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CHAPTER THREE

The strange ways of spending and saving public money in Britain and their consequences

Money is the life blood of the modern state. It energizes all the essential economic functions: spending, buying, investing, saving, earning. These are essentially the major moving joints of the economy and money is the blood which serves them with oxygen. In modern states money is created in a number of ways principally by governments who issue currency in the form of notes and coins, and control its amount, and by banks and other financial institutions who also create liquidity when, for instance, they borrow from each other. As Mrs Thatcher found, it is very difficult to control the actual amount of money in the system because it exists in so many different forms apart from coins and notes.¹ Indeed modern governments have had major problems in controlling these other forms of money. In 2008–9 they were facing a major crisis in the credit system which led to a sudden and severe contraction of credit available, in the form of mortgages, for house purchase. This looked likely to continue for two or more years.

This chapter is concerned with the decisions about spending, first, in the budget of a government or of a local authority; and second by companies when they decide to invest directly in a state by sending money into it from outside. In the first case the budget necessarily involves a lot of decisions about spending on a wide variety of matters such as hospitals, new roads, schools, welfare, and so on. In the second case the budgetary decisions of companies to invest, say, in Britain, necessarily reflect a judgement about the target economy and the competence of its government. The question considered is whether there is a positive or negative relationship between the decisions of companies to invest from outside – foreign direct investment (FDI) – and the budgetary decisions of governments. Is a higher total level of spending by national governments and the higher level of taxation this implies – and greater commitment of national resources to welfare – necessarily a deterrent to inward investment, as has been claimed by neoliberal economists? Does a civilized system of welfare provision repel FDI?

There is a general complaint about the way that the British budget is made and a number of more specific complaints. The general complaint is that it is not subject to enough scrutiny before approval. The budget of the United Nations was rightly loudly complained about by the contributing states in the 1980s to 1990s precisely for this reason, and reforms were forced upon it.² The failures in the United Kingdom were acknowledged in 2009 in the proposal made by George Osborne, the Shadow Chancellor, that it should be possible for every UK taxpayer to scrutinize online every item of government spending above a certain sum. This would enable those who contributed the money to discover how their taxes were spent and to hold the government to account.³ It would certainly concentrate the minds of those responsible for spending. But, of course, the government in office would be reluctant to let its dealings with money be too transparent, since spending is one of the most important sources of political power. In debates about public spending the big sums might be discussed in Parliament, but rarely in a comparative setting, and for most people the arguments were close to meaningless. The problem of weak overall scrutiny of the budget existed at the highest level: even the Cabinet lacked the time or capacity to look at the whole thing in the light of agreed priorities.

Fairness and the national budget

There was no general principle, even in modern democratic states, which governed the distribution of money from a national budget. The broad pattern was of demands on a kitty which at the local or central level was constantly replenished out of taxation. At the central level there were spending departments and there was the holder of the purse, the Treasury, under the responsible politician, in Britain the Chancellor of the Exchequer. In responding to the various requests for finance the Chancellor and his advisors played a key role. Their allocation of priorities was, however, often mysterious. A central difficulty in Britain was that decisions about public spending were made behind closed doors between ministers and officials, and Parliament was powerless to do much about it except after the deals were done and the final product was brought to them for approval. This was one of the nooks and crannies of government which was not subject to direct democratic oversight.

It may be that the priorities were dominated by the need to serve higher causes, such as the obligation to maintain a stable economy and to balance this against achieving as much growth as possible. This might be said to be an

ethically neutral consideration: its objectives are not contentious. Or it could be that budgetary decisions reflected the greater strength of a particular interest, private or public. Or they could be a reflection merely of political expediency: money was directed by politicians simply to buy votes. There is however another possibility that money was distributed through national and local budgets in a country such as Britain largely in consequence of various inefficiencies in the budgetary process. These are considered below.

Resources were allocated to maintain the essential service functions of the state, such as, in the United Kingdom, the National Health Service or the state school system. Problems in these areas were however rarely solved by increasing budgetary allocations but merely alleviated. The government could not bring itself to give a high enough priority in the budget to solve them. Various policies to improve, for instance, state schools were adopted, and money was spent, but this did not seem to have raised their standards to the level of private schools, at least not in the areas where the problems were greatest.

The schools which most needed attention were those of inner cities, particularly in English cities – less so in Wales or Scotland. In Birmingham, for instance, only those who could demonstrate unusual academic ability – mostly from middle-class homes – succeeded and most of the others went to schools where academic standards were not so high. This was because of the scarcity of places in good academic state schools and the intense competition which followed to gain access. As a result even bright students often did not get into university. In Caernarvonshire in North Wales, and other Welsh counties, in the 1950s, in contrast, all students who had academic ability went to academic schools and then to University because there were so many more good schools in proportion to the population. As a result Wales became known as an exporter of schoolteachers. There was little evidence that this unfairness had been corrected in the English cities at the time of writing. Though the number of academic institutions labelled as universities had been increased, English students at good English universities still came mainly from the private schools.

It became an unfortunate truism that there was no end to the amounts that could be spent on public health. In the United Kingdom this was part of the defence of a system which in effect amounted to the rationing of drugs. In the first decade of the twenty-first century, drugs were given to patients in England because they had enough effect to justify what they cost. The British New Labour government institutionalized this unfairness for England and Wales,

but not Scotland, when it set up the National Institute for Clinical Excellence (NICE) which was asked to decide upon the effectiveness in relation to cost of new drugs. Though it would never be admitted by government this amounted to a way of rationing drugs. It measured the effectiveness of drugs against their cost, and if, in its judgement, the effectiveness was below a certain threshold it authorized their non-supply by regional health authorities. In consequence the rich could obtain drugs even if they were only, say, 10 per cent effective, because they could afford them, whereas the rest were denied them until they were, say, 80 per cent effective, and drugs might be available in one region, but not available in an adjacent region. A regional health authority could decide to make a drug available in its area which was not available in an adjacent region.

The fair principle, one which would be applied in a civilized state, would be that clinical need should always prevail over all other criteria. A measurable beneficial effect, though it might be small in some cases, should be enough to justify the prescribing of a drug. Similarly the fair principle would hold that schools should always be effective providers of a high level of education, even if they were not all able to afford tennis courts, or one-to-one teaching. The difficulty in achieving these standards derived from a problem with the making of decisions about budgetary allocation. The public position of governments about the inadequacy of the funds available to solve the problem seemed convincing: if the cupboard was bare what could be done? But the facts were different: the cupboard was bare only because the decision had been taken to spend the money elsewhere, or it had been decided to keep it back. This meant that there was a sense in which the cupboard was never bare. In October 2008 the public was surprised to learn that local government authorities in the United Kingdom had lost millions of taxpayers' money in failing Icelandic banks, when they had been told earlier that no money was available to pay for an adequate system of refuse collection. The public could not be allowed to decide which programmes should have a higher priority. It would be hard to demonstrate that even British Members of Parliament could do this.

In February 2009 it was reported that the government, entirely without the explicit approval of Parliament, had spent £34.5 billion on so-called Quangos (quasi-autonomous executive agencies) in 2007–8. The amount spent had increased by 12 per cent since the previous financial year. They were agencies made up of government appointees, headed by officers chosen by government

and paid substantial salaries, and had responsibilities such as speeding up the planning process, defence procurement, or overseeing the operations of the Grown Cereals Market. Alongside quangos were other unaccountable organizations which were titled 'non-departmental public bodies'. The amount spent by the latter organizations had increased from £37 billion in 2006–7 to £43 billion in 2007–8.

It was not that these agencies were all necessarily pointless, but rather that there was no way of finding out whether this was the case or not. They were unaccountable. The Conservative Party judged that a good number of them were not needed. The amount of increase was a telling comment on what happens when budgets are not transparent and comparable. The government was accused of keeping spending by quangos under wraps and of using them to avoid being held to account. An increase of almost £6 billion on non-departmental public bodies went through on the nod, while the short fall of £9 billion in the pension fund of postmen was judged an impossible burden on the public purse. There was also a great increase in the employment of professional consultants by the New Labour government. The cost of these enterprises together probably amounted to more than £50 billion* a year at a time when schools were told they could not have the £25 million they had been promised for new buildings.⁴

The national budget was also to pay for the defence of the realm, with appropriate numbers and training for soldiers, and to provide equipment, from boots to aircraft carriers. Here again the needs of the military were determined usually, not by the requirements of the state, but by the self-image of a small number of national leaders, or by the need to finance a military adventure, the second Gulf War, itself decided upon by a small elite of four individuals, namely the Prime Minister, Tony Blair, his unelected but powerful press secretary Alastair Campbell and two officials with links to the Foreign Office. Defence was necessary. But effective national defence was attainable with forces that were not by themselves up to allowing a state to play a global role. The Swedes and the Swiss were well aware of this. But top politicians in Britain hankered after more than a solid defence. They also wanted the military equipment, like an up-to-date nuclear weapons system, or new aircraft carriers to project themselves as major players on the world stage.⁵

* Throughout the book the US billion is used, which is 1,000,000,000.

The idea that Britain *should* be a world power might reflect a tradition of that state, but by well before the twenty-first century it had become a cruel indulgence at the expense of more effective budgetary allocations to such matters as schools, pensions and health systems. Successive British governments also declined to dilute what they believed to be their high status global role by persuading the members of the European Union to form an effective European army, powerful enough to play a role in the global balance of power. In the fairness state the hierarchy of spending should be to make sure that civilized standards were obtained at home as the very highest priority before pursuing heroic goals abroad, and to do what could be done, with others, to share responsibility for maintaining a stable international strategic system. There was little justification for maintaining national forces for a world role if this was in effect at the cost of the proper care of the elderly or the sick.⁶ Of course the government should ensure national security, but this does not require heroic unilateralism.

The decision to become involved in the attack on Saddam Hussein in 2003 led to massive expenditure on a military expedition which was increasingly seen to be failing. This single action had huge budgetary implications, but the British system was such that it could be embarked upon against the advice of the Foreign Office, and without much consultation. The end of this expensive adventure was not in sight at the time of writing. Much has been written about its failures, particularly the way it was sold to the House of Commons, which was persuaded to give it its approval, on the basis of the so-called *dodgy dossier*, after the decision had been made. This claimed, amongst other deliberate untruths, that there was an urgent need to act because Saddam had developed the means of launching weapons of mass destruction against the United Kingdom within 45 minutes.

Comparison of the costs of the Iraq war and those of the financial crisis was revealing. Stiglitz and Barnes concluded that the British system of defence spending was ‘particularly opaque’ and in consequence British citizens ‘have little clarity about how much is being spent’.⁷ They calculated that the Iraq War would cost the British taxpayer more than £20 billion by the end of 2010. The military costs were around £10 billion, but a further £10 billion had to be added to cover costs such as medical support, and pensions, for soldiers. It would cost the United States about \$3 trillion. The on-going involvement in Afghanistan would cost Britain a further £2 billion a year. The IMF concluded in early 2009 that the financial crisis would cost the

British about £140 billion. The British Treasury disputed this figure. Much of its bailout spending, about £2.1 trillion, would make a profit and loans would be repaid, so the net cost would be nearer £60 billion.⁸ The costs of the 'rescue' amounted to 12.8 per cent of the IMF figure, and 33 per cent of the cost proposed by the Treasury. Either way this war would cost the British a significant percentage of the bill for repairing the worst economic crisis in 60 years. If only they had seen it coming!

But insult was added to injury: the massive expenditure in Iraq was highly inefficient. There were not enough properly equipped helicopters. Several Chinook helicopters were kept in storage in Wiltshire because the order from the United States had been bungled. There was a shortage of armoured personnel carriers. Soldiers were sent into battle with no body armour – indeed some decided to buy their own. One wondered whether the Ministry of Defence was 'fit for purpose'. Its record in managing its enormous budget was one of disgraceful inefficiency, yet Parliament failed to give it any real censure. The war expenditure alone diverted massive sums away from where it was needed to make the state more fair and civilized. The further £2.1 trillion spent on bailouts for failing banks would have kept the National Health Service going for 20 years.⁹

In other areas where it had been decided to spend, the arguments in favour and against on the basis of fairness could be more complicated. It might be decided to finance a long-term project which seemed to serve a general interest, such as a promising area of medical research, or to help bring a new product to market, or build a better motorway or train network. In each of these cases criteria of fairness applied. It might be that research in some areas brought general benefit and that success made it more likely that there was overall fairness. It was reasonable, and fair, that the budget should finance projects which did not bring immediate obvious general benefit, but could in the future. The calculation became more problematic when a project brought benefits to some consumers at the cost of others. It might be unfair for everyone to be required to pay for a better train service out of general taxation when the beneficiaries were a small group of better-off commuters. In this case there was an argument for a greater part of the cost of public transport to be paid for by those who used it, rather than by all taxpayers. Fairness in supporting expensive medical research lay in its availability to everyone if successful. Each individual carried the risk of needing the product of research, though in practice it might not be needed. Payment out of general

taxation for this kind of research was fair because it went to improving health provision available to everyone. It was rather like an insurance policy which paid out if needed.

The budget might also provide a gift to one or other section of society, such as the elderly or unemployed or the rich, in order to win electoral support, or to attract the approval of influential individuals. Such gifts might be in the form of tax reduction, or tax concessions for business. In this case there might be some notion of the need to achieve an acceptable standard, to move towards a fairer society. But this ambition was always tempered with expediency – enough must be given to head off public outrage.

Technical problems in the budgetary process

There are numerous examples of procedural inefficiencies in making budgetary allocations. Some of these are:

- The insistence that institutions such as hospitals should spend all of the money allocated for the current financial year, and punishing those institutions which failed to do so by withholding the unspent sum from the budget for the following year. This was a budgetary principle which was often applied in Britain, not just in hospitals. The government retreated in November 2007 from the proposal that it should also be applied to the budgets of state schools. This procedure was not conducive to budgetary prudence, but to its opposite of spending for its own sake, as it discouraged budget holders from saving a surplus from the current budget to buy something more worthwhile but more expensive in the next financial year. Being careful led to being squeezed rather than rewarded. This budgetary trick was obviously flawed. It was not one that sensible parents would recommend to their children.
- Another failure of procedure was the lack of any capacity for overall prioritizing once the budget had been determined. This problem was a common one in national systems and local authorities in the United Kingdom but which was rightly condemned in international organizations. It led to situations such as the following: a massive road building programme was set in motion at the end of the financial year, paid for out of allocated funds, because they would be lost if unspent, even though it had emerged that the local hospital was in severe need of capital investment. Or the use of hospital theatres was rationed because the budget of a hospital was at its limits, even though there were patients

in urgent need of operations, when, at the same time, massive amounts of money were being spent on new street lighting, or on signalling equipment for motorways. In the financial year 2006–7 British Government Ministers spent £6 million pounds from taxation in their use of cars, and MPs allowances and expenses increased to £95 million, when schools in their constituencies found it difficult to pay for qualified teaching staff (*The Independent*, Friday, 27 July 2007).

- Unfairness in the allocation of funds was often hidden because of the difficulty of comparison across sectors. If an increase were presented as a percentage of a particular account, without any note of what it meant in terms of a percentage loss to other accounts, the real value of the increase was hidden. It was as if the money in different accounts was in different currencies which were not convertible. In consequence there was rarely any discussion in the press about whether a particular spending decision made by government should be changed and the money spent on something else. In illustration of this consider that an increase of say 5 per cent in the Defence Budget, which seemed modest, was colossal compared with a similar increase in total spending on school maintenance. An increase of 10 per cent in spending on universities sounded enormous but in real terms was small compared with a modest percentage increase in defence spending. In the routine of accounting these figures were not set out side by side, so that the lack of any overall principle of allocation, such as fairness, was obscured. Making such decisions about priorities in Britain was entrusted to groups of specialists in the Treasury and in Town Halls. The public had no say in these decisions.
- A major difficulty in the way of even modest increases in taxation was that the public had no confidence in government's promises about how it should be spent. On the one hand was the lack of clarity about how much individuals might gain by a reduction in taxation compared with what they could lose. Reductions of say £500 might be judged to be not worth the candle if it were at the price of an effective health service.

On the other hand a proposal to increase tax on individuals by £500 in order to put the health service right was not believed. The fear was that such an increase would simply disappear into general taxation and that it would be hard to measure any benefit. One answer would be to have a guarantee by ring fencing, sometimes called hypothecating, an allocation of money. Money raised by a particular element of taxation would have to be spent on

a stated purpose. There would have to be a formal procedure for diverting money from a hypothecated fund if there were another genuinely more pressing need for finance. The lack of comparison across national systems was relevant here. It was difficult to persuade taxpayers in a particular country that their overall level of payment of tax was low, compared with that in another country. In the United Kingdom the public was completely persuaded that taxes, at 36 per cent of GDP, were higher than those in any other state in Europe, even though this was quite untrue. The highest level was in Sweden at around 50 per cent. The right wing political parties were of course very happy to promote this untruth.

Lower taxation did not necessarily mean worse public services but it probably did. Traditionally a central principle of the philosophy of the Conservative Party in Britain was that tax should be reduced to a lowest possible level, but the implications of such a policy for the public services was usually left unconsidered. Since the 1997 election there was, however, some evidence that this had changed. New Labour promised it would not increase taxation after coming into government in 1997 for at least two years. In 2007 the Conservatives promised they would not *reduce* taxation if they won the next general election.

- Often public money was used to subsidize the private sector, as when large sums were spent on roads which were intended to service speculative housing.

The conclusion from an examination of the budgetary process was that ethical considerations played a small role. It was not aimed at perfecting the fairness state, but rather at satisfying a range of conflicting utilitarian demands, each aimed at strengthening a particular narrow interest. At the head of this pyramid of demands was of course the demand of the government for re-election. It was likely to meet the needs of those who it thought had to be persuaded or rewarded, and did not reward those who it judged to be weaker or less important electorally.

In the history of modern states this failure led to a characteristic pattern of evolution. The French and Russian revolutions, and the emergence of trade unions and, later, the Labour Party in Britain, were all the result of budgetary unfairness. They were a response to the extreme privilege of the few, but this was brought home by the juxtaposition of great poverty and enormous wealth, the result of miscalculations by governments about what they could

get away with when they made their budgets. This is the point: budgetary decisions were at least as much about what a government could get away with in benefiting favoured interests as it was about that great amorphous thing, the public interest. Indeed the modern developed state was getting to be like a pork barrel. Developing states were often best seen as containers of valuables which individuals struggled to get for themselves, their families and their tribes at the expense of the other citizens. But this image also seemed to fit the modern USA quite nicely. It had become a pork barrel from which those who could helped themselves. The idea of the public interest, so strong in the minds of the founding fathers, had become a fig-leaf for private greed. The need to return to some sense of the public good was one of the themes of the 2008 Presidential election, and in Britain the overall unfairness of the balance of tax contributions and budgetary expenditure was brought home by the financial/economic crisis.

The total take of taxation was of course relevant to the problems of making budgetary decisions. Deciding between budgetary priorities certainly becomes more difficult when the tax take is lower. In Britain, at one end of the scale, there were significant numbers of workers who earned too little to pay income tax and who received contributions out of tax in the form of tax credits. At the other end were the rich who avoided tax by various means, from tax havens, to non-dom privileges. If there was not enough in the pot part of the reason is now clear: on the one hand were those who earned so little that they could not pay, on the other hand were those who earned so much that they could ensure they did not pay.

Private or public?

There may be good reasons for not having higher levels of taxation, such as the difficulty in trusting governments about how it should be spent. But it did not follow that doing more through the private sector was necessarily better. The right wing of the political spectrum had it that government should be small and individuals should be allowed to keep most if not all of the money they had earned. But a little thought would lead most people to conclude that it was better if society, that is people in general, took on responsibility for some actions since that way they could be done better.

For instance every society required some common infrastructure such as a road system or an effective way of dealing with fire or flood. For these activities it was not very important whether they were built by the government or private

enterprise, as long as they existed and were efficient. There were however many others where the general feeling would be that the market should decide. As pointed out in the Introduction most would accept that the purchase of toasters should be left to individual decision among a range of products produced in competition between different designers and manufacturers. The problem of course is finding the right place to draw the line between these two ways of meeting the needs of individual citizens. The financial crisis of the autumn of 2008 reopened a debate that many thought had been settled. The crisis was largely the result of leaving too much to the private sector and inadequate governmental supervision and regulation. Much to the surprise of those who had become resigned to the triumphalism of neoliberal free marketeers, there was now a realization that the market could not be left to itself.

No one should be fooled into accepting that it was necessarily morally superior for individuals to carry more personal responsibility directly and for the state to carry less. There were political philosophers at the time of Mrs Thatcher's government who argued that the state should retreat from performing charitable functions such as coping with orphans, dealing with abused children and providing homes for the destitute. This should be regarded as an objectionable view. Thatcherism was an ideological bandwagon onto which many ambitious right wing political philosophers in the universities climbed, some of whom now prefer to keep this quiet. They held, in the fashion of the times, that it was morally better that charities should deal with the sick and destitute, that labour in this should be voluntary and the money provided by gifts from individuals. But few, even under Mrs Thatcher, went so far as to say the government should have no role in welfare. Leaving so much to private charity also became problematic when it emerged that the super-rich were not very good at giving.

For the right wing in the universities and the political system the next step did not need arguing. It was an obvious truth. Health should be privately funded. Unemployment benefit should be minimal. Indeed every activity previously carried out by the state could be a candidate for transfer to private hands. In Britain the business ethic and the skills of private management were mysteriously judged to be superior to those of hallowed public institutions such as the universities. Despite the world class reputation of British universities and the notable failure of British business managers, universities were put under pressure to appoint a majority of businessmen to their governing councils. In Britain, electricity generation and distribution,

gas manufacture and distribution, the railways, and water supply were all privatized by Mrs Thatcher or by her successor John Major.

This great experiment in the transfer of wealth did, however, have the useful consequence that its advocates were shown to be wrong. Placing more and more in the hands of businessmen did not lead to greater efficiency. In some cases efficiency declined. At the centre of the range of government activities that affected the lives of most individuals in the modern state were the welfare services. These could be better in providing support for those in need, or they could be worse. Better generally meant higher taxation and more done by the state. Worse generally meant lower taxation, and more done privately. Both systems could be efficient, both could be inefficient. The difference was that privatization meant that more individuals were able to impose a levy as profit on activities that had previously been not for profit. There was certainly an expanded revenue stream for a few, but most individuals noticed no improvement either in the more efficient provision of services or the lowering of taxation.

The US experience was that private provision could be highly inefficient, with impenetrable bureaucracies, impossibly slow and evasive responses, and an energetic commitment to limiting obligation. This was a fact of life known to most Americans which the ideological right wing in Britain would not acknowledge. This system worked well for those who could afford to pay more for excellence. It worked badly, if at all, for those who could not afford health insurance, which was true for around 40 million Americans.¹⁰ Middle-class Americans lived in constant fear of long-term illness for themselves and their dependants, which could drain their personal resources dry. Such illness could literally pauperize families. Beneficiaries from this system were the rich, the medical profession, which was ludicrously overpaid, the drug companies, which could charge what they thought the market would stand, the owners of hospitals and the insurance companies which demanded their profit.¹¹ This system of private medicine was strongly defended by the doctors' management committee, the American Medical Association, for reasons which were essentially and selfishly commercial, rather than for any argument about the responsibility of doctors to patients' health.

In contrast the British NHS was free for everyone, it had a system through which it negotiated the price of medicines with the drug companies, and did not pay a rake off to insurance companies – except to cover cases of negligence. The problems with it were that there were often waiting periods

for treatment in non-urgent cases. Conditions in hospitals might be less congenial with mixed sex wards, rather basic food and excessive pressure to free up hospital beds, non-use of some expensive drugs and, by the 1990s, problems in controlling hospital infections. These were certainly good reasons for vigorous complaint. But they were not because the system was run by the state, but rather because the system was in some regards badly run by hospital authorities. One reason for this was that generations of British governments had kept the system short of funding, providing around half of the resources per capita compared with other European health services.

Another reason was a consequence of Thatcherism: the outsourcing of responsibility for essential work such as cleaning and hygiene to private companies which let standards slip to increase profits. Tony Blair's government determined that the amount spent in Britain on health should be increased to the level of other European countries. Unfortunately the increases in funding were not spent entirely sensibly. Some very serious errors were made. For instance the salaries of general practitioners were increased by about 50 per cent from the mid-1990s and their workload reduced. Another reason was the entrenchment of bad habits among middle and senior ranks of the medical profession which tolerated inefficiencies and sometimes shielded negligent colleagues. A further problem, which was revealed as overwhelmingly important, was the increasing commitment of hospital managers to achieving targets and good financial performance. The output in terms of the health of patients became of secondary importance.

By the later years of the first decade of the twenty-first century it seemed that both right and left had committed themselves to spending more on the NHS and getting rid of its inefficiencies rather than going private. There was some realization that individuals could receive their wages either directly from their employer, or from the state in the form of what was called a social wage. It did not matter morally or from the point of view of efficiency if one was higher than the other. But there were some gains in efficiency in having a higher rather than a lower social wage. For instance an NHS could more easily force down the price of the drugs it needed and would deny profits to intermediaries such as the insurance companies. It could also more easily reduce the social costs of having an unequal distribution of health support. Such costs were entailed in the form of untreated illness and inadequate vaccination programmes, which amounted to an informal transfer of the failures of the private sector to the public sector. This was the root cause of

the reappearance of significant rates of tuberculosis infection in some US cities, such as New York, in the late twentieth century.

Given enough spending a private system could be as comprehensive as a public one, but only if every potential customer had the means to pay for private treatment. This would mean that in a civilized state with high levels of private provision, wages had to be high enough to cover the necessary payments. But in practice the argument for more private provision was an argument for having a worse system and paying less for it. In the United States in the twenty-first century almost the first step taken by the Ford Motor company to get itself out of the red was to reduce its support for workers' health.

Privatization did not always improve things. The British record on stripping business away from the state and selling it to the private sector was a mixed one. There were obvious failures, such as the privatization of the railways (see Chapter 5) and some cases of good performance, up to a point. The privatization of electricity and gas manufacture and distribution could be rated a success. It was able to capitalize upon a surprising discovery that the distribution system for the various forms of energy need not be owned by the energy-producing companies. Gas was gas and could be put in the system anywhere by any supplier and taken out anywhere by the consumer. The same was true for electricity. The one probable source of inefficiency in these two sectors was that there appeared many separate companies at various stages in the system each of which took a profit. The company that bought or made the energy was separated from the company in charge of distribution. The company that maintained the boilers or wired the houses was separated from the first two. Before all of these there had been one public supply company which aimed to cover costs. Now each bit took its profit.

Another problem with the private sector's control of energy appeared in 2007–8. This was the lack of any mechanism for acting quickly in the consumer's interest to reduce charges when the price of oil fell, which happened in October 2008. The privatized companies had an obligation to shareholders which naturally obliged them to make as much profit as they could. The government was left with no option but to appeal to the companies to reduce their charges more, and more rapidly, to reflect the reduction of costs to consumers.

Does the British experiment with privatization lead to any conclusions about where the line could be drawn between the public and private sector? There were natural local monopolies which should have remained in state

hands. An example of this was the supply of water. This industry could not be competitive since there was no national distribution system. Water companies became notorious for their inefficiency with regard to the maintenance of the local systems of supply. They also became notorious for their reluctance to spend their regulated profits on the improvement of the supply or purity of water. (Profits had to be capped by regulation to prevent the exploitation of monopoly.) The owners of water companies often spent their earnings on investments in other more profitable companies such as television companies for the greater benefit of managers and shareholders. They were also sometimes sold on to companies which had a reputation as asset strippers. Thames Water was bought first by a German company and then by an Australian company, Macquarrie, which had a reputation for asset stripping. (More about this in Chapter 2.) The conclusion had to be that water privatization was a costly failure.

Having lower levels of taxation, and a bigger role for the private sector, rather than paying higher levels of taxation and receiving a bigger social wage was neither morally superior nor necessarily more efficient. Indeed some degree of lower efficiency in the public sector was more than offset by the profit taking and asset stripping on transfer to the private sector. Too frequently the essence of the budgetary nonsense in this context was that the debate was not about efficiency, rather it was about ways of reducing the social wage. It was easier to pay less in total, from the public and private budgets together, if more was done by the private sector. In other words the argument for privatization was often an argument for a less civilized state, and a moral argument in favour of making individuals self-reliant. This was precisely the argument which led a Tory government in 1846 to view with indifference the mass starvation of the Irish because of the failure of the potato crop. It would have been possible then to reduce the export of wheat and to use it to feed the Irish, but the government insisted that such help would undermine self-reliance.

The line between what was better privatized and what should not be privatized did however need to be discussed. There were privatizations in Britain that seemed to be successful, though attempts to prove this beyond any reasonable doubt were not persuasive. Economists used arguments in support of privatization which rested more on political ideology than economic logic. It was extraordinary that it could be supposed, as it was by some right wingers, that those who decided to pay their taxes so that the state could pay for welfare were being less moral than those who supported charities directly.

The above argument has demonstrated that decisions about how to spend and save public money in Britain were made for various reasons, some ideological, some virtuous, and some to do with political expediency, and often they were subject to technical constraints which affected ability to target resources where they were needed. The conclusion has to be that the budget in Britain was only loosely related to the idea of achieving a just society. Rather it was a forum for contention between political philosophies with rival views about the role of the state. It had little concern with achieving equity as between individuals, and, it follows, in moderating the increase in the inequalities of incomes which led to the appearance of a class of super-rich. The next question to be considered is the external consequences of this kind of budget – was it better, from the point of view of inward investment, for Britain to have a budgetary process which allocated money in such a way that, according to the Anglo-American socio-economic model, the social wage was kept low and the private sector was favoured? Were the social democratic states in Western Europe, with high levels of welfare spending, likely to lose out?

Money from outside

Neoliberals held that the correct budgetary priorities of successful modern states should rest on low levels of taxation, lower levels of government spending, less regulation and as big a role as possible for the private sector. Their view was that high tax and welfare spending discouraged economic development and frightened investors away. In other words their views supported the development of private capital ahead of public capital, and encouraged the emergence of the inequitable distribution of wealth found in modern Britain.

It was not, however, as simple as that. The pattern of direct investment (FDI) flows into the EU states in 2004–5, and other indicators, according to OECD figures, appeared not to be correlated with tax levels, and did not reveal any noteworthy differences between the states that had generous welfare systems and those that were not generous (see Table 3.1). International business found the economies even of countries with generous welfare systems attractive. There was some indication that the form of taxation rather than its level mattered. Total company taxation and higher employer social security contributions seemed to correlate with lower inflows of FDI. The figures suggest that changes in inflows and outflows of FDI changed rather quickly.

Table 3.1 Direct Investment Inflows and Taxation¹³

Direct investment inflows as Per Cent of GDP			Taxation 2003				
Country	2005(04)	1995(94)	Total as Per Cent of GDP	Per Cent from Personal Tax	Per Cent from Employer Social Security Contributions	Per Cent from Corporate Income Tax	Per Capita GDP in \$ Defined PPPs ^a
Belgium and Luxembourg	16.50 (22.17)	3.69 (3.32)	Belgium 45.4	Belgium 31.4	Belgium 19.1	Belgium 7.4	Belgium 32,500
Luxembourg			41.3	17.1	12.4	19.1	67,700
Czech Republic	8.98 (4.17)	4.92 (1.99)	37.7	13.0	28.0	12.3	20,200
United Kingdom	7.48 (3.69)	1.73 (0.89)	35.6	28.7	10.3	7.8	32,100
Netherlands	6.99 (?)	2.97 (?)	38.8	17.9	11.6	7.6	34,200
Hungary	6.14 (4.16)	11.30 (2.73)	38.5	18.9	24.1	5.8	17,200
Sweden	3.83 (−0.53)	5.82 (2.98)	50.6	31.3	22.9	5.00	32,700

France	2.99 (1.19)	1.90 (1.15)	43.4	17.5	25.7	5.7	30,200
Germany	1.17 (?)	0.67 (0.34)	35.5	23.9	19.9	3.5	29,800
Italy	1.11 (0.22)	0.40 (0.22)	43.1	25.1	20.6	6.6	28,500
Ireland	−11.28 (7.75)	2.17 (1.56)	29.7	26.5	9.2	12.9	39,200

*PPPs: Purchasing Power Parities, obtained by evaluating the cost of a basket of goods and services between countries for all components of GDP.

(?) Not available or negligible.

Source: OECD in Figures, 2006–2007 Edition, Paris, 2007, pp. 12–13, 60–61, and 64–65.

In 1998 the only countries which had a positive position on direct investment flows defined as a percentage of GDP were Austria, Denmark and Ireland. All the rest, including the United Kingdom had a negative position.¹² Close to balance, though still in deficit, were Sweden and Belgium/Luxembourg. The United Kingdom had a negative balance, with outward flows at 55 per cent of inward flows.

The figures on flows of direct investment in Table 3.1 are revealing in that they reveal very little. They do not demonstrate that the new members, with their relatively ungenerous welfare systems, or the older ungenerous members, such as the United Kingdom and Ireland, had a great advantage when it came to attracting inflows of foreign investment.¹⁴ Measured as a percentage of GDP the winner in 2005 was Benelux, with Belgium a generous provider of social benefit, and Luxembourg a less generous provider. Among the older members of the EU the United Kingdom seemed to have done well in 2005, but in 2004 was behind the new members, Benelux and Ireland. Ireland's performance was somewhat erratic in that there was a significant outflow of foreign investment in 2005, though there had been significant gains in earlier years. The United Kingdom's good performance in 2005 was, according to one report, largely due to a major one-off international merger.

The performance of the heartland social democratic countries varied from very good for the Netherlands in 2005 at 6.99 per cent – only marginally behind the United Kingdom (and well ahead of the UK's 2004 figure) – to modest improvement for France, Germany and Sweden. France benefited from inflows to the amount of 2.99 per cent of GDP. (One report stated that inflows from the United States into France had exceeded those into China in 2006.) But France and Germany, like most EU members, had moved strongly upwards since the mid-1990s.

The difference in performance between the member states was not strong enough to justify the claims of neoliberals that social democracy was a failing system. A glance at the figures on direct investment positions in the heartland countries and in the United Kingdom and Ireland confirms this point. With the exception of Ireland there was marked increase, and though the United Kingdom was ahead on inward and outward investments, the other countries showed significant totals (Table 3.2). The figures on per capita GDP suggest that their economies were well capable of generating high incomes for their citizens. The value of inward investment in France and Germany was less

Table 3.2 Leading EU Direct Investment Positions in Billions of US Dollars

	Inward		Outward	
Countries	2004 (2003)	1994	2004 (2003)	1994
United Kingdom	707.9 (609.0)	189.6	1268.5 (1235.9)	276.7
Germany	675.6 (659.5)	87.5	754.6 (718.1)	194.5
France	619.6 (520.2)	163.5	829.3 (720.2)	182.3
Netherlands	501.1 (433.4)	93.4	595.4 (544.4)	142.9
Ireland	(?) (217.2)	0.0	(?) (238.9)	(?)

(?) Not available or negligible.

Source: International Direct Investments Statistics, OECD, Paris, 2006–2007.

than in the United Kingdom, but the difference did not seem to justify the claim that the Anglo-Saxon model was necessarily superior.

The figures on direct investment reveal only a part of the pattern of economic improvement in Europe. In 2006 it was noted that, though further legislative and regulatory reform was needed, there were various signs of the growth of European economies.¹⁵ By 2003, of the 20 biggest non-financial multinationals ranked by foreign assets, 13 were European. In 2005 direct investment out of Europe was 20 per cent higher than in 2003, and exports rose from 17.6 to 19.2 per cent of world market share between 2000 and 2005, despite the rise of China. Inflows of FDI into the 15 pre-enlargement states between 2000 and 2005 amounted to half of the global total, and equity returns in Europe outperformed those in the United States. There was new confidence in the recovery of the traditional leader of European growth, Germany. Though unemployment remained high there were signs that it was beginning to decline. The point here is not to demonstrate that all was well, but rather that the view that European social democracy was a recipe for economic disaster could simply not be sustained. As reforms were being introduced, be it too slowly, so growth was beginning to accelerate. But even before reform had got off the ground – around 2002 – improvement was taking place.

The consequences of the global economic crisis made this even more apparent. The social democracies seemed to be weathering the storm more effectively than the Anglo-American economies, and they had stronger welfare systems to cushion the individual distress caused by the crisis. If any economic model could be said to be the cause of the collapse of international banking it was the Anglo-American, light regulation, lower social wage, and lighter taxation one, and not the social democratic one characteristic in various forms of the rest of Europe. There was suddenly in the autumn of 2008 a new enlightenment about the value of a strong government role, and the costs of the arms length relationship of government with banking which had been previously recommended. In other words the experience of the autumn of 2008 is revealing about the overall error of having the kind of economic and social arrangements which encouraged the appearance of the class of the super-rich and lodging it in London. The most successful exporter in Europe remained the social democratic Germany, not the United Kingdom, and poor internal demand was a reasonable explanation of high levels of unemployment. Worker productivity in Germany was the highest in Europe.

Conclusions

In the early twenty-first century the debate about European economies revolved around the question of whether the 'the European Welfare state must die'.¹⁶ The key problems to be tackled were slow economic growth and high levels of unemployment – amounting to 10 per cent in France and Germany in 2006. The discussion of the real problems in the press was greatly confused by the intrusion of ideological considerations. Neoliberals and right wingers saw the issue in moral terms: publicly supported welfare was bad for individuals, since it sapped their will to work, and the rich were robbed through high taxation. Little regard was given to the view that there was such a thing as a civilized state, marked by justice for all, the protection of the weak and a low level of differentiation between the mean salaries of the top 10 per cent of the population and those of the bottom 10 per cent. Too often, also, the debate employed weasel words: the word reform was used to mean spending less, and the word poor meant idle and undeserving.

Real reform could take place without abandoning the European social model. But the right wing rhetoric, pushing for its view of reform, made real reform less likely because of the fear that change if accepted would mean tolerating extreme poverty and the kind of private affluence and public squalor

found in parts of the United States and, increasingly since Mrs Thatcher in the 1980s, in the United Kingdom. The difficulties found by governments in France and Italy, in particular, in bringing about reform was partly because of this and partly because the leaders were not themselves clear about the possibility of defending welfare spending, accepting sensible reforms, as well as introducing beneficial change. They could not free themselves from the shadow of neoliberal economics. This situation was much changed by the economic crisis: it was the Anglo-Americans who were now on the defensive.

The welfare states of continental Europe were also criticized for having excessive support for their labour force, which therefore became inflexible, and too expensive. This was the point where the arguments of the neoliberals collided head-on with those of social democracy. The neoliberals interpreted flexibility of labour as the employers' right to fire, and the workers obligation to look after him- or herself. Social democrats in contrast realized that the need was for effective systems for helping workers to move from one job to another. This would mean a number of forms of support: it would mean protecting incomes during the period of adjustment, providing effective retraining, and providing efficient systems for advertising work and facilitating the new placement. The right wing would argue that workers needed the threat of extreme poverty to adjust. Some might – and some incentives might well be needed. But the overall system in a civilized state had to be one which supported, retrained and re-placed.

The moral codes of the mumbo-jumbo right wingers, so powerful in neoconservative America, and highly influential in Britain, had to be met with greater clarity and less fear.¹⁷ It was also necessary for them to grasp the reality that the over-rich would have to pay more. One of the greatest benefits of the economic crisis was that it took the wind out the sails of the neoliberals. Their righteous condemnation of the civilized state was revealed as a cloak for making themselves richer come what may.

Nevertheless the principle of fairness was not the predominant one when it came to public budget making in modern Britain. What seemed to have happened was that the government placed more stress on the appearance of success for the country as an organic entity, as is summed up in the expression now often used, of the UK Ltd, rather than on the achievement of good standards for all its citizens. In the election of 1959 the British Prime Minister told the British people 'you have never had it so good'. At the time this seemed fairly non-contentious and no group sprang up to say 'not for

me mate'. Fifty years later a British government could not be so direct in its claims for fear of being contradicted.

In contrast, however, the experience of other European states supports the view that Britain could strive for higher standards of fairness with regard to all its citizens, through what was conventionally called social welfare, without losing FDI. Greater national fairness did not come at a price.