid tribute to Patricia Hewitt recently for the work she has done in the DTI on developing some of these counter-cultural levers, and particularly the work on alternatives to regulation. But there is a great deal of unevenness when we look across the various ministries as to how far they have gone with these agendas.

Patricia talked about the need for culture change in both the civil service and with ministers. My question is: How can we get a more even performance across Whitehall, because these ministries all affect business in different ways?

My second point is about governance. I very much welcomed what Patricia said about regulatory boards for the economic regulators but, of course, there are huge numbers of regulators, affecting both business and the public sector, who are not economic regulators. Those independent regulators, with blurred lines of accountability and varying levels of transparency, are introducing a lot of friction into the system at the present.

Linked in with that, there has been a lot of heat and not quite so much light created by the Higgs report, which is actually giving more power to the institutions over business. That may well be right, but we do have to recognise that the governance of those City institutions is extremely uneven. If we introduce more power into institutions that do not have transparent governance, we are introducing a different kind of instability into the system.

Professor Sheldon Leader, Department of Law, University of Essex
I have a small question for Mr Troup about the role of exceptions in tax policy. While it is a small question, it does go to the heart of some of our puzzles about regulation. You portrayed the rationale for the tax system as revenue raising and, if that is your starting point, it would naturally follow that you would see exemptions of various sorts as reluctantly conceded. They are the kind of unfairness you said we should put up with, but the starting point is against it rather than for it.

The alternative way of seeing the tax system would be both as revenue raising and as a tool for shaping social institutions for implementing government priorities, be it about the film industry, be it about families, etc. Now, on that second approach, the exemption would be seen as part and parcel of the strategy of the tax system.

Your approach to implementing a goal of favouring, say, the film industry might be via a subsidy quite outside the tax system: say, a cash allocation. The alternative would say: “No, let us subsidise via the tax system, via the grant of the exemptions.” I wonder if you could address that issue?

Peter Lehmann, Chairman, Energy Saving Trust
I would like to ask a question about the independence of regulators. Independent regulation has certainly brought huge benefits, but there are also some drawbacks.

For instance, it can be more difficult for government to implement its policy objectives – and I am thinking in particular of energy, where in recent years we have seen a regulator making different decisions to what the government might. They are his decisions; they are not things imposed on him entirely by his duties. And he is making decisions about the balance between keeping prices low now, and seeking environmental gains in the future. I wonder if we can hear from the panel about how they see this going forward.

Response: Edward Troup

I can probably deal with Hermann Hauser's and Sheldon Leader's points together, which is to pick up the issue of venture capital and businesses coming out of universities. One of the proposals that has been put forward by a number of bodies – at least one of which I am involved with – is to say that there should be some sort of tax break for qualifying kinds of investment in venture capital start-ups coming out of universities.

My answer to Sheldon Leader as to whether this is a good thing is, I am afraid, based on over 20 years of bitter experience as to what actually happens. What happens is that businesses are motivated, by and large, simply by maximising their return. They are also driven very much by the desire to do what they want to do where they think they are going to make money.

So they will not say: "This is a great opportunity that government has offered, let's change our strategy." They will say: "Can we do what we are doing already, in a way which falls within the rules that government has designed?" So you have an enormous dead weight cost; you give a tax relief, and lots of people go on doing what they were going to do anyway, but they have now got a subsidy from government; and very few people change their behaviour. And you have all the unintended consequences, the complexities, and the abuse which any rule-ridden system is open to.

So, if we do feel there are economic failings, whether it is in the venture capital field or anything else, I do believe reluctantly that cash subsidies are the best way forward. Now, we do not like giving cash subsidies because we have to leave civil servants to make decisions and write cheques, but that is exactly how it should be. We know that government is not good at picking winners, and we should only write cheques if we are absolutely certain that it is necessary to do so. We should not leave it to the imperfections of the market, because in tax avoidance the market is very imperfect.

Response: Ian Russell
I thought the point about the Higgs report and the governance of the City institutions was a really crucial point. I imagine everybody at this seminar has, through their pensions, an interest in the prosperity of British companies. Seventy per cent of British company equity is owned by us, the pensioners; and the institutions in the City are really our way of directing the traffic in a large sense. In introducing the Higgs report and integrating it into the combined code in the summer, there are opportunities to introduce a degree of governance over our pension fund money.

The other comment on the independence of regulators was a crucial point. From our own perspective, the separation of the chairman and chief executive role at OFGEM is an extremely important and good move. From our point of view, OFGEM is very much the link between government and society's aims – the outcomes that the secretary of state referred to earlier – and what we can deliver through our enterprise.

I believe there are now strong needs to broaden OFGEM's remit beyond being purely an economic regulator, if we are going to succeed in delivering the energy white paper, because OFGEM is that key conduit between government and the companies. That would be a very strong way of making sure that regulation delivers what we as a society want to achieve.

Response: Rt. Hon. Patricia Hewitt MP
David asked how we spread better practice across Whitehall. The regulatory panel – the accountability panel – has quite an important role here. I speak as a former junior minister hauled in front of it. It is very salutary to get ministers and, indeed, heads of some of the agencies up in front of a very tough panel of ministers and others saying: "Why are you doing this? Why do you need to do this? It is costing too much," and so on and so forth. That is very helpful and that is culture changing.

Another way to change the culture is something I have done in the DTI. All my senior officials have to spend at least one week a year in business, preferably a smaller one, so that they get a sense of what this is like at the coalface. I am moving that down the department gradually. Spreading that out across into other government departments would be a very good thing indeed, and probably the best way of getting the mindset change to "think small first".

On the issue of non-economic regulators, there are some very good practices there as well. For instance, the Foods Standards Agency works in a wonderful way: it is very open, has a lot of open meetings and puts masses of stuff on its web site. It works rather like the Genetics Commission and the various medical ethics bodies in really trying to engage the public in a conversation about some very difficult issues. We are all learning this stuff, but there is some good practice among the non-economic ones.

Can government continue to achieve its policy objectives? There will be some situations where we are giving almost complete power in future to the competition authorities on mergers. There will be situations where we would have taken a different decision, but we think it is right to take the politics out of it.

The question is much sharper when it comes to Peter's point about low prices now versus environmental improvements from investment later, and I thought Ian's point earlier was absolutely right. There are two things we have to do as a government: one is to ensure that, wherever possible through a market mechanism, we are actually integrating the environmental goal into the operation of the market. We will put a price, in effect, on carbon and, by driving the cap on carbon-dioxide emissions down, over time, the price will go up and we should be able to get a large part of our carbon-dioxide goals from that. It will not need the regulator, apart from us deciding what the cap actually is.

The other issue, without overcomplicating the regulator, is that there are markets, including energy, where the regulator has got to have environmental goals as well as purely economic ones.

We looked at whether we needed to rewrite OFGEM's statutory objectives. We only wrote them about a year-and-a-half ago, so we decided we would not rewrite them just yet. We may have to come back to that, but we do have the power already to give OFGEM environmental guidance.

The guidance that they are currently operating under is, frankly, quite weak and does not reflect the thinking of the white paper. OFGEM is perfectly happy with the idea that, in effect, we say: "Here are our white paper goals; we are not going to tell you how to do it, but these are the goals." For instance, if we are going to have an awful lot of distributed renewable electricity generation, then that stuff has got to be able to come to market, and that has implications for infrastructure investment. It is not for us to say: "Thou shalt invest," but it is up to the regulator to make that investment possible.