

The Crisis of Conservatism

Remarks to the Big Tent Festival of Ideas

Rt Hon Liam Byrne MP
Friday 22 September 2017

Thank you very much for inviting me to speak today and I hope you have enjoyed this week's Boris and Theresa show – that epic battle of charisma versus cardboard – just as much as I have.

I suspect you know as well as I do that this is in fact far more than a conference-season game of thrones.

The Theresa-Boris show is not a *cause* of division; it's a *symptom* of a much deeper confusion within the Conservative party about how to come to terms with the new realities of the world around us – and crucially whether or how to escape from the deep grip of five decades of New Right orthodoxy.

Renewal in office is always hard. Believe me, we tried it.

But it is harder still when you need to reinvent both the politics and economics of an approach that once worked well for you, but which today is but faded and jaded.

In office, political parties, like companies, always face an innovator's dilemma. Do we string out a winning formula? Or do we take the leap and change?

Labour is moving through those gears as we move decisively beyond the politics of the third way and build on our manifesto.

And for those of you I convince today, I have with me plenty of Labour Party membership forms – and I’ll be pleased to sign you up at the end.

Now, you can’t explain a crisis without a bit of history. And for the old New Right, first came the politics and then the economics.

Although some trace the movement back to Walter Lippman’s *The Good Society*, the founding fathers were the three Austrians: Karl Popper, Ludwig von Mises and Friedrich Hayek.



Popper (left); Hayek (Middle) and Mises (right)

Together, they took aim at Roosevelt’s New Deal and Labour’s plan to ‘win the peace’, which they saw as a Left-wing ‘plan’ to design, build and operate a centrally-planned economy.

They challenged the idea that anyone could masterplan Utopia: “We cannot possess such knowledge since we have insufficient practical experience in this kind of planning, and knowledge of facts must be based upon experience”, wrote Karl Popper.

Nor, they argued, could the new Jerusalem be built in a world where the price system is demolished. “Once centralisation is necessary,” said Hayek, “the problem of coordination arises... This is precisely what the price system does...and which no other system even premise to accomplish. It enables entrepreneurs, by watching the

movement of comparatively few prices, as an engineer watches the hands of a few dials, to adjust their activities to those of that fellows.”¹

Third, they argued operating such a society would be so complicated that decisions would be outsourced to experts, risking an inexorable slide to dictatorship.

To this thesis, thinkers like Milton Friedman added a powerful critique of Keynesian demand management, which in the cold light of the 1970’s began to look rather attractive as governments were forced to replace the inflation-managing-fixed-exchange-rate machinery of Bretton Woods with ever more intrusive micro-management of wages and prices.

Friedman’s *Theory of the Consumption Function* and his monumental *Monetary History of the United States*² underpinned an argument that control of monetary policy and shaping individuals’ rational expectations were the keys to fostering growth.

To this formula, the supply-siders added a twist. Within three years of President Nixon declaring ‘I am now a Keynesian’, modern supply side theory took shape. First coined in a paper presented by Herbert Stein in 1976, and fuelled by the anti-tax protests of the late 70’s, supply side theory became part and parcel of the Thatcher-Reagan project.

Supply-siders think many things but nothing is more important than fueling the supply of *capital* to power growth.

¹ Hayek, p.36

² Published with Anna Schwartz

To do this, nothing is more important than tax cuts, especially for the wealthy. As Larry Lindsey, George W. Bush's Chair of the Council of Economic Advisors, put it: "in its simplest form the supply side claim has been 'taxes matter'".

Thus Reagan, like Thatcher, proposed sweeping tax cuts, a formula that George W. Bush eventually took to the extreme, slashing Federal revenue in 2004 to the lowest level since 1959. It was a model George Osborne tried to emulate, inaugurating the bitter legacy of today's austerity.

So here was the New Right formula: manage money supply, maximise markets, minimise states.

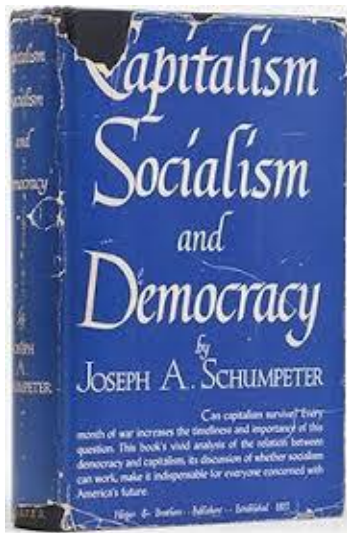
But the challenge for the new neoliberal today is this: their formula cannot handle *liberalism* and its consequences, which have taken shape since the turn of the century.

The law of comparative advantage is about as close as you get to a consensus amongst economists. It inspired the free trade and free exchange of ideas that was the great achievement of 19th century liberalism.

This idea inspired both left and right to transform the world economy after the death of Mao and the collapse of Soviet Communism. Together, we built NAFTA, the World Trade Organisation and doubled the size of Europe to create a marketplace that linked 6 billion of the world's seven billion people. It was quite a *fin de siècle*.

We bet that trade and tech together would deliver the tax we needed to rebuild public services and roll-back inequality.

But the best explanation for what followed is offered by another Austrian: Joseph Schumpeter.



It was 75 years ago this year that his book, *Capitalism, Socialism and Democracy*, popularised the idea of creative destruction: "The opening up of new markets," wrote Schumpeter, "and the organisational development from the craft shop and factory to such concerns as U.S. Steel illustrate the same process of industrial mutation... that incessantly revolutionises the economic structure from within, incessantly destroying the old one, incessantly creating a new one."

Now, Schumpeter famously forecast that capitalism's success would inexorably lead to socialism. I wish! In fact, it is leading to nationalism.

Why? Because people forget the flip side of creative destruction that Schumpeter forecast is the *destruction of competition*; the emergence of vast new oligopolies with the power to drive forward progress – yes – but also to set prices – and wages.

This is precisely what is happening today...

The creation of vast new global markets has transformed the commanding heights of capitalism; huge new companies bigger than countries have taken shape with unprecedented market power.³

A \$20 trillion merger wave inside America and around the world has created exactly the sort of oligopolies Schumpeter predicted; giant new firms with unparalleled power to set prices – and wages.⁴ Just as they were taking shape, one billion people

³ Few have argued this point as early or as effectively as Prof Peter Nolan. See for instance: <https://academic.oup.com/cje/article-abstract/32/1/29/1685937/The-global-business-revolution-the-cascade-effect>

⁴ See for instance, https://obamawhitehouse.archives.gov/sites/default/files/page/files/20151016_firm_level_perspective_on_role_of_rents_in_inequality.pdf or <https://www.economist.com/news/briefing/21695385-profits-are-too-high-america-needs-giant-dose-competition-too-much-good-thing>

entered the labor force in a massive movement from “farm to factory”⁵ offering these new global firms new power to outsource production to wherever costs were lowest, while the transformation of technology meant that in industries like automotive, robots are already two-thirds cheaper than people.⁶

These firms do everything they can to destroy the theoretical, nice-to-read-in-textbooks, utterly abstract, perfect competition that is the very foundation of New Right theory.

The vast spending by giant firms – on tech, on brand, on creating standards – means together, as Obama’s White House put it, new mega-corps have monopsony power:⁷ the ability to dictate wages while workers lose all power to ‘vote with their feet’ and move to different firms paying better because those alternative opportunities simply did not exist.⁸

This fundamental change has ruined the political economy of ‘trade, tech and tax’:

- The new inequalities created by low wages have become almost too big to bridge with a politically plausible level of redistribution.⁹
- The innovation that creates high wages simply didn’t diffuse throughout the marketplace in the way it once did. Big firms make sure it doesn’t. So good ideas are hoarded by what the OECD call ‘frontier firms’,¹⁰ high-tech behemoths like Apple or Boeing or GE, which dominate all around them. If you are lucky enough to work there, you do well. But if you don’t, you don’t.

⁵ McKinsey & Co, The world at work: Jobs, pay, and skills for 3.5 billion people

⁶ In the American, European and Japanese car industries, it costs \$8 an hour to employ a robot for spot welding, compared to \$25 for a worker

⁷ See Council of Economic Advisors Issue Brief, Labour Market Monopsony: Trends, Consequences, and Policy Responses, October 2016

⁸ <https://stats.oecd.org/glossary/detail.asp?ID=3265>

⁹ See HM Treasury, Draft paper on Issues and Prospect for Medium and Low Income Households, 2010 at http://liambyrne.co.uk/research_archive/challenge-equality-britains-squeezed-middle/

¹⁰ <https://www.oecd.org/eco/growth/Frontier-Firms-Technology-Diffusion-and-Public-Policy-Micro-Evidence-from-OECD-Countries.pdf>

- Third, creating global markets without effective global regulation created huge new risks in the booming, unbalanced, inter-connected banking sector, which, when it collapsed, brought down the roof on all of us.

We thought the old law of comparative advantage would mean new trade and wealth that would lift all boats. Instead, the old law of comparative advantage became a new law to advantage the comparatively rich.

Proof? Today, half of global wealth is owned by just 1% of the world's population; 85 families own more than 3 billion of the world's people.

The terrible result of this is that the relationship between economic and political freedom is breaking down. Back in 1980, economically free states powered about 75% of global growth and grew much faster than unfree states. Now, the politically and economically unfree states are growing faster than the free.

Now as it happens, Karl Popper knew full well that this Paradox of Sovereignty was likely. "Freedom...defeats itself, if it is left unlimited" he wrote in Social Philosophy. "Unlimited freedom means that a strong man is free to bully one who is weak and to rob him of his freedom".

Just like Mike Ashley's regime at Sports Direct.

Countries with 'low' political freedom are now growing nearly 50% faster than countries which are 'free'

Countries with 'low' economic freedom are now growing nearly a third faster than countries which are 'free'

But this paradox of freedom affects most workers in Britain today.

Economic freedom has led to inequalities of economic power, which in turn now limit the economic freedom of millions and their power to earn a good life; workers today are confronting the worst squeeze on living standards since the days of Dickens.

So it's no surprise that the Conservatives are in crisis. And the Boris and Theresa show underlines the confusion about which way forward might be right.

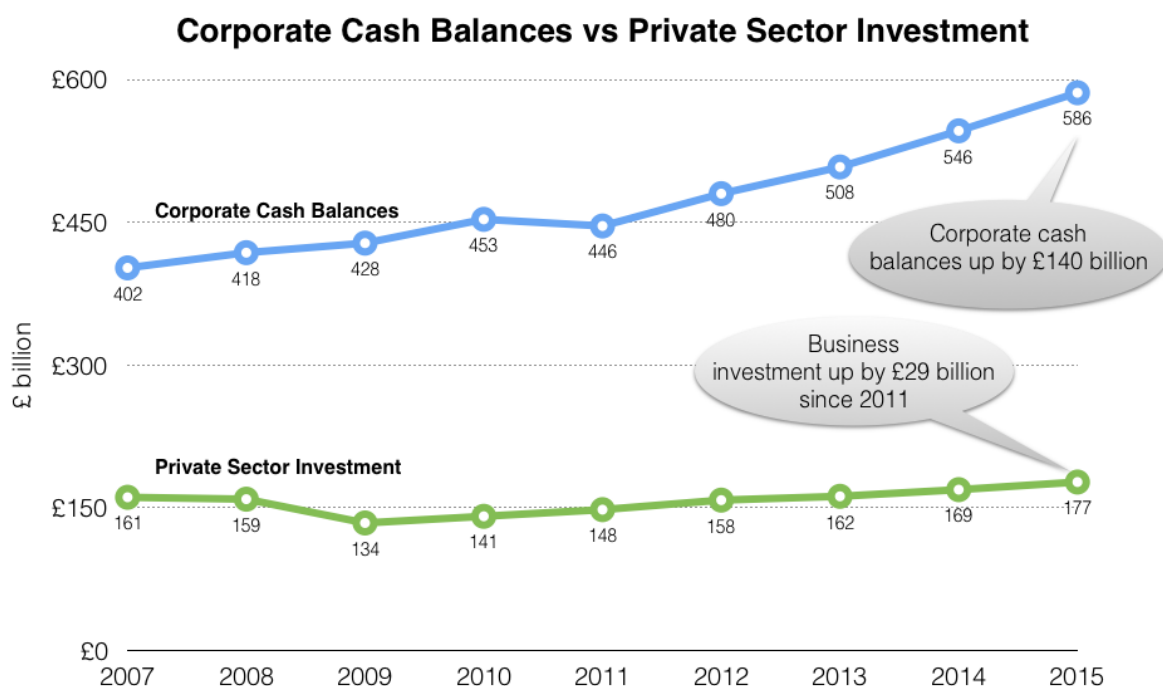
Both now face two road-blocks to reform: first, the wrong analysis of what factors fuel modern growth; and second, a reluctance to reform or renew the institutions that might ensure that growth is stable and shared.

Let me explain.

TRAP 1: SUPPLY SIDE FANTASIES

First is the challenge of escaping supply side economics.

Supply side economics traces its roots to 19th century thinking. It's a basket of ideas but the most important is that supply of *capital* is what drives long term growth. That is why George Osborne cut the top rate of tax (claiming in fact, like Ronald Reagan, that it would pay for itself) and why both he and Philip Hammond are slashing corporate tax to all-time lows.

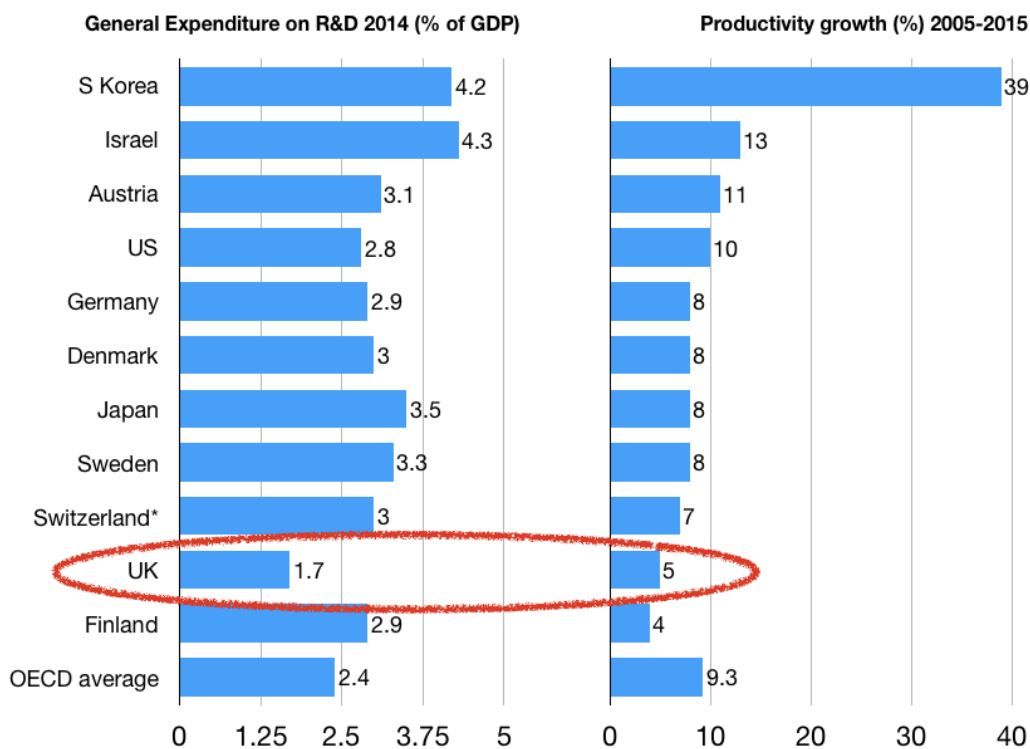


The problem for supply-siders is that *capital* is not the factor driving growth in the 21st century. Corporate tax cuts totalled an extraordinary £25 billion in the last parliament. But most of the money has been hoarded by firms – not invested but put in the bank. So, since 2010, corporate cash balances have grown five times faster than investment.

The truth is that the supply of *capital* is simply not as important to economic growth in the 21st century as the supply of *knowledge*. Knowledge is by far and away today's most important factor of production but Britain today has one of the lowest spends on R&D in the OECD.

Yet, because the supply-siders reign in the Treasury, in the last Parliament corporate tax cuts were 25 times greater than increases in science spending.¹¹ Now, to hit the international benchmark of 3% of GDP, we need to raise science spending by something like £23 billion a year.

The UK under-invests in science - and UK productivity grew between 2005-2015, at 5% compared to 9.3% in OECD's high science spenders



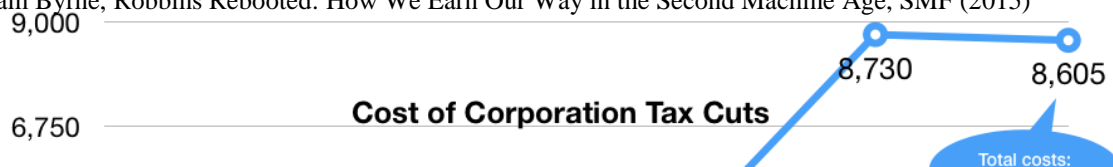
This helps explain the reality of why only one in five British workers earn their crust in ‘knowledge intensive industries’ where on average pay is 40% higher than average (that’s £161 a week)¹² and why – surprise, surprise – we have low productivity growth.

By contrast, countries (with the exception of Finland) that spend more on R&D have seen rates of productivity growth way ahead of ours.

The Conservatives Have Spent 25X More On Corporation Tax Cuts Than Science

¹¹ The House of Commons library estimates the (forecast) of corporation tax cuts totalled £25.5 billion. Science spending increases, net, were around £255 million.

¹² See Liam Byrne, Robbins Rebooted: How We Earn Our Way in the Second Machine Age, SMF (2015)



TRAP 2: EDWARD BURKE

Now, suppose Mr Hammond recanted. Suppose he agreed with me. Conservatives would still then confront the problem of how to connect gains in national productivity with rising wages.

The relationship between productivity growth and wage growth broke down some years ago. And we are struggling to rebuild it.

But that task is impossible unless we reform, re-invent and, in some cases, invent the *institutions* that shape our market place.

Now there is an affection for institutions in some parts of the Tory party; that bit, what's left of it, with a reverence for the ideas of Edmund Burke.

Burke argued we need something to transmit tradition and experience down the generations: “a partnership not only between those who are living, but between those who are to be born.”¹³

But there is an incredible reluctance amongst Conservatives to review or rebuild them. This instinct is born of that Conservative scepticism best expressed by TS Elliot: “From the crooked timber of humanity, no straight thing can ever be made.”

The problem is even worse for the New Right, which, in its disdain for Government, too readily sweeps clear the public realm altogether in some misguided view that ‘there is no such thing as society’. For the new right, progress is only made by getting government out of the way. Maximum market; minimal state.

This is wrong-headed.



From the earliest English market charter, we see markets have been and always were social institutions. There are no ‘natural’ laws. Society gets to write the rules.¹⁴

In my book, *Dragons*, I tell the story of 700 years of British capitalism through the lives of ten of our greatest entrepreneurs. It’s an epic read. With angels and demons. High and lows. Think *Horrible Histories* meets the *Apprentice*. The economic history that emerges is clear.

Entrepreneurs make history by inventing the future. But down the ages there would have been no British entrepreneurial miracle if it wasn’t for our social technology, which at great moments had to be invented and re-invented.

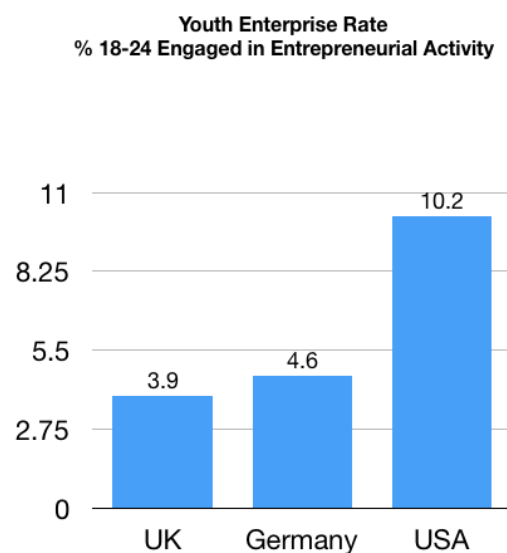
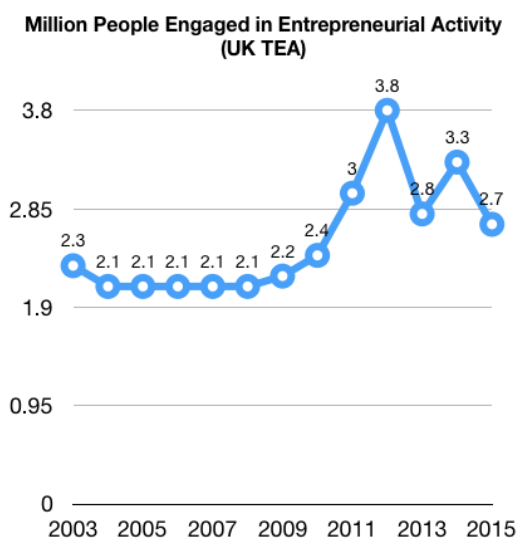
¹³ Edmund Burke (1790), *Reflections on the Revolution in France*, Oxford University Press, 1999

¹⁴ For a longer account of this argument see Robert Reich, *Saving Capitalism*, Icon Books (2016)

Think of parliamentary control of tax, the Royal Navy, the Royal Exchange, the Royal Courts of Justice, the Royal Society, monopolies like the East India Company created and abolished, the patent system, limited liability companies and the welfare state first pioneered in places like Bournville, Port Sunlight and the board rooms of John Lewis.¹⁵

Institutions matter to growth because the ‘visible hand’ of the public realm has always helped the invisible hand of the private market to deliver, creating that treasured ‘cooperation without coercion.’¹⁶ Institutions help create the stability and opportunity on which entrepreneurs do their thing. The poor shape of our institutions is one reason why we don’t have enough entrepreneurs.

OVER A MILLION PEOPLE HAVE LEFT ENTERPRISE IN THE LAST 2 YEARS - AND BRITAIN’S YOUNG PEOPLE ARE NOT AS ENTREPRENEURIAL AS EITHER GERMANY OF THE USA



Today, our institutions are not fit for purpose. They do not connect people with progress and what is needed is a new settlement that rewrites the rules of the

¹⁵ This is, if you like, a verification of the the insight offered by the late, great Nobel economist Douglass North: the quality of a country’s economic growth depends on the quality of its institutions. See <http://www.ppge.ufrgs.br/giacomo/arquivos/econ-crime-old/north-1991.pdf>

¹⁶ Milton Friedman’s famous phrase

marketplace around a new role for the state; not always a 'producer state' but a 'collaboration state', which organises the institutions needed to democratise the opportunities of this new world; using both monetary and fiscal policy to keep demand high and stable; encouraging long term investment in good jobs; keeping skills at the cutting edge; encouraging new ideas; and trading fairly with the world around us.

Conclusion

So: this is the challenge facing Britain's political parties. My party is taking the bull by the horns. The question you have to face is: will you? And, if so: how?

You can either cling fast to the old verities (actually, not so old) of the new right – cut taxes, deregulate, reach for your greatest hits – or you can take the harder path and re-imagine what the social technology of the 21st century should look like.

My bit of the Labour party has come to terms with this; we could have sat back, chanted 'three election wins!', mocked the new idealists (and the old ones) and leant on policy tools of the Third Way.

But the harder path is to think again, to synthesise the old and the new. And that's what I'm determined to do.

Conservative answers won't be the same as mine but the country would benefit from the debate and if, in the final analysis, you agree with me: well, I've a membership form you can sign right now.

ENDS