THE DISMAL SCIENCE?

Is economics influential enough in government decision making?

Vicky Pryce

INSIDE

*Inside*OUT

A series of personal perspectives on government effectiveness

INSTITUTE FOR GOVERNMENT

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Foreword

Economics is at the heart of the most pressing issues facing Government, and it is vital that good economic advice is available to ministers. More generally, how government employs economists, and how they work with the other professions within departments, is a live concern. This is why we are delighted to publish Vicky Pryce's thoughts on how economists are used in government, and whether they and their profession are influential enough. Vicky is ideally placed to consider this question, having held some of the most senior economics posts in government.

I hope Vicky's paper sparks debate both about the role of economics in government and about the wider use of professional skills in Whitehall.

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The Rt. Hon. Lord Adonis, Director, Institute for Government

About the author

Vicky Pryce – Vicky Pryce is a Senior Managing Director in FTI's Economic Consulting practice, and is based in the London office. Vicky joined FTI in September 2010 and leads on business economics, working with leading companies on issues from corporate strategy to public policy. Prior to this, she was Director General, Economics & Chief Economic Adviser, Department for Business, Innovation and Skills (BIS), 2002-2010 and Joint Head, UK Government Economic Service, 2007-2010.

Vicky is a member of the Secretary of State for Business Panel on monitoring the economy and also a member of Vince Cable's Business Advisory Group.

Before joining the civil service Vicky was Partner at London Economics, Partner and Chief Economist at KPMG, Corporate Economist at Esso Europe and Chief Economist at Williams & Glyn's Bank (later RBS). She was also instrumental in the creation of GoodCorporation, a company formed to promote Corporate Social Responsibility.

Vicky is a visiting Professor at the CASS Business School, a fellow of the Society of Business Economists, Adjunct Professor at Imperial College Business School and a visiting Fellow at Nuffield College, Oxford. She is on the Council at the University of Kent and on the Advisory Board for the Centre for International Business and Management (CIBAM) at the Judge Institute at Cambridge University. She is also a member of the Standing Advisory Group of the Financial Reporting Review Panel (FRRP), and of the International Advisory Board of British American Business Inc (BABI). She serves as a Fellow at the RSA and a Freeman and Liveryman at the City of London and has just become the first female Master of the Worshipful Company of Management Consultants. She is also on the Board of Trustees at the Centre for Economic Policy Research (CEPR) and Patron of "Pro-Bono" Economics.

About our *Inside*OUT series

There is little systematic attempt to capture the knowledge and insights of people who have worked closely with government and share them with a wider audience. The Institute for Government is keen to remedy that. Our *Inside*OUT series gives people with an interesting perspective on government effectiveness an opportunity to share their personal views on a topic that sheds light on one of the Institute's core themes. The Institute for Government is pleased to be able to provide a platform to contribute to public knowledge and debate, but the views expressed are those of the author.

Introduction

Economics as a discipline is fundamentally about ways to allocate scarce resources. As scarcity of resource is a perennial issue in public policy, this means that economics has much to offer to those responsible for resource allocation both at the official and the political level. Governments are typically either spending the public's money or are asking (or forcing) citizens and businesses to spend their own time and money in ways deemed to serve the public good. In a democratic society, it is essential that such decisions are transparent and consistent and explained in ways that enable Governments to be held to account. It is therefore my contention that economists, whether or not you regard them as proper scientists, and whether or not you regard them as dismal, are true friends of good government and democracy.

Historical perspective – links between politics and economics as disciplines

Politicians and indeed officials need to make policy. Sometimes it is in response to particular events, sometimes it is to try to improve things, sometimes it is just because a 24/7 news cycle demands it. They have to decide on changes to programmes, to adjustments in total expenditure, to the allocation of available spend across departments or programmes within departments. They have to work out what works and what does not, how to evaluate and assess it.

In sum, in economists' language, they are probably trying to maximise social welfare (although their view of what that is varies with their politics).

Politics and policy making has been going as long as history. It is not always scientific or even pseudo-scientific. Strong rulers often just insist. It is not known, but pretty doubtful that Alexander the Great looked at much economic analysis before deciding which country to invade next. The Romans may have had some sort of cost benefit going on in their minds when they decided between roads and forts, and between Spain or Turkey. But sadly we have no text books form the period to look at. Machiavelli was not that interested in marginal cost or Pareto optimums.

Economics on the other hand is quite a young discipline – although the rod is Greek, like everything else of importance, it is often traced in its modern form to Adam Smith on the micro side and to Keynes on the macro. It is basically about trying to think of how to allocate resources when there is rationing (i.e. always).

Economists like to think it is a science – and have tried to ape scientific method whenever it can. That is all to the good – it brings a rigour and clarity of thought that is often missing in similar disciplines.

But in fact it is clearly a social science. There are no absolute laws. There are no 100% 'controlled experiments'. Indeed the outcome of an 'experiment' can be different at different times – because of the pesky habit of people not to always act in the same way. So lower interest rates usually mean we get more demand – but not if, as now, the rest of the economy is nose-diving and if consumers, businesses and investors just don't trust the future. Which in itself puts boundaries on what the latest economic fad, behavioural economics, can tell us in terms of helping us to predict

the future. Frankly, not a lot in my view- and I risk here being ostracised by a large part of the UK academic economic establishment for saying so. .

But the politicians want action and they usually want it quickly. They also want certainty about the impact of their actions. It is easy to see therefore why the relationship between the world of policy making – and politics – and economics will never be an easy one. In politics there is a need to make decisions, and to a timetable, and once having made them – however uncertain the evidence really was – to argue for it, not accept any doubts, not wait for the results of lengthy randomised control group experiments. At the decision point, the economist who tells the decision maker that 'it is all very difficult and uncertain' is not much help and will soon find themselves not invited back.

How influential have economists in Government been?

In some areas economics has been very influential. Corry (2008)[1] for instance points from his experience on both sides of the fence as a civil servant and special adviser to areas where economists have played a serious role in shaping policy. These include areas such as the shaping of the macro and microeconomic frameworks; game theory and time consistency (leading for example to the setting up of an independent MPC); the role of incentives, accountability and governance; and to the huge improvement in impact assessments and evaluation techniques in government to assess the net effects of policy (i.e. accounting for things that would have happened anyway or just displaced other activity). I could extend this to cover the influence economists have had in proving the long term benefits of competition and deregulation in various areas (not all) and also in free trade and elimination of tariffs. Corry though argues that there are many areas, which to me seem to cover issues where political ideology seems to play a larger part, like welfare economics, the design of public services, the allocation of expenditure and equity issues, Corry argues economics and economists have been less influential on policy.

But another problem for economists, and even more so for the policy makers that work with them, is that economists do not always agree. It is no accident that there are so many jokes about economists although scientists also disagree, though maybe not quite so often. Such disagreement is pretty transparent at present in terms of macro-economic policy. On micro policy there is more consensus because most economists are rather conventional and of the 'neo-classical 'school. So they take on board all the elements of this – that markets are basically a good thing, that they are generally rational, that interventions and subsidies distort, that taxes are bad for work effort and so on. At times they also assume that the market works perfectly.[2] But economics per se does not say that – only a particular branch of it. At some points the more extreme versions of the market paradigm may have become too powerful in policy making, not only during the Thatcher years but

[1] See Dan Corry, 'Economics, government, policy and politics: reflections from the front line' (2008); available at http://www.qmul.ac.uk/media/docs/corrylecture.pdf

[2] As in the joke 'How many Chicago School economists does it take to change a light bulb? A: None. If the light bulb needed changing the market would have already done it.'

also arguably under Labour.[3] But although there has been a move away from that following the financial crash of 2008, there is no doubt that economists do bring a certain amount of baggage to issues which they would claim are based in the profession but others might argue were just one way of looking at the world. But then of course the danger emerges that once you start no longer believing in efficient markets do you then extend this to all areas of economic activity, thus justifying extensive regulation and intervention in the markers? Surely not. And in any case how does that sit with the attempt to reduce the size and role of the state which is what the Coalition government is supposedly trying to achieve in line with mostly Conservative and Liberal ideologies, (admittedly aided in this journey by the fact that there is an urgent need to cut the budget deficit). Difficult for economists to sort those conflicts based on what economic theory tells us alone.

How modern economics thinks about politics and decision making

Economics likes a world where we have can put numbers on things, where we can then balance out the benefits of a move against the costs and – often with fancy methods of discounting – even compare streams of benefits and costs across time.

This gives rise to at least two problems:

First, because economists can measure lots of different things but not necessarily decide between different priorities, they ideally need what they would call a utility function. In simpler words, they want to know the weights policy makers give in terms of trade-offs. How much efficiency is valued relative to increasing inequality? How much the environment relative to growth; how much regional balance versus aggregate output; how much – whatever the theory of the social time preference or costs of capital may be – do policy makers really value the bird in the hand over 'two in the bush'?

In practice policy makers are unable usually to define at all precisely what their trade-offs are. They sometimes reveal this in the decisions they make (what economists call 'revealed preferences') but in general these trade-offs remain unclear, obscure and certainly non-transparent. In such circumstances decisions often get made on what works fast, brings in money quickly (or costs less), or cuts costs most (and fastest). This can be very frustrating for economists who spend their lives trying to maximise an obscure concept of the NPV – but which rarely wins votes or plaudits from the commentators and so is often rejected by policy makers .

Second, despite all their nice theories, economists have also noticed that their methodical process is not how policies actually get made. Being economists, they have tried to apply economics to work out how decisions are actually made.

One strand of economic theory has looked at how democracies work. In a famous book *An Economic Theory of Democracy* (1957), Anthony Downs explored this giving rise to much of what we

[3] See Corry op cit.

tend to call public choice theory today and to the concept that policy makers and politicians target much of their activity at the 'median' voter. William Niskanen's book *Bureaucracy and Public Economics* (revised version 1971) brought to us the rational choice models of bureaucracy, trying to explain why the civil service did what it did.

But having understood how decisions actually get made, economists are not necessarily in a better place to help and influence policy making. Do they accept that policy makers are never going to behave in a pure, rational, market clearing way and throw in their lot with them, knowing it is imperfect but that their insights and approach to issues will - if only on the margin – make policies a bit better. Or do they stand a bit aloof, trumpeting 'the truth' and keeping pure even if ignored?

The Government Economic Service (GES)

Economists in the UK Government (and devolved administrations) are members of the GES. The GES exists to raise the profile of economics inside and outside Government, to maintain professional standards and, importantly, to co-ordinate recruitment and maintain an internal labour market for economists within Government. I became a member by virtue of joining the Civil Service in 2002 and later became one of its Joint Heads.

The GES was founded in 1964 although the Government started employing professional economists in economist roles (albeit in very limited numbers) from around the time of the Second World War. The GES has grown in membership over time with significant expansion during the 1997-2010 Labour government, when New Labour's emphasis on making social policy decisions on the basis of 'what works', rather than ideology, led to increased attention being given to data collection, research and analysis.

The GES is co-ordinated and managed by a small central team based in the Treasury. Individual GES members are employed, and paid by, their own Department. As a result, while the GES may express a collective position on issues such as recruitment standards or on professional methodology (such as best practice in how to measure the cost-effectiveness of different public expenditure options), the GES will not take a formal position on policy issues such as whether option A offers better value for money than Option B, because this may compromise the position of GES members working in Departments with conflicting objectives.

The GES also manages graduate recruitment on behalf of Departments. Economists with graduate and postgraduate qualifications are recruited as Assistant Economists centrally, as part of the wider Government Fast Stream recruitment process, and then allocated to Departments, who are responsible for their coaching and development. The Fast Stream status of GES recruits is very important – both for ensuring that economists within Whitehall have the status and development opportunities open to the Fast Stream and for maintaining quality. Although Whitehall has undoubtedly got better at taking analysis and analysts seriously, we still see echoes of a time when analysts were strange people who were put in a cupboard well away from the Minister and only brought out when a number was required.

Economists in Whitehall Departments

All Departments of any size have someone who is their Chief Economist – although that is not always the job title – and their Head of Profession for Economists. The Head of Profession role is to maintain professional standards and to coach and mentor and supervise the internal labour market within their Departments. In some large Departments, these roles might be split in order to ease the burden on one individual. Chief Economists are at various levels of seniority within the Civil Service hierarchy. I was one of two people in Government occupying an economist role at Director General level (the other being the Managing Director for economics in the Treasury, Dave Ramsden). Most Departments had Chief Economists at Director level or at Senior Civil Service Pay Band 1. I am pleased that, during my time in Whitehall, we managed to increase the seniority of Chief Economist posts in a number of Departments.[4] My concern is that Departmental cuts will involve cuts in the number of senior posts, and specialist posts will be seen as an easy win.

In some Departments, economic advice is centralised in a team reporting to the Chief Economist. In other Departments, economists are 'bedded out', with economists placed within multidisciplinary policy or spending teams with responsibility for both policy and analysis. Some Departments have adopted a hybrid 'hub and spoke' model where there is a central team and groups of economists organised in teams supporting the policy and business functions.

There are arguments in favour of, and against, all these organisational models. Central organisation means that the economic advice is provided independent of the policy advice – and in theory is less susceptible to 'capture' – and resource can be shifted as priorities change within the overall control of the Chief Economist. Bedded out teams are closer organisationally (and often physically) to the policy or business teams they work with on a day to day basis. Their advice is more likely to reflect the latest thinking about the issue and to carry greater credibility with the policy team. But the risks are that the economic advice is compromised by the need to maintain harmonious relations with policy colleagues (who may well be writing their staff reports) and – from a central viewpoint – this form of organisational model locks up a lot of staff resource in decentralised teams, making it hard to shift people from one job to another quickly if the occasion demands it. I have come to the conclusion that this is a debate with no clear and settled answer. At some times, and in some Departments, a shift towards more centralisation will make sense. At other times and places a shift in the opposite direction will be the right thing to do. It is important, though, that Departments review their arrangements for economics on a periodic basis – probably as part of a wider review of their analytical functions and the Chief Economist should either carry out the review or be deeply involved in its work. My sense when I left Government was that the need to streamline and reduce costs might push a few Departments towards a more centralised provision of economic advice.

[4] For example, the Home Office and Ministry of Defence, where SCS Payband 1 posts were upgraded to Director level.

Relations with other analytical disciplines

Economists sometimes work in teams with people from other analytical disciplines, most often members of the Government Statistical Service (GSS), Government Social Research (GSR) class or the Government Operational Research Service (GORS). A number of Departments have appointed a senior analyst to a Director of Analysis role, with responsibilities cutting across all these disciplines for the integration of professional advice from various sources.

There is some fluidity around responsibilities of these disciplines and who works within them. Members of one of these analytical disciplines might manage analysts from another discipline. Sometimes the more senior analytical roles have an explicit remit to combine professional advice from all sources.[5] If people have the necessary qualifications and experience they can move between analytical disciplines, or possess joint membership of two services. For example, quite a few people who join the GSS or GSR have qualifications in economics and, if they keep these skills up to date, might subsequently be able to compete for a GES post.

Alignment alongside GSS, GSR and GORS is understandable because all these services have common underpinnings in the social sciences and/or the collection and analysis of data. Economists work less often alongside other scientists although there have occasionally been examples of Departments placing their economists in a management line reporting to the Chief Scientist. In a small number of Departments, the Chief Economist also doubles up as the Department's Chief Scientific Adviser (e.g. Department for Education, Department for Culture, Media and Sport).

How to make friends and influence others as an economist- is it possible?

So, how can economists make themselves relevant to policy? They can have fantastic academic qualifications but if they are not able to help people understanding the environment in which politicians are operating and presenting them with the options that exist to influence future events and meet the ambitions of the party in power they will be ignored. But money needs to be spent wisely and the impact of policy actions on the economy needs to be properly assessed. We have thankfully the sort of civil service that does not change each time a new party is elected. There is therefore continuity and also is serious competence that has been developed over the years. Unlike many other countries in Europe and elsewhere which rely on think tanks to provide them with economic input, this is much less the case here – although think tanks matter too. We have a GES which is as impartial as they come with direct entry criteria and yet, the danger is always that, instead of evidence based policy, one could end up with policy based evidence. This is a world where the evidence is constructed retrospectively to support the pre-determined policy decision and that too many compromises are required to be struck across Departments, reflecting the various different Ministers' priorities. The end result is a poorly constructed policy with weak evidence to support it and which will come back to haunt the various Departments involved – but, quite importantly, long after the Ministers have gone.

[5] Although, in the case of official statistics, there are some responsibilities that only the Head of Profession for statistics within a Department can perform.

When I joined the civil service in 2002 I discovered that in many government Departments the most senior economists were very junior in relation to the policy people they were dealing with and their influence was therefore limited. At times they were severely understaffed in terms of the number of economists and other specialists which again restricted their ability to be heard. That has in most cases been rectified now. But the various external lobbies that were seriously influential in many parts of the public sector remain so. As an economist one has to always watch out for what we term 'industry capture ', i.e. shielding against the fact that the interests of the industry departments are meant to 'be sponsoring' have a disproportionate influence on policy despite the evidence, which gets ignored. While I use the term 'industry capture', a similar process could take place where any external interest group has undue influence. And this is more likely to happen if that evidence is poorly presented and ignored.

A process started under Gus O'Donnell to raise the influence of economists was pushed forward by Nick (now Lord) Stern as head of GES, under whom I served as his Deputy, along with the current head of the Institute of Fiscal Studies, Paul Johnson. And since Dave Ramsden at the Treasury took over as Chief Economist and he and I became Joint Heads of the GES for three gloriously fun years, the seniority of GES Chief Economists in Departments across Whitehall went up significantly, the GES board was further strengthened and through these moves and the mutual support the economics profession working with the other disciplines, including the physical and natural scientists, became increasingly relevant.

The recession in some way helped- it was, if one may use these terms, a 'good crisis' for the economists in government as we all felt wanted and needed. The National Economic Council (NEC) Officials Group that was set up to support the Cabinet NEC itself was an obvious demonstration of that. The NEC Officials Group, chaired by Gus O'Donnell , Cabinet Secretary and Nick Macpherson , Treasury Permanent Secretary, consisted of the Permanent Secretaries of the relevant 'growth' departments and also the two Joint heads of the GES, Dave Ramsden and myself. The need to get proper and topical economic advice was paramount. So was, at the time, the willingness of all to experiment to get the economy moving again and various policies were tried when the outcome was not so clear given that we were living through circumstances not experienced by anyone round the table before. And the politicians were prepared to experiment again. We as civil servants had to demonstrate that we aware of the rough implications of these options and used theory and experience to assess possible outcomes. The current troubled external environment, which has direct implications for the UK and the impact of the deficit reduction plans, should mean that economic advice is crucial. But there are cuts across the public sector and analysts cannot be immune. And yet the need for good advice is more needed than ever. Economists therefore need to make themselves as relevant as they possibly can. Here is a rough guide:

1. Sort out their theories- or at least don't make differences visible and engage external research establishments as allies (academic and think tanks)
2. Approach what they were doing in a way that leads to influencing a policy decision- not just research for its own sake
3. Be visible
4. Argue things in a language that is easily understood

5. Be seen as part of the decision making process in the Department focussing on value for money, working closely with finance directors
6. Withstand pressure to change views from policy colleagues/politicians unless new evidence becomes available
7. Insist on proper evaluation of policies, something that gets easily forgotten.

To sum up

The various Departments have to translate manifestos into policies and achieve the Government's aims. That is clear. However within this confine it is the duty of the civil servant to ensure that their Permanent Secretary can stand up in front of the PAC and the NAO and generally parliament and his/her cabinet colleagues and be able to declare that the nation's finances have been wisely spent and that the impact of various measures on the economy were properly assessed before various policies were set in train – and that they are being evaluated and monitored.

The role of the economist in this is clear. It is to find the proper evidence relevant to the issue and to advise Ministers on what it says – and to be clear where it does not exist. He or she might also need to advise which other options should be considered and the evidence for and against them. In some cases, it may become clear that a Ministerial decision is not supported by the evidence. Ultimately this might mean insisting that a 'direction' is given by the Minister for whom they work (i.e. that the Minister 'directs' the Department to do something they would not otherwise advise doing) and that direction is a sign, when it comes – as it did in my case a number of times – that one was doing one's job properly. As I said in my leaving speech from BIS, if one is loved by all policy makers as an economist in the civil service then one is definitely not doing their job properly.

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