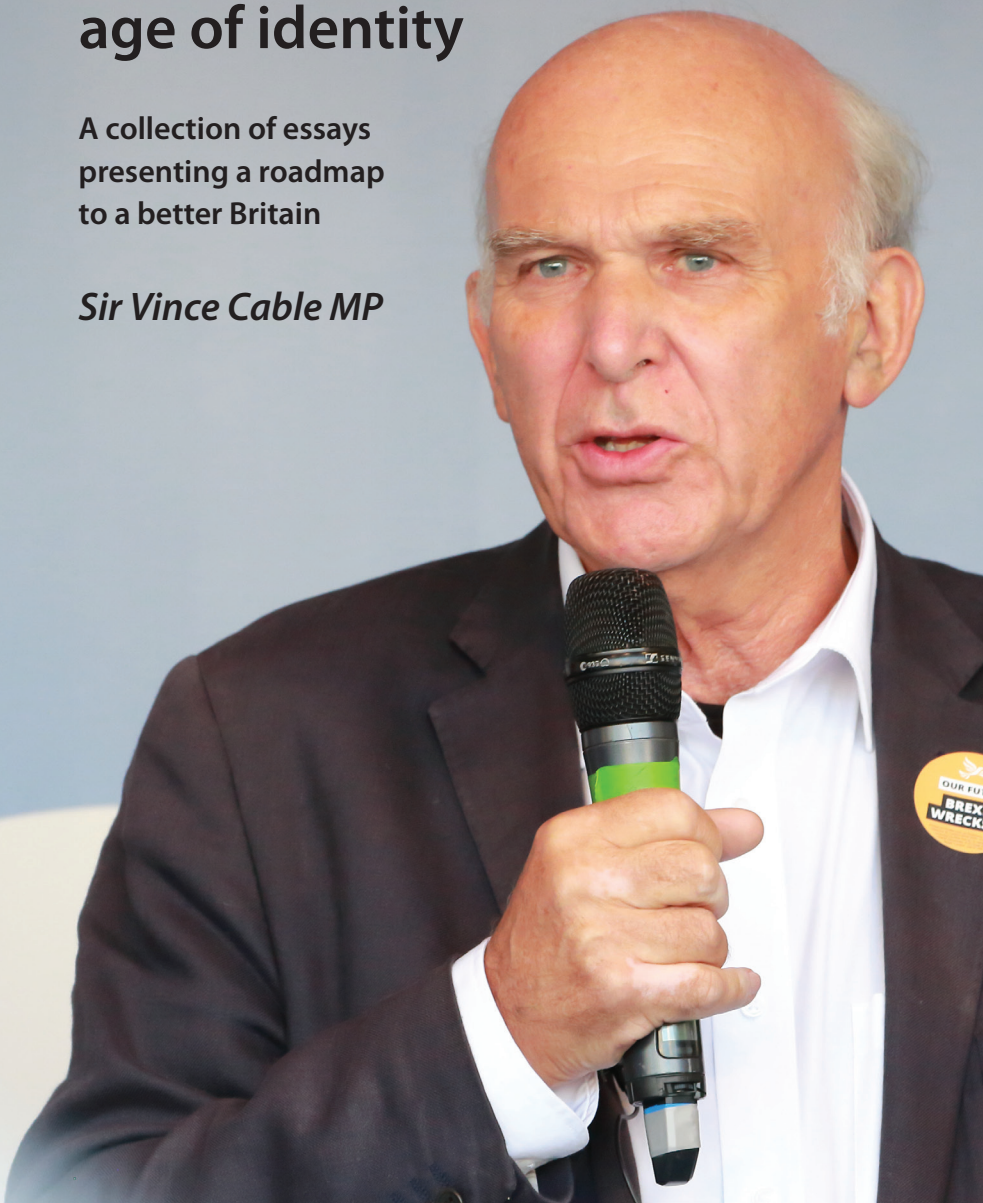


Beyond Brexit

Liberal politics for the age of identity

A collection of essays
presenting a roadmap
to a better Britain

Sir Vince Cable MP



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By

Sir Vince Cable MP

Leader of the Liberal Democrats

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Introduction

Beyond Brexit

As I write this, the Parliamentary battles over our future in the European Union are unresolved. 2019 was billed as the year of Brexit. Yet even if the Government succeeds in any version of its plan there will be years more of negotiation and debate in prospect during a transition, before settled new trading arrangements could be agreed.

I am one of those people who believes Brexit would be so damaging that it should be stopped, and the focus of Liberal Democrat political efforts has therefore been fighting for a Peoples' Vote including the option to stop Brexit.

One of the most damaging consequences of the national absorption with Brexit is that almost every other issue of importance is being relegated to the sidelines. Important though it is, Brexit cannot be the end of debate on the future of our country. On the contrary, Brexit is a symptom of a deeper political shift involving the 'politics of identity' and the emergence of new alignments that do not fit comfortably into the 'left – right' narrative. The old political parties have failed to understand these shifts and to find an authentically liberal response.

I have written this collection of essays to suggest where liberals and social democrats – and the wider movement in the country looking for a progressive alternative – should be directing our collective energies in future, whether or not Brexit happens or whatever form it takes. I draw on speeches I have given in the last year or so and a variety of recent books and pamphlets, all of which were written independently of the Brexit debate. The scope is far from comprehensive and is largely confined to issues I have recently been working on, not least as Secretary of

State for Business, Innovation and Skills in the Coalition government. As a result some important topics such as civil liberties or health and social care are not addressed in any depth here.

If Brexit duly happens, abruptly this year or cushioned by a two-year transition, the almost certain consequence is that the British economy will be smaller, and government revenue weaker, than it would otherwise be, reducing the scope for government spending in particular. That in turn makes it more difficult to address the causes of Brexit, but this shouldn't stop us countering those who peddle fear and division and instead imagining what can be possible.

One feature of so-called 'identity politics' is that the previously accepted norms of rational economic debate do not seem to apply – in effect, people vote against their own apparent self-interest. As I argue later, this opens the door to charlatans and rogues to exploit fears and stir up hatreds, all the while making sure that their own interests are protected.

Our response cannot be to banish experts and usher in an age of unreason. Rather we must be better at demonstrating what we believe, to calmly continue setting out the facts and evidence – which these essays seek to do – and to propose radical change which leads to a more prosperous, socially just and environmentally sustainable society.

Winning those arguments in the current divisive atmosphere is much harder if living standards are squeezed and inequalities widen. That is why I make no apology for starting my argument here with an explanation why our economy is malfunctioning and what we should do about it. I go on to explore important issues such as young people and housing, migration, the green economy and reform to our broken political system. I conclude with my ten-point roadmap to a better Britain.

The message of these essays is simple and optimistic: Liberal politics *can* thrive in an age of identity.

Where We Are

A Malfunctioning Economy¹

Britain's economy has, for a decade, been functioning at a level well below what was considered its potential in what has been characterised as 'an age of austerity'. The current appeal of populist – and specifically 'identity' – politics has complex causes but is attributable in significant part to the hardship resulting from 'austerity', and the sense that business and government have failed to deliver what had long been taken for granted: steady economic advance.

Living standards have barely risen since before the 2008 financial crisis; median real wages have fallen, especially for younger workers in their 20s and 30s. In parts of the country, the 'left behind' towns in the North and Midlands, this hardship has compounded deeper problems stemming from a long history of industrial decline. There has, however, been little unemployment and a steady rise in employment, so the weakness of the economy is manifested as low productivity.

The financial crisis was not a uniquely British event, but the severity of the crisis and the extent of the economic damage owed much to the high level of dependence of the UK economy on the financial sector – especially banking – and the high level of indebtedness in relation to the economy overall.

There is much finger-pointing amongst politicians as to who was to blame for the crisis and its aftermath. In fact both the (Brown) Labour government and the Coalition did many of the right things to minimise and then repair the damage. The banking system was prevented from collapse and then made safer, by reducing leverage and through

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the structural reforms of the Coalition (the so-called Vickers reforms). Demand in the economy was sustained by initially running a large, though unsustainable, budget deficit and then by the Bank of England's aggressively loose monetary policy while the budget deficit was brought down. By 2016 the economy had largely recovered and Britain had the fastest growing economy in the G7.

One of the common arguments in circulation, and a product of the populist politics which has emerged after the crisis, is that austerity – variously described as stagnation in living standards or reduction in the government's fiscal deficit or debt – is a matter of choice and could simply be stopped by a change of government. Of course, there are some elements of choice – the reliance at present on government spending curbs rather than taxation to stabilise the budget is one, and the Coalition government could have permitted more public investment to revive the economy immediately after 2010. But it is fantasy to magic away the difficult choices that have had to be made, and will in future. The revenue base of government will be steadily eroded by a combination of technology and global business trends. This will make choices still more painful; fundamental, if unpopular, changes to the tax system will be imperative.

Where there are more genuine grounds for criticism is that successive governments (Labour, Coalition and Conservative) have been largely concerned with shoring up a collapsing structure rather than trying to strengthen or even rebuild it to a better design. For example, the economy relies heavily on worrying levels of debt – household, corporate and government – which are sustainable only in an abnormal environment of very low interest rates. This in turn relates to the way in which the banking sector combines with a dysfunctional housing market to generate high levels of mortgage debt and the way the tax system encourages debt creation rather than equity financing. Then there is the continued role of the – mainly London-based – financial sector – a mainstay of government tax revenue but otherwise almost completely

divorced from the UK's real economy and a potential source of serious financial instability, playing a role very similar to oil in the OPEC economies of the Middle East. And despite all the efforts made to develop an industrial strategy and to embed long-term timeframes into business decision-making, there remains a business culture – corporate investors and senior managers – heavily skewed towards short-term rewards.

Brexit, by adding another level of uncertainty, is adding to these ills and, in particular, inhibiting investment.

A Divided Society²

The economic weaknesses of the country are in turn reflected in some underlying, societal changes. Central to these is growing inequality. The evidence does not all point in the same direction – contrary to the popular political narrative on the left, post-tax income inequality (measured by the Gini coefficient) has not changed much since the financial crisis and actually improved a little during the Coalition years. But the more egalitarian culture and mobile society I and my contemporaries grew up with, post-war, has all but disappeared; inequalities of income, wealth and opportunity, between classes, regions and generations are significantly wider in general. And overall, a decade of stagnating living standards, superimposed on inequality, have left those at the bottom of the pile experiencing real hardship and poverty.

More specifically, in the supposedly halcyon years before the financial crisis, the gross real earnings of the top 10 per cent of full-time workers doubled between 1978 and 2008, but the median grew by only 60 per cent and the lowest 10 per cent of workers' wages grew by just 25 per cent. Over the same period the standard measure of inequality (the Gini coefficient) for post-tax income inequality rose from 28 per cent to 40 per cent (where 0 per cent is complete equality and 100 per cent is one individual having everything). From being one of the world's more egalitarian countries the UK has become one of the least (95th in international rankings) and well behind Scandinavia or Germany.

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And, within the relatively well-off, there is a shift to the top 1 per cent (around half a million individuals) and within that group, the top 0.1 per cent (50,000 top executives and entertainers, mostly).

And wealth inequality is even greater than income inequality, as high earners turn their income into assets, compounded by efficient wealth management and tax planning and then passed on as inheritance. This in turn is widening the gap in wealth – asset ownership – between generations. The age group 26–44 have estimated average net assets of around £75,000; under 25s no net assets; and 55–64 year-olds net assets of £430,000. Traditionally, owner occupation was the way in which a reasonable level of wealth equality and opportunity was maintained, but since the start of the 1990s the rise in house prices relative to earnings has boosted the wealth of older owner-occupiers unencumbered by mortgages; for low and middle-income families under 35 the proportion of owner-occupiers has fallen from 60 per cent to 25 per cent.

The blockage to social mobility through the housing market is paralleled in education where, despite countervailing measures like the pupil premium, the evidence suggests that the UK (like the US) is one of the worst performers in terms of social mobility, with a large wage premium for children growing up in a well-educated family and, conversely, a wage penalty for the less well-educated.

Meanwhile, gender equality has still not been realised, despite efforts during the Coalition to increase the number of women on boards, and to expose gender pay gaps in big firms. The approach I adopted – encouragement, followed by naming and shaming the poor performers – remains the best.

Rising inequality is not just a matter of concern for idealists and socialists. There is evidence that it is not a necessary evil, a by-product of a dynamic capitalist economy, but actually harmful to economic performance. Studies suggest that higher levels of inequality are associated with unproductive, ‘rent-seeking’, activity; feed ‘asset bubbles’ rather

than productive investment; weaken demand, leading to over-dependence on personal debt to sustain consumption; and lead to under-investment in education, training and health. Too much inequality is bad for all of us and is part of a malaise which encompasses economic under-achievement, greater economic instability, more social tension, insecurity and unhappiness.

Populism and Identity³

A malfunctioning economy and a growing sense of grievance arising from greater inequality of income, wealth and opportunity – together, these forces are also shaping politics. Much has been written about the rise of ‘populist’ politics everywhere: the appeal of politicians of ‘left’ or ‘right’ offering simple solutions to complex problems; identifying a variety of plausible villains – foreigners, minorities, rich elites – to explain today’s economic and social problems; and a widespread sense of grievance and unfairness that promised progress is not being delivered by established politicians. In Britain that has taken the form of UKIP – and, more important, by the attempt by the Conservatives to head off UKIP by adopting its mantras and prejudices – and the capture of the Labour Party by the seemingly extinct militant left. At the same time, centrist politicians – mainstream Labour, ‘one nation’ Conservatives, the Liberal Democrats – have been seemingly discredited and marginalised: held responsible for the crisis and its aftermath of austerity; lacking the vocabulary of simple, popular, solutions; tarnished by association with unpopular minority groups or foreigners and international institutions; written off as ‘the political class’. There are similar stories in the US, Germany, Scandinavia, Italy and parts of the developing world with functioning democracies, like Brazil and India.

But some of these political currents were flowing well before the financial crisis and could best be described as the politics of identity. When I wrote about this subject a quarter of a century ago it was in more optimistic times. But it was apparent even then that a new

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dialectic was emerging that had little to do with the traditional left – right axis. Rather, it posed a new form of political alignment based, at one end of the spectrum, on attachment to an exclusive identity – national, religious, racial, linguistic – and, at the other, on an open, inclusive, outward-looking approach, comfortable with multiple identities. What appeared then to be happening, now more so, is that many people have reacted against the opening up – the ‘globalisation’ and liberalisation – of trade, investment, migration and culture. This reaction may be based on the experience of being part of the decline of mining and manufacturing or the fear of being ‘left behind’ or losing out, or ‘losing control’, as technologies advance or on distaste for the unfamiliar, the alien, the different. Immigration is the issue which brings many of these forces together.

None of this is wholly new – the first half of the twentieth century was disfigured in many countries by the ‘politics of identity’ – but for the first time in living memory the politics of Britain is overwhelmingly preoccupied by issues of identity: Brexit and disengagement from the European project, immigration, the nationalism of Scotland (albeit peaceful and dressed in social democratic clothes) and the sectarian divisions of Northern Ireland. The Brexit process has not stalled on the economic costs and benefits of EU membership but on the interaction between two ‘identity’ issues: sovereignty and Ireland. In the US, President Trump has won power and entrenched it by declaring a trade war against the world in general and China in particular, by fermenting hostility to Latin American immigrants and Muslims (and, by hints and nudges, black people), and by adopting the priorities of Christian evangelicals. Germany, Sweden and Italy seemed immune to these forces but their politics is now dominated by the issue of immigration in general and Muslims in particular and, in Italy, some hostility to the European project. A third of French voters opted for the National Front candidate in the second round of the 2017 Presidential election.

Traditional parties of right and left have adapted to this new

world with varying degrees of comfort and coherence. The British Conservatives have become the party of Brexit, though divided on the particulars, and have elevated immigration control to a central position even though it has meant reversing a previous enthusiasm for the Single Market, one of Mrs Thatcher's signature policies. The Labour Party, like continental parties of the left, has been seemingly confused by the politics of identity: ambiguous about Brexit and immigration, almost wiped out in Scotland in the face of nationalism, preferring to talk hopefully about the 'old' politics of left and right. By contrast, a substantial body of US Democrats has embraced the politics of identity, building a powerbase among ethnic minorities and seemingly rallying behind Trump's economic nationalism on trade, as a break with their party's more internationalist traditions.

What British politics needs is a party or group of parties which recognises that there is a new organising principle in politics, based on identity, is able to articulate a response to it, which is understanding of its causes but willing to take on those who demand loyalty to exclusive identity whether it is based on the nation state or ethnicity. In the battle over Brexit, Liberal Democrats have performed that role with assorted allies from other parties. The challenge now is to build a movement and a set of recognisable principles for this new kind of politics. I will call it the 'liberal' position, since it is not 'centrist' in the new polarity, but at one end of the spectrum.

A movement of this kind will embrace several different strands, reflecting the values of the liberal and social democratic and 'one nation' Tory traditions: outward-looking, rejecting narrow nationalist and ethnic politics; with a strong liberal appeal, with respect for legally enforceable individual rights; supporting freedom of expression and worship, privacy and property ownership; with a social democratic belief that the state has an active, positive, role to play in a market economy, including countering gross inequality; and an understanding of ecological imperatives and our obligations to others, including future generations, for

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the state of our environment.

These values, of course, inevitably come into conflict and are prioritised in different ways by different people. I will attempt to set out what a policy agenda should be on some of the emerging issues we face.

I believe that the Liberal Democrats should and will be leading a movement of this kind but we will need to reform to become more inclusive and representative and to work alongside others with a similar agenda.

Notes

- 1 Draws heavily on my book *After The Storm* (Atlantic Books, 2015), the sequel to *The Storm* (Atlantic Books, 2009) and speeches since, including on the 2017 and 2018 budgets.
- 2 Draws on speech to the Resolution Foundation on Inequality, September 2017.
- 3 Draws on my two Demos pamphlets: *The World's New Fissures* (1995) and *Multiple Identities: Living with the new politics of identity* (2005).

Chapter 2

A Functioning Economy and an Entrepreneurial State

Without an effectively functioning economy, such objectives as ‘fairness’ cannot be realised, and political extremes flourish. What Britain needs to prosper socially and financially in the 2020s is a longer-term strategy for sustainable growth which addresses the country’s deep failings in respect of skills, short-term financial horizons and housing. And, now, those of us who oppose Brexit and economic nationalism generally face the challenge to say how we would improve the functioning of an economy damaged by the financial crisis and then, again, by Brexit. Good economic management will be more critical than ever.

In the late 1960s and 1970s Britain suffered from ‘stagflation’: rates of inflation well above historic trends and occasionally reaching double figures (leading to a balance of payments crisis under a fixed exchange rate system) combined with slow growth relative to developed-country comparators. What followed was a revolution in policy terms which came to be known as ‘Thatcherism’ (with similar reactions elsewhere, notably the US): a fundamental switch from state ownership and controls to much greater faith in private ownership and market freedom (and with it, toleration of greater inequalities); independence for central banks to control inflation; fiscal rules to stop the build-up of unsustainable deficits and debt; and full-blooded engagement with an open ‘globalised’ economy through trade, financial markets, international investment and (to a degree) migration. The Blair/Brown era of Labour government cemented this transformation.

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Yet after the 2008 financial crisis no such fundamental rethinking of economic policy has occurred. On the British left (as also in the US and France) there is much denunciation of 'neoliberalism' and austerity but little indication of what this means in practice except in a few exotic (and disastrous) experiments, as in Venezuela. There has been a revival of belief in nationalisation, though not in explaining how it would actually work. There is a reaffirmation of the belief in more progressive taxation, but no developed economy has yet moved strongly in that direction. And led by the Democrats in the US, the emergence of the 'Green New Deal' is proving a rallying point for mobilisation around a powerful and compelling theme – combatting climate change – albeit, so far, without realistic thinking on the financing of it.

If there has been any kind of paradigm shift it has been a revival of economic nationalisation, mainly in the form of trade protectionism (and anti-immigrant attitudes) in the US and disengagement from EU integration in Britain by the decision, as part of Brexit, to leave the EU Single Market.

It makes no sense to go back to the 1970s, as some on the left wish to do: restoring price, rent and exchange controls (or trying to); re-nationalising utilities and the manufacturing industries which used to constitute the 'commanding heights' of the economy; abandoning fiscal rules in the name of 'ending austerity'; bringing back penal tax rates on high incomes and corporate profits. Nor is there much attraction politically (or economically) in taking the Thatcherite revolution to another level, as some on the Brexit right wish to do: scrapping many of the remaining labour, consumer protection and environmental regulations; pursuing as a matter of doctrine, rather than fiscal necessity, a 'small state' agenda in respect of tax and government spending.

In reality there are market failures and government failures. Good policy is about getting a sensible balance between making use of markets where possible and government where necessary – not a philosophy that will appeal to demagogues, but correct, nonetheless. Economic

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competence is not a message that stirs the soul but, without it, rising living standards and socially progressive measures are not possible. And we start from a position where there are major elements in the current model that we should be fighting to preserve as well as some major failures to correct.

One of the big advances of recent years which populists of the right and left are trying to undermine is independent central banks, overseeing financial stability. Unsurprisingly, the Bank of England is one of the main targets of the Brexit right and the radical left, complaining about the 'liberal elite', as represented by the Federal Reserve in Trump's US and the European Central Bank in the Eurozone. What is fundamentally at issue is the principle that day-to-day economic management, be it of monetary policy or financial regulation, should be left to politically independent 'experts' acting on the basis of evidence. That principle should be defended as tenaciously as the principle that operations in NHS hospitals should be carried out by medical professionals rather than witchdoctors or cranks. I made my maiden speech in Parliament in 1997 in support of Gordon Brown's decision to grant operational independence to the Bank of England, one of the most important parts of his legacy.

Where politics come in is in setting the rules for the Bank to follow, reflecting the experience of a major financial crisis and the fact that inflation is no longer the issue it was a generation ago (indeed, deflation has emerged as a real threat). The first changes could be to recognise the reality that the aim of policy, especially for interest rates, is to keep the economy growing as fast as possible. The way of expressing this, technically, is to set a target of money GDP (inflation plus real growth) which is pretty much what has happened in practice. The second is to acknowledge that where inflation has been dangerously high is in the property market. That is partly an issue of supply and demand, as I discuss below, but also of the availability of credit. Instead of politically driven, counter-productive and costly schemes like Help to Buy, the

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availability of credit should be determined by the Bank in what are now called ‘macro-prudential’ policies. And third, one of the very painful lessons of the financial crisis is the danger posed by financial institutions that are not closely regulated (or supervised), and that accumulate high levels of leverage (debt), threatening the stability of the system. I have argued that the British financial service industry and its collection of banks (and shadow or quasi banks which create credit like banks) is simply too big for a medium-sized country. Brexit will now reduce it, but unfortunately in a way which randomly cuts its export earning potential rather than by ending activities which are high risk and of questionable value. Adair Turner, the former financial regulator, and Mervyn King, the former governor, have described how we cannot simply apply sticking-plaster solutions to a financial sector suffering from fundamental instability.¹

Perhaps the most serious issue, looking forward, relates to the vulnerability of the economy if we again face recession or depression (a period of falling production, wages and prices). The weapons to fight a crisis of this kind are heavily depleted. Interest rates are already close to zero. Government debt is already at levels which have historically occurred after times of war. The economy has been kept going by quantitative easing (the Bank of England buying government bonds to force down long-term interest rates, or purchasing assets in the hope that this will boost confidence to invest or spend). The side-effects (widening inequality of wealth) have become politically toxic.

In future, perhaps sooner than we think, the authorities may be forced into more extreme alternatives. Even if the international economic outlook is benign – which is increasingly unlikely – a disruptive Brexit could trigger a serious downturn requiring emergency action. One possibility discussed during the financial crisis, but not acted upon, would be for the government to finance its spending – either boosting spending through a tax cut, or handing out vouchers to spend, or investing in capital projects – by borrowing from the central bank. This

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is, in effect, 'printing money', the original 'magic money tree'. Were we to find ourselves in another major financial crisis, or a deep depression caused by other factors, such unorthodox measures would prove necessary. But it would be essential to maintain the separation between monetary policy, managed by technocrats on our behalf, and budgetary (fiscal) policy run by politicians. If it were not, it is not difficult to see how populist politicians, if in power during the next crisis, could manufacture short-term popularity by seizing control of the Bank of England to harvest the 'magic money tree'. Debasement of the currency is bound, in due course, to have the same baleful consequences as it did for medieval monarchs and modern dictators. We should not be looking to the likes of Venezuela and Zimbabwe for a template for monetary policy.

All the more reason, then, to ensure that budgetary policy also operates within rules (though we can sensibly argue about what they are). The current battle between the European Commission and Italy over Italy's chronic inability to set a sustainable budgetary policy reinforces that principle. In Britain, the phrase 'the end of austerity' has the effect, if not the intention, of conjuring up a world where budget rules can be broken or no longer apply. We should be having a proper national debate about how much the public is willing to pay in higher taxes (and what taxes) to pay for better financed public services. Liberal Democrats are clear that some rises in general taxation are justified, in particular to pay for healthcare, and that changes to the way we tax wealth are essential to fund the services and investment the public wants to see. What makes no sense is vague appeals to have Scandinavian levels of public sector spending without any way to meet the costs in the long term – the stock in trade of the present Labour Party.

What is required are rules of the kind originally set out by Gordon Brown – and in the EU in the Maastricht conditions – requiring governments to balance their (current) budget over the economic cycle (an elusive enough concept), policed by an independent body (currently the

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Office for Budget Responsibility). The major unresolved controversy is what to do about public investment. In theory public investment should be able to pay for itself and therefore not add to government debt. But in practice a lot of public investment, however worthy (like school buildings), simply adds to debt, and the Treasury treats all investment as no different from current spending (a source of some tension within the Coalition). What is needed is an arms-length and professionally staffed body, perhaps constituted like the Green Investment Bank set up by the Coalition, which can vet and promote public sector investment projects which the private sector will not undertake but which produce a clear, long-run economic return. Railways and housing are obvious areas and the next generation of renewable energy. The ambition to mobilise political energy around a Green New Deal can be a central part of this investment provided it is separated from magical money.

There is a deep pool of potential infrastructure investment in pension funds. But the UK pension fund sector is very fragmented, and a proactive government should amalgamate them into bigger wealth funds to enable them to diversify in this way.

Another important role for public investment is to pump-prime private investment in some of the 'left behind' areas of the UK. There is a category of projects which do not require financial subsidy but do require the 'comfort' of government co-financing or enabling investment in the form of a key piece of infrastructure. The Regional Growth Fund operated by my department during the Coalition (since relegated in importance) provides a model. Private businesses bid for investment funds. These were vetted by a politically independent team of advisers led by Michael Heseltine and then subject to a detailed economic evaluation before being signed off by ministers. In this way, substantial new investment was generated without the overheads associated with the earlier Regional Development Agencies. Future investment could be via some hybrid of the Regional Growth Fund and Regional Development Agency model, seeking to devolve decision-making away

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from Westminster and to put a local democratic process in place to oversee it.

The big underlying issue behind budgetary (tax and spending) policy is how big the state's share should be. The effect of a period of 'austerity' under the current, Conservative, government has been to take the public spending share of the economy (including investment) from 41 per cent in 2015 to 39 per cent in 2018 (and tax revenue as a share of the economy largely unchanged from 36.2 per cent to 36.15 per cent). Under the Coalition the public spending share went from 43.75 per cent to 41 per cent (and tax from 35.2 per cent to 36.2 per cent). Despite the fierce ideological arguments around austerity, the shares haven't greatly changed. The 'small state' revolution, if that was what it was, didn't get very far. And Britain is somewhere in the middle ground of developed economies, spending and taxing far less than some countries (France; Sweden) but more than others (the US). Here, economically liberal and social democratic values pull in opposite directions. My instincts are that important public goods are underfunded (health, education, policing) and taxes need to be raised to pay for them. The Lib Dems 'rip in the pound' on income tax is a statement of intent to move in that direction; but we have yet to see how much appetite there is for funding a much bigger state (as opposed to taxing 'someone else' (the 'super-rich' or 'multinationals')).

One important question, not raised since the debate around the poll tax a generation ago, and its replacement by a new form of residential property taxation, is whether the tax base should change in a fundamental way. The one, big, radical reform which is crucial is to shift tax from work (income tax and national insurance) to land. Land taxation has long been advocated as a form of tax which is economically sensible (it taxes something in fixed supply, encouraging efficient use), which cannot be avoided by shifting overseas (as can taxation of income and profit) and is relatively efficient (requiring collection from landowners rather than vast numbers of property-owners). A prototype has been

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designed, replacing business rates by a landowner's levy, which could progress from there to residential land (also replacing council tax). There are administrative and political challenges, but it is the direction in which we should be travelling.

Another fundamental change, which is obscured by arguments about how to squeeze more tax out of companies, is to shift to shift tax away from equity (risk capital) and on to debt, which is currently treated as tax-deductible. The Coalition recognised the need to make this change as a step to a more entrepreneurial business sector but it has not yet been followed through.

Arguments about how to divide up the spending cake, or how to realise the tax revenue to pay for it, beg the question of what government can do to help the economy become more productive and environmentally sustainable. The more successful Western economies have long appreciated that a judicious mixture of competitive private enterprise and state intervention (within agreed international rules) works best. The serious issue here is not how to create a 'small state' dominated by Conservative ideologues or a 'big state' fantasised by Corbynistas. It is how to make government smarter and more entrepreneurial. There are three specific things which British governments should be doing more of.

The first is that while Britain has a good record in promoting, financing and safeguarding the quality of scientific research, this is not true of innovation – translating science into new products and processes through investment. UK R&D spending (especially the D) for non-military purposes lags behind that in comparator countries. Tax incentives (R&D tax credits) have helped but are wasteful of resources compared to targeted investment by government alongside the private sector. The Catapult network launched under the Coalition through Innovate UK now provides a good structure, but it needs considerably more sustained government support. Professor Mariana Mazzucato has described the model of an entrepreneurial state working alongside the

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private sector, which has led to breakthroughs in space exploration, the internet and pharmaceuticals and will be necessary for future success in dealing with climate change or cancer.²

Second, all the evidence suggests that a more educated labour force raises the performance of the economy. Britain should aspire to be a successful knowledge-based economy – ideally, the best-educated country in the world. There have been piecemeal attempts to raise school standards, particularly in core subjects like literacy and maths, albeit at the expense of creativity. And there has been a massive expansion of higher education, even if it is often simply satisfying a perceived need for paper credentials. The priority now is to help young people prepare for a world of rapidly evolving technologies in which traditional skills and professions are becoming redundant and the premium is on adaptability: learning how to learn.

There are two glaring failings at present. The first is the lack of resources for the FE sector, both in providing basic skills for young people who do not go to university and providing progression for many more people to progress to higher apprenticeship and other advanced training. The apprenticeship levy – essentially another employee tax – has badly set back progress that was starting to be made. Raising the demand and supply of quality apprenticeships must now be a priority. One way in which this could be made a reality is to put Britain to work on a radical programme of new house-building – a subject I address in Chapter 8 – with an associated skills academy to train people in construction.

Second, adult education has been allowed to atrophy. What is needed is a much stronger commitment to lifelong learning. The concept of Individual Learning Accounts which was briefly tried but discarded two decades ago because of fraud and lack of financial control should be revived as a way of giving adults an incentive to keep learning and relearning. I established a commission to take forward this proposition for the Liberal Democrats. It is possible to see how such a system

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would work with a state-financed Individual Learning Account of – say – £10,000, topped up by private and corporate contributions used to finance tuition fees whenever they are incurred and across the range of higher, further and adult education without discrimination.

I know from my experience in government the enormous barriers to creating a level playing field between the various forms of post-school learning. Snobbery and ignorance play a big part. In the civil service and in politics there is a strong bias to traditional undergraduate learning (based on some imagined variant of Oxbridge colleges) as the ‘gold standard’. I don’t for one moment decry the merits of universities which have recently transformed the economic outlook of many provincial towns and, at best, can do wonders for creative and critical thinking. But in a world of scarce resources they have been wrongly allowed to crowd out equally valuable institutions of learning (and virtual learning).

My final role for the state is to build on the Industrial Strategy developed in my period as Business Secretary and before and continued by my current successor. The twin ideas are to develop public-private partnerships especially in areas of high risk and uncertainty into which the private sector alone will not venture; and, a related point, to provide longer-term horizons than capital markets will normally allow. There are successful experiences to draw on in automobiles, aerospace and life sciences. Examples include the development of the next generation of motor vehicles, including electric cars, the Aerospace Growth Partnership, sponsoring new biotech companies, and the promotion of the Fintech sector.

Concretely, this will involve the government establishing priorities, a process sometime pejoratively called ‘picking winners’. The experience of the 1970s, including Concorde and the nuclear Advanced Gas-Cooled Reactors, provided many examples of failures which absorbed and wasted a lot of scarce capital. But recent experience, including mine, has suggested some useful lessons. One is the value

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of co-investment, so that the state leverages private investment rather than replaces it and goes with the flow of the market rather than against it. Recent experience with automobiles, aerospace and biotech, the (former) Green Investment Bank and the Regional Growth Fund all followed this model. Then, there are sectors like the creative industries, professional services, construction and IT, where there isn't a demand for large amounts of state capital but for a good framework for training, intellectual property rights, better functioning credit and equity markets and funding of early-stage innovation. The work is often unglamorous, and this is not territory for ideologues and showmen. But there are undoubtedly areas where the state will need to go where the private sector currently fears to tread – for example, renewable energy, where recent decisions on solar and tidal make a nonsense of long-term sustainable energy strategy.

There is also too trusting a belief that competition will somehow naturally emerge as part of the workings of a market economy. In reality there are powerful forces working in the opposite direction, creating and entrenching monopoly power through the use of intellectual property rights – which may be necessary to spur innovation but also acts to protect monopoly positions – and through the sheer scale of new technology platforms. The next chapter deals specifically with this challenge.

Notes

- 1 Adair Turner, *Economics after the Crisis* (2012); Mervyn King, *The End of Alchemy* (2016)
- 2 Mariana Mazzucato, *The Entrepreneurial State* (2013)

The Digital Economy and the Tech Titans¹

If Britain is to break out of the current pattern of low productivity, low growth, stagnation in living standards and austerity in public finances, it will come in part from successfully harnessing the power of new technologies. But the companies which dominate the world of ‘high tech’ are global (US or Chinese-owned) titans which, for a medium-sized country like the UK, invites the question of who exercises effective control over the behaviour of these companies, the technology they use and the data they accumulate for their own use or to sell on.

The infrastructure of the internet, the ‘commanding heights’ of the modern economy, is currently in the hands of a small number of giant companies – Google, Apple, Facebook and Amazon – along with their Chinese equivalents Tencent, Alibaba and Baidu, and other companies which have colonised specialist applications (such as Uber or Airbnb). This dominance is reflected in the facts that Google drives 89 per cent of internet searches, 95 per cent of young adults on the internet use a Facebook product, Amazon accounts for 75 per cent of e-book sales, and Google and Apple combined provide 99 per cent of mobile operating systems.

It would be ludicrous to be wholly negative about a major liberating force which almost all of us use.

The internet and digital platforms have often been a force for the wider public good, empowering activists and investigative journalists in fighting for democracy and exposing corruption, and amplifying

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important campaigns like the #MeToo movement and anti-gun marches in the United States. Our individual lives are greatly enhanced by being better informed and better connected and having access to higher quality and cheaper goods and services. Meanwhile, these giants mostly provide a 'free' service to the public, albeit paid for indirectly by the sale of advertising space and the bundling and sale to commercial clients of 'free' user data.

The problem these companies present is not therefore one of price but one of power. Apple has an annual income higher than that of Portugal. The big firms have acquired a pivotal position by providing a service or platform through which data can be extracted, collected and used, under rules set almost exclusively by the supplier. The companies are global while regulation – save in the European Union – remains stubbornly national.

There is also a natural tendency to monopoly. Economies of scale reinforce the position of the company which is the first to establish a global network, and the more who use the network the more valuable it becomes for both its users and its owners. There are now 1.9 billion Facebook accounts, accounting for a quarter of the world's population. Why would an individual or company opt for an alternative with less reach? Operating systems – Windows for personal computers, Android for smart phones – tend also to concentration because they provide basic services that others need in order to run.

There are several problems to address. The first is that the companies have been used as a conduit for content which society regards as unacceptable: the promotion of terrorism, depictions of child sex abuse, and hate speech. Google (and YouTube, part of its empire) and Facebook in particular stand accused of complicity or incompetence.

The second is that one particular type of content – online news – is no longer simply competing with established news providers but has been used systematically, by state and non-state actors, to spread false information and to corrupt democratic elections, as in the US in 2016

and the Brexit referendum, all enabled by the inability or unwillingness of digital platforms – Facebook in particular – to curb the misuse of the data it collects.

The big platforms have the capacity to filter the information we receive as consumers, turning the taps on and off to their own advantage. And they sell information about us to clients with not just business but political agendas. They can influence not just the goods and services we consume but how we vote and, indeed, what we think. Their algorithms can be used to disseminate information – true or false – to selected groups of people. The power this gives Facebook, for example, over its two billion users is immense. And even if today's owners of such platforms are benign and well-intentioned individuals, the systems they have created and now monopolise may threaten democracy as we know it. In the age of identity politics, the misuse of data to fan prejudice is especially dangerous.

Artificial intelligence (AI) may prove to have great benefits in bucking this trend, or it could exacerbate it. Mark Zuckerberg has invoked AI as a potential means to provide a mechanism for screening out 'fake news' or dangerous information. But since the profit motive alone will not bring this screening about, it must be a matter of concern that the priorities and direction of AI will likely be heavily influenced by the same handful of data giants.

The third problem is that the new internet giants operate in a largely borderless world where their main source of profit is intangible intellectual property rather than measurable 'things'. This is difficult to track and quantify and has turned national tax authorities into largely powerless bystanders. The UK has been driven to introduce a special new tax on these companies, but revenue expectations are very modest.

The fourth problem is the real concerns that while the tech giants may have begun as innovative upstarts, they have, by virtue of their sheer size, become a barrier rather than a boon to entrepreneurship. By acquiring potential challengers before they become a real threat,

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spending millions lobbying governments to ensure their interests are protected, and tying in users through the sheer scale of features and interaction they offer, the tech giants' dominant position often leaves entrepreneurs feeling they have no choice but to sell up or close down.

Smaller challengers that show a potential for using large amount of data are likely to be on the radar screen for purchase by the first-tier platforms. Facebook, for example, absorbed two major potential competitors – Instagram and WhatsApp. When this approach failed with another competitor, SnapChat, there was an aggressive campaign to copy SnapChat until Snap (the parent company) lost advertising revenue and its share price tumbled.

Innovation remains possible but controlled. Anyone can write an app for an iPhone but it needs to pass Apple's tests and Apple keeps a share of the sales. E-commerce sites like Amazon and eBay are platforms like physical markets where people like to shop – but independent traders outside the market place are squeezed out.

And the giant companies are best placed to absorb the multiplication of data. The most far-reaching aspects of 'datafication' are in the interconnectedness of devices (including household appliances and instruments involved in healthcare, for example) – part of the 'internet of things'. According to IBM, an estimated 90 per cent of the data in the world – much of which has been captured by a small number of platforms – has been created in the last two years. The growth of artificial intelligence gives extra momentum to this process.

Small companies which are either potential competitors or can add to the harvesting of data are snapped up; Google and Facebook alone have acquired well over 200 European companies in the last few years, many in the UK. But the nature of competition and monopoly or oligopoly is subtle and rapidly changing. While Amazon, for example, encourages small online merchants (competitors) through its 'Marketplace' retail service, it could decide to change its terms if it felt the merchants were a threat. And although Facebook offers free

internet facilities to consumers in developing countries, this supposed philanthropy is also a way of building up its user base.

Then there is evidence that the platforms are actually destroying not just competitors but competition in markets in which they operate. Google and Facebook have been sucking up two-thirds of all digital advertising revenue in the US (in 2017), because they can use their data to target advertising at potentially the most lucrative markets. One of the effects of this dominance is to suck revenue from media companies, including TV channels and newspapers, which rely on advertising. We are seeing the death of regional newspapers and the erosion of media plurality in general.

Here in the UK, Amazon has aggressively exploited its dominant position and has used its far better margins to invest in acquiring significant amounts of customers and their data. Figures from *Retail Week's* online footfall index suggests that internet shopping drives around 90 per cent of the growth in shopper visits – one of the main reasons for the demise of ‘bricks and mortar’ shopping centres and the ‘high street’.

Optimists can take the view that the innovative insurgents will do the work for them, in due course eroding monopoly power. They would say that government intervention is potentially more damaging than letting markets and technology find their own solutions. They could cite the example of Microsoft, which no longer has the world's dominant operating system because it failed to make the jump from PCs to mobiles (though it has staged a comeback). And for billions of customers and millions of small and medium-sized companies the digital platforms continue to offer abundant opportunities for recreation and business.

But the immense power and reach of a small number of companies does raise the issue of how to regulate them in the public interest to prevent abuse. Leaving aside Chinese-style nationalisation and control, the most prominent approach to this challenge of monopoly is the traditional Western anti-trust model, which has been employed most vigorously by the European Commission on behalf of EU governments.

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As well as financial size, the type and total amount of data a combined company controls should come into consideration. National governments and, even more, supranational bodies like the EU, can and should look to break up enterprises where size is detrimental to the economic well-being of the country, its citizens and its capacity for innovation. There is a case for splitting Amazon into three separate businesses – one offering cloud computing, one acting as a general retailer and one offering a third-party marketplace. Other examples would be Facebook being forced to divest itself of Instagram and WhatsApp as a condition for operating in the EU, creating two new social media networks. Divesting Google of YouTube would be another.

The US competition authorities have a history of ‘trust-busting’ which should, in theory, make the internet giants nervous. Yet in practice, the US authorities have shown little inclination to move against the tech giants. In practice they have come down harder on companies seeking to combine to confront competition from the platforms than on the platforms themselves.

What is striking is that the most effective competition authority in the capitalist world – the European Commission – is probably the only body with the clout to take these decisions. Each of the main technology companies has been or is being investigated. While the process is very slow, Google was recently fined €2.4 billion for market abuse involving competition between its search engine and price comparison sites.

As the world grows closer together, Britain is committing an act of serious self-harm by doggedly setting itself apart from the power of shared sovereignty with our neighbours. When it comes to regulating the growth industry of this century – data – Brexit will be like giving up shared protection from the rain in return for absolute power over a tiny umbrella.

Meanwhile, the British Competition and Markets Authority has anyway shown little interest. If the UK is to develop its own competition policy independent of the European Commission, it will need to

up its game quickly. It will need a different approach to mergers and takeovers, getting away from the traditional concern with short-term consumer welfare (measured through prices) and challenging them where they may reduce innovation, following the principle ‘competition is the mother of invention’. Enforcement also needs to be accelerated to reflect the speed of technical change.

Regulating content

In addition to addressing the primary problem of monopoly, there are three other issues to consider: the right balance between ‘free speech’ and responsible publication; the transparency of digital advertising algorithms; and the rights of individuals to own their data.

There is a strong case for setting up an independent standards body to act as a watchdog on the digital platforms in moderating content. Platforms above a certain size would be compelled to join.

This body would uphold common policies governing the identification, monitoring and deletion of content which offended an ‘offline criminality test’ – that is, where statements made *online* would breach incitement or harassment laws if made *offline*, the companies should act. The body could be funded by government directly or by the tech platforms themselves through a compulsory levy, as in the case of the Pension Protection Fund.

A shared set of standards enforced by an external body would go a long way in restoring trust in social media platforms, and put an end to the current unsatisfactory Wild West approach of self-regulation together with government haphazardly telling individual companies off when they step out of line.

A further general principle should be one of transparency. In practice this means that the algorithms used by the data companies should be available for close inspection by regulators acting for democratically elected governments, along with access for regulators to the programmers responsible for designing and operating them. Transparency

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becomes even more important as the data giants develop the use of AI.

Privacy

In that vein, another set of reforms with a liberal spirit is to strengthen data ownership and privacy rights for individuals. There is already a variety of initiatives in this area, above all the EU's General Data Protection Regulation, now in effect in the UK, which establishes citizens' control over their data. The new rules require any use of individual data to be accompanied by explicit permission – opting in rather than opting out – requested through a written statement in clear language. The strength of the GDPR lies first and foremost in its formidable sanctions.

We should also look carefully at the fundamental economic issue of whether any company which uses data from individuals to make money should pay the owner of that data for its use. It is astounding that people have been so happy to give up something so valuable without charge. Individuals should be rewarded every time their data is used, in a mirror of the worldwide copyright structure. While there are practical difficulties in establishing a charging structure, it cannot be beyond the technical power now available to us to make this happen, and such an innovation would be much more effective and liberal than capturing the value through taxation for the common good.

Putting power over data into individuals' hands, and empowering them to choose who to sell it to, would not only be a huge shift of control from companies to people. It would enable innovative insurgents to overcome the big monopolies by buying the data they need, rather than being swallowed up at birth by the larger companies.

Notes

- 1 Based on speech to the tech industry, 19 April 2018, and 'Regulation and Competition in the World of Datafication' in *Four Go In Search of Big Ideas* (Social Liberal Forum, 2018)

Chapter 4

Capital and Labour

One of the big changes of the last three decades has been a shift in negotiating power from labour to capital: the re-emergence of the type of 'classical' labour market conditions which are like the nineteenth century before the emergence of an organised labour movement. In the aftermath of the financial crisis, recession, then depressed growth, did not result in mass unemployment but in falls in real wages. The widespread assumption that near full employment would result in wage inflation, requiring higher interest rates, has not materialised. The assumption of the Low Pay Commission and others that a significantly higher minimum wage would result in big job losses has, so far, proved unfounded. One of the central assumptions of Keynesian economics – 'sticky' (downward) wages – appears to be no longer relevant. It is fair to say that the jury is still out on some of these controversies, but the evidence is stacking up that there has been a shift in the balance of power from labour to capital. This can be measured in the decline in the share of national income going to wages and salaries rather than profits, from over 60 per cent in the mid-1970s to around 50 per cent (with fluctuations since between 50 and 55 per cent). This phenomenon is common in the western world but is less marked in Britain than in the US, Spain or Italy.

Several factors appear to be involved. One is the sharp decline in trade union membership, from over 13 million in 1979 to just over 6 million today (13.5 per cent of the labour force), including only 2.7 million in the private sector. Allied to that phenomenon is the near-monopoly power ('monopsony' in economic language) of some major employers (including the government) over a scattered and disorganised

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workforce. A further factor, and perhaps crucial, is the spread of ‘flexible’ working practices.

To put this concept into context, the employed UK labour force is 32.4 million, of whom around 15 per cent, 4.8 million, are self-employed. Many of these are traditionally self-employed: shopkeepers, entrepreneurs, artisans, artists and professionals. And there has long been, in some industries, a tradition of casual work. But a growing number are ‘gig’ workers who work as contractors, without guaranteed employment, at a set rate for a specific task – usually on an app-based platform (as with Uber or Deliveroo or People per Hour). A Business Department study has shown that just under 3 million workers had some kind of gig work in the last year, half of that number frequently, which tallies with an estimate of the Chartered Institute for Professional Development of 1.3 million gig workers. There are in addition around 1 million workers on ‘zero-hour contracts’, with no guarantee of work but no obligation to work. Putting these numbers together, it is plausible, as estimated by the TUC, that there are around 3 million workers – one in ten – in ‘precarious employment’ without statutory labour rights and benefits and, mostly, not covered by the minimum wage. Crucially, this is the main growth area for employment, and business expectations are that the proportion will grow.

At first sight, this development seems undesirable: exposing millions to the prospect of exploitation and weakening further the capacity of the workforce to bargain for better wages and conditions. Certainly, the trades unions and the Labour Party interpret it in this way, calling for example for the ‘banning’ of zero hours contracts. The awkwardness is that surveys of this new workforce show high levels of satisfaction with flexible working, especially amongst students, older semi-retired workers and parents with young children. That is the main reason I was persuaded as Secretary of State *not* to legislate to ban zero-hour contracts.

Nonetheless, to avoid abuse, new, clear legal rights for the workers in the gig economy should be established. The courts have already established that Uber workers should be treated as ‘employees’. The

Matthew Taylor report on the gig economy has led to – broadly sensible – government proposals to give legal status to ‘dependent contractors’ who should enjoy some labour rights (so called Day 1 rights, against discrimination). We should go further in the range of labour protections and statutory benefits by extending to them the minimum hourly wage, for example. And for the 90 per cent of workers who are not in this form of employment there should be acknowledgement that the pendulum has swung too far against organised labour and collective bargaining. It is also clear that some of the changes forced through by one side of the Coalition – such as the prohibitive employment tribunal fees – were very damaging and have had to be partially reversed. And one of the measures I promoted at the time with the support of the TUC – electronic voting within trades unions – would empower unions in a positive way.

But there is another factor which may have played a role in the weakness of labour in pushing for higher wages: the ‘globalisation’ of business through trade, ‘offshoring’ and migration. The academic literature, to which I contributed, acknowledges the importance of China’s emergence as a large-scale manufacturing exporter in depressing real wages in the developed world, but also shows that this effect is usually exaggerated relative to technological change.

The really powerful influence on wages and employment in future will be technological progress. It will take the form of technology platforms opening up new sectors of the economy to the kind of relationships now quite common for courier and taxi services and online shopping. There is, additionally, the spread of robotics from manufacturing production lines to service occupations like domiciliary care. And, potentially most potent, the dissemination of artificial intelligence technologies displacing many existing administrative or professional roles where problem-solving can be reduced to sophisticated algorithms. In this world, it is no longer just unskilled and semi-skilled labour which becomes redundant but entire areas of employment which

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were assumed to be immune to replacement by machines – a lot of legal work, architecture, driving (with driverless cars), teaching, security and health care. There are important ethical as well as economic issues, particularly as we approach the so called ‘singularity’, when machines outperform humans in almost every capability. Together with Jo Swinson, I have established a commission to explore them.

As in previous waves of technological progress (industry, railways, electricity, mass automation, IT) there is hype around both the opportunities and the threats. Books were written in the 1960s about how computers would create mass unemployment; the onset of mechanised agriculture and manufacturing were equally treated as having heavenly or diabolical consequences. In reality new jobs emerged where others were lost, though particular occupations and settlements suffered grievously (like ‘left behind’ mining communities in Britain and the ‘rustbelt’ in the US). The lessons from the past are clear. First, new technologies bring considerable benefits as well as some threats, and regulation is a better response than banning and blocking. Second, the employment effects are much less likely to be mass unemployment than a weakening of workers’ (and professionals’) bargaining power over pay.

Change is coming, come what may. Populists have no answer other than to hark back to a mythical bygone age, a romanticised picture of bucolic contentment and working-class solidarity in the mines and factories. The best defence against the disruption of technology change is education in the widest sense, including lifelong learning: ‘learning how to learn’, making it easier to acquire new skills, leading to higher-paid and more secure employment and an ‘opportunity economy’.

This is the liberal approach to the fourth industrial revolution: preparing people for the future rather than eulogising the past. Without this preparation, those who would divide our society by pointing to scapegoats (immigration, elites) when employment becomes more difficult to find will be emboldened. I address the challenge of a liberal response to immigration in the next chapter.

Migration, Security and Identity

In the UK, as in the US and continental Europe, the issue of migration has proved to be a defining issue in which the merits of globalisation are pitched against the politics of identity; it was undoubtedly the one key specific issue which swung the 2016 referendum in favour of Brexit.

In economic terms, most immigration (at least of workers) expands the economy in terms of GDP but not necessarily GDP per head. That depends on the productivity of the migrants. In general, the migration we have experienced from the EU has been of young workers in skilled roles or in unskilled roles where there is a labour shortage; so, their impact has without doubt been economically positive. Of course, there is a call on public spending for schools and health services, but the evidence suggests that additional tax revenue to the UK far exceeds the cost in public services and benefits.

Those who argue the negative economic case say that immigration displaces jobs and drives down wages. As Secretary of State I commissioned a variety of studies which suggested that any negative impact is small, since, by and large, EU migrants are complementary to, rather than competitive with, British workers. But clearly there is some impact and we are now seeing the converse: a tightening of labour markets as Europeans return home or stop coming.

The politics, however, does not simply follow the economics. Anti-immigrant prejudice tends to be strongest where immigration is low, and amongst older people who benefit from the impact on house prices and the greater government revenue; conversely, the metropolitan areas which experience the biggest impacts (on house prices and

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job competition) appear relatively relaxed. And where immigration does pose the biggest challenge to the indigenous population's sense of identity and social cohesion, as in the former mill towns of Lancashire and Yorkshire and the former manufacturing towns of the East and West Midlands, it centres on past migration from parts of the Indian subcontinent rather than from Europe, and specifically on Muslim communities.

Meanwhile, for many, a successful economy and rising living standards is no more important than freedom from fear, in particular fear of crime and terrorism. This is a fear which populists have ruthlessly exploited. Trump's wall is all about excluding 'terrorists, rapists and drug traffickers' (who just happen to be dark-skinned Latinos from Central America). The backlash against Mrs Merkel's policy of admitting refugees from the Middle East into Germany received an enormous boost from the isolated cases of terrorists entering Europe alongside the vast majority of bona fide refugees.

There is some suggestion that where immigration, rather than race or religion, is an issue, concerns centre on the rate of change rather than immigration as such. Overall it is reasonable that the public expects immigration to be 'managed', while recognising the merits of an approach that is both liberal and humane, and also applies basic common sense.

At first sight this conclusion conflicts with the EU aspiration to maintain freedom of movement and freedom of trade in services which often involves movement of people to perform a service. There is much to celebrate in the basic entitlement of Europeans to live, work and study wherever they wish in the EU, and many Britons take advantage of it. Many young people value the 'idea of Europe' precisely for this reason, and it is an important part of making the EU a lived experience. But, in practice, most European countries recognise that the first choice of new jobs should go to local people, that there should be limits on the social security benefits which overseas migrants enjoy, and that

freedom of movement should be treated as a privilege as well as a right. The literal, idealistic – or naïve – approach of the Blair government in opening the doors to newly liberated Eastern Europeans has in practice undermined public support for the overall principle of free movement. The UK was one of only three member states, alongside Sweden and Ireland, to open its labour market to these new EU citizens immediately. If Britain does finish up staying within the rules of the Single Market, the pragmatism of the other EU countries on this issue will need to be deployed (as Germany does, for example, in relation to the non-mutual recognition of professions), along with reforms within the EU to permit safeguards when immigration flows are large and destabilising. There will always be people who will want to exploit the politics of identity to divide us politically; whilst fighting their politics, we need to avoid feeding them excuses.

A lot of the debate (and prejudice) around migration has little or nothing to do with the, essentially economic, arguments around the EU Single Market (though arguably the freedom of movement involves a deeper commitment to share citizenship rights than the right to travel aboard to work without visas). The episodic immigration ‘panics’ which have occurred in British politics essentially concerned refugees. Before the First World War there was a panic over Eastern European Jews, mainly fleeing to Britain from the pogroms of Tsarist Russia, and the territories which it controlled in the Baltic and Poland. What followed was the draconian Aliens Act, effectively blocking asylum. There was a similar episode in 1968 when around 100,000 British Asians were expelled from Kenya; many arrived, but special legislation was passed – opposed by a handful of Liberal and other MPs – to bar further entry. Since my late wife was a Kenyan Asian, I formed strong views about the British (Labour) government’s inglorious role in this episode. The politics of that period were toxic, culminating in the infamous speeches of Enoch Powell which were explicitly directed against black and Asian migrants (whose movement to the UK had, in any event, been

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controlled under the Commonwealth Immigrants Act).

There were further, if lesser, panics around refugees from the Yugoslav civil war and then from potential refugees from Hong Kong as the Chinese takeover loomed. Crucially, the Brexit referendum coincided with the influx into Europe of large numbers of refugees from the Syrian civil war which were welcomed to Germany by the Merkel government (and Sweden) but rejected elsewhere, including by Britain, which agreed to accept only a derisory number. The outcome of the Brexit referendum might well have been swung by images of dark-skinned Muslims portrayed as the face of 'immigration' and a threat to 'identity'. And as I write this paper, another immigration 'panic' is developing around a few hundred Middle Eastern refugees attempting to cross the English Channel in small boats.

Developing a coherent, let alone humane, response is bedevilled by the fact that the formal legal concept of a refugee – someone fleeing persecution – is impossible to apply when people are escaping some combination of political repression, war or civil war, famine and destitution. Scientific warnings of severe climatic change from global warming suggest a new class of refugees. It is never going to be possible or right to eliminate the basic impulse for self-improvement and a better life from an asylum application.

The issues are not easy and there are few, if any, arguing either for a complete ban on immigration of all kinds or for unrestricted admission. The arguments in practice are about numbers and enforcement and ensuring that those who have legal residence are treated fairly and not subject to the 'hostile environment' meted out to Caribbeans of the Windrush generation and many others. On balance the benefits of immigration outweigh the costs, and not just economically; but it cannot be denied that there have to be controls which are managed and policed.

The promised post-Brexit system of immigration controls (ignoring the mass of practical problems which will be created around 'settled

status' for three million EU citizens) threatens to extend the worst features of cumbersome and bureaucratic Home Office regulation. An arbitrary salary minimum of £30,000 is being proposed which excludes not just unskilled and semi-skilled workers, even where there is a demand for them, but many creative young people in scientific research, for example. Apart from obvious changes like excluding temporary students from the numbers being controlled, what is needed is a much more flexible system of allocating visas – using auctioning, for example, or the taxation of employers to capture the benefits of immigration for society.

It must be absolutely part of the liberal cause to rebuild trust in the migration control system, to protect migrants from scapegoating and to put in place well-financed and protected police and security forces, coupled with a recognition that in a world of porous borders security is more often attained by cooperation than by erecting barriers, at both European and wider levels.

Chapter 6

Capitalism In Crisis: Reforming The Model¹

Scarcely a day goes by without a scandal erupting around greedy or bullying bosses, pilfered pension funds, business tax dodging, chaotic private train operators, rewards for failure, bankers' bonuses, excessive pricing or exploitation of employees. In response, the public appears to want more nationalisation, more regulation and higher taxes on business. The problem with populist solutions which take us down the road of government ownership and control of business is that we know that it doesn't work in a world of rapidly changing technology and international competition – and it is even less likely to work well now than in the era of post-war socialist reconstruction. What appears to work better, at least in economic terms, is a form of 'state capitalism', best illustrated in China. But to succeed, this model requires a politically disciplined command-and-control structure which cannot (and should not!) be transplanted from a (nominally) Communist state to the UK. It seems likely that the structure will eventually prove to be unsustainable in China too. And where tried elsewhere this model has degenerated into large-scale corruption and misallocation of resources.

So, in practice, the search is one for better models within a private-enterprise market-based system. Since there is no perfect formula, the best approach is for the UK to provide a laboratory for different kinds of business and ownership models.

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Diversity

We already have a lot of foreign companies, and some – like Siemens, Tata or Nissan – are based on stable shareholder structures that do not permit easy takeovers. They often demonstrate a social awareness and long-term investment planning superior to native companies.

Mutuality (or consumer ownership) has – just – survived in the finance sector through one big building society (Nationwide) and many small ones, as well as several mutual insurers, and has potential elsewhere. The mutually owned Dwr Cymru Welsh Water, for example, offers an alternative to renationalisation of the water industry.

Cooperatives which are a form of mutual have had a chequered history, but the Co-op appears to be undergoing a revival in the retail sector. Employee participation in ownership and decision-making too has some demonstrated success stories – John Lewis and Arup to name two. The great Liberal philosopher John Stuart Mill was a passionate advocate of workers owning their own companies, predicting that the ‘relation of masters and workpeople’ would be superseded by partnership and ‘association of the labourers with the capitalist’.

Indeed, worker share ownership is a liberal, pro-business response to inequality and workplace apathy, and empirical evidence from across the world demonstrates that employee-owned workplaces are happier, more productive and more resilient in economic downturns. Yet the presence of such companies remains surprisingly small as a share of the economy. Indeed, the UK ranks near the bottom among EU countries when it comes to formal participation and governance rights for employees, rights which are themselves linked to higher levels of productivity, equality and R&D.

Social enterprise resting on a charity base meanwhile operates well on a small scale, but there are also good examples at larger scale like the bus company, HCT, of which I am the volunteer chair. And if bus franchises, why not trains?

All of these alternative models have one basic problem, which is

how to scale up through large-scale investment. Either the company relies on borrowing becoming highly geared, with all the vulnerabilities of indebted companies, or it relies on equity, diluting the shareholding of the worker/consumer/charity-owner. And where large scale is achieved (as in the Co-op or Nationwide) there is then a challenge of making managers accountable to dispersed owners without creating a governance structure which is cumbersome and slow.

There is also an inherent tension between professional managers whose instincts may well be to maximise their own remuneration and/or simple commercial metrics (growth, profitability, dividends) rather than the wider social purposes envisaged by directors and trustees. This tension is particularly apparent in companies which are constituted as charities – like most housing associations. That is why in practice those who want enterprises with a social purpose often turn to public ownership. And those of us who have no doctrinal obsession for or against privatisation can see that in some cases publicly owned enterprises can be both valuable and efficient (like three I helped to set up in government: the British Business Bank, the Green Investment Bank and Post Office Ltd, which became independent of the Royal Mail in 2011). It is certainly possible to assemble top-quality management teams able to manage large portfolios in the public interest without political interference in operational matters. No government should be close-minded to this model in the right circumstances.

Diversity matters. And despite the genuine difficulties with some forms of non-state, non-private ownership it is often the case that state regulators (prompted, no doubt, by competing private interests) make life unnecessarily difficult. It has proved, for example, extraordinarily difficult for new community banks (constituted as charities with local authority and university shareholders), which flourish in Germany, to get off the ground in the UK because of the requirements imposed by risk-averse regulators. Similar obstacles are thrown in the way of mutual building societies and insurers. There is no good reason why

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financial mutuals and co-ops should flourish in the US and most of the EU but struggle in the UK.

Corporate governance

The other approach is to make shareholder capitalism work better. Corporate governance reform has been historically undramatic and modest in scope, drawing on business consensus. But precisely because it commands wide support it can effect genuine cultural change.

For example, the reforms to executive pay, strengthening shareholder rights and responsibilities, which I and my successors have introduced have checked the more egregious pay awards and made remuneration policy more transparent and professional. The voluntary approach to greater diversity – women on boards – has produced results. In both respects, however, there is a long way to go.

One further step is sharply restricting or even outright banning share buybacks, as was the case in the US before 1982. As former US Labor Secretary Robert Reich argues, ‘there is no reason buybacks should be considered anything but illegal manipulation of stock’.

We must also strengthen the duties of company directors so that companies are not just the property of their shareholders but have explicit obligations to a wider range of stakeholders. The existing Companies Act does ‘take account of’ a variety of interests (workers, the environment, consumers etc.) but ‘primacy’ rests with shareholders. Large companies should be required to set up ‘stakeholder advisory panels’ to represent the interests of employees, customers, communities and the natural environment. Many companies talk about a ‘triple bottom line’ but the challenge is to get beyond the rhetoric and good intentions. And a still more radical step would be to remove the legal ‘primacy’ of shareholders. The risk of creating confusion about what managers’ priorities are would be addressed by specifying a broader purpose for business, and making managers more accountable to owners to deliver that, having regard to other stakeholders. This can all be

achieved without being draconian and taking the risk that public companies revert to being private companies with even less accountability to a wider group of stakeholders.

A particularly challenging problem has been executive pay. The current arrangements are unsatisfactory: egregious pay awards unrelated to performance; examples of remuneration committees and board chairs being ‘captured’ by executives; a malfunctioning market in which all chief executives aspire to be in the top quartile. There is, simply, quite a lot of outright greed. The conundrum is to design a mechanism which prevents top executives from enriching themselves at the expense of the companies they work for, without undermining the principle that good performance should be rewarded.

The first step to reform introduced by the Labour government was of (voluntary) votes by shareholders. I strengthened the policy by making it mandatory for forward-looking pay policy to be determined by shareholders, coupled with a legal requirement to produce a simple number capturing all the components of pay. The result is that more awards are now challenged and occasionally pay policy is rejected as excessively generous. Nonetheless serious discontent continues. It is therefore time to experiment with bringing in worker directors and setting up new metrics on top-to-median pay ratios. These are not without their flaws, but what is clear is that the status quo cannot persist.

However, we must also look at reshaping the structure of executive compensation itself so that it no longer encourages short-term, often damaging behaviour. The Purposeful Company Taskforce (chaired by Will Hutton) recommends linking executive compensation to longer time horizons, so that shares are released on a phased basis over periods of up to five to seven years, with at least half the shareholding requirement applying for two to three years after executives have left the company. That raises the wider issue of ‘long-termism’ in companies.

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Long-termism

I have noted above that some widely admired foreign-owned companies appear to have the advantage that their management can make major long-term decisions without the worry of being ousted by their shareholders. By contrast, managers of UK quoted companies are often judged by short-term returns, which is how institutional investors are themselves judged. I instigated a variety of reforms to counteract this bias: the Kay Review, leading to institutional investor forums; a change in the fiduciary duties of fund managers; inserting long-term returns into the terms of reference of the Competition and Markets Authority and the Takeover Panel; the industrial strategy. But a key problem is the very permissive British takeover rules which incite bids whenever a share price (and/or exchange rate) is depressed, however temporarily.

There is of course an argument for a competitive market in ownership to keep managers on their toes. But the economic analysis of takeovers suggests that on average there is no overall gain in efficiency, and the process is driven primarily by professional fees, senior management windfalls and short-term share price movements.

So, takeovers should in future be subject to a stronger public interest test, especially for those involving the country's science base and R&D in particular. Reforms are also needed to reverse the rise in short-term shareholding, with the average length of UK shareholding falling from six years in the 1950s to just six months today. The simple remedy – which I now support – is to restrict voting rights to those who have held shares for, say, a year. A less direct mechanism for achieving the same end is for shareholders to be allowed to designate part or all of their holdings as a 'stewardship stake', granting enhanced voting power in return for a minimum 'lock-in' period of ownership.

Such changes would have prevented the Kraft-Cadbury and the Melrose-GKN takeovers, and perhaps others. The time is right to strengthen protections against short-termism further through the disenfranchisement of speculative investors and the empowerment of

long-term ones, particularly UK pension funds which control £3 trillion of assets.

Utilities and outsourcers

There has been little public dissatisfaction following the privatisation of a host of former government enterprises – airlines, oil and gas, steel, motor cars, road haulage – where there is plenty of competition and business people are better qualified to operate in a market economy than civil servants. There has been more dissatisfaction where the industry includes a natural monopoly (water, electricity and gas grid, railways) and especially when executives and shareholders are seen to enrich themselves at the expense of consumers or the taxpayers, and systems of regulation (of price, returns, quality, etc.) are perceived to be weak and ineffectual.

It is, however, one thing to be (legitimately) annoyed at the egregious, greedy or incompetent behaviour of particular companies (e.g. Thames Water, Southern Railways); it is another to overturn the whole system of private utility regulation, or to advocate wholesale nationalisation. The failings of the railways are down in part to the private franchisees and the terms of the franchises (which are set by the government) and in part down to (nationalised) Network Rail. The grumbling about high energy prices could be down to the distributors, the generators or the primary fuel suppliers (who may be in the Middle East). And to reverse their ownership status would once again expose these industries to the problem that they can only borrow on the government's balance sheet, a constraint which seriously inhibited investment in, inter alia, Royal Mail modernisation and rail infrastructure. Outmoded accounting conventions should not be permitted to drive policy in this way; instead, the wider public interest should be the determining factor.

It is clearly unacceptable that owners of low-risk utilities like water companies should be able to load up large amounts of debt, extract large

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dividend payments – often to owners which are overseas governments – and dodge taxes while sacrificing new investment. But nationalisation is a clumsy and expensive way of dealing with this problem. Instead, government should use windfall taxes to claw back ‘excess’ distributed profits and restrict them in future, where the ‘excess’ is not determined by politicians but by regulators acting on pre-agreed metrics (to minimise the probability that regulatory risk will simply raise the cost of capital). What we should be looking at is smarter and, if necessary, tougher, regulation rather than renationalisation.

The opposite set of problems has arisen with government outsourcing, where fierce competition has generated low margins, helping central and local government to cut costs but creating companies which are financially unstable, leading to collapse and either government bail-outs or the disruptive collapse of complex supply chains. Carillion has collapsed and others (Interserve, Capita) have been in serious trouble. There is no ideologically clear-cut coin-in-the-slot solution. There are good reasons for government to bring in external expertise on major construction projects, for example. But we must set clear red lines for sensitive areas in which the profit motive should play no role – such as the rehabilitation of prisoners and ex-offenders, and the assessment of welfare claimants – where private multinationals such as Atos and G4S have poor track records. And Britain should develop a new legally defined corporate form for companies which regularly deliver major public sector contracts (as floated for the Ministry of Defence) and where we need stable, reliable, commercially savvy suppliers which are not politicised or simply an extension of the civil service. In doing so, large private sector entities providing a public service – in this new corporate form – could be made more accountable to the citizens they serve by bringing them within the Freedom of Information Act.

Though capitalism finds itself in difficulty, it is still the only game in town. Politicians and commentators across the board use ‘entrepreneur’ as a compliment, not an insult. Small business is praised and

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cultivated. And some of the most visible billionaires – Branson, Buffett, Gates – remain widely admired. But this goodwill will not be sufficient to prevent a more profound crisis if reform is not forthcoming.

Notes

- 1 Based on speech to IPPR (Institute of Public Policy Research), 7 June 2018.

The Different Dimensions of Inequality¹

My earlier references to inequality in modern Britain led to certain conclusions. First, part of the sense of malaise in the country stems from a variety of grievances around the idea of 'fairness'. The facts around inequalities in income and assets can be interpreted differently but they broadly suggest that Britain is becoming a more unequal country, and also more unequal than our European neighbours. Secondly, inequality is multidimensional – it is not just about income and asset wealth but it involves geography, ethnicity, gender and generation. Inequality and, also, lack of social mobility is linked in turn to parenting, early years and school-age education and post-16 education and training. Third, inequality is bad for all of us, not just the disadvantaged; growing inequality is linked to poor economic performance and instability, social tension and personal security.

Remedies can involve attacking the inequalities at source ('pre-distribution') or mitigating the impact through progressive taxation and benefits. Part of the problem with 'pre-distribution' is that there is often no consensus around the sources of inequality. The increasingly influential populist right will blame immigrants, and globalisation in general (especially Chinese competition). The left will tend to blame capitalism and the rising share of profits relative to wages in the economy, or the excesses of 'fat cat pay'.

One practical remedy for low wages is the minimum wage system, with a minimum wage set on the advice of an independent Low Pay

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Commission. With hindsight, this has had a broadly beneficial effect in lifting wages without negatively impacting on employment, though we are yet to see the full impact of a more politicised National Living Wage driven by ministers rather than in response to Commission advice. There are potentially negative consequences for skills development of squeezing the differential between minimum and average earnings; and a system which rewards households with multiple earners rather than single-earner poor families is a distraction from the issue of poverty. But, overall, the minimum wage system has had benign effects, raising wages but not at the expense of employment. It is an important fixture, provided the evidence-based disciplines on which it is based do not fall victim to interference in the short-term political interest of any government.

Income and wealth tax

Progressive income tax is often seen as the most politically appealing route to greater equality. The British left remains beguiled by very high marginal tax rates on the rich, variously defined. Yet the experience of other countries, including those in more egalitarian Scandinavia, is that marginal tax rates of anything much above 50 per cent are counterproductive, and lead to rapidly diminishing returns. Sweden has top tax rates of 60 per cent, but this is now an exception. There is greater merit in trying to eliminate the large opportunities which exist for legal tax avoidance and arbitrage: cutting the differential between capital gains and income tax, equalising rates of tax relief on pension contributions between high and low earners, and ending the remaining tax privileges of those who are resident but not domiciled in the UK. A big cultural shift could be accomplished if the UK were to move to the Scandinavian model of full public disclosure of tax returns, private and corporate.

Incentives created by the income tax system matter just as much at the bottom end of the tax range as at the top, since there are already

steep rates of benefit withdrawal which create a disincentive to work or seek overtime.

Liberal Democrats in coalition made considerable progress in lifting the income tax threshold for low earners, but extending it further is an expensive tax reform which benefits high as well as low income tax payers. National insurance employee contributions kick in at much lower incomes, and future tax-cutting policies should concentrate on lifting the NICs threshold. The whole national insurance system has long since departed from its original purpose of financing the welfare state and creates numerous tax anomalies (for example in the shifting boundary between employed and self-employed or the exemption of working pensioners). It would make more sense to integrate fully the income tax and employee national insurance systems while recognising, however, that there are serious 'cliff-edge' problems and unintended consequences for which careful planning would be needed.

As noted above, it is widely believed on the left that the root cause of inequality is a shift from wages to profits – a modern version of standard Marxist theory. The left has often jumped to the conclusion that the way to rectify this measure is to tax profitable businesses, by raising corporation tax, or to tax profitable business activities, like the proposed tax on financial transactions. There is actually a good, pragmatic basis for reversing some corporation tax cuts (my party argues for returning the corporation tax rate to 20 per cent) and also for reversing the exemption of financial services from taxes like VAT. But this has nothing to do with inequality. Businesses are merely legal entities, and business taxes are passed on to the consumer or back to wage earners.

If Britain is to become a more equal society, a serious review is needed of the set of taxes which are there to mitigate the sharp, jarring, differences brought about by asset inflation and unearned income. We must tax wealth effectively while not stifling wealth creation.

The present system is a patchwork of different taxes, all flawed in different ways and full of loopholes. Inheritance tax allowances have

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grown more generous, reflecting house price inflation, and there is considerable scope for avoidance through gifts before death. Capital gains tax, too, has a plethora of reliefs though they don't, at present, give an incentive to entrepreneurs who have built up a successful business to keep investing in it rather than selling out. Britain has no tax on property values as such, and council tax serves as a very unsatisfactory substitute based on ancient property values and not proportional to property or land values. One could add various wealth-related charges like stamp duty. Together these taxes raise around £50 billion a year, of which half is council tax, representing, overall, half of one per cent of household net wealth.

I do not doubt that unravelling this complex and uncoordinated system would be a major undertaking, but government cannot dodge it forever. One relatively straightforward way of reforming the system would be to reform council tax by creating more bands and making the tax rate proportional to the property value. Low bands would pay less; high bands more. In the long term we must look at radical reforms, shifting the tax base to land so as not to disincentivise property improvement and building. Land cannot run away to the Turks & Caicos Islands. The Liberal Democrats have set out in detail how to make the first step, for commercial property, and this is an idea whose progression from economic theory to reality is long overdue.

It is also necessary to ensure that there is effective taxation of inherited wealth. Inheritance is a major factor perpetuating inequality of wealth and inhibiting social mobility. That is why rich meritocrats – like Bill Gates, for example – argue for aggressive taxation of inheritance. In fact, policy in the UK has moved in the opposite direction.

Wealth taxation should not be anti-business. Well-designed wealth taxes encourage long-term investment and entrepreneurship while discouraging speculation, inheritance and passive asset ownership. Nor should asset taxation be seen as a cash cow for government; it would be better supported and understood if it were linked to, say, learning

accounts for young people. Hypothecation of taxes is bad economics but good politics and this is the kind of linkage which would make difficult tax measures more palatable and understandable.

Poverty and welfare

Issues of poverty and inequality are related but different. Minimum wages, for example, do not help those who are poor but out of work or retired. Making the income and wealth tax system more progressive does not affect those who are too poor to pay tax. We have noted that, in the last decade, post-tax income inequality has been broadly stable in the UK, but in-work poverty has grown. The Joseph Rowntree Foundation has calculated that there are 2.8 million children and 2.6 million working parents in poverty (that is, with less than 60 per cent of median income) with another 1 million expected by 2020. But pensioner poverty has declined with the protection of state pensions and various age-related benefits since the financial crisis. The issue of poverty is linked to welfare 'reform', and both quantitative and qualitative changes.

Cuts in welfare benefits have become associated with Universal Credit, which is becoming heartily loathed. But there is a danger of confusing its harsh and incompetent implementation with the principle behind it. It makes a lot of sense to combine benefits to get rid of complexity and perverse incentives which discourage work. The OECD has acknowledged the force of these arguments. However, UC has been undermined by sanctions and the testing regime around it, faulty IT, a parallel decision to discontinue payment of housing benefit to landlords, delays in payment in the switchover to UC and, above all, the attempt by the Treasury to extract £5 billion of cuts alongside UC. Some partial restoration of the £3 billion cuts to the 'working allowance' took place in 2018 but, still, an estimated £1.5 billion of cuts have taken place since 2016. There have been serious cuts in UC for the 800,000 low paid self-employed; there are cuts for those with fluctuating

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incomes; there are benefit penalties for those with over two children; and benefits are being cut by not being proofed against inflation. An estimated £5 billion is needed to make UC roughly neutral in its impact (of which £2 billion was found in the 2018 budget) and that should surely be the minimum requirement in a successful welfare reform.

Dissatisfaction with the operation of UC is fuelling the demand for alternatives like universal income. This could at least, in principle, simplify the welfare system, with less means-testing (like UC, at the cost of ignoring tricky problems like housing benefit), promote non-monetary employment (like caring for dependent relatives and children), and make it easier for workers to reject low-paid employment (at the expense of removing any real incentive to work). But the real problem is the financial constraints: limited amounts of finance would be used to subsidise the less needy. Like all simple solutions to complex problems, universal income is attractive as an idea but quickly runs into a host of practical problems, just like Universal Credit. Early experiments, as in Finland, have been very discouraging.

Reforming the welfare system, however it is done, begs the question of how to raise the economy's productive potential, and hence wages, and how to ensure that growing numbers have access to the education and training required to maximise opportunities for remunerative, relatively secure employment. Overall economic performance and rising pay, underpinned by a strong minimum wage, is what will lift the working poor out of poverty. But there will still remain vulnerable people hit by hard times, mental or physical disability or caring responsibilities. And that requires a generous 'safety net', which in turn requires a successful economy or higher taxation, or both.

Notes

- 1 Based on speech on inequality to the Resolution Foundation, 6 September 2017, and speech to Joseph Rowntree Foundation, 24 October 2018.

Chapter 8

The Housing Problem¹

There is a big (negative) gap between the realistic expectations of young people born after the millennium and those born a generation earlier. Millennials now face the prospect of less secure employment, inferior or non-existent pension arrangements and – most serious – a sharp reduction in the availability, security and affordability of housing with good space and amenity standards.

Of course, the whole idea of a ‘housing crisis’ necessarily obscures great complexity and different experiences. At one extreme are individuals with serious mental health problems and other needs, sleeping rough on the streets or ‘sofa surfing’, and tens of thousands of homeless families trapped in unsuitable ‘temporary’ accommodation. At the other are millions of mainly young people who, despite being in good jobs, struggle to pay the deposits or rents required for satisfactory rented accommodation or to afford home ownership.

One simple way of looking at the problem is in terms of aggregate numbers. An estimated 240,000 to 300,000 units per year are needed to keep up with the rate of household formation, but even that figure excludes a lot of hidden demand – in the form of young people living with their parents, for example. Historically, these numbers were met. The inter-war National Government, under the much-maligned Neville Chamberlain, managed a similar achievement in the aftermath of, and as an antidote to, the Great Crash. More recently, in 1969, when I was embarking on a political career as a councillor in Glasgow, a record level of 378,000 homes were built.

Large-scale housebuilding was then the template of successful local

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government. Today, there is a significantly larger number of people per home available. Yet in the 2010 post-crisis nadir only 133,000 homes were built during the year. And even as the economy has come out the other side, there were just 178,360 built in 2016/17, and numbers are now falling again.

The overall numbers of houses built matter since, even though new homes are under 1 per cent of the housing stock, continual undersupply feeds scarcity and rising prices. But there are other sources of housing demand (credit) and other factors influencing cost (land prices). Together, these factors have created a severe decline in affordability. The ratio of house prices to gross average earnings per head is at record levels of around 10 to 1, double the level of the mid-1990s. On the official definition of 'affordability', only 20 per cent of new homes are affordable. Even these are out of reach to many.

This crisis of affordability has radically affected tenure: owner-occupation has gone down over the last three decades from 64 per cent to 38 per cent amongst 25–35 year-olds, and from 35 per cent to under 10 per cent amongst 16–24 year-olds. Younger people in particular have been pushed into the private rented sector where, for under 45s, average usable floor space has fallen from 38 square metres in 1996 to 32 square metres in 2014/15. And a third of homes in the sector fail to meet the Decent Homes Standard. At the same time, there is more under-occupation, which has grown by 25 per cent in a decade. Seven million owner occupiers have two spare bedrooms, and 25 million – overwhelmingly older owner-occupiers – have one spare room.

These twin problems of availability and affordability have other consequences. Official homelessness is at record levels (80,000 in temporary accommodation) and this excludes those, mainly single, people, who have not been counted. Government subsidies for rent through housing benefit have tripled over a decade to around £25 billion per year (£10 billion to private landlords) while subsidies to increase supply (of social housing) have fallen to around £1 billion per year.

These problems are well-rehearsed and much lamented, but there is too little recognition that radical change will be necessary if the crisis in housing is to be addressed in our lifetime.

What has gone wrong?

Essentially there are four big, interconnected, issues.

First, the market in land does not work properly, resulting in unearned rewards for hoarding and restricting supply. The pressure of growing numbers of people and households on a fixed supply of land will inevitably generate rewards (rent) for landowners through higher land prices.

Planning restrictions which reflect society's preferences for land use further limit the supply available for homes. In the UK, the result of scarcity combined with planning is (often enormous) untaxed differentials between the value of land for housing use and for alternative uses such as agriculture. A consequence of the land market is that the price of housing is predominantly determined by the price of land which, in many parts of the country, makes new housing unaffordable for the majority of first-time buyers. Developers often seek very high returns – typically 20 per cent return on capital – because of the risks inherent in an investment whose return relies on the slow, unpredictable process of planning permission. They also make use of strategic land banks which cushion risk and strengthen their balance sheets if values are rising. There are currently 400,000 plots with planning permission but not yet built – well over a year's supply. It is easy to demonise the big developers who dominate this market but they are acting entirely rationally within the incentives offered by what is a lousy system.

Until the model is radically changed, politicians will continue to promise far more than the available land can deliver.

There is also a dangerous and damaging link to the second big, structural problem: the banking system. Banks (backed by a myopic regulator) are encouraged to fuel demand for housing. Mortgage debt

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has increased eight-fold in real terms over the last 40 years and accounts for one half of the banks' loan book. The banks have to set aside almost eight times more capital to cushion themselves against risk when they lend to builders than they do when they lend to home-buyers. It is extraordinary that it is so much easier for a house purchaser to obtain a loan to *buy* a house than for a smaller builder to *build* one. Lack of credit helps to explain why only 30 per cent of new-build projects up to 500 units are delivered by small companies today, whereas the figure was over 50 per cent before the financial crisis.

This in turn leaves the industry in the hands of big developers, who share with the banks a strong vested interest in rising house prices and perpetuating scarcity. The bias is then reinforced by damaging and misconceived taxpayer subsidies boosting housing demand while doing nothing about supply. The Institute of Directors understandably said of Help to Buy, for example, that 'the world must have gone mad'. A powerful coalition of developers, banks and existing homeowners has a strong self-interest in perpetuating this madness.

In addressing these problems, there is a further problem: ideological dogma. A 'public' (or in this case 'council')-bad, private-good mentality has determined not just the number of homes built but the balance of tenure too. Social house building has contracted from over 200,000 a year at its peak to the pitiful level of just 1,409 social home starts in 2017/18. Meanwhile, over 1.5 million publicly owned homes have been sold off thanks to the 'right to buy'. Contrary to assurances, only one in five of these homes have ever been replaced in the public sector. Moreover, many of the privatised homes have not remained in owner occupation, as was intended; around 40 per cent have been used for buy-to-let purposes. And since better-off tenants were, in general, those best able to exercise the 'right to buy', social housing is no longer socially mixed but is almost exclusively for the most disadvantaged.

The overall consequence is that the current housing market and housing policies reflect and reinforce inequalities. Rising house prices

are good news for property owners, enhancing their wealth, and they exclude those lower down the income scale from ownership which, in turn, reinforces inequality. Housing costs – mainly rent – are rising for those on low earnings but falling for high earners. ‘Right to buy’ and ‘Help to buy’ both use public money to help relatively well-off house purchasers and, in turn, restrict access to low-cost housing for those unable to get on the housing ladder.

So, what is to be done?

There is no single solution. A one-size model doesn’t fit all. There is a role for the current developer model but it is to supply one part of the market: the high-end market for owner occupation or rent. But we should not pretend that it is a suitable vehicle for providing the programme of large-scale affordable housing which this country needs desperately and needs quickly. We should recognise the role of the private sector in providing the housing which it is within its interests to provide, and then broaden the definition of social housing to include everything from traditional social homes for rent through to a new form of ‘rent to buy’ which enables young people to get on the housing ladder without a deposit.

Social rented housing

There has to be a big step up to building at least 50,000 social rented houses per year, rising to 100,000 as soon as we can. The government has taken the important step of removing the cap on local authority borrowing, but additional measures are needed including the use of stronger compulsory purchasing powers, providing capital subsidy to housing associations to build and removing the affordable housing exemption for small developments.

At present many social houses are built on the back of private developments through an affordable housing ‘obligation’ subject to a ‘viability assessment’. There is growing consensus that the present viability assessment system is weighted in favour of the applicant, and

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leads to inflated land prices being paid at the expense of infrastructure, affordable housing and design quality. So viability assessments must be reformed to keep companies to their promises, and in return government must commit to an increased social housing grant to ensure a fair margin.

But reform to the cross-subsidy model of private developments funding social or affordable housing will not be sufficient. There will still be a need for an additional supply route for first-time buyers of modest means who cannot afford either to buy through the open market or to rent in perpetuity from private landlords.

The key is to create a mechanism for obtaining land cheaply. One proposal, by David Garrard, involves a non-government and non-profit agency empowered by law to acquire land of low amenity and market value through compulsory acquisition (without paying the 'hope value' which attaches to those sites currently earmarked as having development potential). With the land acquired cheaply this public interest company would provide, initially, five-year rentals which could be converted into freehold acquisitions with a mortgage. In due course the owners would sell into a pool, retaining any housing market inflation but not the discount to market value, which would be recycled to provide affordable housing for the next generation of occupants. The model is one which would be attractive to long-term investors without government subsidy or underwriting.

To acquire the land there will have to be amendments to the 1961 Land Compensation Act, permitting the use of compulsory purchase orders in these strategic developments. By eliminating the 60 per cent or more of the cost of homes absorbed in prohibitive land costs and developers' profits, it also becomes easier to ensure that homes are of adequate quality, safety and insulation standards.

Variants of this model have been developed, including 'rent to own'. Here, housing associations build properties as they would for social rent, affordable rent and shared ownership. But instead, occupiers of

these properties would pay a market-level rent. The additional margin would yield the occupier an increasing stake in the property over time, just like a mortgage – approximately 10 per cent after five years, and 20 per cent after ten years. These ideas are already applied in Liberal Democrat controlled local authorities like Eastleigh, and these just show the capacity of local government – even now – to step up to the plate and tackle housing affordability head-on.

Where would all the houses be built? One emotional issue is the Green Belt. The philosophy of preventing urban sprawl is a good one. It ought to ensure that real green space – some of it green belt, some of it metropolitan open land – is protected where it provides real beauty and utility to the community.

But to improve housing supply, we must be flexible and pragmatic, not ideological and dogmatic. There are some parts of the Green Belt, for example, which have disused petrol stations or abandoned warehouses and could hardly be called areas of beauty and tranquillity. Nobody who is serious about resolving the housing crisis would argue that such sites should be off limits.

Existing stock

Millions will, of course, continue to live in the existing stock of social housing, privately rented property and owner-occupied property, many of them faced with poor conditions, unaffordable rents and instability. And most transactions are of the existing stock. Beyond building more homes, other actions are necessary.

One is raising quality, safety and environmental standards in the existing stock. Almost two years on from the Grenfell Tower fire, residents in high-rise buildings across the UK are starkly aware of the often precarious conditions they are living in. In addition, roughly 19 million homes of all tenures need insulation retrofits to raise them to an Energy Performance Certificate rating of C or higher – a challenge the Coalition's Green Deal was trying to address, but it was neutered

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by the Treasury. As a priority, we should start with the 4 million households in fuel poverty.

We need also to deal with exploitative, greedy, negligent or neglectful practices in the private sector, which give the majority of good landlords a bad name. Attempts to stop rent inflation simply by freezing rents potentially recreates all the problems of contracting supply and neglect of maintenance which was experienced under rent control. But there is a strong case for mandatory licensing with a publicly available database of rogue landlords, promoting longer private tenancies with inflation or wage-linked rents and promoting a right-to-buy right of first refusal for sitting tenants when a landlord sells.

The sanctions for leaving homes empty should be strengthened, with fiscal measures to incentivise domestic use. We could, for example, increase the 200 per cent council tax on homes deliberately left empty to 500 per cent. And for overseas residents a levy as a proportion of the property value, or an extra stamp duty surcharge, should be introduced. Conversely, a proper look at how the tax system could incentivise downsizing for (mostly older) property owners is overdue.

The most visible and emotionally affecting aspect of the housing crisis is homelessness, and especially street sleeping. While anything which pushes rents down rather than up will help, in practice the main remedies to street sleeping do not lie in housing policy but in benefits policy, support for mental health in the NHS and proper resourcing and support to hostels, where the Housing First model has been shown to be effective.

In the 1950s, faced with post-war rebuilding, housing was regarded as one of the highest government priorities, and successive governments delivered. We now require a similar level of commitment.

Notes

1 Based on speech to the Royal Institute of British Architects, 26 June 2018.

Taking a Green Economy Seriously

One of the most sobering experiences of my professional life was working in the team in the 1980s which produced the Brundtland Report, *Our Common Future*, for the UN Secretary General. The report helped to define the concept of 'sustainable development', the recognition that economic growth (or development) has to be environmentally sustainable, respecting the importance of environmental limits and costs. It was sobering partly because it brought out clearly the nature of the threats; the scientific findings of global warming and climate change emerged from the Bellagio conclave at that time, and the scientific work on mass extinctions was solidifying.

It was also sobering because of the very different reactions of the representatives of rich and poor countries. While the former demanded a reversal of the fixation with economic growth and its environmental, resource-depleting, side-effects, the latter wanted more growth in living standards to counter the environmentally negative effects of poverty: high birth rates, lack of facilities for sanitation, polluting forms of primitive energy like green wood and charcoal-burning. The last generation has seen, through the rapid growth of China and, now India, Vietnam, Korea and elsewhere, the latter view predominate. Moreover, that view has been largely vindicated, as economic development has fed through, sometimes dramatically, to lower fertility and population growth and energy efficiency.

It is usual in progressive politics to be deeply despondent about environmental threats and to warn that 'the end is nigh'. It may be, and the scientific warnings on climate change are, indeed, alarming in the

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extreme. But it is also right to start with the positive and the success stories. In the UK, many environmental indicators have improved, including river and beach pollution, levels of most air pollutants, including sulphur, lead and particulates (though not nitrogen oxides), have reduced thanks to tougher regulation; there is a high level of public engagement in recycling and composting and a growing understanding of the importance of ‘the circular economy’ in business; and there is a growing consumer demand for (and supply of) low-emission vehicles, renewable energy and food, timber and other products boasting high environmental standards. At a global level there is a successful multilateral agreement in which the UK took the lead, to curb a major threat to the planet: the Montreal Protocol on the depletion of the ozone layer. In the first tentative steps in dealing with the enormously bigger problem of climate change, Britain is something of a world leader, with the world’s first legally binding Climate Change Act, which governs CO₂ and other greenhouse gases, emissions of which have fallen by more than 40 per cent over 30 years, though this is in part due to the economic slowdown and more imports as well as a switch from coal to gas and renewables). In 2017, for the first time, low-carbon sources, nuclear and new renewables surpassed fossil fuels as the biggest source of electricity in the UK – despite a current government seemingly uninterested in the problem.

Of course, the glass is half empty as well as half full and the list of unsolved or mounting problems is formidable: upward revisions in temperature forecasts at a global level, apparently increasing numbers of species lost to tropical deforestation and intensive agriculture, oceanic pollution from non-recyclable plastics. Perhaps the biggest threat, now, is political: the rejection of science by populist leaders and movements, the growth of nationalism and disdain for cooperative approaches to shared international problems. The politics of identity has reinforced the idea that there is no such thing as a ‘common future’.

As Britain is no longer one of the world’s biggest economies – we

are now eighth or ninth in purchasing power terms – our ability to solve the world's problems directly is limited, but there is much to be done at a national and European level, and we can exercise leadership within agreed global frameworks. Britain starts from a position where there is already a high level of awareness of environmental issues and consensus, a strong scientific base and strong regulatory institutions. There is no need to reinvent the wheel. I suggest five different ways of taking the environmental agenda forward.

The first is ensuring that environmental policies are not just ad hoc, random interventions responding to the politicians' fancy or the public mood but are baked into the way we make economic decisions. There is already a Natural Capital Committee to ensure that 'natural capital' is properly accounted for, and any depletion of it is counted as a negative to set against the positive of growth (conventionally measured). There also needs to be a consistent and environmentally aware system for evaluating big new projects. The recent rejection of the Welsh tidal lagoon project was due in part to a government refusal to consider the long-term time horizons and very low discount rates applicable in projects of this kind. And there has to be a consistent and rational system for applying the 'polluter pays' principle.

The whole idea of environmental taxation has become somewhat discredited by the fuel duty escalator, which had the effect of penalising vehicle use in remote areas. President Macron has also now discovered that careless use of environmental taxes is politically disastrous. A better approach is charging for road use in congested cities where there are alternative modes of transport. The important concept of a carbon tax has been undermined by its use (through the Carbon Price Floor) as a revenue-raising device rather than remaining focused on incentivising fuel switching. Concerns about British-based companies being disadvantaged relative to overseas competition do need addressing. However, a proper carbon tax, and the use of fiscal instruments such as road user pricing, do have crucial roles to play in addressing climate change and

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other negative environmental impacts.

Second, one important way of moving to a sustainable economy is to ensure that the financial system – capital markets in particular – directs money away from polluting activities and towards environmentally friendly ones. To a degree, this is happening. The Governor of the Bank of England, in his capacity as financial regulator, has exposed the risk of financial institutions owning fossil fuel assets which are then ‘stranded’ by public policy measures to achieve climate targets, including a rapid switch to renewables. Tougher disclosure rules, and clarification and strengthening of the fiduciary duties of pension and insurance companies, would add to the pressures to invest in clean energy rather than fossil fuels. One of the big environmental achievements of the Coalition was to set up the Green Investment Bank, which was responsible not just for derisking large-scale investment in offshore wind but also for promoting innovative schemes, like LED street lighting in Glasgow, that would not otherwise have occurred. The Conservatives’ decision to sell it off was a massively retrograde step, and there is now a big gap in financial markets for higher-risk green projects, where state intervention would again have a beneficial catalytic impact.

Third, it is crucial to have an industrial strategy to link together different activities which depend on each other. Electric cars won’t develop unless there is a charging infrastructure to support them. A revolution in rail investment won’t happen without there being a supply of trained people like tunnellers, and train manufacturers to supply the vehicles. One success story has been the investment in manufacturing wind turbines in Hull – but that, in turn, has required the parallel development of skills.

Fourth, there are some sectors of the economy where radical reform is needed to make growth sustainable. Farming is no longer governed by foolish Common Agricultural Policy rules incentivising over-production, but under the new revised system farm payments are based on acreage rather than on carrying out specific environmental stewardship

roles. A subsidy system focussing on the preservation and enhancement of natural capital is starting to be funded under the Common Agricultural Policy but has a long way to go. Another sector where little has been done and radical action is required is food waste. Only 10 per cent of the UK's 2 million tonnes of food waste is composted, with the rest going to landfill or incineration (adding 10 per cent of greenhouse gas emissions); meanwhile, UK topsoil is becoming infertile but could be helped by mandatory food waste collections boosting composting.

Fifth, and of most fundamental importance, the UK is not on track to meet its legally binding emissions targets to contribute to its climate change objectives, despite the impressive gains in the decarbonisation of the electricity sector. The contribution of the transport sector, and especially aviation, to decarbonisation is lagging behind and this must be a future focus of environmental campaigning.

These are all important and necessary changes, and provide a very full agenda at local, national and global levels. There is some attraction to the idea, popularised in the US by a new generation of Democrats, that a unified plan of action rather than lots of random activities can be constructed around the idea of a Green New Deal. The idea of a Roosevelt-style New Deal is appealing because of its ambition and the understanding that our current physical infrastructure – of energy generation and distribution and of transport – needs radical overhaul. So far, the economics of it is hazy: a mixture of hope that the new infrastructure will pay for itself (which some will), and a resort to magical money. Using carbon taxes or similar signals to influence consumer demand and the use of green technology is a better approach than some centrally-driven, top-down, plan. However, the principle of having a unifying environmental theme to policy is a powerful one. And it reflects and reinforces the idea that there is a common future – an antidote to the divisive politics of identity.

What 'Global Britain' Really Means

The all-absorbing debate about the EU and Brexit detracts from the bigger question of how we see Britain fitting into the world beyond our shores – a fundamental issue for the 'politics of identity'. Whether or not Brexit happens – and I continue to believe that it would be so damaging that it should be stopped – we shall continue to face the issue posed with crude clarity by Donald Trump: do we see ourselves as part of a world of competing, largely self-contained, nation states, or part of a more cooperative network of states which invests, heavily, in shared rules and institutions at a regional or global level, or both. The latter approach is currently under siege and Brexit is just one of several assaults on common rules and standards, whether these apply to trade and commerce, environmental protection and climate change, nuclear proliferation or human rights.

Membership of the EU is a trade-off: being part of a much larger grouping with greater bargaining power and influence versus greater freedom of manoeuvre to act unilaterally. Outside the EU, the UK would be one of a number of countries which are substantial but dwarfed by the major economic superpowers (US, China, EU, potentially India). In terms of economic size, the UK has a GDP in purchasing power terms currently somewhat bigger than that of Brazil, Mexico, Indonesia, Russia and Korea; in the decades to come it will almost certainly, simply because of 'catch-up', be overtaken by most of them and, in due course, by Turkey, Iran and, eventually, Nigeria and Pakistan and others. Economic size is of course not everything, and some countries are disproportionately important militarily (Russia) and through

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'soft power' (Canada). Britain currently has elements of both, but in a Brexit-world would struggle, in isolation, to justify continued UN Security Council status and a continued presence in – for example – the Falklands and Gibraltar.

It is not at all clear how a Brexit administration would recalibrate priorities. It is possible to envisage a close and amicable relationship with the EU. Some cases of divorce end in friendship. Equally, and sadly, there could be rancour. Some Brexiters envisage a closer (and dependent) relationship with the US, building on what the British, if not the Americans, see as a 'special relationship'. The Trump administration has admirers on the political right. But the price of a special relationship with the US and a bilateral trade deal would be restricted freedom of manoeuvre in relation to developing closer relationship with the world's biggest economy (China) and others of significance (Iran). There is also a tension between the aspiration to have a free-trading 'global Britain' outlook and a close link to the US which, under Trump (and not just because of Trump), is retreating into economic nationalism.

And, there is a strand of Brexit which for nostalgic reasons favours a kind of Empire 2.0, based on affinity with the old Commonwealth (Australia, Canada, New Zealand) and an imagined preference for British goods and services in Africa and the Caribbean. However, Empire 2.0 has gone down like a lead balloon with those Commonwealth countries which experienced Empire 1.0.

If Brexit does proceed, with all the damage that entails, Britain would find itself outside EU foreign policy decision-making. In those circumstances, there would be a temptation amongst those of an internationalist persuasion to adopt a priggish, moralistic, self-important tone, which cannot be sustained in a world where Britain is of diminished significance, supporting liberation movements and secessionist groups in parts of the world where the UK has little capacity to determine the outcome, but enough to make enemies. The response of the

West to the Arab Spring – promising more than it could deliver – and its crushing, brutal, climatic defeat in Syria, is a salutary warning of the dangers of well-intentioned cheering from the sidelines. And there is nothing to be gained from taking up a partisan position on long-standing conflicts like Kashmir and Palestine which are the legacies of Britain's failure as a colonial power two generations ago. The Victorian tradition of 'liberal interventionism' reached its disastrous apogee in the Iraq War and Afghanistan via more successful action in the former Yugoslavia, Sierra Leona and Liberia. There is a role for multilateral peacekeeping in which British forces have a part to play, but gung-ho interventionism is a thing of the past.

Our first priority, however Brexit evolves, must be to maintain and support alliances with our neighbours and NATO allies. It is plausible to believe that the EU will evolve into a closely integrated core built around the monetary and economic union which excludes (and was always likely to exclude) the UK. But alongside it there could emerge a looser grouping which accommodates most Scandinavians and a – somewhat chastened – UK along with other EU members who seek a confederal rather than federal arrangement, which is an iteration of the European Economic Area. It is also likely that, with growing US disinterest in Europe, there will be increased military collaboration: not a 'European army' of the Brexiters' dystopian fantasies, but a 'Europeanised NATO' with parallel cooperation on terrorism and other aspects of security.

A second set of priorities is to strengthen the network of international institutions and the 'rules-based order' which, unevenly, has been built around them, operating through the EU or alongside it. A few years ago, this would have been uncontroversial, even anodyne. And it is not particularly glamorous to campaign for – say – the financial replenishment of the Bretton Woods institutions or multilateral trade negotiations. Torture victims and conflict zones will always demand a stronger emotional response. But the anti-globalisation agenda of the Trump

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administration and the populist and nationalist movements seeking to emulate him have already undermined the World Trade Organisation, the World Bank and which ever UN agencies have annoyed the US government. This legacy of the last 75 years of post-war international institution-building has to be defended.

A third priority is to defend and strengthen the main vehicles of British 'soft power', which would become increasingly important if the UK were sadly to exit from the EU: DFID's development programme, the peacekeeping contributions of the armed forces, the British Council and our globally oriented universities and cultural institutions, the BBC World Service. It is, however, unfortunately the case that those who want to cut our links with Europe are also the same people who regard these activities as largely a waste of resources. This is particularly true of DFID. One of the largely unrecognised achievements of the Coalition government was to defend, implement and embed the commitment to 0.7 per cent of UK GNP for overseas assistance to poorer countries. There has since been some fudging of definitions and dilution of the commitment and it will be important to defend it from Brexit populists. Similarly, one of the main vehicles of British influence and 'soft power' – the universities – have been under attack from those, led by Theresa May, who regard temporary overseas students, EU and non-EU alike, as migrants and wish to curb their numbers; such restrictions are bad for the universities and bad for Britain.

Then, there is the question of what the global priorities should be for a medium-sized country outside matters of military and economic security. There is a limited amount of political capital to spend on influencing the world, but countries like Sweden and Canada show us the way.

I would argue that climate change and support for an effective international framework should be top of the UK's list, not just because of the transcendent importance of the subject but because of our credibility in having developed renewable technology – notably offshore

wind and potentially tidal – and having strong prescriptive legislation to mandate it. Hopefully the Conservative government will not trash too much of this asset in the meantime. And there is a set of international environmental commitments around the so-called global commons, including the oceans, Antarctica and space, which it is in Britain's interest to uphold.

Another priority derives from Britain's historical role as a nuclear power. It is doubtful how much Britain's independent nuclear deterrent is either independent or a deterrent, but Britain has a shared responsibility to stop the continued spread of nuclear weapons technology. That means, at present, upholding the multilateral agreement with Iran rather than undermining it as the Trump administration is seeking to do.

Another priority combines self-interest and responsibility: to establish some consistency and discipline amongst tax regimes. Nothing better illustrates the limits of national sovereignty than the way rich individuals and companies practice tax arbitrage at the expense of government exchequers. Even within the EU, the UK aided and abetted this practice by offering itself as a tax haven, refusing modest attempts to harmonise the corporate tax base. The UK has placed more confidence in the OECD to produce a genuinely global set of tax rules to stop abusive avoidance. However, the UK's practical and moral authority has been undermined by the refusal, to date, to require dependent territories like the British Virgin Islands to follow the British practice – which I introduced during the Coalition – of an open register of ownership, designed to identify the owners of companies for tax purposes. In or out of the EU there is an important piece of unfinished business in creating more transparent and less easily avoided tax regimes.

And there is one area where there are no meaningful global rules, but there are European rules, and where the UK is a major player: arms exports. Depending on how arms and security exports are defined Britain is the second or third most important exporter. One of the

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more obvious temptations in a post-Brexit world is to look for export opportunities in one area where there are no preferential or other trade rules. The likely consequence is to be drawn into regional disputes by becoming a major strategic supplier – the position we currently ‘enjoy’ in relation to Saudi Arabia and its various disputes, notably in Yemen where the UK government is clearly in breach of its own guidelines. An important political battleground should the UK leave the EU – with all the damage that would imply – would be over whether to maintain and strengthen the current safeguards code or to relax it further to create, in effect, a free-for-all. And that, in turn, hinges on whether a ‘global Britain’ is committed to strengthening the rather tenuous global rules related to human rights or to disregard them in the interests of amoral commerce. Those of liberal bent must incline to the former.

Rebuilding a Damaged Political System

The Brexit referendum and its bitter aftermath have their roots in a dysfunctional political system. The British pride themselves on pragmatism, on the ability to improvise, the art of compromise and the lack of anything as formal and confining as a written constitution. These virtues have proved to be absent or inadequate at a time of political deadlock; the absence of a clear constitutional route map is a serious deficiency. And one of the legacies of the 2016 referendum, whatever happens ultimately, will be a feeling amongst millions of people that the democratic system has failed.

These deficiencies are frequently listed yet rarely acted upon, since the two largest political parties have no interest in changing a status quo from which they benefit. So, we have a first-past-the-post voting system for Westminster and local government in England and Wales which produces outcomes with only a tenuous connection to the balance of public opinion. It is justified by the need to provide strong and stable one-party government – but has produced arguably the weakest government in modern history, following a strong and stable government that was a two-party coalition. The devolved administrations in Scotland and Wales, which are chosen by a more proportional system, have led to several cases of power-sharing; where not, this has reflected the genuine choice of the electorate. Then we have a second chamber, the House of Lords, whose membership is almost entirely, these days, determined by political patronage, which all agree must be changed,

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but which survives because of lack of consensus on how to change it. To which we can add a party funding system which is, now, more transparent but fails any test of fairness.

Perhaps the biggest failing is less debated: the extreme centralisation of decision-making caused by the decline and financial starvation of local government. Almost all Western democracies have strong local and regional government; in the UK there is no regional government beyond the devolution of Scotland, Wales, Northern Ireland and, to a degree, London, and local government has been stripped of many of its functions (notably in relation to schools and colleges, municipal enterprise and social housing) and, not least, its capacity to raise revenue from taxation or borrowing. As a consequence there is little sense that people have much control over decisions that affect their lives, let alone anything that could be described as ‘community politics’.

The most important political reform which could give back a sense of control would be to breathe life back into local government. If councils are to be given more power, then they must be fairly elected, not one-party states, as is so often the case in England. Scotland has adopted proportional representation in local government (using the single transferable vote) and is much healthier for it. The time is ripe to extend this reform to England and Wales. And with power must come responsibility over finance: lifting the controls over council tax, giving greater freedom to levy local taxes, and allowing more freedom to raise capital through borrowing. And some nationalised functions of local government should be restored, including the planning and oversight of schools and admissions.

Some serious devolution has happened under the City Deal system introduced during the Coalition, together with the election of mayors, which has had uneven success. The positive outcome of this partial devolution is to bring together councils to address common problems in relation to transport and economic development, providing for some of the conurbations of England (Manchester, Merseyside, Teesside,

Bristol–Avon) the integration of services combined with a degree of political accountability.

The success or otherwise of devolved government hinges in significant measure on whether it reflects, and reinforces, a sense of identity and pride of place. This is manifestly the case in Scotland and Wales, and arguably so in London as well. The English conurbations, led by Manchester, show some encouraging signs but sometimes do not reflect public opinion (as in the appetite for Yorkshire rather than a narrower area based on Sheffield).

What is missing is any real sense of community engagement with politics. This can be provided at a very local level by parish councils and town councils. And enterprising local councils (often run by Liberal Democrats) have devolved small budgets and control over local planning decisions and the running of amenities (parks, libraries, sports centres, etc.) to ward level.

There are obvious problems with very local decision-making. The articulate and well-organised, and those with time on their hands like pensioners, will tend to dominate. Parochial interests and NIMBYism may prevail over the wider interests of the city or region or country. But set against this are the positives from tapping into the energy which community politics can unleash, and a sense of pride of place. For all the faults of our politics and society, there is still a rich civil society: an infrastructure of voluntary caring groups, charities, chambers of commerce, arts and sports societies and church organisations which produce all the summer fetes and carnivals and other community events. Increasingly, social enterprises and Community Interest Companies have sprung up to run swimming pools or libraries or theatres. One of the most useful roles of community-based politics is giving organisational and financial support to enable this kind of activity to flourish, and not only in middle-class enclaves and villages.

If the challenge to our politics is to help people to ‘take back control’, then there has to be concerted reform at different levels: a

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parliament that is more representative, moving to the kind of voting system currently enjoyed by the Scottish Parliament (or in Germany); a second chamber that is predominantly elected; a transfer of powers from central to local (and very local) government; and a system of funding for parties that severely caps spending at national level (but is more relaxed locally).

Freeing up the structures may also help to free up the parties which exist on the basis of tribal loyalties, decades or centuries-old vested interests and ancient ideologies bearing little relation to today's alignments of ideas and interests. If the Brexit process (however it concludes) could have one positive legacy it would be the break-up of one or both of the traditional major parties and with it a real chance to achieve thorough-going political reform. A Britain governed by governments of more than one party, a party system which better reflects the views of the public, and parties which themselves allow looser association with their supporters and a continuing conversation between government and citizens, are all critical to steering Britain away from the democratic crisis which brought about the 2016 referendum.

Conclusion

My Roadmap to a Better Britain

In these essays I have argued that Britain has a malfunctioning economy and a badly divided society. These are both a cause and, increasingly, a consequence of Brexit. The financial crisis in 2008 caused great and lasting damage, even if the damage was minimised in the closing stages of the last Labour (Brown) government and then by the Coalition government. There remain many underlying weaknesses: an over-dependence on the financial sector, low savings and investment, poor performance in innovation and training, a totally dysfunctional housing market and a business culture dominated by short-term thinking. These problems are now compounded by Brexit uncertainty, which in turn is feeding a poisonous and divisive politics.

In a world of populist politics, there is a search for simple solutions to complex problems. We need to build on strong, stable, operationally independent structures overseeing economic policy, which rely on evidence and expertise, to counter the snake-oil salesmen who promise self-financing tax cuts and magically financed expenditure. As liberals and democrats we must not succumb to fear-based politics but instead offer a route to a better future.

Here I summarise my proposals in a ten-point Roadmap to a Better Britain – to build a more prosperous, socially just and environmentally sustainable society.

1 Strong public services and honest tax

Within an overall framework of rules and financial discipline, the need for better funded public services and a programme of poverty

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alleviation is paramount. This has to be honestly financed by taxation.

The tax system is over-complex and needs radical reform to shift the burden of tax from work, savings and innovation on to unproductive wealth, land, expenditure (online or in shops, equally) and environmentally damaging activities – and meaningful international cooperation to ensure that the global rich and tax-dodging companies and individuals pay their share.

Even within the disciplined approach to public finance I've argued for, there is scope for considerably increased public investment for infrastructure and housing, alongside the private sector, paid for by public borrowing and subject to a rigorous test of impact.

2 An entrepreneurial state

Party political debate is disfigured by an ancient and debilitating ideological conflict over the roles of the public and private sectors. Successful, profitable, competitive private enterprise is to be valued while the state has an essential economic role in promoting education and training, science and, especially, innovation, and infrastructure, all within an industrial strategy which prioritises advanced manufacturing, emerging technologies and services like creative industries and professional services.

3 Bring in the left behind

The 'left behind' towns and communities cannot be expected to catch up simply from 'trickle down' from successful cities. We need an urgent programme of targeted public (alongside private) investment using the model of the successful Regional Growth Fund on a bigger scale. While the economy remains so centralised, we need to rebalance power away from London and redistribute resources based on need and potential.

4 The best education in the world

The priority area for public spending should be education, at all levels,

to bring the UK closer to the standards of the best, internationally. A particular gap is post-16 education, where the long-standing neglect of vocational and adult learning needs to be remedied. The best approach would be a generous individual learning account for all young adults to pay for the fees involved in quality lifelong learning.

5 Competitive and responsible business

A healthy economy demands competition and forceful policing of anti-competitive behaviour. The natural monopolies of rail, water supply and energy distribution need smarter regulation rather than renationalisation. And government should tax excess profits over a utility rate of return. The main threat to competition comes from the major internet platforms which operate de facto monopolies across national frontiers. The response has to include a welcome for innovation, transnational (i.e. EU) curbs on monopoly, national regulation of damaging content, and protection of consumers, including payment for the use of their data, as is now being developed in California.

The British takeover regime is too lax, providing lucrative fees for some but undervaluing long-term performance by good companies. Let's give greater voting rights to long-term investors or disenfranchise speculative short-term investors. Maintaining and strengthening the science base should be an important national interest test in takeover cases.

The current model of business in which directors' overriding duty is short-term profit is discredited. There has to be a rebalancing of responsibilities, through the reform of corporate governance, to long-term and wider responsibilities including to employees, customers and the environment. Government should be much more actively encouraging different models of corporate structure: social enterprises, mutual and employee ownership.

6 Fair labour markets

Labour markets have become too flexible, undervaluing security, loyalty,

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training and experience. The outcome is full employment but depressed wages and low productivity. Many workers, as well as employers, welcome flexible arrangements but the pendulum has swung too far towards 'hire and fire'. We need tougher enforcement of the minimum wage, stronger legal rights for 'gig' and other flexible employment models and a strengthening of the opportunities for collective action (including electronic balloting in unions).

The economic arguments for a liberal immigration regime for workers inside and outside the EU are powerful. But there are undoubted costs, notably in the impact on the housing market. And there is a reasonable demand to ensure that migration is managed. It is simply not correct to suggest that Britain has to leave the EU Single Market to ensure some management of migration flows within the framework of 'freedom of movement'.

7 A housing market that works for young people

The housing market is badly broken, with severe negative implications for most of the younger generation and those in relative poverty. There is an urgent need for large-scale building of social housing by councils and housing associations alongside affordable housing to buy. Existing policy which inflates demand and prices, like Help to Buy, is counterproductive. It will be necessary to acquire land cheaply, through compulsory purchase without inflated valuation created through the planning system, and through a managed market in which houses can also be sold on at affordable prices.

8 The green imperative for a sustainable future

Awareness of the environment has to provide a green thread throughout policy. Action on reducing greenhouse gas emissions is imperative as part of a global process to combat global warming; the UK already has strong prescriptive legislation, a record of reducing emissions and diverse technology initiatives. But carbon reduction policy has recently

gone into reverse, and there needs to be a renewed and urgent commitment to solar, wind and tidal renewable energy, to energy efficiency and to curbing aviation emissions. There is much to be said for mobilising activity around an ambitious US-style Green New Deal, albeit with a greater willingness to use markets and without reliance on magical money.

9 Open to the world

As a medium-sized developed country, whether inside or outside the EU, Britain has limited scope for useful unilateral action; outside the EU, it would not be taken very seriously in any event. As an outward-looking country we have to play a role in common security and in defending a rules-based system around trade, international finance, environmental commons, tax rules, nuclear proliferation, the protection of human rights and much else. One of the most dangerous dimensions of populist politics is a revival of nationalism and the rejection of cooperative arrangements. We must not indulge either.

10 Fix our broken politics

Underlying many current failings in the UK is a creaking and increasingly discredited political system. A reform agenda must include a change in the first-past-the-post electoral system for local government and the House of Commons, an elected second chamber, an overhaul of party funding and a radical decentralisation of power to local government, going beyond the 'earned autonomy' of the current elected mayor model.

The two main, traditional, parties are starting to break up. This is welcome and Liberal Democrats should be acting as a partner and a catalyst to aid the formation of a new liberal and social democratic force to take forward and implement these ideas.

While the immediate battle in British politics is to stop the

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damage caused by Brexit and keep open the option of going back to the public – the possibility of Remain is still very much alive and decidedly worth fighting for – the ideas in this roadmap give us an agenda for future action.

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Liberal politics for the age of identity

In a wide-ranging set of essays on Britain's future, Vince Cable casts his party not at the centre of the traditional left/right axis but as the leading proponent of a values-based politics which is open, inclusive and outward-looking, not closed or narrow-minded. He examines how liberals should respond to the 'age of identity' and proposes an ambitious programme of radical reform.

In a thoroughgoing analysis, the Liberal Democrat Leader warns about the growing inequalities of income, wealth and opportunity that are fuelling populist movements. His prescription for change embraces reforming capitalism; tackling the power of the tech giants and harnessing their potential; changing the tax system; investing in public and private housing, infrastructure and the green economy; and achieving a revolution in lifelong learning.

Together these changes will help individuals take control in a more meaningful way than Brexit could achieve, particularly through establishing new rights for workers in the 'gig' economy, creating opportunity for young people, dispersing power from the centre to communities, and fixing the broken model of UK parliamentary democracy.

He challenges liberals and social democrats to avoid eulogising the past, and instead to prepare the country and its citizens for the 2020s.

About Sir Vince Cable MP

Sir Vince Cable is the leader of Liberal Democrats and MP for Twickenham. He was Secretary of State for Business, Innovation and Skills in the coalition government. Before election to Parliament, his varied career included positions as deputy director of the Overseas Development Institute, special advisor on economic affairs for the Commonwealth Secretary General, Sir Sonny Ramphal and chief economist at Shell International. He is currently a visiting professor at the London School of Economics.