Brexit and Beyond

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The Brexit vote represented, in the most part, a public reaction against radically increased material insecurity, frustration with political elites seen to collude with international business at the public expense, despair of public services wreathed in regulatory red-tape and perverse decisions and, finally, austerity. And yet the root of these phenomena with which the EU became associated can be traced back not to Britain’s accession to the then EEC in 1973, but to the state reforms initiated at the national level within liberal market economies over the past 30 years. Indeed, within Europe, Britain has been at the forefront of these reforms, initiated by Margaret Thatcher’s Conservative governments during the 1980s. To the extent that the case for Brexit was built on the claim that the EU alone was the root of these evils it should be understood as a tragic exercise in misdirected blame, particularly since, insofar as the EU became increasingly supportive of these reforms, it did so directly at the behest of successive UK governments. If the Brexit vote was largely based on opposition to these policies then it is diagnostically important that these phenomena be traced back to their original source in the state reforms of the past three decades, which is the aim of this chapter.

Over the last 30 years liberal market economies have transformed the character of their states through privatisation, outsourcing, internal managerialism and agencification, and through the rejection of interventionist industrial policies and the development of ‘quasi-markets’ in welfare provision. These changes have been pursued in parallel to increasingly ‘competitive’, market-conforming tax and regulatory regimes that at the same time reduce the social requirements on corporate capital. These measures have been driven by the dominant
New Right diagnosis of the economic and state crises of the 1970s, justified by the analysis of the public choice or ‘supply-side’ school of economics aligned with the Chicago School. This diagnosis said that the self-aggrandising and bureaucratic ‘Leviathan’ state was essentially to blame for these crises, rather than other factors such as technological change, the Nixon shock, the end of Bretton Woods, the oil crises or conflicting craft unions. However, far from producing better government for less money, these pro-market state reforms have caused a new crisis of ungovernability that is far more profound than the original.

The problem is that very few supply-side reforms have worked on the terms by which they were publicly validated. Instead they have created new organisational pathologies that have served to aggravate rather than reduce the social polarisation resulting from de-industrialisation in the 1970s and the liberalisation of capital movement after the 1980s. Capital mobility and technological change spurred the growth of multinational companies and these have in turn found increasing scope for deploying regulatory and tax arbitrage between newly competing, rather than coordinating, states. Not only have state reforms failed to deliver a more efficient state and more socially inclusive economic growth, but the unprecedented increase in the porosity of these states to business involvement has enabled more political corruption and conflicts of interest. This has created the most damaging possible scenario for democratic capitalism. In this situation the mainstream political elites are seen to instrumentalise the powers of the state for party political or even private gain while simultaneously withdrawing its protections from the public.

If we look back through the last 30 years we have a history of increasingly bi-partisan efforts towards the marketisation of the state in accordance with supply-side orthodoxies that hold most of the modern functions of the state to be suspect. New Labour reversed multiple Thatcherite reforms but critically, over successive governments, it opened up welfare services to taxpayer-funded private providers on an experimental basis while moving more wholeheartedly towards regulatory and tax competition, leading a social democratic shift in the same vein in much of the rest of Europe. New Labour saw in the creation of a mixed-market state the possibility of combining wealth creation with greater efficiency and responsiveness in public service provision: that consumer choice would keep the middle classes attached to the welfare state. But with the end of the social democratic veto on private provision for public goods the route was opened for the massive extension of these reforms by subsequent right wing governments in which supply-side thinking increasingly dominated.
Unfortunately the assumptions behind supply-side criticisms of the modern state are fundamentally flawed for at least two reasons. Firstly, this critique of the state is based on an abstract, super-reductionist understanding of really-existing states. Supply-siders see the state as equivalent to a monopoly business firm or cartel, with radically dispersed and hence inattentive shareholders (read: voters!). In this approach the monopoly or cartel has become the presiding stylised fact in deductive modelling of the state and its sins (Brennan & Buchanan 1980; Niskanen 1973; Tullock 1965; Dunleavy 1991). With these extreme normative working assumptions the state is depicted as being doomed to operate with all the negative tendencies of a monopoly, such as exploitative price-making, parasitic rent-seeking and general budgetary greed and institutional complacency and inefficiency. Clearly, if you conceive of the state in this narrowly economistic way then the only rational solution is to break up the monopoly wherever possible and subject it to market forces, but the argument is circular rather than empirically founded.

The second flaw in supply-side reasoning, even if you find purchase in the diagnosis, is the failure to anticipate the practicalities of marketising the really-existing state. As a different body of economic theory – namely, of contract and property rights – warns, the higher the complexity of a good or product the higher the risk of ‘asymmetrical’ contracts in which the seller has more information than the buyer and hence has built-in opportunities to exploit that buyer (Barr 2015; Hart et al. 1997). Transaction cost theory, which considers the ‘friction’ costs of contractual negotiation and compliance, shows that trying to manage such contracts leads to massively increased costs (Williamson 2002). These costs can hardly be rendered efficient because of the intrinsically unbalanced nature of the original contract (Baker et al. 2002, 41). The analogy between state and firm also elides the fact that a failed firm reallocates labour and capital resources in a way that is painful in the short term, whereas a failed state collapses the main mechanism for social integration and public order per se (Shaxson & Christensen 2016).

The vast majority of the tasks and goods provided by modern states violate most of the preconditions for efficient markets, such as perfect information between buyers and sellers, no external effects not priced in the original transaction (‘externalities’) and no interdependencies between buyers and sellers. As Hans Werner Sinn remarked of regulatory and tax competition between states, ‘since governments have stepped in when markets have failed [historically], it can hardly be expected that a reintroduction of the market through the backdoor of systems competition will work. It is likely to bring about the same kind of market failure
that brought about government intervention in the first place’ (Sinn 1997, 249). And indeed it has, but in the meantime the now profoundly ‘hybridised’ UK state has developed distinct pathologies of its own.

The supply-side theory of the state as a scheming Leviathan anticipated nothing about what would happen when marketisation of the state necessarily failed to produce a competitive market as a result of the nature of the goods and services it provides. After 30 years the evidence suggests that introducing choice and competition into the state and between states produces the worst, rather than the best, of both public and private regimes. In the case of tax and regulatory competition, the largest, wealthiest firms in particular have increasingly escaped their share of the fiscal contract via a race to the bottom on rates, standards and enforcement. They have also pushed the burden for continuing taxation onto less mobile factors such as labour and small- and medium-sized enterprises, while producing no evident compensatory dividend in greater productive investment or increased growth (Shaxson & Christensen 2016). In the meantime, the evidence for the profound market and regulatory failures behind the global financial crisis is comprehensive. In the case of welfare, the norm has become one of profit-seeking firms engaged at the tax-payers’ expense but in thoroughly non-competitive conditions which force the state into Kafkaesque games of regulatory catch-up because of its ongoing statutory responsibility for outcomes. These are textbook scenarios for ‘moral hazard’, in which private providers have few incentives to avoid risky or perfunctory behaviour because of de facto (publicly funded) insurance. And of course such hazards existed in theory in the vertically integrated state, but with fewer transaction costs, minus the profit motive and (whisper it) offset by a vocational sense of public service.

Today’s taxpayer-funded quasi-markets in welfare and public service provision are characterised either by highly fragmented systems, such as the poorly regulated private trusts with low economies of scale seen in Academy schools, or by public service industry oligopolies, with the necessary conditions for efficient competition a rarity. Public service companies like G4S, SERCO and Capita have a proven tendency to sweat the guaranteed public funding while only producing ‘satisficing’ – that is to say perfunctory, low-quality – performance within hard-to-monitor contracts, which explains the higher costs, lower service quality and increased regulatory oversight of the services in question. Moreover, this oversight is largely doomed to ineffectiveness because the most important activities in schools, prisons, hospitals, etc. cannot be codified, and
attempts to codify them increase transaction costs whilst incentivising behaviour towards box-ticking at the expense of the core but uncoded tasks. Even the quickest study of Communist central planning would have warned supply-siders that overbearing regulatory control and sanction creates multiple systemic informational and organisational distortions and contributes to professional demoralisation.

The problem, which is relatively hidden from the service-using public, but which is equally serious, is that the increasing role for private businesses is replicated throughout the entire state administration. This has caused extensive administrative and informational fragmentation and hence, again, those increased transaction costs. After a sabbatical in the Cabinet Office, Matthew Flinders argued that institutional fragmentation and the bureaucratic Taylorism of agencification had ended the capacity of UK central government to operate ‘meta-governance’ over state authority (Flinders 2008). But this process of disintegrating state capacity has only intensified after 2010 and 2015 under the supply-side policies of the Conservatives. The process of Brexit is going to reveal how critically weak the capacity of the UK state has become.

According to one of the very few studies that evaluates these reforms over the long term, Ruth Dixon and Christopher Hood find that reported administration costs in the UK have actually risen by 40 per cent in constant prices over the last 30 years, despite a third of civil service numbers being cut over the same period, whilst total public spending over the same period has doubled. Most significant of all, they find that running costs have been driven up the most in the outsourced areas. Service failures, complaints and judicial challenges have at the same time soared (Dixon & Hood 2015). This is in no respect the ‘better government for less money’ heralded across the political aisles.

The UK is now experiencing a crisis of supply in social care and in the NHS and an unprecedented recruitment and retention crisis for doctors and teachers. Indeed, one recent YouGov poll showed that over half of the UK’s teachers contemplate leaving the profession within the next two years (Boffey 2015). These shortages are exacerbated by the new ambiguity surrounding the immigration status of EU nationals and the rate of EU nationals leaving the NHS has already accelerated sharply since the referendum. UK trains are roughly six times more expensive than those on continental Europe (Khan 2017). The UK recently saw the worst prison riot in decades at the G4S-run HMP Birmingham. UK prisons now have the highest suicide rate since records began (BBC News 2017). But not only do these reforms repeatedly fail to deliver on their promises, they have also undermined the democratic
accountability of the state by undercutting the government’s ability to reverse failing or unpopular policies. State autonomy is undermined when authority is given to unaccountable and poorly regulated private business actors on long-term and highly informationally asymmetric contracts. The National Audit Office, for example, has declared the financial statement of the Department of Education to be unsafe and unsound for the second year running (National Audit Office 2017). At the same time, via the creation of Academy Schools, parents have lost their legal rights of redress in a system that performs more poorly on the gaming of league tables and on exclusions and attainment for disadvantaged students compared with Local Education Authority (LEA) maintained schools, because the legal contract now stands between the Secretary of State and the legally private institution of individual Academy Trusts, of which there are now thousands. In the meantime, supply-side reforms have created major business interests in the perpetuation of these policies and increased the structural dependence of the state on individual businesses. It is hard to imagine a system more productive of a popular perception that political elites collude with business at the expense of the public interest. But since the leading Brexiteers are also the strongest exponents of these already failed state reforms, that sense of public disillusionment may actually worsen once they deepen these practices and the EU is no longer available as the target of frustration. However, there is a serious risk that other more xenophobic and less potentially constructive narratives will be brought into play first.

So why isn’t there a public debate about the systemic crisis of the state, as occurred in the 1970s? One reason is that this crisis does not fall neatly between party lines as it did in the 1970s. The expressive function of the main parties is not aided by the fact that all the most powerful actors in this system, from the political parties to large public industry corporations and the City, are implicated in its creation. Nor is an effective party political debate encouraged by the fact that business representatives now form some 30 per cent of senior civil service appointments, constitute the majority of non-executive board directors in every department, and can be brought in as special policy advisors through a revolving door that now spins – without serious regulation or sanction – both in and out of government. The system of party political finance in this context has become a political economy of its own.

The double standards are stark if one compares the relentless criticism of Britain’s failing industrial corporatism in the 1970s to that of the corporatist relationship between the City of London and the UK Treasury, though the City’s neglect of national developmental needs is
an entrenched historical tendency (Crouch 2005, 146–7). If warring UK craft unions were a restraint on UK productivity in the 1970s, then why is there no equivalent outcry today over the fact that tax and regulatory competition have contributed more evidently to the financial crisis and the financialisation of firms than to either their improved productive capacity or innovation potential? And why are the City and the Treasury not deemed unhealthily close when this relationship produces a dystopian vision of the UK as a tax haven (Withnall 2017)? Even if supply-side reforms had not built so powerful a constituency for their extension it would be politically awkward for mainstream parties to call for actively rebuilding the state after so many years of insisting on its comparative inefficiency. But that criticism was only ever coherent in the light of the analogy between state and firm: an analogy that not only ignores the historical role of the state in making and sustaining markets but also the entire body of behavioural economics regarding the theory of firms that questions their profit-seeking efficiency, and understands them as complex institutions prone to internal opportunism and contractual failures.

Is it any wonder, then, that those with the poorest life chances in this economy in particular despair of mainstream parties? It is the populists alone who have said ‘we feel your pain’. The trouble is that the UK’s populists argue that the voters’ problems have been caused exclusively by the EU. The more glaring truth is that many voters are disappointed because mainstream UK parties – sometimes aided, sometimes countered by EU policy – have, over the last 30 years, made the state both an inefficient public regime and a poorly performing market. Indeed, they have succeeded only in creating a chaotic hybrid state that is now prone to all the rent-seeking and exploitative behaviours, along with byzantine and bureaucratic attempts at regulatory catch-up, which supply-siders are supposed to abhor. But on these failures the supply-siders have had nothing consequential to say. As for the main opposition party, in the continuing absence of a coherent analysis of why supply-side reforms have failed, Labour leader Jeremy Corbyn looks like a time traveller from the state crisis of the 1970s, while the Blairites just look guilty.

One of the most remarkable ironies of Brexit is that it is the supply-siders who are now in the driving seat who have done so much to discredit the efficacy of the state and, by extension, its executive, while passing the blame largely onto the EU: if we were looking for appropriate culpability then exactly the wrong faction won. If you consider the politics of Michael Gove, Iain Duncan Smith, David Davis or Boris
Johnson in the UK, these are supply-side militants still determined to disintegrate the institutions of the state and rent out its authority to the private sector.

The persistence of supply-side reforms in the face of their demonstrable failure is consequently profoundly politically dangerous as well as socially damaging. Ironically, though predictably, these failures will be intensified under any Brexit outcome engineered by the chief exponents of supply-side reform. In the short term, it is hard to be optimistic. It is not clear how this trend to political polarisation can be reversed without a radical shift in the political economic paradigm, since the UK production regime, like that in the USA, offers up an increasingly divergent set of social interests. The knowledge economy encourages a dramatic shift in the producer coalition landscape and the welfare regime that it favours. There were distinct patterns in the Brexit vote and the 2016 US election of divergent voting preferences between the centres of the new knowledge economy – rooted in ICT and services – and those of the rural, industrial and mid-range technology economies. These trends support a worrying thesis (Schwartz 2017), which is that there are deepening structural divisions in advanced capitalist economies between those higher educated voters who feel able to self-insure in minimal or failing state conditions, and therefore prefer the dynamism of highly liberalised economies, versus those with little hope of achieving a stake in that system. Such massive social polarisation, particularly in a majoritarian electoral system, is inimical to compromise, consensus and democracy.