Built on Sand

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A new paper by a group of influential right-wing thinktankers on Britain's economic stagnation has garnered attention from across the political spectrum. Labour should think twice before accepting its questionable analysis and recommendations.

> *'For every problem, there is a solution that is simple, neat, and wrong'*
>
> – H. L.Mencken.

A few pages into 'Foundations: Why Britain has stagnated'[1], Ben Southwood, Sam Bowman and Samuel Hughes write: 'Rapid economic growth is possible for Britain. Because what we get wrong is so mundane and straightforward'. Britain could experience this rapid growth if only we invested more in infrastructure and housing, and the simple reason we don't do so is because the state gets in the way. Liberalise the use of land, radically reduce the level of regulation, and the private sector would rapidly multiply the supply of housing, energy and transport infrastructure.

Plainly such views are finding resonance with the current government, with its growth agenda and its commitment to focus investment on housing and infrastructure. But do the claims made in the pamphlet add-up?

In assessing these claims the reader is faced with two kinds of obstacle, what we might call the procedural and the substantive. Procedurally, assessment is complicated by the fact that while sources are given for the data used in the paper, none are given for the many bold claims made in the text, so it is hard to know on what basis these are made. (Close referencing is also not helped by the lack of pagination).

Substantively, the problem of assessment is complicated by the framing of the argument in terms of economic growth. The authors offer a broad-brush case for the desirability of growth, in terms which will be familiar to anyone aware of the rhetoric of growth in British political discourse since the 1950s.[2] They do not address any of the critiques of this which have abounded since those made by Simon Kuznets at the very foundation of quantified growth estimates. These critiques are multi-faceted, but the one of most immediate political significance relates to climate change. For these authors, that problem is only discussed in the context of the decarbonisation of electricity, and the desirability of expanding nuclear generation. Broader issues about the meaning and sustainability of growth are ignored.

However, my primary concern here is not the problem of the growth objective, either as an overall way of thinking about the economy or as an immediate political objective.[3] Rather I intend to focus on the 'mundane and straightforward' obstacles to infrastructure investment, and the account of the economic history of Britain in which the claims about the present are embedded.

The key claim

The essence of the claim made in this paper is that 'higher investment in the UK is mainly frustrated by systems that effectively ban private companies from doing it (like building houses, infrastructure, and energy generation), rather than being down to short-sightedness by these businesses, or a lack of generosity by government'. This is Economics 101. Private investment flows to where returns are highest unless obstructed by government.

Of course, the real world is not so simple. Calculations about investment by privately-owned entities are embedded in complex institutional structures, and these institutions and calculations shift over time. Concretely, what has shifted the whole pattern of investment in housing and infrastructure over the last half century (alongside the decline in public investment), has been the financialisation of the economy. Often used as a vague descriptor of recent shifts, this term has a very precise meaning and consequence when applied to investment in infrastructure. As explained with great clarity by researchers working in the Foundational Economy tradition, the innovation of high-yield bonds and private equity holdings since the 1980s has raised the expectation of rates of return, so that the kinds of yields standard in much infrastructure are no longer deemed adequate. The result is a focus on cash extraction and immediate returns, in the context of ever more elaborate financial engineering.[4]

The best-known recent case of infrastructural investment failure in Britain, that of water and sewage, especially Thames Water, fits this analysis almost too perfectly. Financial engineering aimed at rent extraction from existing (publicly financed) assets is the well-established story of this case.

Another highly instructive case is railways. The authors of this pamphlet draw a contrast between the huge private investment in Britain's nineteenth century railways and the supposed sclerosis under post-war public ownership. According to them, only after privatisation was expansion once again possible. I will return below to the broader story about post-war public ownership offered here, but it is useful to look in more detail at the case of railways.

For these authors, nationalisation of the railways was clearly a failure: 'British Rail ran in 1994 a third as many trains between London and Manchester as did private franchises by the 2020s—overall passenger numbers fell steadily between nationalisation in 1994, after which point they have more than doubled'. This must count as a classic of misleading privatisation rhetoric. On the one hand, by the time of privatisation British Rail had in comparative terms low operating costs, having cut its number of workers by three-quarters since nationalisation and driven through major rationalisation (the Beeching cuts) and modernisation of the network. Its financial position had always been compromised by the use of rail fares to limit consumer inflation in periodic incomes policies, and the provision of *de facto* subsidies to industries using its services. But after privatisation public subsidies have remained very large, not only to the infrastructure provider (now Network Rail) but also to the Train Operating Companies. Indeed, one of these companies, Virgin Trains offers a nice example of the implications of financialisation. Having made a very small initial investment (it leased its trains) Virgin extracted £2.5 billion in state subsidy over fifteen years. Effectively, this represented the state taking on the risk allowing a one-way street to cash extraction for the company.[5]

Virgin, of course, operated on the London Manchester route cited by these authors. But the growth of traffic they note owed little to privatisation, and even less to nineteenth-century style entrepreneurial capitalism. The rise in passenger numbers mostly reflected general GDP growth and the evolution of commuting patterns induced by London house prices. Moreover, Virgin would have laughed at the sub 5 per cent returns typically earned on Victorian railway investments.

The housing history narrative presented here is similar: one of a thriving largely private-sector housing market flourishing up until the Second World War, until fatally inhibited by the Town and Country Planning Act (TCPA) of 1947, which gave Britain 'the most restrictive development control system in the world'. In their view, the 1930s housing boom in particular, demonstrates the possibilities when housing is untrammelled by serious state regulation. As David Edgerton has pointed out however, this portrait of the 1930s relies partly on a statistical sleight of hand: the unfavourable contrast they draw between the experience of the 1930s and the 1960s is based on using the ratio of houses built to the existing stock, which inevitably puts the 1930s in a better light; if one instead looks at total numbers of houses built, the figure for the 1960s exceeds that of the 1930s – despite the TCPA.[6] What is most striking in the long-run housebuilding statistics is the collapse of local authority building since the 1970s, only very partially compensated by housing association starts. To claim that 'since the introduction of the British planning system in 1947, there has been very little increase in housing supply when better jobs make an area more desirable' is an exaggeration, to say the very least.

Thatcherite history

The authors tell a broadly Thatcherite story about Britain's economic history, with the Attlee government imposing a statist regime which inhibited economic performance until the liberalising reforms of the Thatcher period came to the rescue. The added twist here is that the Thatcher government failed to liberalise the rules on land use, hence the infrastructure problems of the present period. What we need is more Thatcherite reform.

Thatcherite narratives about Britain's economic history face a problem of periodisation. If the key moment of malign development, of economic 'decline' and failure was either the Attlee government or the 'consensus' of Butskellism of the 1950s and 1960s, what story is to be told about the inter-war years? These obviously came before the dark years of statism but are nonetheless widely regarded as years of economic failure.[7]

In the face of this problem, the authors of 'Foundations' resort to re-inventing the 1930s as a period of prosperity, the time of 'a British economic miracle', based on proto-Thatcherite reforms: 'Conservatives are the traditional party of business, and in the 1930s and 1980s they pushed through reform programmes that successfully renewed Britain's economy.' Furthermore, the housing boom 'was the key reason we didn't experience a Great Depression while Germany, the USA and France did'.

This is misconceived in all sorts of ways. Britain suffered a sharp depression in the early 1930s, with unemployment rising to over three million in 1932. Britain's recovery was faster than many countries in part because having a very small agricultural sector was a great advantage when globally that sector was hit disproportionately hard by the decline in prices and incomes. Britain, along with several other countries, also rebounded more quickly because of the abandonment of the Gold Standard in 1931, which allowed monetary policy to be used for domestic purposes, rather than for defending the exchange rate. The departure from gold was resisted by the Bank of England and the government, so the ensuing low interest rates were arrived at accidentally, rather than as any kind of strategy. Those low rates were important in fuelling the housing boom, though falls in building costs and changes to building society lending rules also played a significant role. There was no economic miracle, and insofar as the recovery was the result of the housing boom, it was not the consequence of a well-conceived Conservative policy as much as the accidental impact of the collapse of the Gold Standard.

Finally, it is of course the case that economic recovery in the 1930s was highly regionally variable. In the areas of concentration of the 'old staple' industries across much of Northern England, South Wales and central Scotland, mass unemployment endured until the rearmament boom right at the end of the decade.

The pamphlet gives a standard Thatcherite account of the Attlee period, with, as noted, extra emphasis on the TCPA. The broadest claim is that 'the reforms of the late 1940s, largely [sic] under Clement Attlee's governments caused Britain to grow more slowly than any other major European country and the US until the mid-1980s'. This is largely mistaken. Even those who are sceptical about many of the policies pursued in early post-war Britain have recognised that what was happening after 1945 was Western European countries catching up with the richest industrial countries at the end of the war – Britain and the USA.[8] Western European countries in this period were shedding enormous numbers of workers from their agricultural sectors (as Britain had done in the nineteenth century) and shifting them into much higher productivity industrial jobs. This was the process of convergence, which in other contexts the authors seem to recognise as operating to allow 'followers', under favourable conditions, to catch-up with 'leaders' in the growth process.

Talk of 'low' growth in the post-war years serves to obscure the fact that the 1950s and 1960s were years of the fastest sustained GDP and productivity growth in British history. They were also years of fast-expanding investment, as the graph on 'investment as a share of GDP' clearly shows the ratio rising from around 18 to 22 per cent of GDP between 1960 and the early 1970s. This boom was sharply reversed in the 1970s, but prior to that we can reasonably talk of a 'golden age' of macroeconomic performance, with low inflation, low unemployment and the best ever sustained rise in living standards. Perversely, this was when talk of British economic decline started to proliferate, but this had more to do with contemporary politics than a rounded view of economic performance.

That point is particularly strong when we compare those years with what has come afterwards.

Of course, the central Thatcherite claim is that after years of 'decline', after 1979 the Thatcher government so reformed the economy that its performance markedly improved. Again, such a perspective is deeply problematic. In the short run, helped by global forces, the Thatcher government delivered a sharp fall in inflation, but at the cost of gravely exacerbating the global deflationary pressures, especially through highly adventurist monetary policies and their effect on the exchange rate. The result was a historically unprecedented appreciation of the real exchange rate, with devastating effects on the tradeables sector.

In longer run perspective the economy in the 1980s recovered from the serious problems of the 1970s, but the growth trajectory was one of a return to the trends of the 1950s and 1960s, rather than some new pattern. That was the trajectory sustained through the 1990s, up until the onset of the Great Financial Crash of 2007/8. In short, claims about a Thatcherite 'miracle' are grossly exaggerated. Like so much discussion of the development of the British economy, it is over-determined by contemporary political claims. It suited both Thatcherite Conservatives and New Labour to use the problems of the 1970s to construct a story about the supposed failures of the whole post-war period and base their rhetoric on a rejection of the supposed malign example of the post-war consensus.

The role of the public sector

Returning to more specific criticism of the post-war settlement, the authors claim that 'the British state chronically failed to invest in the various companies it had nationalised, succumbing to the permanent temptation of politicians to allocate resources to frontline services (i.e. immediate consumption) rather than investing for the long term'. Unfortunately, the authors do not give any examples of the 'companies' they have in mind when making this claim.

The industries nationalised in the 1940s were viewed by Labour at the time as the 'commanding heights' of the economy, but in the main they turned out to be declining industries. So, in the long run the new public corporations largely engaged in managing this decline. This is especially the case in the two industries with by far the largest number of employees when nationalised (coal and the railways, each with six-to-seven hundred thousand workers), where the question of the right level of investment was especially fraught. However, despite their declining status and the huge job losses that came with it, both industries were extensively modernised under public ownership; in neither case was their decline a result of under-investment.

More broadly, public sector investment was substantial throughout the 1945-1975 period, peaking in 1967/8 at 7.6 per cent of GDP.[9] This was partly because of the nationalised industries, and the scale of public sector housing. Leaving aside railways, public sector investment in infrastructure was important, with heavy expenditure including in water. Contemporary claims by water companies that they are hindered by their 'Victorian' heritage are significantly exaggerated. There was lots of renewal of water and sewage systems in the 1950s and 1960s. Huge investments were also made in nuclear power plants (despite their uneconomic character). Overall, 'between the 1950s and 1970s and 1980s, roads, pipes, electricity lines and bridges were built on a vaster scale and faster than the railways of the Victorian age'.[10]

It is true that from the mid-1970s the scale of public sector investment fell sharply. This was partly the result of privatisation and the almost complete ending of public sector housebuilding, in the wake of the sell-off of council houses. But it did also reflect the political pressures on state spending overall following the 'fiscal crisis' of the 1970s, with current spending increasingly crowding out investment. Privatisation and council house sales effectively meant the transfer of assets built-up by public spending to private individuals and corporations, often on advantageous terms.

Where to Start

Neither the general stories told about British economic performance, nor the more specific accounts given of the history of infrastructural development provide an accurate basis for the diagnosis offered by 'Foundations'; 'Thatcher-plus' is not going to solve the problems identified.

Embedding the discussion of sectoral problems in issues of growth and productivity is a major hindrance. 'Economic growth' as an unexamined panacea is not a useful starting point. For example, one reason most social democrats have been so keen on promoting growth is because of the belief that rising GDP readily transforms into increased taxable capacity, offering a painless route to higher tax and spend. But this relationship is complicated by the question of to whom the extra income accrues and ignores other changes in the economy.

Britain in the 1980s saw an upward surge in income inequality, and since then an even more persistent increase in wealth inequality. The rise in income inequality means that there is more resistance to the broad-based tax increases at the middle and lower ends of the income distribution which sustained the post-war settlement. The way in which the current government boxed itself in before the election by ruling-out any tax increases on 'working people' reflects a perception in Labour circles that there are powerful political constraints on taxing the mass of the population that are unlikely to be overcome unless incomes for that group rise substantially. But deindustrialization and the polarization of incomes it has brought about means that even if overall growth increased, it is far from clear that much of the benefit would accrue lower down the income scale.

Much of the limited rise in GDP in recent years has accrued as income at the top end of the distribution but also been turned into large capital and wealth gains for the same sector of the population. This means that, in principle, taxable capacity in the form of accumulations of wealth have risen at a pace largely detached from the growth rate. As a result, potential tax revenues now depend less on economic growth than on the political and technical feasibility of taxing current wealth stocks.

Similarly, the 'British productivity problem' is a venerable trope, whose existence was first identified by the Anglo-American Council on Productivity in the 1940s and has remained as a problem without a solution ever since. It is not clear what focussing upon this 'problem' in the abstract means given the heterogeneity of conditions which govern such productivity, both within and between sectors.[11]

But we don't need to engage with these framings of 'the economy' to make the case for increased housebuilding or better infrastructure. We can make the case on more straightforward specific grounds without invoking the grand, deeply problematic, (and often tedious) narratives of national failure and success.

For housing, the case is simply that need, for a significant part of the population, has outrun affordable supply, and that affordable housing is a key component of household welfare. The high cost of housing bears particularly hard on the real incomes of the poorest households.[12] Similarly, infrastructure such as internet access and affordable transport are key parts of the 'foundational economy' upon which everyday welfare relies. In discussing how to achieve improvements in these things, *not* invoking the discourse of national economic performance helps us to escape the simplistic nostrums which always come into play when that performance is debated. Most obviously, in the context of 'Foundations' we can cast aside the Manichean 'private enterprise versus public control', as an obstacle to understanding.

The simple claim that privatisation plus deregulation is the route to infrastructural renewal is, as noted above, fundamentally challenged by the well-known case of water. But there are other, less well-known cases, where the role of ownership is by no means straightforward. Digital roll-out is an especially interesting example, because it is the responsibility of BT, widely seen as an example of the benefits of privatisation. It is undoubtedly the case that by the 1970s telecommunication investment, especially in automated exchanges, was obstructed by the then public ownership of the network. Overall public spending policy led to intransigent Treasury resistance to the investments required. Privatisation opened up new investment sources, and in the decade after 1984, mechanical exchanges were replaced by digital exchanges. But, *contra* 'Foundations', this transformation was not evidence of the general benefits of throwing off the shackles of the state. Rather, it relied on the very specific effect of the technical change to make possible the shedding of labour on a huge scale and thus cut costs and boost profits for BT. Thus, in these very particular circumstances, the demands of the 'financialised' corporation could be met. But there are no such easy financial wins with broadband roll out, so investment has been low, the process has been slow, and the quality and reliability of the installation poor. [13]

There are some elements in this pamphlet which partially escape the entanglements of the simplistic overall framing – examples of 'the rational kernel within the mystical shell'. Most important is the argument about how far local control of infrastructure development may yield better outcomes than national. While the discussion here is still embedded in fantasies about Victorian success versus modern failure, it does usefully suggest that local (and regional) control and funding of projects is both better able to mobilise local support but also incentivise tight cost control. Unfortunately, this theme isn't pursued in great depth, and clearly it doesn't apply to all infrastructure. But it provides the starting point for a significant argument.

Adoption of the Thatcherite, anti-state narrative by Labour is potentially seriously damaging. As suggested above, it rests on an inaccurate and simplistic account of Britain's economic history and therefore cannot be the basis of successful policy. Rather than being over-regulated, recent decades have seen the hollowing-out of many of Britain's regulatory agencies. Many of them need reforming and strengthening.

But the problem goes beyond the need to resist unhelpful binaries of less state/ more state. Once the narrative becomes about growth these binaries are almost locked-in to the discourse, so embedded have they become. So the challenge is to frame economic policy in a different fashion. Here the 'good jobs' focus of the work of economists like Dani Rodrik and his collaborators, while no panacea, seems to offer a far superior starting point that avoids the pitfalls of thinking in terms of growth and the obstacles to its achievement.[14]

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Notes

1. Ben Southwood, Samuel Hughes, and Sam Bowman, 'Foundations: Why Britain has stagnated', https://ukfoundations.co/, 2024.
2. Jim Tomlinson, 'Imagining economic growth in post-war Britain' *Twentieth Century British History* No 34, 2023, pp754-779.
3. On the latter: Jim Tomlinson, 'Growthmanship in the twenty-first century', *Political Quarterly* ,Vol 94 No. 4, October/December 2023, pp634-641.
4. For a summary of these arguments see The Foundational Economy collective, *Foundational Economy. The Infrastructure of Everyday Life*, Manchester University Press, 2022, pp44-85; for more depth, see Julie Froud, Sukhdev Johal, Adam Leaver and Karel Williams, *Financialization and Strategy. Narrative and Numbers,* Routledge, 2006.
5. The Foundational Economy collective, op cit, pp73-76.
6. David Edgerton, 'Don't be seduced by the myths of the economic right', https://www.newstatesman.com/, 8 October 2024.
7. For the varieties of declinism, and their periodisation, see Jim Tomlinson, 'Thrice Denied: "Declinism" as a Recurrent Theme in British History in the Long Twentieth Century', *Twentieth Century British History* No 20, 2009, pp227-251.
8. Nicholas Crafts, 'The golden age of economic growth in Western Europe 1950-1973' *Economic History Review* No 48, 1995, pp429-447.
9. Martin Chick, *Changing Times. Economics, Policies and Resource Allocation in Britain since 1951*, Oxford University Press, 2020, p29.
10. David Edgerton, *The Rise and Fall of the British Nation. A Twentieth Century History*, Penguin, 2018, p299.
11. Julie Froud, Colin Haslam, Sukhdev Johal and Karel Williams, '(How) does productivity matter in the foundational economy? *Local Economy* No 35, 2020, pp316-336.
12. Alex Clegg and Lindsay Judge, *Housing Outlook Q4 2024,* Resolution Foundation, December 2024.
13. Andrew Bowman et al, *The End of the Experiment? From Competition to the Foundational Economy*, Manchester University Press, 2014, pp29-56.
14. Vidit Joshi, Huw Spencer and Dani Rodrik, *Creating a Good-Jobs Economy in the UK, Economy 2030 Enquiry*, Resolution Foundation, London, 2023.