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CHAPTER TWO

How the somewhat better off became much worse off, and why it made them angry

Emerging patterns of economic conflict

The development of states since the eighteenth century has been marked by the development of characteristic social fault lines. Eighteenth and nineteenth century industrialization led to the emergence of a large group of workers, who provided labour by hand, and a smaller group of managers. In the nineteenth century, the number of middle-class professionals greatly increased. They included office workers, lawyers, public servants in local or central government and others with exceptional talents or skills. The main fault line was between labour and the owners or management, though it was noticed that the disagreements were often marked between those who worked by hand and the lower ranks of the middle classes. Even in the twentieth century, as Ralf Dahrendorf pointed out, when these two groups met and interacted there were often particularly strong tensions and disagreements.¹ The middle class was thought to be the main bulwark of democracy and were relatively content and self-contained. But within the middle class there was a group which was entitled to be discontented. Those who did not own property were usually the last group to be enfranchised, and this included women, who in many western countries had limited rights to own property until surprisingly late.

Labour unions played a key part in increasing wages and improving the conditions of employment for workers with regard to hours of work, holidays and pensions, health and safety protection and security of employment. As unions became more powerful the tensions with management also increased, and in many countries it seemed they had hung on to outdated and restrictive working practices and resisted change. It became a commonplace to argue that the unions had become the enemy of economic development and that their rights and freedoms needed to be curtailed. In Britain Mrs Thatcher was determined that the labour unrest of the 1970s should never recur, and it was striking that the New Labour government which came into office in 1997 did not abandon the restrictions on the activities of trade unions which she had introduced. The restrictions included the prohibition on secondary

picketing – where there was action against a second company in support of strikers in the first – an insistence on new democratic forms within unions, and the outlawing of the closed shop by which a union insisted that all workers in a particular factory should be its members.

In other countries the pattern varied somewhat. In continental Europe the battle was more about adjusting – usually reducing – the protections which labour had gained, and making the workforce more flexible by persuading organized labour to accept reasonable adjustments. Unions were accepted but socialized. Sometimes, for instance, in Germany and Scandinavia, the tensions were resolved by involving representatives of labour directly in management. The kind of government this produced was called corporatism.² In contrast in the United States the owners of capital vigorously resisted the increase in unionization, often with bloody violence, and succeeded in creating doubts in the minds of Americans about whether labour needed to be organized at all.³ In the early years of the twenty-first century there were big companies in the United States, such as the retailers Wal-Mart, which refused unionization and used all necessary means to prevent it. New players in the United States, such as the British retailer Tesco, tried to follow the Wal-Mart model when they started operations in the United States in 2006, even though they accepted unionization in the United Kingdom.

There was therefore a historical pattern which was connected with the present trauma. Labour became powerful and inflexible. It had begun to stifle economic progress, and there was a reaction against what had come to be seen as the irresponsibility of organized labour. In consequence more restrictive laws on what unions could do were introduced. As a result the whip hand in the workplace returned to owners and management, which found new ways of reducing the power of workers and limiting their rewards, often in wages, but more often in worsening the conditions of employment. The new disposition of management was linked closely with the increasing power of capital, which was greatly amplified by the creation of a more liberal globalized world economy. Capital was hugely increased, more mobile, and now increasingly concentrated. There was a marked increase in the number of aggressive takeovers of companies, and in a number of sectors a move towards global monopoly. These developments helped capital to resist the claims made by labour. In the United Kingdom, the tipping point came in the early 1980s. In the 1970s it was largely the unions which had the whip hand; by the mid-1980s capital had regained the ascendancy.

The owners of capital, newly energized, did not stop with restricting labour. The next group in line, the middle class, had traditionally felt secure and apart from the struggle of labour and capital. In the new world of rampant capital the middle-class confidence in what they had thought were their rare and valuable skills, and job security, dealt a severe blow. The skills were increasingly discounted and did not prevent redundancy. The only mission for the new capitalism was profitability in the short term, as defined by profits for the investors/shareholders and the incomes of managers. When the crisis came the complaint was often heard that business schools were partly responsible for this as they had stressed that managers should serve the interests of shareholders above all else (see Chapter 6). Attention was given to making the skills of the middle classes in the developed world dispensable.

If they got in the way of increasing rewards to shareholders, or investors from private equity, the skills were either simply translated to countries where they could be bought more cheaply or ways were found of making them unnecessary. One example of such takeovers by private equity, chosen at random, was that of the successful major British recording and audio technology company, EMI, which led to the loss of thousands of jobs (*The Independent*, 16 January 2008). The middle classes were now subject to the rules of a more turbulent and less-civilized market place. Their jobs, no matter how skilled, were not secure. Their pensions were threatened. Their children's ownership of their own houses was put beyond their reach.

What had begun with labour becoming too powerful had turned into an attack by those who commanded capital against both workers and the middle class. In the United States this had reached the point at which the middle classes could barely afford health insurance and had to rely on the value of their house to provide a pension. The elderly and the indigent still had a right to medicare, but this was a stripped down service which no American with money would countenance. In the United Kingdom the middle classes found that management reduced their pension rights, and ruthlessly dismantled what appeared to be perfectly viable companies, often throwing away rare skills in the process. By the last decade of the twentieth century the social democratic states on continental Europe were under pressure to go the same way. The economic systems of the United Kingdom and the United States with their more flexible workforces and more energetic capitalism were seen to be the way of the future. The global economic crisis showed that this was a delusion. It was the social democracies that seemed better equipped to survive the crisis.

In the United States and the United Kingdom security of employment was a thing of the past and for most people the job market became a place of intense competition and change. What mattered now were transferable skills rather than specialist skills. There were attempts at palliative action by governments in Europe, separately and through the European Union, such as programmes for retraining and relocation, but in the United Kingdom these were invariably inadequate.⁴

The new economics of exploitation

One example of the new economics was the appearance of massive venture capital companies funded by private equity, that is, equity not derived from the stock market but held in private hands, be it banks or individuals. The size of this new investment was only realized in the United Kingdom when it tried to take over large and well-liked public companies such as the grocer Sainsbury's. An investment bank called Delta-Two, backed by the Qatari government, had made an offer of £10.6 billion(US) for the company. These developments are discussed further in Chapter 5. One extraordinary mechanism used by private equity amounted to getting a targeted company to pay for its own takeover. The money borrowed to make the takeover was added to the company's debts if it succeeded. When the English Premier League football team Manchester United was taken over by the American venture capitalist Malcolm Glazer the money he borrowed to make the purchase became a debt for Manchester United. When the Spanish conglomerate Ferrovial had problems servicing the debt it had incurred in buying the British Airports Authority in 2006 it persuaded the British regulator, the Civil Airline Authority (CAA), to permit increases in landing charges. In effect the airlines were being required to help with the financing of Ferrovial's purchase of the airports.

Venture capital's single-minded search for profit meant it was indifferent to rare talent among the company's workers. It was not impressed by a full order book for the product of that talent. It was only interested in squeezing out value from the company even if that meant dispensing with the talent, throwing out the order book, and selling its assets. The investors needed only to pay off the debt from the initial purchase to acquire all the price of the now diminished company as personal gain. What was left of the company could be sold on, minus the assets which had been stripped away. This was often the main purpose of the exercise. There was a major incentive under British tax law for the venture capitalists to behave in this way. The financial

rewards squeezed from the acquisition were taken by the individual managers as capital gains which were taxed at the low rate of 10 per cent. They did not pay the standard upper rate of income tax, which was 40 per cent, even though the gains were in reality income. There was no question of declaring a dividend as there were no shareholders.

One of the difficulties with venture capitalism, as practiced by private equity groups, was that it avoided the disciplines of the stock market. Companies which had shares available for purchase in the market place had to accept a set of rules about how they managed their affairs, the circumstances in which they could sell their shares and the code of behaviour that governed managers regarding their work and investments. The affairs of a publicly quoted company had to be relatively open to public inspection.

The rise of the private equity venture capitalist was related to another development which in retrospect can be seen as marking a further step in the developing global economic crisis. In brief, the problem arose from the earlier decisions of US mortgage companies to lend money for house purchase to individuals with poor credit records and salaries barely adequate to cover the monthly payments required. This was known as sub-prime lending. The debts of these high risk borrowers were then sold on by the issuing companies to other financial institutions and operations such as hedge funds, which could then sell them on again. The original debts were split and put together with other forms of debt which were better supported, so that the scale of the risk debt in the investor owned utilities (IOUs) being sold on became hard to identify. Banks holding such IOUs did not know, or could conceal, how big a proportion of there holdings was sound and how much unsound. These new financial instruments, which were essentially marketable IOUs, created a new form of wealth which was sold and resold, and became one of the bases of new wealth such as much of that of private equity investors and hedge funds (discussed further in Chapter 5).

When interest rates increased in 2005–6 a large number of sub-prime borrowers found they could not repay what they owed, and their houses were repossessed. In this situation banks found it impossible to restore their position by selling what they held, because no one could work out how big a proportion of the debt instruments was safe debt and how much was worthless. Some banks began to move towards insolvency and had to be bailed out by the central banks. At an early stage the US Federal Reserve acted to protect a number of banks and in the United Kingdom Barclays Bank

had to borrow from the British Central Bank, the Bank of England, at a high interest rate. A number of British banks revealed losses because of sub-prime debt. Later events are discussed in Chapter 5.

Questions were asked about the blame that should be attached to auditing companies which had rated the IOUs based on sub-prime mortgage lending as good investments, such as Standard & Poor's and PricewaterhouseCoopers. It was hardly surprising that the auditors declared themselves content when they had also advised on the company's investments. Some venture capitalists holding these debt instruments found themselves caught short in mid-shot at a takeover. The offer to takeover the UK grocers Sainsbury's was withdrawn because the investor suddenly discovered they had less capital than they thought. But the implications of the problem for the future activities of private equity were unclear.

For the time being private equity continued on its predatory way. There was an escalation in the number of companies whose sole activity was to takeover and squeeze value out of other companies. One such company was the Australian finance company Macquarie which focussed on utility and other public service companies in the United Kingdom, such as Thames Water and Bristol Airport. In September 2007 it was involved in an attempt to take over Southern Water (reported in *The Observer*, 30 September 2007). The number of such takeover efforts was so large that it seemed that no company could afford to concentrate on its core business. This tidal wave of company takeovers slowed to a trickle only when the debt market dried up. The banks lost confidence in each other and became much more cautious about lending. The banks and investment companies had recklessly increased their funding gap, the difference between deposits and lending, from near zero in 2000 to £530 billion (US) by the end of 2006 (*The Observer*, 30 September 2007). Now they became anxious to reduce the risks to which they were exposed.

Some of the problems involved in this cycle of massive gain followed by crisis and debt at the expense of non-capitalists can be summarized at this point. More is to come in Chapter 5!

- It was unacceptable that companies should be able to hold massive undisclosed debts off the balance sheet, as was the case with Enron and, apparently, the Halifax Bank of Scotland (HBOS). A requirement for transparency would also prevent the setting up of byzantine arrangements such as the so-called special purpose vehicles created by the UK mortgage

bank Northern Rock before its collapse, under which money was allocated to a charitable offshore trust from which the bank then borrowed.

- Transparency should also lead to complete disclosure of any clashes of interest. In the case of Northern Rock the accountancy firm PricewaterhouseCoopers was involved not only in auditing the company's books, but also in advising on the purchase of debt instruments. Indeed the fee obtained for the latter, £700,000, was considerably higher than for the former, which was £500,000.⁵
- It was clear that those operating in the financial world had a strong interest in keeping their affairs mysterious, away from the official gaze – even Nobel prize-winning economists like those involved in the collapse of Long-Term Capital Management (LTCM) in the United States in the 1990s! This was a perfect example of what Susan Strange called *Casino Capitalism* in her classic text.⁶ It was a gambling game which was carried out according to semi-secret rules. Ruth Sutherland made the point as follows: 'In their relentless drive for profit, the banks have not only relegated their UK customers, they have also abandoned their role as prudent custodians to become gamblers in the global casino'. (*The Observer*, Business section, 2 September 2007, p. 3). The head of the investment banking division of Barclays Bank was taking an annual salary of nearly £23 million at a time when there were serious concerns about the bank's solvency.
- It was hard to say who benefited from these new arrangements: it was often asserted that they served the public interest, and in some cases this might be true. But the scale of benefit could not be calculated and there were also major costs. A line should be drawn between the kind of game that helped to stabilize the international commodity markets – the commodities futures market (discussed in Chapter 5) – and the kind of market that was based entirely on the undisclosed trading of unsound debt. Unfortunately, governments in the developed world were simply incapable of drawing up rules which would stop such practices.
- Many members of these governments were too close to the people who were gaining from casino capitalism. One of its causes was the social one – that politicians from the left and the right had become part of the same society as the venture capitalists. They went to the same parties, played together, belonged to the same clubs, wore the same ties and lived in the same neighbourhood. They were reluctant to accept that this game was played at the expense of the real economy and the interests of the majority.

- There was an underlying moral consideration. In the age of homely capitalism, when mortgages came from building societies, and the bank manager was a pillar of the local community, it would have been unthinkable that the person who agreed a debt could sell it on for profit. It was arguably morally unacceptable to sell on a mortgage agreed in good faith with a known and trusted building society to an unknown, possibly disreputable institution. Borrowers should have the right to know the person or company to whom they owed money. The conclusion had to be that for reasons of probity and economics the selling of debt should be prohibited by international regulation unless approved by the initial borrower.

Capital and the medium wealthy

This chapter is concerned with the way in which the medium wealthy became less well off. This is not only about their income, in the sense of their salaries, but also about their other assets, such as health, education, pensions and housing. Of these various kinds of quasi-salary provision the most valuable is the pension, since for most people the amount of capital needed for a reasonable pension exceeds that needed to buy a house.

Funding pensions

Most of the developed economies of the Western world faced a crisis in their systems of pension provision in the early twenty-first century. In the United Kingdom there were three main kinds of pension, personal pensions, occupational pensions and the state pension. In this discussion attention is focussed on state pensions and occupational pensions. Occupational pensions provided the pension of up to 30 per cent of British pensioners, and were characteristic of those of the professions and the better off – the middle class. But the largest number of British pensioners depended exclusively on the state system.

In the last decade of the twentieth and the first decade of the twenty-first centuries, companies gradually abandoned the form of occupational pension called final salary schemes. These provided a guaranteed level of pension paid for by contributions by companies at between 10 and 15 per cent of salary, and, usually, a rather smaller contribution by employees of 8–10 per cent of salary. The level of the guaranteed pension was usually half of the final salary reached after 40 years of employment. A large number of companies closed these schemes to new workers and a few closed them for existing workers,

even though both sides had made contributions for a number of years. Companies opted instead for cheaper defined capital contribution schemes in which the company and the individual contributed to investment in the stock market at the risk of the worker. The retiree got the capital pot which had accumulated at the time of retirement and was required to invest the pot, following rules laid down by government, in an annuity.

Oftentimes the company availed itself of this opportunity to reduce the amount of its pension contributions, in effect reducing payments in salaries and wages to its workers. Companies increasingly found that they had too little money in the funds to pay the agreed pensions. In August 2008, 80 per cent of defined benefit, final salary and pension schemes were reportedly in the red (at the same time the FTSE 100 executives achieved pay awards of 11.5 per cent) (*The Independent*, 15 October 2008). In February 2009, it was reported that the post office workers fund had a deficit of £9 billion (US).

The range of methods being used by government and companies by the mid-1990s to limit payments into pension schemes, and the excuses used for these evasions, were ingenious and extensive. It was almost as if, regardless of the financial imperatives, companies had suddenly realized that this was a way in which they could save money. There was straight criminality such as that of the businessman Robert Maxwell who in the 1980s simply stole money from the pension fund of his employees at the newspaper the *Daily Mirror* when he found himself short of money. There was also negligence of a kind which ironically financial companies routinely strongly advised their customers against. The companies decided in the 1990s, with the approval of the government and their auditors, to ignore their own warning to customers that the value of shares could go down as well as up. They decided to take contribution holidays from payments into their funds on the grounds that they were already sufficiently well funded to cover the costs of their pension obligations. Employees were not permitted to take such a holiday.

This was at a time when the stock market, in which most such funds were invested, was riding high. When it fell after 2007 companies found that their pension funds were inadequate. There was a shortfall because of the lack of sufficient company contributions in the good times. The imposition in 1998 by the New Labour Chancellor Gordon Brown of a new tax on pension funds, and the requirement of greater transparency of pension commitments in relation to the size of the fund, made a bad situation worse. But there was a strong impression that the reductions were driven as much by emerging

norms as by economic and regulatory pressures. Many companies were grateful that they now had cover to reduce their total payments into pension schemes and protect their profits. They were eager to capitalize on the perception that times were bad for pensions.

One of the problems with pensions in the United Kingdom might be described as a problem of ownership. In the case of personal pensions, which were the subject of contracts, the pensioner was the owner of the pension. In the case of the state pension the situation was also clear: the government retained the right with Parliament's approval to amend the rules related to pensions and the level of pension provision. If it did this it would have to deal with the political fallout, and perhaps challenge under the human rights legislation, but its discretion under existing law was wide. The British population regarded the basic state pension as a right acquired by paying national insurance, but the government could change the amount to be paid to a sum even below its present derisory level. Though national insurance contributions (NICs) were hypothecated in that they went into the National Insurance Fund, separate from the Consolidated Fund in the public accounts, the amount spent on pensions was not firmly related to the amount of the fund. Indeed the amount now greatly exceeded the sum spent on pensions.

The situation was confusing when it came to occupational pensions, which used to be seen as one of the perks of the middle class. Employees signed up to such a pension when they signed the contract of employment, and it could appear that this implied a legal right to a pension according to the terms agreed. The employee and the employer both paid into a pension fund. In practice, however, firms had been allowed to play fast and loose with their pension funds. They had been allowed to pay less into them than was necessary to cover the pensions by, for instance, taking contribution holidays. They could transfer ownership of the fund to another company which might use it to generate funds of its own at the risk of the pensioners. They could unilaterally change the terms of the pension agreement, for instance, by abandoning final salary-related pensions for existing employees. And if the company went into receivership the right of workers to pensions was third in line, the Revenue coming first and the Banks second. The employees got what was left.

After the Maxwell episode protection of the rights of workers in company schemes was increased, but companies could still take steps which either changed the terms of the pension or reduced it without the approval of

pensioners. It was debatable whether this was good enough for a state that boasted about its welfare system. Arguably in a fair society employees should always be entitled to pension at a level which could be readily calculated, be it under the terms of the state pension, or an occupational pension, and the company or government should put that requirement first. This was not the case in the United Kingdom: it was perfectly possible that employees who had made a lifetime's contribution to an occupational pension fund would find that the cupboard was bare.

Companies and government promoted the doctrine that contributions to occupational pensions from the companies and the employees were not part of salary. This curious assumption ignored the fact that most employees had taken on the job in return for an agreed package of remuneration which they had every right to believe belonged to them. It would have seemed a matter of natural justice that companies which reneged upon this agreement could be accused of stealing. Companies were pleasantly surprised to find how easy it was to tap into pension assets. Once again employees, including middle class people who had thought themselves adequately provided for, came off a poor second to the interests of companies.

But there was another problem: investment bankers realized that pension funds could themselves be a source of profit and began to bid for failing companies to get their hands on the funds. Since the workers had no enforceable legal claim to the assets of the fund, they could be bought and sold at the whim of management. It was reported that the buying of pension funds by the big investment banks was a rapidly growing business. One company in this business was Pension Corporation (*The Observer*, 18 November 2007).

In late February 2008 a subsidiary of the banker Goldman Sachs bought the pension fund of Rank which was in financial difficulties (Goldman, of Goldman Sachs, had played a role in the downfall of LTCM in the 1990s; see Chapter 5). Despite the problems of contribution holidays of the 1990s, it was judged that the fund had a surplus of £20 million which was paid back to Rank 'as a kind of sweetener' for the sale to help with its financial difficulties. The press blithely passed on the companies' message that this was the best outcome (*The Times*, Saturday, 1 March 2008). Naturally the pensioners were not consulted. No doubt the deal generated large fees for the managers concerned, but it would also be found shortly that the Rank workers faced pension restrictions because of a shortfall in the fund.

Over a period of a few weeks the knock-on effect of the banking crisis led to a fall in the FTSE index from around 5,500 points to less than 3,500 points, a drop of around 30 per cent. It was certain that funded pensions were finding it more difficult to cover payments because the value of returns on stock-market investments was going down, but their payments to pensioners were not. Those with the new kind of funded pension, which depended entirely on returns from equity investments, found that the amount of pension had been reduced by a third or more.

The state pension scheme in the United Kingdom was compulsory for everyone, rich and poor, and all individuals in employment paid into it and, regardless of wealth, got benefits from it. It depended upon a promise to pay pensions out of future taxation. When the national pension scheme was introduced in Britain by the Liberal administration in 1908–11, a system of national insurance was also introduced to pay for pensions and unemployment benefit, and this scheme has continued to exist to the present. From time to time the contributions were increased, and every employed person in the United Kingdom, rich and poor alike, paid this insurance out of their pay packet. But things were not what they seemed to be. The money from the NICs was not tied to the exclusive support of pensions – even though it was formally hypothecated – and amounts over and above what was needed to cover the miserly pension obligations could be spent on other things. It was in practice another form of direct taxation.

This was an area where developments were driven as much by changing norms as by so-called economic facts. In a letter in August 2007 to Pat Healey, the head of one of the major British pensioners' organizations, The National Pensioners Convention, the Prime Minister, Gordon Brown, admitted that the National Insurance Fund was in substantial surplus, but money was routinely transferred out to pay for other services such as schools and hospitals (reported on 'Talking Politics', Radio 4, 11.00 am Saturday, 8 August 2007). The Prime Minister admitted that this was to avoid having to contribute to these other services out of general taxation. Indeed the National Insurance Fund had a growing surplus as earnings linked contributions went up at a faster rate than payments which were based on inflation. In March 2006 the surplus was £34.6 billion (US) of which £25 billion (US) could be treated as a usable surplus.⁷ One academic commentator referred politely to what should be regarded as a disgraceful deceit, namely, 'the illusionary nature of post-war national insurance'.⁸

In effect the money was being diverted for political reasons from the purpose for which it was intended. State pensions were kept at poverty level to avoid the embarrassment of a marginal increase in general taxation.

The conservative administration of Margaret Thatcher took the downgrading of state pension provision a stage further. It decreed that any increases in the meagre state pension should follow the rate of inflation rather than any general increase in wages and salaries. Hence those who depended on the state pension were now doomed to falling further and further behind average personal wealth. Alongside this was the freezing of the pensions of all those who decided to live abroad after retirement. The worry at that period was that wage indexation together with projected population ageing would over time greatly increase public pension spending to an amount in excess of the NICs. A policy was adopted of managing costs to keep them within the limits of the NICs rather than maintaining pensions by diverting resources or increasing the level of NICs.

According to the terms of the Superannuation Acts of 1957 and 1972 the pension schemes of public service workers, including schoolteachers, became the responsibility of Parliament. The funds were still identifiable as accounting devices, especially useful as a way of measuring contributions, rather like the National Insurance Fund. But in future the contributions would not be invested and pensions would be paid out of general taxation. Instead of being financed from invested contributory funds, these pensions would be 'unfunded' and paid for out of general taxation. They had the advantage of being less exposed to the whims of the equity market but the disadvantage of being vulnerable to the whims of government. In the later years of the first decade of the new millennium such pensions were attractive and helped recruitment, but the increasing tax burden could leave public servants very vulnerable to the political decision that they must be drastically reduced. In contrast the pensions of higher education workers, such as university teachers, had remained funded, and, despite the fall in the value of investments, at the time of writing were holding up reasonably well. Some authorities insisted that the only solution was to reduce public sector pensions.

Putting the problem right

The problem of paying for national pensions boiled down to a straight forward relationship between the level of taxation and the level of pension provision. The most important study of the problem was the Turner report

published in 2006, generally approved by the specialists and largely ignored by the government.⁹ By the late 1990s it was obvious that this was likely to be a burden on the next generation which would be compelled to pay the pensions of the current generation out of their taxes. The government stressed that individuals would simply have to pay more for any level of future pension out of their own personal private investments. There would have to be more saving, and more individual input by employees into their pension pots. This sounds fine for those with adequate salaries – private pension provision is not morally superior or inferior to state provision. But the problem was that for most people in Britain, even those who might have been thought to be reasonably well off, the level of surplus income in the early twenty-first century was not sufficient to pay the further cost of pension. For most people it was not possible to divert money from surplus expenditure to private pension provision.

In the United Kingdom salaries and wages were not calculated to allow for such expenses. One illustration of the difficulty concerned housing. In the 1960s it was possible for those with a modest salary to pay for a mortgage on a small house out of income. Such a small house would be priced at about £4,500 when the income of a modestly successful professional would be about £1,500 per annum. But by the early twenty-first century – until the housing crash – a modest house in most of the country was out of reach of those on average income. It would be unusual for such a house to be priced at less than £250,000, and equally unusual for even a successful professional to be earning as much as £50,000 per annum until well on in their career. Few mortgage companies would agree to a mortgage which was more than four times annual income. High mortgage payments on houses were the biggest element in raising the level of total personal debt in the United Kingdom. In 2006, for the first time, such debt exceeded the annual gross national product.

The British government was negligent in not seeing the crisis coming, but blame does not solve the problem. The demographic trends were clear, and the level of taxation needed to pay for even basic pensions could be calculated within a reasonable margin of error, so it must be regarded as a gross error that this was not done much earlier and remedial action was not taken. The high level of company prosperity in the United Kingdom in the early twenty-first century and the unprecedented national wealth made the argument that proper pensions could not be afforded look laughable.

One commentary pointed out correctly that one of the problems was that the debate about pensions had been dominated by the Treasury which was always anxious to limit public expenditure. This allowed 'pension politics to degenerate into a technical debate on pension finance'.¹⁰ There was no sense that, come what may, a civilized country must look after its old people, and that pensions should be adequate, and certainly above the subsistence level at present afforded.

If pensions must be funded from individual taxation on workers, and there were too few workers, why not increase the number of workers? There were workers now in part-time employment, women who were unable to work because of child minding and other – unpaid – family caring duties and, of course, workers from abroad. There were about 400,000 individuals working illegally, and not paying taxes, in Britain in 2007. But more women working would require more flexible working hours than men and increased provision for child care. Neither companies nor most men had any wish to introduce such changes. Importing more workers would be met with the opposition of existing workers, and xenophobic citizens, egged on by the British right-wing press.

Another helpful change was increasing the age of retirement to reflect increasing life expectancy. People were living longer, healthier lives and retiring too soon – thus an increase in retirement age must be part of reform. This was the change with the most obvious advantages since at a go it would both reduce the need for pensions and increase the amount needed to pay for them. Across the heartland of Europe there was certainly an excessive generosity in allowing retirement at too young an age. In Italy retirement on full pension at 55 was possible, even though falling birth rates had caused a reduction in the workforce and the tax base. In developed countries with increasing life expectancy there was a strong case for increasing the legal age of retirement to the late sixties or seventies, equally for men and women, depending on fitness to work. Perfectly sensible changes in pension provision were possible and would make it possible to maintain civilized levels of payment, as the Turner report in the United Kingdom in 2006 had indicated.

In the United Kingdom it remained undecided whether the legal age of compulsory retirement should be increased, or whether it would be sufficient to allow those who did not wish to retire to continue. In 2009 employers retained considerable discretion to impose retirement, a right supported by

the European Court of Justice. But by this stage the injection of money into the economy by the government by purchasing gilts – the policy described picturesquely as *quantitative easing* – was also making things worse for pensioners.

Increases in the number paying tax would depend upon the expansion of the domestic economy so that the new workers could be employed. Even increasing the retirement age entailed finding new jobs for the young. But in the age of globalization mobile capital preferred to exploit the lower costs of developing countries to help solve the social problems of the developed ones. The sort of changes needed to increase the tax base at home ran against the grain. Globalization was for the freedom of capital, not labour. For companies neoliberalism dictated that less-developed countries were a better bet for any economic activity that required action outside the city of London. The only way of countering this was to make it impossible for companies to access developed markets from abroad without having to pay a tariff, but this ran against the liberalization agenda of globalization.

Companies were naturally anxious, having reduced their contributions to their own pension schemes, not to have to pay that charge again through increased wages to fund an increasing number of personal pensions. Capital preferred that labour from the developed world did not follow it to developing economies, bringing with it objectionable habits such as unionization, health and safety legislation and higher wages. It was more likely to win the battle to keep costs low in new centres with poor core labour standards than to reduce higher costs in old ones. This was a mirror of the earlier movements in the United States, which gained pace in the 1970s, when business escaped from welfare payments, as well as the unions, by moving from the north and the east to the south and the west of the country. The international movement of capital not only benefited from lower costs elsewhere, but also hindered efforts to restore the tax base in the location from which it was moving. A bad record on human rights was not a problem. Indeed it was an asset that made it easier to have lower costs. But moving enterprise to China also made adequate pension provision in the United Kingdom more difficult.

The failures of the system meant that around 2 million out of a total of 17 million pensioners were living in poverty in 2007. In 2006 and 2007, it was reported, British pensions were the lowest in Europe, averaging 30 per cent of the average UK wage. The European average was 60 per cent. Donald Duval, the chief actuary of the group that produced these figures, said

the UK government held that a pension was to ensure that people did not starve, rather than that they should have a reasonable standard of living.¹¹ But surely the government of a civilized country should not be balancing the books by paying its pensioners less. Rather it should be focussing on getting the resources to finance a reasonable level of pension for everyone, be they in the private or public sector. The problem of the shortfall in taxation needed to be addressed if necessary by radical measures. But the problem here was obvious: taxation was unlikely to be sufficient if a large number of the rich paid less than they should and a large number of the poor were not earning enough to pay income tax at all (discussed further in Chapter 3). The constraints on appropriate adjustments were social, political and ideological: they were all contingent on policy preferences rather than economic necessities.

Housing and pensions

Another problem was related to that of pensions, namely, the cost of housing. Since the 1980s it had become more and more difficult for young people to buy their own house out of income without the support of their parents. The *Observer* and *Evening Standard* columnist Nick Cohen maintained that there had been a massive transfer of wealth to the older generation over the last decade, particularly because of the inflation of house prices. In one sense this was a fair judgement in that their houses had been bought relatively cheaply in the 1960s and had now increased with the general housing market. He unfairly added that 'the elderly are very selfish: they will take money from the young',¹² implying that house prices were out of the reach of first-time buyers because of a sin of commission by those who were older. This was simply wrong. House prices had gone up, and new younger buyers had to pay the price, because too much money was chasing after too few houses, which came back to the excessive credit made available through the banks.

The reasons for this included the shortage of houses in relation to an increasing demand from young people themselves who increasingly wanted their own place. But there was also increasing demand from single people, like divorcees and single mothers. As this demand increased there was also an increasing supply of credit from banks and building societies fed by their borrowings from the wholesale market and by the importing of liquidity from countries such as China. The housing market was hugely affected by the massive increase in funds available for the purchase of a relatively fixed supply of houses. It was also pushed up by the problems with pensions,

as property seemed a safer bet than pension funds. Of new apartments built in London in the late 1990s, 70 per cent were bought to let to those who could not afford to buy because the houses had been snapped up. There was also straight property speculation; it was a good bet for anyone with capital to invest.

As a result the housing market was bifurcated. In one market people were seeking to borrow four or five times their income in order to buy their first home, which was usually only possible with the support of their parents. In the other market there were the super-rich for whom house price inflation was a minor inconvenience, and who even got richer investing in property. For the less well off, the price of housing became a financial burden which prevented them from investing in pensions. For the rich it was a benefit: it meant they got richer.

Profits and the public

The increasing tensions between the corporate sector and its rich incumbents in the United Kingdom and other developed countries and the rest of the population in the early twenty-first century was sharply illustrated by a series of complaints and stand offs. There was increasing publicity for the ways used by the executives of companies and bankers to increase their wealth, a focus on the unfairness of this and attempts to head off future grabs for the trough. All this, one should be reminded, was at a time when the total wealth in the United Kingdom had never been greater.

The cosy coteries of the remuneration committees of public companies were adept at increasing each others rewards. The number of executive and particularly non-executive directors on the boards of British public companies was surprisingly small. Individuals who acquired positions on particular boards tended to be appointed to other boards, so that the happy practice arose of helping each other in different companies to increase salaries, share options and bonus payments. They often knew each other and were happy to do each other favours. Quite frequently it was observed, much to everyone's astonishment, that the failure of managers and companies led to larger rather than smaller executive payouts. There were Golden severance payments, which greatly boosted salaries, and large contributions to the private pension schemes of failed managers, at a time when the pension schemes of workers were in trouble. It was reported at the time of a strike by prison officers in August 2007 over the staging over a year of an

agreed pay increase of 2.5 per cent that senior figures in the public sector were getting away with bonuses greater than the total annual salary of their individual employees. On 12 November 2007 it was reported that the top 300 public sector executives received salary increases of 12.8 per cent in 2006 and that the top ten earners received salaries more than 40 times that of nurses or soldiers (information from the 'Taxpayers Alliance', reported in *The Independent*, 12 November 2007).

This level of financial award reflected a feeling for the value of money on the part of company executives which was quite at variance with that in the wider community. It was as if they dealt with a different currency with its own rules of valuation. One example of this concerned the banal subject of the payments package of the ex-manager of the English national football team, Steve Maclaren. He was appointed in 2006 at a salary of more than a million pounds per annum – much more than the amount paid to other European nation's managers. When England failed to qualify for the finals of the European Nations Cup he was fired. His severance package, for someone who had failed, was another payment, but this time of over £2 million. Maclaren was not however to blame for this. The real culprits were the Football Association executives who thought that this kind of deal was reasonable. The point was that it was the kind of deal which they themselves would find reasonable in the management of the companies with which they were linked. An exorbitant sum was payable for performing the functions of the appointment, but failing to perform them should attract massive compensation. These people lived in a different world.

The executive committees of companies had traditionally got away with this because the recommendations of remuneration committees were buried in much larger annual reports about company performance at annual plenary meetings. These meetings were notified to shareholders, as the law required, but very few of the non-institutional shareholders bothered to turn up. It was not until the abuses of the power to reward by the institutions were more widely noticed that complaints began to appear first in the financial press and then in the wider press. Attempts were made by energetic individuals to organize votes against the recommendations of the remuneration committees. Several companies including banks like HSBC faced demands that their remuneration policies should be changed (*The Observer*, 9 September 2007) because top salaries were too generous. (In October 2008 the matter again surfaced with particular attention to the role

and remuneration of non-executive board members.) But this was always difficult since the corporate investors tended to side with each other. Thus the practice, though now more widely noted, continued. The evidence of the greed of managers was however widely broadcast, and this brought the corporate sector into disrepute. It also fuelled the increasing bitterness of the public about the ways of the rich, particularly when their incomes were compared with the salaries of their employees. The situation of the non-doms simply added fuel to this particular fire (see Chapter 3).

The greed of the rich, and their success in further enhancing their rewards, had to be put beside the observation that more individuals in Britain were now being paid wages on which they could not live, and which required topping up out of taxation. A system of tax credits was introduced and supported by the New Labour government. This went alongside the introduction of a national minimum wage, fiercely opposed by business, of around £5.00 per hour. The complaint was that such a wage would make British industry uncompetitive. But the minimum wage was set at a level at which it was impossible to survive and income support in the form of tax credits had to be provided. These were paid out of general taxation. A term for such lowly paid jobs became common which was derived from the employment practices of the US hamburger chain Macdonald's – macjobs. The appearance of, on the one hand, a group of rich who found it easy to line their own pockets even further, and on the other of a cohort which was paid wages below what was needed to survive, explained the widening gap between the highest and the average wages. The pattern at the bottom was often that, after a takeover, long established workers would be fired and rehired at a lower salary. One notorious case of this was that of Gate Gourmet, the company that provided on board meals to several airlines, after its takeover by an American company. These practices must be regarded as part of the Anglo-American economic model.

The consequences of these practices on social welfare provision should be noted. Increasing income differentiation had several knock-on effects. One was that a larger group was now emerging which could now be eligible for various forms of support from the state. This support started with tax credits from the income tax system, and income support, and of course corporations were required to pay their share of the cost. Therefore, it can be said that the payment of low wages was not always beneficial to the companies. Apart from tax credits other benefits included state support for housing and paying the costs of meals at school. Other maintenance costs were payable.

Another form of aid from the state was to cover the costs of going to court, known as legal aid. This aid came to be regarded as excessive. One reason was that lawyers and barristers as a group became more proactive in seeking out work through which they could earn legal aid. A second was the increase in the number of people who were claiming legal aid because their income was below the level at which they could pay for themselves. The government determined that the cost of legal aid should be reduced. In January 2008 the government reduced by 75 per cent the amount payable to lawyers for attending police stations on behalf of suspects previously qualifying for legal aid.¹³ In consequence the services of the legal system were put out of reach of a large number of individuals. No one could be certain of winning even a strong case in law. The poor could not risk having to pick up the costs of a failed action.

Other effects were the increased effort given to uncovering those who were claiming benefits illegally. One group attracted controversy early in 2007. This concerned the question of cohabiting by unmarried couples. A single mother could claim a wide range of support from the state, and a single man, if his income was below that of eligibility for tax credits, could also claim benefits. But if the two decided to live together their eligibility for such benefits was greatly reduced. The state therefore set up an arrangement for spying on the domestic arrangements of couples who were suspected of living together, and, disgracefully, neighbours were encouraged to report if they thought this was happening. It was reported that lie detectors, itself a flawed technology, was to be used to uncover benefit fraud. Interestingly the right-wing London suburb of Harrow was used to try this method out. Such harsh investigative techniques were one of the consequences of income differentiation, and bound to lead to a more bitterly divided society. The zeal with which the authorities pursued low-level suspected welfare cheats should be placed beside their insouciance when faced with the grossly massive pension funds and bonuses of bankers, even after the crisis caused by them in the global economic system.

Left-wing theorists and Labour Party politicians had long debated whether a welfare system should be open to everyone and whether all benefits should be distributed according to eligibility in terms of universal criteria regardless of wealth. If the level of income differentiation was low, such a system was possible because it amounted to a system of social insurance. Where there was very low income differentiation a society was made up of individuals of roughly equal wealth who would only need state support at points of

crisis. Where income differentiation was high state welfare systems became ways of redistributing income from the rich to the poor in the long term. In this case it was natural that the deserving poor should be sought out, and that the undeserving should receive no benefit. In this situation welfare provision had to be more focussed. The rich also had an interest in limiting income distribution. For these reasons as the level of income differentiation increased the number of exclusions from the ranks of the deserving poor was likely to increase. The policy of locating the poor who deserved support and those who did not was also likely to lead to increased social tensions and bitterness.

It was difficult to measure changes in the level of probity of the institutions with which the public dealt. But in the early twenty-first century it seemed that companies were becoming faster on their feet and more inventive in devising ways of extracting greater reward from the public. It was also noticeable that efforts to prevent this were also being made, though it was hard to say whether they were catching up or falling behind the scalpers. The reaction of the companies was a combination of insouciance and self-righteousness.

Banks found themselves subject to massive public pressure to restore unreasonable charges levied on their customers. Those who went over the limit of an approved overdraft, even by the smallest amount, found themselves subject to charges of up to £50.00 when the cost to the bank of pursuing the matter was less than £5.00. Charges levied caused an account to go into deficit and attracted further charges. Those who forgot to pay a credit card balance, even if the delay was only a single day – and that caused by a problem with the mail – would find themselves paying a punitive charge. When an individual began to organize a protest movement, supported by the British Consumer Association, banks found that they had to restore such charges. Some customers were paid back several thousand pounds they had been charged in unreasonable fees. The Financial Services Authority decided to bring a test case against the banks to reach a verdict on a reasonable level of charges, but the outcome of this was not known at the time of writing (see *The Times*, Saturday, 28 July 2007). The legal proceedings began in January 2008 and would not be concluded until the spring of 2009. The repayment of the charges was suspended while this case was being considered, and naturally the banks did what they could to delay the process by legal appeals and other challenges.

In the meantime the banks looked for other means of charging their customers to make up for lost profits. It was as if they believed that they had the right to increase their profits year in year out. One bank suddenly announced that it would charge interest on overdraft accounts which had previously been free as they were part of an offer to attract the custom of university students. When student protest forced the bank to back down, the bank explained that it had discovered that those given such free accounts sometimes switched to other banks after graduation. Some banks immediately announced that they would now levy an annual charge for a credit card, or, oddly enough, make a charge on accounts which were little used, or when the customer habitually paid off sums owed in full on a monthly basis. Sometimes the accounts of customers who got their money back were simply closed. Businesses seemed to believe that they had a right to an ever-increasing scale of profits. When Centrica decided to buy a company which made more efficient gas boilers, involving a fuel cell technology, the reaction was immediately that some other means of making up the profits made from selling less gas would have to be found. One way being considered was to find a way of charging a rent for the new boilers, rather than selling them outright, as at present, to the customer (*The Independent*, 15 January 2008).

Finally in this section about the various ways in which the interests of the public were traduced by companies attention is focussed on the arrangements of what might be called the big heavy-lift companies. These included the companies concerned with public works and those involved in managing big public services such as transport, railways, motorways, ferries, and so on. One issue that came up over and over again in this context was that of corporate responsibility, discussed in Chapter 1. Could anyone in a company be made to take the blame in the event of negligence which led to a fatal accident? An example from an earlier period is illustrative: When the car ferry the *Herald of Free Enterprise* turned over outside Zeebrugge on 6 March 1987, killing 193 passengers and crew, it proved impossible to pin responsibility on the company, despite the fact that the bow doors had been left open because the company pressured the ship's crew to minimize turnaround time. The father of one of the passengers who died in this accident spent the rest of his life attempting to force the company to accept responsibility but failed. The government of Tony Blair said when it came to power in 1997 that it would deal with the problem of corporate responsibility but failed to do so.

More recently a public works company was fined because negligent maintenance on railway track led to a derailment and loss of life. In this case the company was made to pay a fine, but no individuals in the company management were held responsible. This was the latest of a series of errors in track maintenance which led to the closing down of the privatized company that had been given responsibility at the time of the privatization of the British railways in the closing days of the Tory Administration of John Major. The whole privatization process was a financial and organizational mess which benefited those who acted as consultants and the banks at the expense of the public.

Public works companies benefited from a range of tricks and games at the expense of the public. One was the so-called *cost plus* method of financing. This gave *carte blanche* to companies to buy what they wanted to carry out a job, say of bridge building, and then to add a percentage to that as profit. The companies were put under little or no pressure to minimize costs and it was hardly surprising that by the late twentieth century public works in Britain usually went three or four times over budget. They also went on over deadline. This should be compared with the experience of building the first British motorway in the 1950s. This was built on time and under budget. It was also striking that in Britain in the early twenty-first century it was difficult to discover any continental public works company, despite the liberalization of competitive contracting in the European Union.

A trick promoted by Gordon Brown when he was Chancellor was much liked by the public works contractors. This was known as the private–public partnership, according to which private capital paid for the building of new hospitals and schools, or the modernization of the London tube, then leased their works to the public sector. The capital sums would eventually be repaid to the company at the end of the period of the lease. The advantage of this method for the government was that it kept major capital expenditures out of the public accounts for the time being. The advantage for the companies was that it provided a massive new income stream. Unfortunately the new hospitals and schools were often judged to be below standard. The consortium given responsibility for modernizing the London tube went bust and the work was taken over by the public sector through the organization known as Transport for London. In the longer term the bill for the private–public partnership would have to be paid by a future generation of tax payers. They would no doubt find it easy to do this after paying for their

personal pensions and contributing to their children's mortgages. At the time of writing increasing doubts were being expressed about public-private arrangements.

Conclusions

All of this adds up to a sorry record of incompetence on the part of government and a record of greed well fed by the corporate world and its rich investors and managers. It explains why the somewhat better off became worse off and why they were so angry about it. The cost for the public was likely to be a massive one. What was new this time was the way in which the conflict was between the corporate sector and the super-rich and the middle class as much as between capital and labour.

There were likely to be increasing bills to be covered by a population that included an increasing number of individuals with inadequate incomes. The underlying problem was that Britain was in fact more like the United States of George W. Bush than was generally realized. The gap between rich and poor was increasing. This was greatly encouraged by the greater degree of British involvement in the liberal globalized economy than was the case for other West European countries. It has to be said that there was ample justification for more vigorous complaint on the part of the British public. It was hard to say what form this complaint would take, though it was undeniable that the increasing feeling of being exploited was linked with an increasing level of anger.

There was a trend towards what was called by Marx monopoly finance capitalism though this was apparently not noticed. It was extraordinary that it became respectable to ask the question of whether Marx had not been right all along.¹⁴ The problem was that this capitalism had an innate tendency to self destruct. It made fewer and fewer richer and richer, but eventually destroyed the one thing on which it depended, the market. As Adam Smith had pointed out – much to the surprise of those who thought he had advocated a market free for all – the market had to be regulated. Capitalism was the best system for organizing national economies, and the global one, but it needed governance. In the early decade of the twenty-first century there was little evidence that governments could establish an effective form of governance for what had become global capitalism. There was an increasing and pressing need for more and better international regulation. But since governments were increasingly subservient to international capital this was

unlikely to happen. The predictable crisis of finance capitalism was reached in the autumn of 2008 and is discussed in Chapter 5. But this crisis, as this chapter reveals, is but a further stage in the worsening plight of individuals in Britain.

Their situation was likely to get worse because of the increasing tax burden generated by the massive financial support for failing banks, and the amount spent to kick-start the economy in 2008–9. It was predictable that the burden would fall mainly on the middle income earners. The government was not inclined to ask more of those who had higher incomes.