RETHINKING THE ECONOMIC BORDERS OF THE STATE

By Dieter Helm

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CONTENTS

	Page
About the author	7
1. Introduction	8
2. Keynes, Hayek and the economic crisis	12
3. Responsibilities to the future	17
4. Infrastructure and public goods	20
5. Poverty and inequality	23
Conclusion	27

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INTRODUCTION

The economic borders of the state have expanded in fits and starts since the First World War. Gradually the state has taken on more and more functions, from the provision of social security to health, and education. It has expanded into production through nationalisation and industrial policy and developed wide-ranging regulatory powers. These extensions have taken place within a framework of macroeconomic management with fiscal and monetary intervention designed to control the business cycle. Now this reach into almost every aspect of the economy has been ratcheted up another notch in response to the current economic crisis. It is an expansion which has raised deep questions about the scope and limits of state involvement and a renewed interest in redefining and perhaps rolling back its domain.

Revisiting the economic borders of the state requires first an understanding of the debates of the past. That past, both intellectually and practically, conditions the current debates. Between the First and Second World Wars, the intellectual challenge was to define the role of the state in the economy, and out of this intensive debate emerged a post-Second World War consensus on what became known as the *social market economy*.

The First World War had broken the back of hierarchical societies across Europe: the millions involved and the scale of the destruction broke the back of the upper classes and the aristocracy, to the extent it remained in command. The Russian revolution and the collapse of the German monarchy were events on a par with the collapse of the Soviet Union and communism at the end of the twentieth century.

The initial post-First World War boom gave way to the great crisis in capitalism. It happened early in Germany with hyperinflation and, after

the crash of 1929, elsewhere. By 1930 the old certainties – a stable monarchy, a hierarchical and deferential society, the Gold Standard and, behind it all, a self-correcting capitalism with flexible wages – had vanished. Now a new model was needed to correct the obvious and massive macroeconomic market failures, and gradual democratisation meant that the distribution of income could no longer be left to inheritance and the market.

The intellectual debate was vigorous and revolutionary. In one corner stood Hayek, with continental ideas derived from the supremacy of the law and the European (German) concept of order. Hayek advanced the case for a capitalism which relied on competition, but within the straightjacket of a monetary constitution and a promotion of the virtues of competition.[1] In the other corner, Lange argued that socialism and planning were the rational responses to market failures.[2] In the middle was Keynes, arguing for an activist macroeconomic policy within which a predominantly private and competitive market would function.[3]

Each of these positions was complex, and there was much debate about the details. There were many variants, and each changed their minds from time to time. Their disciples and allies extended and expanded the positions. In the political domain, ideas were moulded to electoral ends. Socialists built on the economic theories of planning. Liberals – notably in Germany – built on the constitutional and rules-based Hayekian model to create the social market economy, whilst in Britain, the Keynesians combined with the planners to create a social democratic blend of macroeconomic activism, nationalisation of the commanding heights of the economy, and the welfare state.

[1] Friedrich Hayek, "The Meaning of Competition", in *Individualism and Economic Order*. (London: Routledge & K. Paul, 1948).
[2] Oscar Lange, "The Foundations of Welfare Economics", *Econometrica* 10 (1942); Oscar Lange and Frederick Taylor, *On the Economic Theory of Socialism*. (Minneapolis : The University of Minnesota Press, 1938).
[3] John Maynard Keynes, *The General Theory of Employment, Interest and Money*. (London: Macmillan, 1936).

The arguments from the 1930s steered the role of the state through much of the rest of the century. The inflationary shocks of the 1970s revived monetary constitutionalism to yield monetarism, and eventually a rules-based monetary policy framework. France's flirtation with Keynesianism in the early 1980s under Mitterrand revealed the limits to fiscal policy. Rules-based competition policy emerged, as did a preference for private over public ownership from the 1980s onwards. The process of European integration followed more the continental philosophy over that of the Anglo Saxons, and unsurprisingly, the European Commission pushed forward a model based on uniform rules (directives), whilst at the same time liberalising trade within the Union. Even European competition policy fitted rather neatly into the Hayekian framework: opening up markets, using rules-based competition law, and breaking up core utilities, were all policies which Hayek would probably have approved of.

By the beginning of the twenty-first century, the Keynesian vision of the role of the state might have looked to be in retreat. Yet in reality, the concept of an activist fiscal policy to manage the business cycle was very much alive: indeed, so ingrained was it that some thought the business cycle itself had been mastered – and thereby abolished. The reality was very different: in the hands of Keynesians, the neat idea of a long term balanced budget, with short term deficits and surpluses to even out the cycles, gave way to structural deficits in the good times and cyclical deficits in the bad times. The growth of the state in its share of national income was a natural consequence of putting the beguiling Keynesian ideas in the hands of practical politicians. The state grew from a share in national income of around 20% in the early 1960s to over 40% by the end of the century. Now it stands at over 50% in many European economies, supported by national debt levels close to 100% of GDP in several countries.

The bust from 2006 onwards presents a massive intellectual challenge which has many parallels with that of the 1930s. Economies are very different now, and the role for the state is of a different order of magnitude. Technologies have radically altered the way firms, consumers and governments behave – and their possibilities. The threat of European war – a persistent and overshadowing fear in the 1930s – has gone away. There are some new problems too: most notably from population aging and the environment. In the 1930s, people did not tend to retire for long, and the provision of pensions was not the challenge it is now. There was no climate change to worry about, and little yet of the destruction to biodiversity that agrichemical industries would bring. Inter-generational concerns mattered little.

The debates of the 1930s give much guidance to the debates now. But a simplistic grasp of the Hayekian or Keynesian answer will not provide much more than a partial guide. The social market economy concept needs to move on to meet the issues of today rather than those of the 1930s. This paper starts with the lessons from the past – and in particular from Keynes and Hayek and particularly how they both shape and limit the current debate (section two). The next step is to add in what is left out of this debate – notably the intergenerational concerns which are raised by debt, pensions and the environment (section three). With the intergenerational issues brought to the fore, the next step is to work out what the role of the state is in providing a stable economic framework through time. This is in large part about infrastructure considered in the widest sense (section four), and intergenerational equity (section five). Taken together, a sketch of a new twenty-first century model for the role of the state can be glimpsed, and the paper ends with this outline (section six).

2. KEYNES, HAYEK AND THE ECONOMIC CRISIS

Both Keynes and Hayek were towering figures in the debates of the 1930s because their contributions were much more than mere economic theories. Both were political economists in the sense that they viewed their contributions in the wider political economy setting. They were concerned with the big questions of economic policy in a way that few academic economists would now understand. And in their approach they both wrote on the wider political economy agenda, and neither had much truck with empiricism. Indeed whilst the role of the state in the economy might be shaped by "facts", they shared with many of their contemporaries the view that economics was not a science subject to empirical testing.

Much has been written on both's wider political economy. For Keynes, the short run was what mattered – the future would take care of itself, and the economic consequences for our grandchildren would be bright provided the immediate problems were fixed. He took an optimistic view of human potential. For all Keynes wrote about animal spirits and especially investment, his worry became underconsumption, and his General Theory was a direct descendant of those on the liberal left who wanted to use the state to solve what classical economists had regarded as the inevitable "stationary state" as appetites for consumption were satiated. Appeals to longer run concerns met the contemptuous often-quoted remark that "in the long run we are all dead". The economy would not self equilibrate at full employment and could get stuck (and in the 1930s was) with unemployment. The market failure was one of co-ordination and expectations. Savings and investment, and therefore aggregate demand and aggregate supply might not be brought effectively together at a desirable level by unaided market forces (such as by real wage reductions). There was a paradox of thrift, and an economy could stagnate in a psychology of pessimism with a deficiency

of effective demand. The source of demand of last resort was the state, and it could borrow to plug the gap. Just who it would borrow from, and what the consequences of that borrowing would be, was in the 1930s as contentious as it is now.

Hayek's time horizon was very different. Hayek was very much concerned with the longer term, with less regard for the short term. For him the state needed to be set into a rules-based constitution, and it is therefore not surprising that many US constitutionalists saw more in Hayek than did their British counterparts with the British tradition of avoiding constitutions and scrutiny of the state by the courts. Hayek was ultimately a legal theorist who saw economics as a dimension of the law.

This was not, however, a simplistic diagnosis, for Hayek thought deeply about competition and its meaning. For him competition combined two great virtues: it gathered, used and distributed information far better than governments; and it embedded the idea of individual liberty. The former was very much an economic claim – and a claim which undermined the socialistic planners like Lange.[4] Socialism simply would not work – and the eventual collapse of that great planning experiment, the Soviet Union, could be explained in this way. In a competitive market, individuals and firms needed to know only their own circumstances and the prices; in a planned system, the state needed to know everyone's preferences and every firm's production costs. Trying to tinker with the market was doomed by an informational impossibility that not even modern computers could solve. Hayek therefore opposed the sorts of tinkering in markets that British social democrats came to expound.

[4] Hayek, "The Meaning of Competition".

The latter individual liberty comes directly from John Stuart Mill and his essay *On Liberty*. Hayek thought it fell to every generation to restate the case for individual liberty, and given his European context, this is hardly surprising.[5] This was a timeless truth for him. It was also the foundation of his political economy. Competitive markets – free from state interference – were the natural places for the flourishing of individuals.

It is no accident that in Britain the left was drawn to Keynes and the right to Hayek. Keynes appealed to the social democratic wings of the Labour party. For Wilson, Callaghan, Jenkins and Healey in the 1960s and early 1970s, the Keynesian framework was a natural way to think about fiscal policy. It provided intellectual cover for the expansion of government spending. It was only in the late 1970s under Callaghan and Healey that the activist fiscal approach was ditched (and Healey discovered monetary targets and privatisation). In the 1980s, Thatcher naturally gravitated to Hayek (and Friedman) as did the Reaganites in the US.

After 1997, and particularly after 2001, the Labour government of Blair and then Brown tried to combine the two political economies. Labour embraced an independent monetary policy with a "golden rule" only to borrow to invest over the cycle. A Hayekian constitutional approach was thereby set out; within which counter-cyclical policy was permitted, but as events unfolded it was observed more in the breach than in conformity. Fiscal policy was anything but constrained, and from 2001, a structural budget deficit of several percent of GDP was run. On the monetary front, interest rates were set well below their long run real rate after the stock market crash in 2000, and as the credit and then the economic crisis broke, any pretence at inflation targeting only was quietly abandoned.

[5] Friedrich Hayek, *The Constitution of Liberty*. (Chicago: University of Chicago Press, 1960).

As the full magnitude of the "bust" that followed the great boom of the late twentieth century become apparent, Keynes was resurrected and proclaimed as the saviour. We are all Keynesians now, the politicians proclaimed. Budget deficits exploded, the stability pact was effectively abandoned in Europe, in the name of maintaining demand and "going for growth". In the process, an enormous mortgage was written on the future, and the borrowing was supported by "quantitative easing" – directly buying up bonds by the central banks.

In Europe, deficits did also rise very sharply, but on average by considerably less than in the UK and the US. The monetary constitution provided by the euro limited the scope to go down the Keynesian route. Instead, economies had to adjust, and standards of living had to fall to levels consistent with the realisation that the future was not as rosy as the prophets of the great boom had claimed. Across Europe real wages fell, pensions were cut, and the public sector was cut back through austerity measures. Devaluation – the option for the UK for decades since coming off the Gold Standard – was not available as a soft option for reducing living standards.

To the Keynesians, Europe was doomed to low growth by the monetary straightjacket. Without the stimulus of government spending, it was argued that it would struggle to recover, and indeed default was widely predicted for the weaker members, like Greece. The jury is still out on whether they are right: Germany has recovered very fast in the first half of 2010, and even Greece seems to be adjusting. It is a debate which will rumble on for years amongst academics and politicians – in part because the extent of Keynesian stimulus in the UK was less than Labour had claimed (because the structural deficit plus the cyclical effects of the recession explained most of the deficit) and because there was more Keynesian stimulus in Europe than politicians wanted to admit to their sceptical publics.

Whatever the outcome of this debate, the "facts" about the consequences remain to be dealt with. The result is a significant reduction in standards of living, a recasting of expectations of what the state can deliver in spending terms, and an enormous mortgage on future generations who will inherit both the debts and the pension liabilities. Few argue that the deficits are sustainable: it is a question more of the timing of cuts in spending and the balance between tax increases and spending reductions. This fiscal legacy will be set in a context in which the environment has also been mortgaged: current generations have debased the atmosphere with greenhouse gas and despoiled the biosphere. Put another way, current generations have been living at a higher standard by borrowing the environment and consumption from the future – the opposite of sustainable consumption. Hayek would have understood – and criticised – this: he was concerned with the longer term. Keynes thought the future was bright and could take care of the deficits and the debt as long as the effective demand was kept up.

3. RESPONSIBILITIES TO THE FUTURE

A central idea from the Enlightenment was that the future would be an ever expanding world of new opportunities made possible by the developments of science and human endeavour. The future was a better place. Now that assumption is not quite so robust: whilst science continues to push out the technological frontiers, the growth of global population spreads these increased possibilities over ever greater numbers, and as population and consumption continue to expand, the environmental degradation may yet provide hard constraints.

The numbers are indeed daunting. The world's population is on course to increase from about six billion to nine billion by 2050 – more extra people than the entire world population in 1950. Economic growth on current trends may quadruple the Chinese and Indian economies by 2050, bringing their (by then) combined population of around 4 billion towards current European standards of living. In the meantime the economies of Europe and the US may double if growth returns to around 2-3% per annum. The implied wall of consumption is awesome.

The environmental consequences are correspondingly awesome too: global warming is predicted as emissions rise towards 550 parts per million, up from 275 parts per million before the industrial revolution. Current trends indicate a rising coal burn and fossil fuels show little sign of ceding ground in absolute or even relative terms to low carbon alternatives. The carbon intensity of global GDP continues upwards. Kyoto has made little difference to these adverse trends.

On biodiversity, the destruction of the rain forests – the repository of much biodiversity – is proceeding apace. Some scientists suggest by the end of the century perhaps half the species on the planet may be extinct.

These environmental problems are big market failures: they will not self-correct, and therefore the role of the state is pivotal in whether and how they are addressed. Nothing in the debate about Keynes and Hayek addresses these enormous challenges.

Environmental problems are complex: and they tend to be global, not national. The climate is not something most countries can do much about on their own (the exceptions are the US and China which together emit nearly half the world's emissions). The destruction of rainforests is an international problem too, as is the state of the oceans.

Environmental problems do, however, share one feature with a number of other pressing problems – like debt and pensions. They are *intergenerational*, and involve significant time spans. The debts run up by government deficits and the Keynesian stimuli will have to be paid by the next generation. The unfunded pensions promised to public sector workers will have to be paid by tomorrow's taxpayers. The next generation will inherit the depleted atmosphere and biosphere.

The organising concept here is *sustainability* – the idea that the state should arrange matters so that future generations are no worse off than current ones. In the past, the assumption of economic growth meant that future generations would indeed be better off. They would inherit a bigger economy. Therefore current generations did not need to worry much about them: economic growth would take care of their needs, and the emphasis, especially for the Keynesians, was very much with the present.

This turns out to be complacent, and for three reasons. The first is the obvious one: future generations may not be better off because the environmental consequences of current consumption may reduce future consumption. The second is that the mortgage from current debt and

future pension liabilities may be too large. They may not be able to pay the interest and the current generation's pensions. The third is related, and has profound implications for the role of the state: GDP measures of growth – and the consumption assumptions based upon them – are very poor indicators of the welfare of future generations. The reason is simple: GDP has no assets, no balance sheet and no depreciation. GDP can go on up whilst the environment is despoiled. Existing natural resources can be used up which will not be available to future consumers. An example is North Sea oil and gas: there was no depreciation offset in GDP to account for its depletion to the benefit of the current generation. More generally, there is no asset balance sheet to account for the rundown of physical infrastructure, and the environment.

Translated into the current context, not only has Britain been running up a structural deficit (not following the "golden rule") but it has also been eating up its assets. Now the infrastructure needs refurbishment and modernising, the carbon externalities need to be reduced and biodiversity addressed. The public sector pensions liabilities need to be funded, and the depreciation in the social fabric needs to be rectified. Obesity builds up future health costs and educational failures last for decades. In other words, when the concept of "rebuilding the economy and the society" is advanced, *what it means is getting back to a sustainable growth path, in which standards of living adjust to take account of the depreciation of natural and human capital*. This very radical idea requires a recasting of the economic borders of the state. The organising concept is "infrastructure".

4. INFRASTRUCTURE AND PUBLIC GOODS

Infrastructure is what lies between companies and markets, and between consumers and essential services. It incorporates the core network utilities – like transport, energy, water and communications. But it also extends further – into social infrastructure – the educational networks, the health services, broader social supports and law and order.

What all these have in common is that they are best considered as *systems*: we have an electricity *system*, a health *system* and a *system* of social support. Another way of putting this is that these are public goods, which lie between the state and the market. Decisions about such systems are not marginal ones: we either have these systems or we don't, and they have embedded characteristics of technology and the way they are integrated.

Much of the literature on the economic borders of the state focuses on the macro and the micro dimensions – leaving out the bit in the middle. Yet infrastructure in this wider context is what makes an economy and a society function. It can be privately provided but its framework is a matter for government decision making. At the system level, almost all are natural monopolies or at least contain monopoly elements, and for most the marginal cost is close to zero. Thus, how they are financed – how the sunk and fixed costs are recovered – is a matter of policy, and therefore for governments to decide. In practice, finance is mixed: health and education are largely financed through taxation, but energy is paid for by customer charges. Broadcasting is partially paid for by the licence fee, whereas the railways are part subsidised by taxpayers.

The fact that the marginal cost is close to zero in most of these examples, and that the average costs have to be recovered, has profound effects on the design of the state and the economic borders

with the private sector. Investors in infrastructure face the problem of how to get their money back – how to avoid being expropriated through marginal cost pricing. In many cases, there is no credible solution and the state does the providing directly. This is part of the explanation for the nationalisation of much of the infrastructure in the twentieth century and why the private sector under-invested.

Privatisation represented a profound change in the economic borders of the state, and it posed a central question: how could the state credibly commit to the new private owners such that if they sunk investments into the infrastructure they would get their money back?

The answer is some form of contract which binds future customers and taxpayers to honour the sunk costs – and it is therefore one example of the intergenerational equity issue raised above. Future generations want infrastructure to be built for them: but they must commit to pay.

How then is this to be effected? In the utilities a novel and impressive approach has been taken. The sunk investments go into a regulated asset base (RAB) and an independent body – the regulator – has a statutory duty to ensure that the functions of the utility are financed, including remunerating the RAB.[6] In some cases (water and the rail network), the assets are treated as infinitely-lived – it is assumed that the services will always be needed. Here the assets are valued in current cost terms, and there is no depreciation, but instead an asset maintenance charge which ensures that the services will continue to be provided.

In this somewhat technical concept lies the germ of a new way of thinking about the role of the state. It is the guarantor of the provision of the core public goods through time, and these are provided largely

[6] Dieter Helm, "Infrastructure investment, the cost of capital, and regulation: an assessment", *Oxford Review of Economic Policy* 25 (2009).

by the private sector under long term contracts which honour the investments, provided they are efficiently made. The "contract" is not only that investments get paid by future taxpayers and customers, but also that current generations behave in a way which is sustainable – that we guarantee that we will invest to pass on infrastructures at least as good as those we inherited. It is an *intergenerational bargain*.

It follows that the current generation must set aside sufficient to do the investment to maintain the assets intact. Setting aside monies for investment means foregoing consumption now: in other words, a responsible fiscal policy focused on the balance between savings and investment, and current consumption would be the residual. This is beyond the Keynesian concern about aggregate demand: investment and consumption are both components of demand, and so less consumption does not decrease demand if it is compensated for by more investment. Provided saving is translated into investment (Keynes's core concern) then demand is unaffected. Conversely, continuing to keep consumption above the sustainable rate requires dis-savings to take place. In the past decade this has been achieved by equity withdrawal and gearing of personal balance sheets – borrowing from the future – and by running down the infrastructure – and hence also, in an important sense, borrowing from the future.

To sort out the intergenerational issues it is immediately apparent that we need accounts – and preferably current cost accounts – for the infrastructure in the broader sense. We now have some of these – for the regulated privatised utilities. However, such asset-based accounts are missing for health, education, social and environmental infrastructure and for defence and law and order. Arcane as it may seem, without the numbers, we have little idea of whether we are consuming at a sustainable rate – and, more importantly, what this might entail.

5. POVERTY VS INEQUALITY

The modern state has obligations in respect of future generations. But it also has obligations in respect of the current generation, notably for those who are poorest. A core political debate of the twentieth century has been how far the state should focus on inequality – should it aim to equalise the distribution of income?

A related but separate question is whether the state should try to reduce poverty. Poverty and inequality are not the same thing, unless poverty is measured relative to income distribution, and then it is just inequality in respect of a particular part of the distribution.

The addressing of these distributional questions has been responsible for the growth of the share of government in the economy by a factor of around two: before the 1960s, the share was around one-fifth except in times of war. After the 1960s, it pushed up to around 40%, with most of the difference, in effect, being made up of transfers.

Different levels of transfers reflect different welfare judgements: the moral case for equality and the treatment of the worst off in society is a matter for political debate. However, a subsidiary issue of great importance given the share of the economy involved is whether the stated objectives are actually achieved. Furthermore, even if the goal is equality, few would contest the idea that it is the worst off in society who should have priority in any steps toward the broader equality goal.

What constitutes poverty is contested: there are two broad schools – absolute poverty and relative poverty. Absolute poverty was what worried Beveridge, and in his optimism about post World War Two recovery, he envisaged that it would get "solved" by the early 1960s.[7]

[7] William Beveridge, "Social Insurance and Allied Services", (London: Her Majesty's Stationery Office, 1942).

Relative poverty is more stubborn, since the goal posts keep moving as society gets richer. At one level, access to television is now necessary to participate in society, whereas once it obviously was not. At another, increased access to sugars and fats has led to obesity and health problems which are highly prevalent among the poor. We can be absolutely poor, in a relative way, as Sen famously pointed out.[8]

It is beyond the scope of this short paper to analyse the detailed design of the policy to address poverty or the precise economic borders of the state that would result for each of the possible welfare judgements. But what can be elucidated within the broader context of infrastructure, public goods and proper accounting is that the claims of the poor now and the poor in the future ought to be incorporated into the intergenerational bargain. For a key component of poverty is the failure to consider human capital. The poor tend to have less education, less good health, less access to broadband, and suffer from fuel, water and transport "poverty" (in that these basic services take up a large proportion of their household budgets). In other words, the poor are poor in access to infrastructure services in the wider sense.

As with the physical infrastructure, the asset-based side of poverty is not accounted for. We have no accounts for the (sometimes declining) value of human capital. When people live off benefits and are, in effect, excluded from the labour market, their skills decline. Human capital depreciates. When they are not given proper health care and education, the human capital is sub-optimal.

Treating people as assets rather than liabilities, and focusing on how these assets can be protected and enhanced, and therefore how the human capital values can be sustained across the generations, is a very different way of thinking about the distributional issues. Indeed, it is

[8] Amartya Sen, "Poor, Relatively Speaking", *Oxford Economic Papers* 35 (1983).

ultimately an efficiency argument and independent of considerations of inequality.

How might these assets be enhanced? The answer is again partly about infrastructure. Concepts like "the Big Society" are in part about social infrastructure within which people in poverty can be invested in through their communities – a basic infrastructure building block for not only a civilised society but also an efficient one. These form parts of the overall infrastructure – in health, education and protections through law and order (given that crime is concentrated in its effects on the poor).

None of this militates against redistribution. But before pure redistribution, poverty has a prior claim, and the role of the state in providing and encouraging social infrastructure needs to be considered alongside the more obvious physical infrastructures.

CONCLUSION

The twentieth century has left us with states which have grown so much that they now account for around half the total economies of Europe. This growth has been in response to a combination of democratic preferences for ever greater transfers, and to the irresponsibility of Keynesians in respect of fiscal policy. Over time a greater and greater mortgage has been written on the future – on the mistaken Keynesian assumption that the long run would take care of itself, because economic growth • measured by GDP • would make future generations much better off than current ones. Borrowing from the future to boost current consumption is only desirable if *sustainable* growth is assumed to be high enough – after accounting for the state of the assets being transferred to the future.

The growth of the state has, since the beginning of the twentieth century, indirectly added significantly to that mortgage. The structural deficits in Britain since 2000, the cyclical deficits since the credit crunch in 2007, the unfunded public sector pensions, the depreciation of the infrastructure (physical and social), climate change and the destruction of biodiversity have tipped that balance. Current consumption is not sustainable – or put another way – savings and investments are too low.

The task in reconsidering the economic borders of the state is to design the intergenerational bargain in a way which maintains sustainable consumption through time. A significant part of this bargain is to ensure that the physical and social infrastructure inherited by the next generation is at least as good as the one the current generation inherited.

Patently this is unlikely to be the case – and therefore there needs to be a significant redressing of the balance. Consumption has to fall, savings

have to rise and the depreciation of the social and physical infrastructure needs to be rectified. And institutions need to be designed to maintain that bargain through time – to pass on assets (including regulated assets) intact in current cost terms. In turn, this needs a revolution in accounting – and in the way we measure the national product through time.

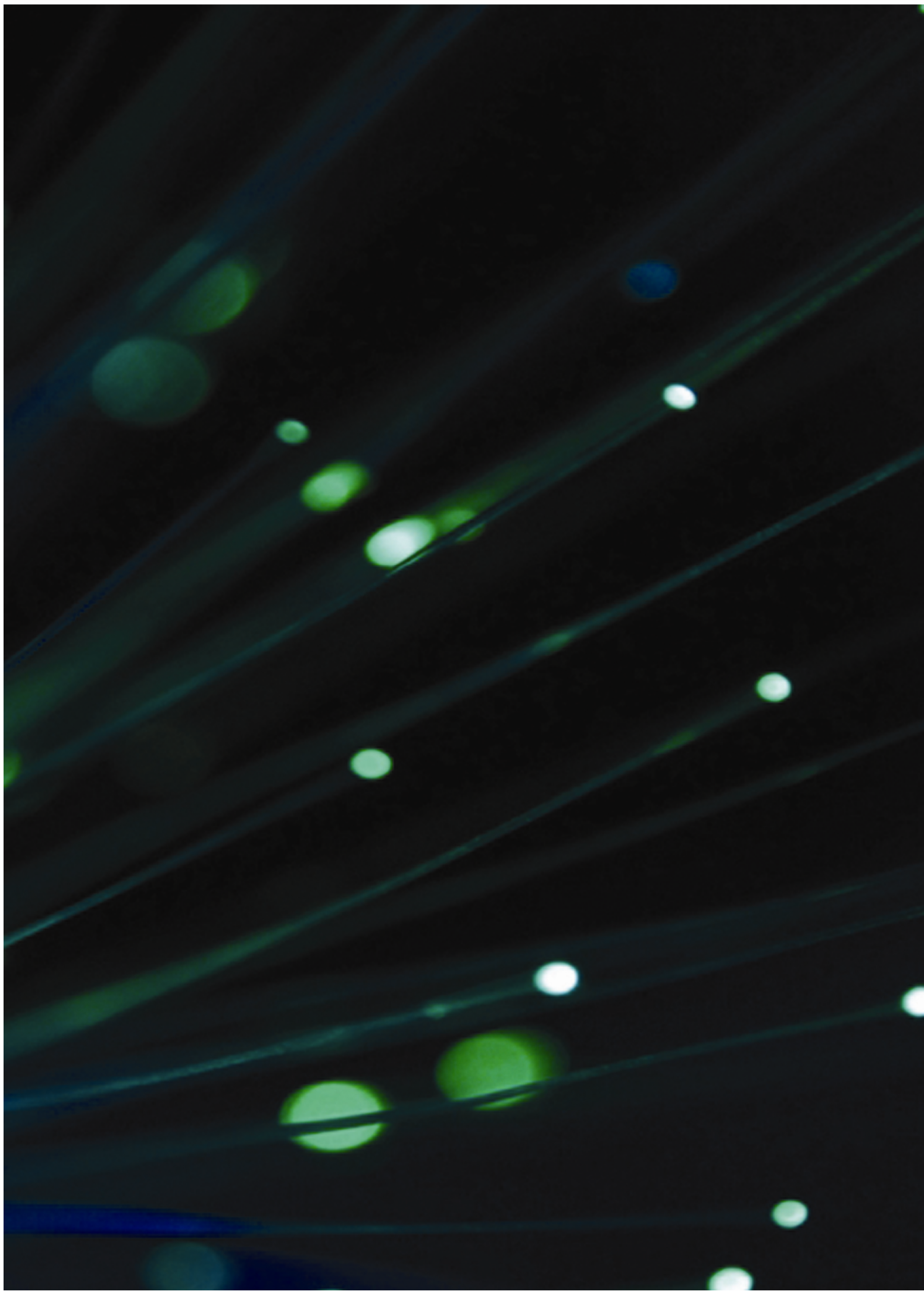
This is not a framework which sits easily with Keynes and his followers. Keynes tended to favour the present over the future (when we are all "dead"), and his followers have tended to prioritise consumption over investment. They emphasise "the paradox of thrift" – that private virtues of saving for the future undermine demand and hence current economic output, employment and growth prospects. They like "stimuli", and do not mind borrowing to maintain consumption.

Keynes famously remarked that practical men are the slaves of defunct economists. It is a remark which is particularly apt now. The task is not to hold up consumption. Rather it is to ensure that (higher) savings are translated into investment, to boost investment relative to consumption, and in the process drive up the savings rate. That investment needs to be concentrated on infrastructure in the widest sense, since it is the set of public goods which enables companies and consumers to function. It drives competitiveness as a result.

High levels of saving, and low levels of consumption are not barriers to growth. On the contrary, they can be argued to be necessary conditions for growth. The great expansions of Japan, and now China, are based on very high levels of savings. China is translating these surpluses into investment: Japan has arguably ceased to do so. In Britain, the last time our infrastructure was in very poor shape – in 1945, after the Second World War – the Attlee government did not set about expanding consumption. On the contrary, the state channelled savings into

investment. The challenge now is to repeat this reconstruction, howbeit primarily through private rather than public infrastructures. To do this, we first need an assessment of the damage. In 1945 it was fairly obvious. The bomb damage could be seen. Now it is less transparent – the damage caused by lax (Keynesian) fiscal policy and the failure to maintain the infrastructures is not in national accounts. Indeed a focus on GDP positively encourages its depreciation.

Bringing these themes together, a very different view of the economic borders of the state emerges than that favoured by Keynes. It is grounded on rules in respect of intergenerational equity, and it is set within a long term framework. In this sense it owes much more to Hayek. But it goes beyond both of their concerns – it includes an asset-based approach, with the public goods of the climate, biodiversity, social and physical infrastructure at the core.



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