

Paralysis or Power?

The centre right in the 21st century

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WHEN THE Centre for Policy Studies was founded in 1974, one of its principal aims was to argue the case for a leaner and more efficient state sector. With the recent announcements of significantly increased public spending, it is now more important than at any time since the late 1970s that these arguments are once again made with vigour and clarity. That is why Rupert Darwall's paper is so timely.

Why? Because both taxes and government spending are set to rise as a proportion of GDP; because productivity growth is falling; because the pension crisis is escalating; because the London stock market is falling faster than those in the US, Germany and France; because the hard-won – and much traduced – economic reforms of the 1980s and 1990s are in danger of being thrown away.

There is a principled alternative to policies requiring ever-higher rates of tax and spending, the case that argues that low taxes are not just good for taxpayers, but for the economy as a whole. As Darwall shows, the Dutch succeeded in reducing public spending as a proportion of GDP by 12 percentage points – and the Dutch economy grew faster than the UK in seven out of the last 10 years. In Ireland, the public spending has fallen from around 50% of GDP in the 1980s to just 26.4%. And over that period, Ireland has overtaken the UK in terms of per capita GDP – \$31,400 compared to \$25,400 in the UK in 2001, according to the OECD.

Over the next few years, the great divide in British politics will become clearer and clearer: the divide over the kind of state sector that we want, the kind of state sector that delivers most efficiently the needs of the people of this country.

It is time that both sides of the argument are heard clearly.

Tessa Keswick
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TWENTY YEARS AGO, the Conservative Party was in the vanguard of an intellectual revolution that swept the world. Today it appears paralysed – trapped between the fear that Tony Blair has colonised its ideological heartland and the fear that Conservative principles are inherently unpopular. The Conservative Party has long ceased being at the cutting edge of reform and the battle of ideas. It has behaved as if it is too frightened to think issues through from first principles, a psychological weakness which is also manifested in the hope of some Conservatives that emblematic issues and an image make-over might provide a short cut to popularity. Change the image, reach out and the voters will come back. So some believe.

After two general election defeats and two leadership contests, the Conservative Party still does not have an accepted view as to what went wrong. There has been no reckoning, similar to that which Labour went through after its defeats and led to the creation of New Labour – or perhaps more appositely, anything resembling the analysis undertaken by Keith Joseph after the defeat of the Heath Government in 1974. Instead the Party is consumed by self-doubt to the point of apologising for its existence.

Indeed, to some leading Conservative politicians, conservatism has served its purpose. The Conservative crisis is, according to them, a crisis of conservatism, of a philosophy facing extinction with little relevance to the modern world. The party should therefore accommodate itself as best it can to the new consensus that was suddenly revealed on 1 May 1997, the year zero of British politics, and find a way to crawl into New Labour's Big Tent.

a deductive approach to politics based on the application of general principles. Rather, it is inductive, picking up policies as it goes along to suit the needs of the moment.

By now, there should be enough evidence of the public's low regard for politicians who do anything and say anything to get votes that would make this self-defeating. As G. K. Chesterton once said, the problem with pragmatism is that it doesn't work. The denial that ideas are at stake reflects a deeper malaise, the failure to analyse what Tony Blair and the Labour Party represent other than as a barrier to Conservative MPs pursuing their political careers.

This pessimistic view of Conservatism evades the hard issues facing the party. And it is the principal cause of the Party's weakness. The real problem is that people don't know what the Party stands for. Trying to find guidance on what the Party should stand for from focus groups and opinion polls risks the party developing a personality that appears incoherent and opportunistic. As Sir Roger Douglas, the former New Zealand finance minister, once said:

Inadequate politicians see instant popularity as the key to power... They look for policies with instant appeal to create continuous public bliss. That approach flies in the face of reality. There is no free lunch... instant solutions do not have instant popular appeal. ... The problem with compromise policies is simple. They do not produce the right outcome at the end of the day.¹

¹ 'Politics of Successful Structural Reform', speech delivered to the Mont Pelerin Society, November 1989.

work Conservatives have to do. Instead they gave up.

To regain its confidence – a prerequisite for success – the Party needs to re-engage with ideas. Far from being the intellectually rootless party of many Conservatives’ dreams, New Labour has tapped into an old philosophy of politics which can be traced back to the ancient Greeks. That classical tradition was attacked by philosophers from the Enlightenment onwards, which defines the great divide in politics – between those that believe in the expansion of the state and those opposed to it. Of the thinkers who contributed to the modern liberal tradition, de Tocqueville, whose unsurpassed analysis of democratic politics contains an almost preternatural forecast of the Blair government, believed that the love of freedom would overcome the proponents of the expansion of state power. The decisive argument against state solutions is that they don’t work. There is little evidence that Labour ministers have found the philosopher’s stone of public sector reform. The scale of public spending required to sustain inefficient public services imposes cost on the rest of the economy, leading to weaker growth and higher taxes.

Arguments that the Conservatives should move to the centre, in a mirror image of New Labour, would finally destroy the Party’s chance of restoring its credibility. Instead it should explain to the electorate why tax and spend will fail to deliver. It should also advocate a pro-growth agenda that turns round the way Conservative Chancellors view tax cuts – to explain that tax cuts can mean that households can afford to pay for services directly.

lead the country in a new direction .

THE LABOUR PARTY has always taken ideas seriously in a way that some Conservatives do not. It did not made the mistake in the 1980s of denying an intellectual basis of Thatcherism. It disliked Thatcherism intensely, but recognised it as a powerful ideological enemy. Yet many Conservative politicians today dismiss the Labour Party's success as being entirely the product of opportunism and the theft of Conservative policies. When Tony Blair talks about Labour's values, it is rationalised away as merely clothing naked opportunism. The implication is to fight opportunism by being opportunistic. The denial by Conservatives that Tony Blair has anything serious to say, to take Labour's seriousness about ideas seriously, is a huge error. As a result, Conservatives have been incapable of putting forward ideas that challenge Labour's hegemony.

Eight days before the 2001 election, the Prime Minister gave a speech on civic society. For a campaign stop, it was heavy on philosophy. He reminded his audience of a speech he had given in 1995 linking rights with duties and responsibilities. He cited William Morris and Tawney and quoted G. D. H. Cole. Labour's aim, the prime minister said, was to create a strong society, a society with rules binding together generations and communities.² The constant references to society and social justice were not vacuous soundbites, but drawn from an age-old tradition of

² Tony Blair, speech, 'The strong society – rights, responsibilities and reform', 30 May 2001.

It is a tradition that can be traced back to Aristotle and the ancient Greeks. Cicero, quoting Antipater of Tarsus wrote in his famous essay *On Duties*, ‘You must identify your interests with the interests of the community.’⁴ The sentiment, if not the exact words, could have been uttered by Tony Blair. To the ancients, the idea of politics was intrinsically bound up with the pursuit of public virtue, about reaching beyond the quotidian to appeal to man’s better nature. It is necessarily a collectivist vision of the idealistic – and idealised – engaged citizenry, fused together to realise the higher purposes of society. New Labour is clearly located in this tradition of ancient political thought, flowing through such thinkers as Thomas Paine and Rousseau to more recent politicians such as John F. Kennedy (‘ask not what your country can do for you, ...’). The old Labour Party’s socialism was one branch of this older, classical tradition. Labour’s modernisers might have abandoned that particular branch; they didn’t cut down the whole tree.

The challenge to collectivism

The collectivism of the ancients was challenged by modern thinkers such as Hobbes and Locke. The modern tradition replaced virtue as the focus of politics with liberty. It placed individual freedom as an end in itself. Whilst adherents of the

³ *A progressive future, ippr’s agenda for a better society*, Institute for Public Policy Research, 2001.

⁴ Cicero, *Selected Works*, translated by Michael Grant, Penguin, 1960, p. 178.

direct the market to ensure it serves social ends. The modern liberal tradition sees markets as an unconscious expression of society, not in the anthropomorphised view of society as something possessing a will and conscience of its own, but as a collection of millions of individuals, crossing state boundaries, just as people do.

Conservatives, for it is through them the tradition of the moderns now flows, see cultural values as being largely spontaneously generated. In Britain, patriotic feeling, as distinct from nationalism, is not sponsored by the state, but reflects the deep attachment of a free people for their free society and their liberties. This distinction, made instinctively by ordinary people unconcerned with political philosophy, was one of the most striking features of the Queen's Golden Jubilee. The outpouring of national feeling was reserved for the human symbol of nationhood, whilst the Government of the day was left out in the cold. There was no political dividend for the Government from the Jubilee.

Even where there is agreement between followers of the two traditions about what services should be provided by the state, there is profound disagreement about why. The old tradition views public services as instruments in the creation of a better society. So schools are about furthering social justice, public transport about curbing selfish car use, taxation about social solidarity, policing about political correctness. For the followers of the moderns, the purpose is more limited and direct; schools are for educating children, transport policies about helping people

THE OPPOSITION OF THESE TWO TRADITIONS defines the great divide in politics. Alexis de Tocqueville, writing in the 1830s, saw:

...two great parties which have divided mankind since free societies came into existence. As one comes to penetrate deeper into the intimate thought of these parties, one sees that some parties are working to restrict the use of public power and the others to extend it.⁵

De Tocqueville speaks directly to modern conservatives: the challenge we face is not the outcome of a unique set of historical circumstances requiring us to tear everything up and start all over again, but inherent in the politics of democratic societies. The divide that he identified separates parties and individuals with profoundly different values. Because the Left sees politics as the battle to create a virtuous society, it needs causes, even if they have to be invented. If there were little to do, we would be less. There is a world of finite resources, forgetting that the most valuable – human ingenuity – is without limit. They have seized on an issue such as global warming because it creates in their eyes a need for virtuous behaviour in order to save the world. What could be emotionally more satisfying? It favours collective over individual provision, indeed sees individualism as a form of selfish cancer in the community. It prefers uniformity over diversity. It is a static vision which derives its strength from that impulse within human

⁵ Alexis de Tocqueville, *Democracy in America*, edited by J. P. Mayer, HarperPerennial, 1988, p. 178.

that in a thousand different ways all tend toward the fulfilment of one great design – that is a God-given idea.⁶

Marching in step might appeal to those on the Left, but de Tocqueville saw that it runs contrary to the freedom-seeking instincts of mankind and the way the world is actually ordered.

Far from the Conservative crisis being caused by the redundancy of its principles, the root of its difficulties lies in their neglect. Great parties, according to de Tocqueville, are more attached to principles than to consequences, to generalities than the particular, ideas rather than personalities:

Such parties generally have nobler features, more generous passions, more real convictions, and a bolder and more open look than others.⁷

These are precisely the qualities voters find lacking in the modern Conservative Party. Conservatives, de Tocqueville is telling us, need to recapture their lost ideals to be a great party again. The public's perception of the Conservative Party as irrelevant and out of touch, and its politicians concerned above all with their political careers, will fall away when it rediscovers its sense of idealism. Philosophy and principles come first. Image and tone come second, otherwise the Conservatives will become a Potemkin party, a painted façade with nothing behind it.

⁶ *Ibid.*, p. 735.

⁷ *Ibid.*, p. 175.

debate over European integration for the Conservative Party. Both sides could draw inspiration and strength from conservative traditions. For this reason, the argument over Europe within the Conservative Party could only be resolved by civil war. On the one hand, national greatness has always been a touchstone for Conservatives. According to de Tocqueville:

Great nations contribute more and faster to the increase of knowledge and the general progress of civilisation than small ones.⁸

On the other hand, he also appreciated that:

Freedom is the natural condition of small societies. Government there offers too little attraction to ambition... Internal well-being is more complete and more widespread in little nations.⁹

After more than a decade, the Conservative Party has, to a great extent, resolved its position on the basis that self-government is more important than a putative form of national greatness in a supra-national bloc. None of the candidates in last year's leadership election ended up trying to change the party's position on Europe. Rather the issue had become one of how the dissent of the minority should be accommodated.

The power of de Tocqueville's analysis comes from his ability to uncover what is timeless in democratic societies. Like other thinkers of genius, his writing has the force of prophecy, as if de

⁸ *Ibid.*, p. 160.

⁹ *Ibid.*, p. 159.

wants to be the sole agent and judge of it.¹⁰

Fast forward to Labour's 2001 manifesto, where we're told the job of government is:

...ensuring that the enjoyment, excitement and inspiration of arts and sport come alive for everyone.¹¹

De Tocqueville recognised the strong current of public opinion extending the reach of the state, even though he didn't like it. In democratic societies, the state would be seen as the 'sole, simple, providential and creative force.'¹² He predicted that men would freely agree that:

...the power which represents society has much more education and wisdom than any of the men comprising it and that it is its duty, as well as its right, to take each citizen by the hand and guide him.¹³

This impulse was not due to 'any vagary of the human mind, but is a natural condition of the actual state of mankind.'¹⁴

The expansion of public power was, de Tocqueville thought, the most formidable threat to freedom in democratic societies. In democracies, men have a very high opinion of the prerogatives of society and a very humble one of the individual:

¹⁰ *Ibid.*, p. 692.

¹¹ *Ambitions for Britain*, Labour Party, 2001, p. 17.

¹² *Democracy in America*, p. 670.

¹³ *Ibid.*, p. 669.

¹⁴ *Ibid.*, p. 670.

The men living in the democratic centuries into which we are entering have a natural taste for freedom. By nature they are impatient in putting up with any regulation ... They love power but are inclined to scorn and hate those who wield it.¹⁶

¹⁵ *Ibid.*, p. 669.

¹⁶ *Ibid.*, p. 702.

EVEN IF THE ‘taste for freedom’ were sufficient to forestall the emergence of a tyranny of schoolteachers, is it strong enough to get a party which believes in restraining the growth of public power elected? After all, as Ronald Coase, the Nobel prize winning economist, pointed out about the collapse of the Soviet Union, ‘the thing that stopped the system was not the fact that human liberties were trodden on, but that they didn’t produce. It was a failed economic system.’¹⁷ And that is the critical weakness of parties of the state: the modern state is bad at delivering the goods. Economic issues still largely define the electoral battlefield. Thus the modern conservative case is about combining analysis of the philosophical roots of its opponents’ politics with its economic consequences. Events will serve to confirm the rightness of the analysis, in turn giving conservatives popular credibility as long as they have the intellectual courage to explain why government policies won’t deliver.

Conservatives have plenty of examples to make their case. When Coase was editor of the *Journal of Law and Economics* in Chicago, he ran a series of studies on the impact of government regulation. According to Coase, he couldn’t find a single example of a regulation that produced good outcomes:

Regulation of agriculture is a, zoning is z. You go from A to Z, they are all bad. There were so many studies, and the result was quite universal: The effects were bad... What was my explanation for the

¹⁷ Interview in *Reason*, January 1997.

scale. It should not be difficult for Conservatives to construct a narrative along the following lines to demonstrate to the public the failures of tax and spend:

Why has the performance of the NHS deteriorated under Labour?

Because Labour ministers decided to scrap the previous government's patient-friendly innovations such as GP fundholders and other reforms to decentralise management authority.

Why are the railways in crisis?

Because successive Labour ministers wanted to prove that rail privatisation wouldn't work – despite impressive gains in output before the over-reaction to the Hatfield accident – in the end subverting the position of an independent regulator to re-nationalise Railtrack, destroying a system with a consistent internal logic.

Why are employer-funded pension schemes in such trouble?

Because the Chancellor abolished ACT dividend tax credits – as if reducing pension fund income by £5 billion a year was not going to have the slightest impact on their financial health. Once Britain had a system for the taxation of pensions that was coherent and helped make Britain's privately funded pension system the envy of Europe.

¹⁸ *Ibid.*

its initial fiscal consolidation, and the much-needed reform of capital gains tax, and it is not an inspiring record. Fiscally, its principal achievement was not doing in its first term what it is doing in its second.

The Prime Minister famously complained of the scars on his back from trying to change attitudes in the public services:

I cannot say too often that state schools exist for pupils, not the other way round. The NHS exists for patients, not the other way round.¹⁹

Ideology has blinded him to all the evidence of the intrinsic intractability of getting performance out of the public sector. Glossy blueprints are written, levers pulled, but in the public sector, the result does not come out as intended. Whitehall initiatives miss the point and often make the problem worse. The failure of Britain's centralised public services is systemic, as the public sector lacks the automatic self-correction mechanism of the market.

Martin Taylor, the former Barclays chief executive, chaired an Institute of Public Policy Research study into the public services. He was struck by the extent to which they are in the grip of their staff:

Institutionally large parts of the public services appear to be run in the interests of the staff, just as one finds in bad companies.²⁰

¹⁹ Tony Blair, speech on public services, Gravesend, Kent, 21 May 2001.

²⁰ Martin Taylor, 'Making the private debate public', *Financial Times*, 25 June 2001.

In the quality of the public services. Technocracy is not going to solve the crisis of the public services, even if ministers were professionally trained managers of huge enterprises.

Tony Blair will find he has more than just scars on his back.

Tax and spend

Ideology also blinds the Left to the wider economic costs of high public spending. For many, there is no growth penalty from increasing public spending above the growth rate of the economy as a whole. Affordability is only a matter of political judgement as to the amount of taxation that can be squeezed out of taxpayers without losing votes. They ignore the longer term economic costs of the public sector appropriating more resources from the economy. Instead they see government as instrumental in raising the growth of the economy. Public investment, particularly in education and training, is seen as vital for raising economic growth. But as one IPPR economist has pointed out:

If skills and productivity go together in this way, we face the problem of explaining why Sweden, for example, appears to be a ‘high skill-low growth’ economy.²²

A problem, that is, only for those who ignore the elephant sitting in the middle of the room – public spending accounted for 56% of the Swedish economy in 2000, the second highest in the OECD.²³

²¹ Tony Blair, speech, 30 May 2001.

²² Peter Robinson, summary document of his book, *Time to Choose Justice*, IPPR website.

spending will become evident in declining long-term growth rates.

There has already been a marked deceleration in productivity growth. In the 17 years to 1997, whole economy productivity growth averaged 2.2% a year. In the three years to 2000, it had fallen to 1.8% a year.²⁵ The full impact of Gordon Brown's tax increases, and those of his Conservative predecessors, has not been felt on living standards because families have saved less and borrowed more. Real household pre-tax income and spending have grown in line at around 4% a year, while real disposable income has risen at an average rate of 2.5% a year. In other words, people have been funding tax increases by increasing their own borrowing – pain deferred, not removed.²⁶ That might have been sustainable when public borrowing was on a downward path, but Labour's recent spending increases have begun to reverse that trend.

The public sector's appetite for taxpayer's money will not be sated once it has absorbed these increases. In the private sector, the capital markets reallocate resources from the inefficient. In the public sector, the opposite is true. Indeed, the Government's spending increases are evidence of its failure to reform. New Labour had originally argued that public sector reform would be self-financing. In the words of the 1997 manifesto:

²³ *OECD in Figures*, OECD, 2002,, Supplement 1, p. 36.

²⁴ *Public Expenditure Statistical Analyses 2001-02*, Table 3.1; *Budget 2001* (HC 279, March 2001), Table C9. Public expenditure includes tax credits.

²⁵ Keith Marsden, *Miracle or Mirage? New Labour's economic record in perspective*, Centre for Policy Studies, 2001.

²⁶ The author is indebted to Richard Jeffrey for supplying this data.

Brown risks conforming to the classic pattern of post-war Chancellors described by Edmund Dell:

It became a tradition of British politics that governments would make optimistic estimates of growth by way of justification for their expenditure commitments. The estimates of future public expenditure tended to be too low and the estimates of economic growth tended to be too high.²⁸

The outcome is a fiscal squeeze, as the rising demand of the unreformed public services for increased public spending crosses the falling line of public willingness to pay. The economy starts to slip down the spiral in which the deadweight costs of high public spending retard growth, so depressing tax revenues, requiring increased tax rates, which in turn further slow down growth.

²⁷ *New Labour – because Britain deserves better*, Labour Party, 1997.

²⁸ Edmund Dell, *The Chancellors*, HarperCollins, 1996, p. 10 .

THE ECONOMY, TAXES and the poor quality of public services should be powerful issues for a party wanting to restrain the growth of public power. Put another way, if massively increasing public spending was the way to public service nirvana and high economic growth, the Conservatives would never be electable. But then Sweden would be the fastest growing economy in the world and the United States would have spent the last two decades in the economic doldrums. In reality, the Conservative Party must be true to its principles and take as its starting point the reality of de Tocqueville's great divide in democratic politics. It must recognise which side of that divide it is on, neither apologising for it nor pretending it doesn't exist.

The counter-argument runs something like this. The Party's unpopularity results from an apparent lurch to the Right, an argument also made by Tony Blair and Peter Mandelson. It should therefore re-position itself on the centre ground to get more in tune with the spirit of the times. Parallels are drawn with the success of the Labour modernisers in dragging the Labour Party onto the centre ground. The implicit assumption behind this thinking is that the political spectrum is symmetrical. On the Left, Labour gave up its socialist principles to become electable. The Conservatives should therefore go through a similar process. Privatisation and tax cuts were needed in the 1980s. Now voters want better public services and are willing to pay higher taxes to fund it.

ailed, markets work. True, opinion polls and focus groups show hostility to increasing the role of the private sector in the provision of public services and a preference for public spending over tax cuts. The politics of change is about finding arguments that resonate with the public's experience in order to shift public opinion.

The Conservatives didn't lose the argument. They stopped making it. They failed to update it and recast it in the idiom of contemporary issues. Putting that right and changing public attitudes do not require a miracle, but hard work – a professional, focused campaign that goes with the grain of reality and gives the public examples of the failures of the Government's attempts to refashion the public sector.

In the past, Conservatives were associated with the sometimes harsh-sounding language of economic logic. Economic efficiency, it seemed, was the Conservatives' main policy objective. Perhaps in reaction to this, Conservative politicians now seem to go out of their way to avoid creating this impression, although Gordon Brown's emphasis on prudence and meeting his fiscal rules has not done his standing any harm. That does not mean Conservative policy should downgrade economic efficiency as a goal. Instead, policy should be couched in language that resonates with people's values and expectations. And here the Conservatives have an ace: the driver for public service reform should be to deliver choice and consumer empowerment.

The Government recognises that voters want choice in the provision of public services. According to the Cabinet Office:

the countless, everyday examples of public sector failure and waste. They should make the point that it is not the people or the cash that is to blame, but the system.

Indeed the cause of the Conservatives' unpopularity, of the sheer lack of respect for the Party, is not any lurch to the Right, but the dislocation between its policies and principles. After all, a Party which fought the last election promising the largest increase in public spending since the 1970s can hardly be described as right wing. But the £8 billion token tax cut made its position untenable. The Party had implicitly accepted Labour's prescription for failing public services, but was going to prescribe less of the wonder drug. It made no sense.

Discrediting tax and spend

Before embracing the Conservative alternative, the electorate first needs to see that tax and spend doesn't work. The patient needs to be persuaded of the diagnosis before signing the prescription. The priority should be to focus the public on what's going wrong with the public services. At the same time, Conservative politicians should talk about their principles. Once these have been established, they can talk about the specifics of what they would do; the aims rather than the means.

²⁹ *Reforming our public services – principles into practice*, Office for Public Services Reform, 2002, p. 8.

increase in public spending before the 2002 budget. Between 1996/97, the last full year of the Major government, and 2001/02, public spending (including tax credits) rose by £45.2 billion after inflation. Of this increase, education accounted for £9.2 billion and health £11.7 billion – together accounting for 46% of the increase. Despite falling unemployment, spending on social security and on tax credits rose by £9.8 billion. Other non-priority areas have also had large increases. Spending on trade, industry, energy and employment rose by £2.1 billion, or 22% after inflation, reversing a long-term trend of reducing industry subsidies. However the largest percentage increase was on culture, media and sport – up over 36%.³⁰ This is a Government in which the habits of public sector extravagance have become deeply ingrained.

The Conservatives should direct the public's focus on how taxpayers' money is being wasted below the baseline. Given the inherently wasteful nature of the public sector, examples abound. Yet the Conservatives fail to make this argument. Richard Littlejohn in the *Sun* has done far more than the whole of the Conservative Party.

Not every pound of public spending is sacred – and that's what the public used to think. 'Labour waste money on useless things,'³¹ according to focus group findings presented to a Labour strategy group in 1985, described by Tony Blair's pollster, Philip

³⁰ *Public Expenditure Statistical Analyses 2001-02* (Cm 5101), Table 3.1; *Budget 2001* (HC 279, March 2001), Table C9. Public expenditure includes tax credits.

³¹ Philip Gould, *The Unfinished Revolution*, Little, Brown, 1998, p. 51.

scepticism of government action, their belief that everything has to be paid for.³³

That confidence and consistency are what Conservatives do not have and must regain.

³² *Ibid.*, p. 49.

³³ *Ibid.*, p. 212.

THE CONSERVATIVE CASE needs to make the connection between reductions in taxation and creating a high growth economy. Albert Einstein once said that compound interest was mankind's greatest invention. Small differences in percentage growth rates roll up to huge differences in wealth generation over a number of years. In other words, low taxes are not just good for taxpayers, but for the economy as a whole. The Dutch succeeded in reducing public spending as a proportion of GDP by 12 percentage points. It is one of the main reasons why the Dutch economy grew faster than the UK in seven out of the last 10 years, averaging 3% a year compared to 2.6% for the UK – a growth differential that would deliver nearly £5,000 more wealth to the average household. And faster growth generates more tax revenues and so makes high quality public services more affordable.

Perhaps the most telling example of the gains from having a low tax, low public spend economy is to be found across the Irish Sea. In the mid-1980s, public spending reached 50% of GDP in Ireland. It is now 26.4%, the lowest in the European Union.³⁴ Over that period, Ireland has overtaken the UK in terms of per capita GDP – \$31,400 compared to \$25,400 in the UK in 2001 (on a purchasing power parity basis).³⁵

³⁴ *OECD in Figures*, OECD, 2002,, Supplement 1, p. 36. Data for 2000.

³⁵ *Ibid.*, p. 12.

term growth of the economy.

Civilised countries with higher quality public services have seen greater reductions in the share of resources spent by the government. Canada, hardly anyone's caricature of a minimalist government, hard-hearted, public service-starved country, succeeded in reducing spending from 50% of GDP to 37% in a decade. Australia, which has reduced public spending to around 30% of GDP, has public services that put Britain's to shame. These countries are not associated in the public mind with being hard-hearted and uncaring. Rather they enjoy a quality of life that many in Britain aspire to for themselves.

Conservatives cannot win the argument on the economic costs of increased spending if they implicitly accept Labour's position that the overall level public spending is sacred. Having a low tax economy is compatible with higher public spending on healthcare. The US is a low tax economy. Yet healthcare spending per capita in the public sector is 61% higher than in the UK – \$1,916 compared to \$1,186. In part, that is because US incomes are nearly 40% higher than in the UK, so they can afford to spend more. But the US also spends a higher proportion of GDP on state-funded health programmes – 6.5% of GDP compared to 5.8% in the UK.³⁶ If publicly funded healthcare needs more resources, priorities within the public sector should be adjusted, not the priority of the public sector over the rest of the economy.

³⁶ Ruth Lea, *Healthcare in the UK: the need for reform*, Institute of Directors, June 2000, p. 13.

terms cut of around £1.1 billion. Keeping housing benefit flat in a growing economy has yielded an annual saving of £2.8 billion compared to what it would have been if it had grown in line with the economy. It can be done.

It means using the tax system to help finance the switch to greater private provision. Expecting people to pay for something they previously got 'free', i.e. through taxation, *without* cutting taxes by an equal or greater amount means squeezing household budgets. It would be tantamount to a stealth tax. To be viable, policies need to create more winners than losers. If you want road pricing, you have to cut petrol duty. If you want to encourage people to opt out of the NHS, give them large tax breaks.

This requires a different perspective from the traditional Treasury approach of seeing tax and spending from the standpoint of balancing the public sector's books. Instead it means looking at decisions on tax and spending from the perspective of families and how they pay for public services, whether through taxation or through charging or insurance premiums. And it changes the way decisions on tax and spending are structured and sold to the public.³⁷ Fiscal neutrality should be replaced by fiscal transparency.

³⁷ Putting money back in people's pockets so they have choice over former monopoly public services is the best counter-attack against allegations of 'cuts' and other forms of shroud waving. The resources being spent on schools and hospitals have not been reduced. What has changed is that the consumer gets to decide where to spend the money, not someone in government.

financial liabilities, governance, and the regulatory environment, small government countries seem to produce better results than the other country groups... The findings also suggest that, *with intelligent policies*, governments can achieve the same social and economic objectives with much lower levels of public spending.³⁸

Conservatives need the political will to champion these ‘intelligent policies’.

³⁸ Emphasis in the original. Vito Tanzi and Ludger Schuknecht, *Public Spending in the 20th Century*, Cambridge University Press, 2000, p. 119.

REGULATION IS AN alternative to public spending. From the Government's point of view, it has the advantage of not needing to be paid for out of taxation, as the costs are incurred directly by businesses and passed on to consumers. The Conservative Party has not had great success in defeating the arguments for government intervention and regulation. At times, it has manifested a Canute-like resignation to the irresistible tide of regulation and intervention.

Success requires having the right intellectual framework. Without being conscious of it, many Conservatives are still trapped in the thinking of the 1920s and the economic analysis of Arthur Cecil Pigou. According to Pigou, because companies do not incorporate external costs, such as pollution into their cost schedules, markets deliver inefficient outcomes. Prices of goods do not reflect pollution and other external costs, whilst society as a whole bears the cost of pollution and all the other externalities. The answer is state intervention in one form or another to correct this – regulation, special taxes or tradable emissions permits. A similar analysis supports intervention to obtain positive externalities.

This approach creates huge scope for government to justify intervention and alter the way people and companies behave, whether it is in planning decisions, in the labour market and so on. Hence regulation and other forms of intervention often nowadays come wrapped in market-friendly language about helping markets work better.

is the existence of transaction costs that prevents this happening.

Coase's analysis has profound policy implications. Instead of government intervening to correct apparent market failure, it should facilitate transactions and lower their cost so the market itself can provide a cure. And government is often the biggest obstacle in fettering bargains. Regulation is by its nature pre-economic – 'do this', 'don't do that'. It doesn't permit bargaining and pricing in return for businesses modifying their behaviour and gives government a free ride, as it doesn't have to pay for the outcomes it wants. The underlying assumption is that business will behave in ways that are anti-social unless compelled to do otherwise. Regulation is thus a sub-species of central planning. As such, it is inherently value-destroying for the reasons given by Ludwig von Mises in his book *Socialism*, which showed that central planning doesn't work because of the absence of the price mechanism.

Coase's intellectual revolution opens an agenda of huge potential, providing a vast *terra incognita* for Tory policymakers searching for fresh ways of applying Conservative principles to modern problems. It implies a huge philosophical shift, from regulation with its aim of 'correcting' private behaviour to one where the government purchases public goods. For a start, government should price the outcomes it wants from regulation and assess whether the public would be prepared to pay for the full costs of regulation out of general taxation. Pricing what government does is a big step to limiting government.

Alternatively it might conclude that such purchases represent a poor use of taxpayers' money. The advantage of this approach is that the public sector must incorporate the costs of the outcomes it wants in the decisions it makes. At the outset, this framework could be used to assess the costs and value of meeting the objectives which new regulations are designed to achieve. Subsequently it could be used to roll back the existing body of regulation.

The more government behaves like an economic agent, contracting and paying for outputs, the better its performance will be in terms of achieving its goals and reducing the dead-weight costs it imposes on the rest of the economy. Giving the Bank of England operational independence is a success because it fetters government's arbitrary prerogatives and instead replaces it with a transparent process. It is a model which can be deployed far more widely across the public sector. Like light on its way from a distant star, Coase's thinking has yet to register with the current Conservative intelligentsia. Putting property rights and the price mechanism at the centre of their thinking shouldn't be revolutionary for Conservative politicians. But it has revolutionary implications for policy.

In some areas, such as competition policy, Labour has colonised the Conservatives' pro-competition agenda and turned it around into an engine of intervention. In doing so, they negate the idea that the market itself is the best regulator. Markets, like water, will eventually find their own level if allowed to do so. Intervention results in permanent distortions which if the market had been left to itself, would have found its own way to resolve.

Office of Fair Trading sweeping new powers, including extensive surveillance powers. Competition will be enforced for the private sector, where it naturally occurs, but is off-limits for the public sector. The greatest impediment to the functioning of the market is not the private sector, but the biggest monopolist of them all – the public sector. The focus of competition policy should be government itself – the denial of choice in the services it provides and the regulations it imposes on the private sector that impede competition and create barriers to entry. Conservatives should be arguing that the Competition Commission should review the performance of the public service monopolies, such as the NHS, and recommend alternatives and the OFT should carry out an assessment of the full economic costs of government regulation.

REGAINING its intellectual self-confidence; communicating a consistent message on why Labour's tax and spend policies to reform of the public services will fail; reclaiming a growth agenda; developing policies for the public services for less pain and more gain; being the party that limits government – are these sufficient for the Conservative Party to become a credible alternative to Labour? Possibly. But something else happened on 1 May 1997.

Ask why the Republicans in the US quickly recovered from losing the White House in 1992 – winning the Congressional elections a couple of years later.

Part of the explanation is institutional. The federal system's dispersal of power between the separate branches of government and the states creates a more open power structure which permits greater competition for office within parties, thereby encouraging fresh blood. It reduces the risk of systemic contamination, in contrast to the closed shop of the House of Commons and the inward-looking Conservative parliamentary party. The Republicans never were political pariahs in the way Conservatives have become.

That points to the deeper cause of the Conservatives' unpopularity. The Republicans do not have the Tory regard for social hierarchy and deference to the governing club and its members. Hayek wrote about the difference between European and American conservatives in his essay *Why I am Not a Conservative*. Liberalism (in the classic nineteenth century meaning of the word) is the political tradition on which the US was

in the traditional 'blue and buff' colours of the Whigs, which they shared with the Foxites in the British Parliament.⁴⁰

The triumph of the American revolution is the reason why there is no Tory tradition in the US. After Yorktown, American Tories either ceased being Tory or stopped being American, leaving for Canada or coming back to London.

Hayek's decisive objection to this type of Tory conservatism was that its sole animating force was hostility to change:

By its very nature it cannot offer an alternative to the direction in which we are moving. It may succeed by its resistance to current tendencies in slowing down undesirable developments, but, since it does not indicate another direction, it cannot prevent their continuance.⁴¹

These conservatives lacked any body of principles:

If government is in the hands of decent men, it ought not to be too much restricted by rigid rules. Since he is essentially opportunist and lacks principles, his main hope must be that the wise and the good will rule.⁴²

³⁹ F. A. Hayek, *The Constitution of Liberty*, Routledge & Kegan Paul, 1960, p. 397.

⁴⁰ *Ibid.*, p. 531.

⁴¹ *Ibid.*, p. 398.

⁴² *Ibid.*, p. 401.

the wise and the good to rule; in other words, Tory to its core. Since the 1997 election, the electorate has discovered it does not need the old governing club and is more happily governed without it. That aspect of the Blair revolution – its popular style of government, citizens not subjects, its political egalitarianism – marks an irreversible change. There is no going back – and no way forward for a Conservative Party that cannot fully adapt itself to this new world, one which it did so much to bring about with the liberalisation and extension of opportunity of the 1980s.

But the Conservative Party appears stuck. The leaching out of idealism and the ageing of the party membership – the two factors reinforce each other – mean that the parliamentary Party has not been able to renew itself with enough talented, attractive candidates. The Party has an institutional problem in the way it selects future members of Parliament. Reforming the party and basing itself on principle are not alternatives. Both have to be done. Institutional change will not succeed unless the Party is anchored on principle, as the Party which stands for reducing the growth of public power and increasing the freedom and responsibility of the individual. For the electorate, belief in principles is a test of a party's sincerity and trustworthiness.

WHILE CENTRE RIGHT PARTIES are resurgent in the US and across Europe, the Conservative Party has yet to regain its stride. Just because the tide seems to have turned elsewhere will not lift the Conservatives in Britain. Their success depends on what they do, not on the success of others. The hard truth is that the Conservative Party is not making the progress it should. What should it be doing differently?

Focus on what it wants to do, rather than how it wants to be seen.

Too much effort is being given to try to change what people say about the Conservative Party and not enough to what it should do. Image is important in helping to project the underlying reality, but the thinking seems to be, 'Once we've got people to like us, we can then take the risk of telling them what we're really going to do.' This simply won't work. The immediate objective is for people to take the Conservative Party seriously and therefore explain to them what the Conservative Party stands for. The first half of a Parliament is the time to do the heavy lifting. Leaving it to the run-up to an election is far too late.

Principles come first.

Voters decide to back a party because they agree with its broad principles. That requires explaining to people day in, day out, why Conservative values are right for the country and why Labour's inevitably lead to a spiral of higher taxes and disappointed expectations of public service performance.

driven by proper objectives would have recognised the significance of the budget. The Prime Minister had said during the last election that there was no need for any tax increases. Yet this has been shown to have been misleading. So at the next election, Labour has no defence against the charge that voting Labour would guarantee further large tax increases.

Take a tough decision to enhance the party's credibility.

Trust and sincerity are among the hardest attributes to gain, and the most damaging once lost. Sometimes taking an apparently unpopular decision engenders voter trust. George W. Bush did this in the 2000 presidential election. He neutralised social security – traditionally a strong Democrat issue – by proposing partial privatisation. At one and the same time, he acknowledged there was a problem with social security and had a policy which voters could see accorded with his party's values. For the Conservative Party, a similar test would be reform of healthcare. There is a hard truth that the Conservatives have ducked: if you want to give people choice, you need to have charges for healthcare. Until this is confronted, the Party's plans for reforming healthcare will lack credibility with the public.

Stop relying on children when there are lots of grown ups.

President Bush's administration is full of people who served in government in the mid-1970s. By contrast the Conservative Party practises a kind of cultural revolution resulting in the five yearly

⁴³ Quoted by Donald Rumsfeld, *Wall Street Journal*, 29 January 2001.

misunderstanding of American campaigning techniques. Consider the following exchange between candidate and political consultant:

“It isn’t mood or image or vibes that elect a candidate; it’s issues,” I said.

“Kennedy won on image,” he responded.

“I think America fell in love with its politicians in the fifties and sixties, when we first saw them on TV... Then came Vietnam, Watergate, lines at gas stations, the bribery scandals of the seventies. Suddenly, our politicians were human beings like us; we became alienated. We got our divorce. We weren’t going to be taken in again for a time.

“These days,” I concluded, “we want to know where a candidate stands – the issues and just the issues. Don’t ask us to fall in love; just tell us where you stand, and we’ll vote for you. We won’t bet our hearts on you, but we’ll give you our votes until you screw up.”

Clinton probed, “So you use the issues you care about to show your personality. If you want to clean nursing homes, that suggests you must be compassionate. If you are for schools, you might be a person who likes kids.”

“That’s right.” I elaborated: “But you can’t go out there and say, ‘I love children.’ Voters sense that’s baloney. You can’t even say, ‘I’m for education’. Voters know you incur no risks with such a bland position. But if you say, ‘I want to raise taxes to help schools’, then voters can believe you really care about kids because they see you’re willing to take heat to help them.”⁴⁴

⁴⁴ Dick Morris, *Behind the Oval Office*, Random House, 1997, p. 47.

Today, the Conservative Party shies away from talking about the need for markets in the provision of public services and why these would be superior to current arrangements. Instead, the talk is about localism, in contrast to the Government's centralisation. The man in Whitehall doesn't know best, but does the person in the town hall? The electorate will sense the lack of conviction in this argument. Conservatives do not convincingly attack the costs of higher taxation, as they are scared of being attacked for wanting to cut public spending. To succeed politically, it has to offer a coherent alternative to the third way, not a mutant version of it.

The Government has set its course and passed the point of no return. Its answer to the public's desire for improved public services is to pour billions of pounds into essentially unreformed structures. It is a policy that is programmed to fail; rather like watching a fatal accident in slow motion, knowing that there is nothing the driver can do to avoid crashing. And the electorate can also see the imminent crash: people are sceptical about Labour's ability to deliver 'a world-class NHS' despite the extra £40 billion promised over the next five years: 58% of those surveyed do not believe that the Government will meet its promise and 35% think the extra billions will make no difference. Five per cent even expect things to get worse.⁴⁵

When the next election is fought, voters will have given Labour two full terms to deliver its collectivist solution to improve public

⁴⁵ ICM Poll for Reform, quoted in the *Sunday Telegraph*, 21 April 2002.

the country that it needed a clear break with the past – in the words of the 1979 Manifesto:

It is time for a new beginning.⁴⁶

The Party admitted that this would require tough decisions. The manifesto stated:

Any future government which sets out honestly to reduce inflation and taxation will have to make substantial economies, and there should be no doubt about our intention to do so.⁴⁷

The politics worked because the argument had been won.

The first half of a parliament should be about preparing the ground for a genuine alternative – explaining, justifying, refining the arguments so they fight their way into the public's consciousness and start to become accepted. That cannot be achieved if the party remains paralysed with fear. The hard truth is that the Conservative Party wasted its first term in opposition. More than one year into the second, little progress has been made. It requires confidence and courage to argue that the country needs a change of direction. It means leading with conservative principles – starting today.

⁴⁶ *The Campaign Guide 1983*, Conservative Central Office, 1983, p. 518. The 1983 Guide contained the full text of the 1979 Manifesto as evidence of the Government's success in meeting its original promises.

⁴⁷ *Ibid.*, p. 503.

“NHS Credit”). This proposal leaves British healthcare overwhelmingly financed through general taxation but gives patients and professionals the responsibility for spending that money. In this way fairness of contributions is maintained. But the inefficiency which characterises NHS delivery is overcome.

An important and illuminating pamphlet... The right has been criticised for failing to engage with the debate over public services... the CPS pamphlet goes a long way to addressing that criticism. – Peter Osborne, Sunday Business

LABOUR AND THE STOCK MARKET

£7.50

John Littlewood

Until 1997, the stock market performed badly whenever the Labour Party was in government. But when New Labour was elected in 1997, it enjoyed a golden economic inheritance; it continued Conservative spending plans; and it gave control over interest rates to the Bank of England. The stock market continued to prosper until the eve of the Millennium. But since then it has fallen dramatically – and by more than those of our international competitors. The author suggests that the underlying cause can be traced to declining British competitiveness since 1997. The widespread imposition of regulations, a higher trade union profile, a rising tax base and the growth in public spending are all evidence that New Labour has indeed reverted to type. If so, that author warned that the precedents of earlier Labour Governments indicated difficult times ahead for the stock market.

*...shareholders have lost out under every Labour government since the war –
Observer column in The Financial Times*

Editorial Note: when *Labour and the Stock Market* was published (19 March 2002), the FTSE-100 stood at 5316, compared to 4076 on 5 August 2002 – a fall of 23.5% in under five months

There are few public apologists for this insidious growth of state interference. Yet the power and intrusiveness of the state has grown steadily over the last five years, disguised by Blairite rhetoric. The cumulative effect represents a major extension of state power – a new statism – at the expense of liberty.

The authors are right that new Labour has a compulsive tendency to intervene –
Peter Riddell in *The Times*

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