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Trust and Transparency in Public Life and Business

As I am sure you will all understand, the preparation of this lecture has cast a shadow over my life almost from the moment the Vice-Chancellor did me the honour of inviting me to give it. I have been acutely aware that each of my two predecessors at this podium was President of the Royal Society at the time of delivery. That sets a very high bar. Another factor has weighed even more heavily on my mind. It is that this lecture is my valedictory after fourteen years holding an office of which I am immensely proud and that continues to give me very great pleasure. I still have a number of duties to fulfil and look forward to them with eager anticipation, but this lecture occupies much the same position in my Chancellorship as does an autobiography in the lives of those who write them. There is more to come, but it is in the nature of an afterword or an appendix.

The only aspect of the preparation with which I have had no difficulty is my choice of subject. At a very early stage I decided that of those I might be qualified to speak on, the issue of trust in public life and business – what's gone wrong and what to do about it – is by far the most important. We British pride ourselves on the ethical standards of our public life and business. We like to believe that we set a benchmark for others. The whole nation has, therefore, been shocked by the rash of crises that has hit so many of our great institutions. Parliament, government, the press, the police, the BBC, banks and leading companies have all in one way or another been scarred and are grappling with the consequences. Each has its own characteristics. Some have involved criminality, but most not. All, however, have given the public ample cause to feel that the behaviour of those involved has fallen well short of what we have a right to expect. Institutional and personal reputations have suffered, confidence in the probity of our public life and business has been diminished and the lives of some of our fellow citizens have been damaged.

In this lecture I won't cover everything that has happened. It would be too much. Rather I shall confine myself to those fields where I have some first hand experience. Since I started my first job in 1960 I have been a journalist, a politician and a regulator. I have chaired a British bank and been involved with a US investment bank. I have chaired a FTSE 100 industrial company and been a director of several other major companies. It is, therefore, on the scandals and issues that have arisen in these spheres that I will concentrate. This still provides, I am afraid, a substantial agenda. I shall deal first with MPs' expenses, then with the cat's cradle of issues involving press abuses, the power of the Murdoch organization and the nature of that organization's relations with ministers and the police. After that I will tackle the bankers and conclude with the explosion of top executive pay in our leading companies and some of its economic and social implications. I will discuss the origins and salient features of each of these phenomena, draw conclusions and, where I can, suggest remedies. I should add that, like others looking back over a long career, I cannot claim that I always saw so clearly at the time what I see now nor that I always thought what I think now.

Before getting down to the substance of what I have to say, I think it is important to establish some historical context. To those who think we are entering a new dark age, I would point out that while there have been better and worse periods in the past there has never been a golden age. A few examples drawn from different decades of the 20th century will, I believe, demonstrate this.

My first is the so called Marconi Scandal that occurred in the years before the First World War. Several senior ministers in Asquith's government, including the Chancellor of the Exchequer, David Lloyd George, were found by an enquiry to have used inside information to engage in improper though not illegal share dealing. Today they would lose their jobs, but they were able to remain in office. In the event it was fortunate that they were, as Lloyd George went on to become our great war leader. After 1918 he continued in office as the Liberal leader of a largely Conservative coalition. As such his political base was very short of money, a defect he sought to remedy by the sale of peerages and other Honours through the activities of his notorious and oddly named aide Maundy Gregory. After the collapse of the coalition he never returned to high office, but this was not the reason and there were times when he was thought to be close to making a comeback.

Those scandals were public knowledge. My next example wasn't and speaks volumes about the standards of the 1930s. When Sir Samuel Hoare became Foreign Secretary in 1935, Lady Hoare told their friend Lord Beaverbrook, who owned the Express group of newspapers, then a great power in the land, that they would find it hard to manage on the salary. So Beaverbrook kindly came up with a subvention. Although recent Prime Ministers and the present one, as well as other senior ministers, have been far too close to the Murdochs, I can't imagine such a thing happening today.

Next a purely business example from the 1950s: As a schoolboy in austerity hit Britain I well remember the press coverage of Sir Bernard and Lady Docker. He was chairman of BSA, at that time a major company that owned Daimler cars. In 1951 he famously presented his wife with one of its limos covered with 7,000 gold stars and with the plating that would normally have been chrome in gold. Finally, and because of its resonance with today, I would remind you of the Secondary Banking Crisis of the early 1970s. One enterprise to go down that is still regarded as a classic case of fraud and regulatory failure was London & County Securities of which the then Liberal leader, Jeremy Thorpe, was a nonexecutive director.

So to MPs' expenses, which, looking back, seems to have launched the current cycle. Scandalous it undoubtedly was. Nonetheless, it seems to me to have arisen primarily from a faulty and out of date regime continuing to operate past its sell by date in a private Parliamentary world shielded from public view rather than from a culture of personal dishonesty – though there were cases of that. In essence, it was a matter of expenses being treated as a form of remuneration. The public was understandably shocked when the details were exposed. But that is how it was set up in the early 1970s when I was a young MP. The Wilson government hadn't wanted to accept an independent report recommending that MPs' pay should be linked to a civil service grade. So, as the government Chief Whip, Bob Mellish, famously put it at the time: "Don't worry you will get it all on expenses".

That sounds appalling now and many of us warned against it at the time. But it was not so strange then. With income tax rates of up to 83%, guaranteed expenses on top of salary were a common practice. Indeed I recall being offered a private sector job in the 1960s, before I became an MP, in which the two items were explicitly set out in the offer. In the public sector expenses were often linked not to receipts but to grade. So, if you stayed in a cheaper hotel or travelled more cheaply than your grade entitled you to, you pocketed the difference. Such a system was still in place at the Civil Aviation Authority in 1986 when I became chairman. I got much stick within the organization for abolishing it and insisting on reimbursements being linked to receipts and pay and expenses clearly separated. Quite apart from the intrinsic fault in combining them, the Thatcher government had sharply reduced taxes on income so that there was no longer any justification for the practice.

The pity of it is that the same wasn't done for MPs. Like Wilson, Margaret Thatcher found herself faced with an independent report recommending that MPs' and ministers' salaries should be raised and put on a new basis. Instead of accepting it, the expenses system was embellished after which it was further added to while lax regulation enhanced its benefits. The surprising thing is that the whistle wasn't blown on it earlier. As soon as it was exposed to the light of day it couldn't survive. Individuals who thought they had been behaving perfectly properly were exposed to public obloquy along with those who had been gaming the system. All, as well as Parliament itself, were brought into disrepute.

I draw two conclusions from this episode. One is the critical importance of transparency. There is no more effective encouragement to the sweeping away of outdated practices and to the meticulous observance of rules relating to money than the awareness that at any moment what is happening can be checked and monitored. By that I don't mean as a result of investigative journalism or whistle blowing. I mean that there should be an established set of criteria and reporting procedures open to public inspection on a continuous basis so that investigative journalism and whistle blowing aren't required. The second is the principle of Caesar's Wife. Standards in public life today are more demanding than in the days of David Lloyd George and Sir Samuel Hoare. Those in prominent and leadership positions are expected to set an example. MPs cannot expect to be treated with respect, or even listened to, if they are thought to be on the fiddle. That rather than the sums of money involved, which were modest by banking or even journalistic standards, is the real significance of this scandal.

I turn now to what I regard as the extremely serious set of issues linking contacts between senior ministers and the top team at Rupert Murdoch's News International, phone hacking and the relationship between the Murdoch organization and the police. Here, of course investigative journalism, above all by The Guardian with help from The New York Times and BBC played a crucial role. I pay tribute to those who, against great odds, blew open the story. And I stand in awe of the courage and perseverance of those individuals who felt they had been wronged and, despite being mocked by politicians and journalists, brought cases against their tormentors. The result has been the devastating expose of the Leveson Enquiry.

Taken together and in their totality, I think this cat's cradle of issues represents something altogether new and rotten in our body politic. Phone hacking is by definition new as a result of technological advances. The significance of close relations between successive Prime Ministers and senior ministers of both major parties on the one hand and the Murdoch family and senior executives on the other is of a different order from the past because of the scale of the Murdoch empire in this country. As the advertising slogan has it, size matters. When in 1931 Stanley Baldwin, then Leader of the Opposition and of the Conservative Party, inveighed against the press barons for wanting, in his words, "Power without responsibility, the prerogative of the harlot through the ages", the ownership of the press was in a multitude of hands with influence correspondingly diffused. No modern party leader in government or opposition would dream of throwing down such a gauntlet.

The concentration of 40% of our newspaper market plus a strong position in satellite television in the hands of Rupert Murdoch's company has tilted the balance away from the politicians. This was symbolized by how, when in opposition, Tony Blair went literally to the ends of the earth to make his pitch for support to a Murdoch management conference in the Antipodes. It was shown too by how much more frequent were the contacts between the present Prime Minister and his immediate predecessors with the Murdoch family and executives than were those involving comparable individuals in other news organizations. Above all it was shown by how close that dominant newspaper group came to fulfilling its ambition to become the monopoly supplier of satellite broadcasting in this country.

It is against this background that close relationships at several levels were formed between Murdoch executives and journalists on the one hand and the police on the other. Details have been exposed in the Leveson report and elsewhere. Consultancy contracts were awarded to individuals with divided loyalties, retainers were paid to senior retired officers and expensive hospitality was lavished on senior serving officers. When the police saw what was happening at the political level they followed suit.

Beneath this canopy of interlocking connections two things happened. One was that some of those who worked at the tabloid end of the Murdoch empire came to believe that they weren't subject to the usual constraints of the criminal law or indeed to other normal standards of decency. I am not suggesting that they were alone in that; other journalists and other titles went way beyond acceptable limits as well. But they were the pioneers and major practitioners of the worst abuses. The other consequence was that the police became reluctant to pursue allegations against the Murdoch newspapers with the vigour they should have. The Murdoch group was too powerful and well connected to take on and there were too many bonds of various kinds between Wapping and Scotland Yard.

Since Leveson reported, public attention has been primarily focussed on the setting up of a successor to the discredited Press Complaints Commission. This was the right priority. The protection of private citizens against the intrusions and excesses of the tabloids and the establishment of means of redress for those who are wronged is very important. I hope that the new body, when it finally comes into being, will fulfil the hopes reposed in it. But I want to deal with the question of competition.

At the very least the Murdoch empire in this country must not be allowed to grow by acquisition any larger than it currently is in relation to the media market as a whole. The need to ensure that there are other viable and competitive news organizations must be kept constantly in mind by government and regulators when questions arise relating to the media, as, for instance, over the future of the BBC, BskyB and other television providers. Looking further ahead the government will, I hope consider what should be done if, for whatever reasons, the Murdoch parent company in the US should ever decide to dispose of some or all of its UK assets. The continuation of a 40% share of the newspaper market in the hands of a single owner should never have been permitted in the first place and is now unacceptable. In my view the maximum permissible stake should be not more than 20%. As and when the opportunity arises, steps should be taken to reduce the holdings now in the hands of the News group to this level.

There are those who argue that the problem of media ownership will solve itself over time given what's happening in the electronic sphere and with the development of social media. The catch is that even if that is true, which I don't know, it will take a long time. Meanwhile, for as long as newspapers are important, plurality of ownership is vital both to ensure that a diversity of views can be expressed and in order to guard against an over mighty organization gaining the sort of influence with politicians and the police that we have been witnessing.

As you will have gathered, I regard the dominant position in the newspaper market that Rupert Murdoch was allowed to build up as the key factor behind what might be called the Leveson issues. But this in no way exonerates the Prime Ministers and other ministers in successive governments for their demeaning relationships with the man, his family and his top executives, a number of whom are now awaiting trial on a range of serious charges.

In the nature of things there will always be a symbiotic relationship between media and politicians in which proprietors and senior executives will become involved. That is part of how the world works. To the extent that meetings and briefings take place on a multilateral basis involving several news outlets, I am not worried. It is the private exchanges and relationships between ministers and shadow ministers with representatives of a single group that worry me and it is to those that I want to bring more transparency. I accept that there will always be back channels and informal go betweens. But to the extent that exclusive contacts, whether face to face or conducted in any other way, can be recorded in a manner that subjects them to public monitoring and scrutiny so much the better. It must be up to the party leaders in government and opposition to convince the general public that they have credible systems in place and that their relationship with media groups is on a proper footing.

From the worlds of politics and journalism I turn to business and initially to banking. Here much of what has happened in Britain has been part of a wider world phenomenon, like the boom and bust to which it gave rise. But as the Governor of the Bank of England has said, while banks are international in life they are national in death and regulation must take account of this. So I will deal with the issues in a national context while being aware of the need for remedies to fit into a co-ordinated European and wider international framework.

What has shocked and amazed observers and customers of the banks is the combination of immense personal enrichment on the one side and the scale of corporate wrong doing and collapse on the other. The details surrounding both are frequently complex to the point of incomprehensibility, but the results in both respects have been spectacular. Moreover, just as the story of The Sun and The News of the World evolved from being about a few rogue reporters to the involvement of the most senior executives so with the banks. Time after time it has emerged that in reality, as well as formally, the buck in terms of both financial gain and executive responsibility went right from the trading floor and the neighbourhood branch to the top.

What concerns me here is why it happened. Among several factors, including globalization and advances in information technology, there is one, I believe, that stands out. It is the toxic mix of light touch regulation with a culture of excessive financial incentives for individuals to achieve short term profit and sales objectives. This was most apparent at the investment banking end of the business with its bonuses beyond the dreams of avarice. But it was not only there. In the High Street too and in the provision of some of their most basic services to retail customers banks were caught up in the frenzy.

What has happened is well known. In investment banking there was an efflorescence of imaginative financial instruments and products the effects and implications of which those who invented and promoted them – let alone their managers and regulators – failed to understand. This was combined with a reward structure designed to encourage the maximum possible use and sale of these instruments to counter parties who were all too often equally ill equipped. What happened in the High Street was, if any thing, worse. The banks came to regard their customers as sales opportunities to be exploited rather than as individuals to whom they were providing a utility type of service. At both ends of the spectrum there was, as with the tabloid press, a disregard of rules and ethical standards.

The actions of the tabloid journalists caused immediate damage to the lives of individuals. In the case of banking the consequences took some time to work through the financial system and were less direct, but for many individuals and families they have been all the more painful for that. There has been a ballooning of debt among both corporate and private clients and the economy has been mired in a recession from which it seems unable to escape. As a result companies have failed, jobs have been lost, mortgages have fallen into arrears, young people have been unable to launch their careers and personal incomes and spending power have been sharply reduced. The effects will hang over us for a long time to come.

The restoration of trust in the banking industry and in banking services will be a lengthy process, but change is moving in the right direction. Light touch regulation has been abandoned and replaced by an altogether stricter and more intrusive regime that includes the regulator vetting nonexecutive directors as well as senior executive appointments. In the banks themselves cultural change is under way as industry leaders admit to past errors and vow to turn over a new leaf; a far cry from Bob Diamond's defiant claim that the time for remorse is over. They have considerably tightened up their compliance departments and are laying a new emphasis on ethical behaviour, service and abiding by rather than gaming the rules. The crucial question of financial reward structures is also being tackled. Objectives are being altered to reinforce rather than undermine responsible business practices while bonuses are being curtailed and subjected to greater conditionality. In some institutions bonuses awarded in the past are being clawed back to pay for what has since gone wrong and current bonus pools are being raided to pay the fines being levied for the Libor rate fixing.

All that aside, the business as well as the regulatory environment in which the banks operate, is being transformed. Many thousands of bankers, especially at the investment banking end of the business, have lost their jobs. For those that are left the bonus pools are proportionately smaller and subject to more conditionality than in the past. In addition, in this country the structure of the industry is on the verge of change. The cultures of investment and commercial banking are very different and there are good reasons to think that within consolidated organizations the takeover of the latter by individuals from the former has contributed to what went wrong. It would be safer if they were at arms length from each other. The Vickers Report has advocated putting a ring fence between the two, a recommendation that has been further strengthened by the Tyrie Committee of MPs and Peers and legislation will shortly proceed through Parliament.

Yet, I worry that we have not fully grasped the lessons of what went wrong in banking. All agree that light touch regulation played a big role in exacerbating the problems there. Nowhere was this more true than in Britain with ministers – Labour and Conservative – boasting in Brussels and elsewhere about how much lighter the touch was in London than in other markets. Despite that I continue to hear the argument put forward as a general principle in relation to other industries and activities that the least regulation is generally the best. Of course, excessive and needless bureaucratic intervention in the market is bad. But banking isn't unique. If the interests of the consumer and public safety are not to be compromised, effective regulation is required over a wide range of goods and services. The lesson of banking is that it is very often likely to be tougher than manufacturers and suppliers would wish.

A timely reminder of this has been provided by the astonishing revelations about horsemeat masquerading as beef in this country and elsewhere in Europe. Some of the most respected food manufacturing companies and supermarket chains have had to admit that they did not know the ingredients of products bearing their names. There is no suggestion of an intention to mislead or to exploit customers and unlike some other food scares nobody appears to have been hurt. Nonetheless trust in well known brands and products has been impaired. Those politicians, business people and commentators, who constantly inveigh against red tape and bureaucracy, should take heed.

I also ask myself whether there is a causal link between the remuneration practices in banking and the way in which in recent years the whole complex and multi faceted system of bonuses and performance related pay has run out of control at the FTSE 100 end of the corporate sector. The figures speak for themselves. In 1998, according to research quoted by the Financial Times, the pay of FTSE 100 Chief Executives in all its various forms was 47x that of average employees. In 2010 it was 120x higher. To put it another way, according to Income Data Services last November, the total pay of FTSE 100 Chief Executives had risen by 266% since 2000 while the corresponding rise in the whole economy earnings was 40%. I could go on and figures for other senior executives show that they too have done far better than the working population at large as well as the performance of their own companies. Not only that. Compensation for those who lose their jobs has been brought into disrepute by the scale of the generosity too often extended to those who failed to deliver outstanding performance.

To a great extent the system that has run out of control was introduced in order to align the interests of top executives more closely with those of shareholders. This was a good idea, but unfortunately the law of unintended consequences has intervened. In practice the system has too often had the effect of distorting top managements' judgement in order to boost Total Shareholder Return in the short term at the expense of longer term and less quantifiable objectives such as innovation, training, holding on to trained staff in a downturn and the cultivation of new and difficult markets. It also contributed to the emergence of a hyperactive market in corporate control with the acquiring companies getting larger and larger. This in turn has led to organizational upheavals during which established management practices all too often break down and risk management procedures with them.

There is another dimension too that was starkly illustrated for me by two stories that happened to appear on the same page of the Financial Times on 6 November last. One reported that, in addition to the increases already mentioned, the median pay of FTSE 100 directors rose 10% in 2011, or more than 6x the increase in overall average earnings. The other was headlined, "Business chiefs warn against compulsion on living wage". If ever there was a case of that old adage epitomizing poor leadership, "don't do as I do, do as I say", being put into practice, the juxtaposition of these stories looks like it.

Now let me be clear: I believe that Chief Executives and others who run big, complex and successful organizations of whatever kind are entitled to large rewards. I believe too that those who take on great management challenges and those who create wealth and jobs for others deserve to be generously rewarded. But the state of our society and the way in which our capitalist system is working illustrated by these two stories is deeply disturbing. Their juxtaposition oversimplifies a complex reality, but it also serves to remind us of the extent to which the fortunes of different groups within our society are diverging. The country needs its business leaders to speak out in the interests of their companies and of business in general. But when their pay and pay increases so far outrun those of the people who work for them and the population at large, they lose moral authority, their words will be discounted and the business case on economic and social matters will go by default.

In the days of the Brown government, my friend Lord Gavron from the Labour benches with my support from the Conservative side introduced a Private Members bill into the House of Lords designed to curb these excesses. Both the government and the opposition opposed it and it got nowhere. Since then, however, there has been the so called "Shareholder Spring" with institutional shareholders protesting against and, in some cases, even voting down excessive remuneration and compensation packages. Public opinion too has become engaged. This year we had drafted another bill, but there was no need to table it. Through the Employment and Regulatory Reform bill currently before Parliament, the present government has taken the matter in hand with clauses that will ensure that companies can only reward directors and compensate them for loss of office with the explicit approval of shareholders. They have thereby established that there is a public interest in the matter as well as providing for much greater clarity than in the past. The responsibility for bringing this gravy train under control will still rightly rest largely in the hands of the leaders of our great companies. But the essential element of transparency that will enable shareholders not just to monitor but also to intervene in a timely fashion is being established.

On that hopeful note I come to the end of what I have to say. I have covered a diverse range of issues, but they have one important characteristic in common. It is that at the heart of some of our country's most important institutions groups of privileged individuals were able to fix outcomes to suit their own interests regardless of the public interest in a manner that would not have been possible if their activities had been subject to a greater degree of transparency. As a result damage has been inflicted on the fabric of our national life and many men and women have been hurt. There is a well known saying to the effect that "the price of peace is vigilance". That is no less true for trust in our public life and business. The reason I attach so much weight to transparency is that it provides the essential pre-condition for the construction of mechanisms to enable that vigilance to be exercised effectively.