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PM'S IN-TRAY

# THE SOCIAL MARKET AND ITS ENEMIES

## A philosophy for Brown?

**David Lipsey**

The Social Market Foundation attracted an excellent slate of candidates when Philip Collins resigned as director to work for Tony Blair at Number 10, and my board colleagues and I had a stimulating time interviewing them. One in particular spoke fluently about public service reform, privatisation, tax and spending, and regulation, and for a moment, I struggled to think why we could not appoint him. The answer, when it came to me, was blindingly simple. He was not a social marketeer! That is to say, his views, coherent and well articulated though they were, were not a set of views that a believer in the social market could possibly hold.

It has to be said that the SMF has not always been so successful in preventing permeation by those who are not truly of the faith. I also recall a piece by a member of staff in our monthly newsletter. It spelt out, quite coherently, the problems with the bus industry in a deregulated environment, problems caused by a variety of examples of market failure. And then the author put forward her solution: a national bus authority. That was it! Bring in the state and all would be well.

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First published by
The Social Market Foundation,
May 2007

The Social Market Foundation
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London SW1P 3QB



Design www.jadedesign.co.uk

**The Social Market Foundation**
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That was an extreme example, but Ann Rossiter, Philip's eventual and able successor, tells me that it reflects a common experience for her. Though the SMF recruits only the best, those who join us do not always have an instinctive appreciation of how social marketeers think. This is probably because they have never been taught.

When they asked how they should remedy this, we have tended to refer them to a paper by Robert Skidelsky. Robert (now Lord) Skidelsky, the biographer of Mosley and Keynes, was the SMF's long-time and brilliant chairman. His first paper for the SMF, *The Social Market Economy,* published in 1989, remains the most coherent statement of its philosophy.[1]

Skidelsky was writing at the height of the penetration of pure market economics into the intellectual community, and it is no criticism of his paper that, over 17 years later, his views seem unfashionably pro-market. Things have moved on (and so has Skidelsky, who resigned from the Conservative Party in 2002). His remains, however, the outstanding short statement of social market philosophy, and is therefore the starting-point for this essay.

1 R Skidelsky, *Social Market Economy* (Social Market Foundation, March 1989).

# 1. THE SOCIAL MARKET IN BRITISH POLITICS

The 'social market' is an ugly phrase, from which it is possible to deduce its intellectual origins. It is a German concept, perhaps with its roots in Bernstein's revision of socialism in the early part of the 20th century.

Post-World War Two Germany was in the market for an animating philosophy to replace Hitler's totalitarianism. It was Ludwig Erhard who deserved credit for finding this in the social market, which soon became the creed of the German Christian Democratic Union (CDU/CSU). However, it did not remain its exclusive franchise. In 1959 at Bad Godesberg, the Social Democratic Party abandoned the last of its quasi-Marxist inheritance. It too became a party of the social market, though not of course exactly the same social market as that of the right. Tripartism and trade union rights naturally mattered more to the SDP than they did to the CDU.

British politics, unlike German, instinctively distrusts the abstract. In retrospect, however, British politics, halfway between the war and now, veered outside the social market framework. Under Harold Wilson, from 1974 to 1979, there was too much social and too little market. The Wilson government's animating spirit was the 'social contract' with the trade unions, which (in retrospect) was a contract that meant that the government gave the unions what they wanted and the unions gave not much back. Under Margaret Thatcher, from 1979 to 1990, the fault was reversed, with too much market and too little social. Lady Thatcher had her remarks twisted when commentators rounded on her for saying that there was 'no such thing as society'. That discounted, however, she seemed to lack a feel for the vital importance of the intermediate institutions that lie between the family and the marketplace.





In this unpromising climate, in 1989, the Social Market Foundation chose the most unpromising soil in which to grow. It was the brainchild of Skidelsky, and funded by David (later Lord) Sainsbury. Both were associated with the Social Democratic Party (SDP). This was a rump groupuscule of the extreme centre, led by David Owen, a former foreign secretary.

The majority of the original SDP had voted to merge with the Liberal Party to form the Liberal Democrats. Owen, and a faithful few, stood aloof. Pungent personal rivalries existed between the majority of Lib Dems and the minority of SDPers. But the Owenites could not rest their decision to split from the Liberals on personality, and therefore understandably found it necessary to create a rival ideology to liberalism. Social democracy in its modern British incarnation was the result.

The Owenite SDP was soon history; but the subsequent party-political trajectory of the SMF is instructive. Daniel Finkelstein, the SMF's director under Skidelsky, converted from Owenism to Conservatism, subsequently becoming the director of the Policy Unit at Conservative Central Office. His successor, Rick Nye, followed his lead. The SMF retained an essentially right-of-centre political affiliation until the New Labour hegemony.

However, the last three directors have all been New Labour, though not all the same kind of New Labour. Collins' libertarianism, for example, contrasts quite sharply with Kath Raymond's populism and Ann Rossiter's determined empiricism. As chair, my personal views are eclectic but my party allegiance in the Lords is to Labour. Our board includes sympathisers with all three main parties, and never yet have we divided along party-political lines.

For, whatever the party allegiance, a consistency of thought lies behind the bulk of SMF publications and thinking. Here are some examples:

1. We believe in markets, but we believe that markets and their operation cannot be divorced from the social context within which they operate. John Kay shows in his important book, *The Truth about Markets,*[2] that what he calls the 'American business model', the pure free-market model, neither accords with the reality of how markets function, nor provides optimal social outcomes. This is, perhaps, the outstanding change in the political consensus since Skidelsky's seminal essay.

2. We believe that there is such a thing as market failure, and that it can be so serious that it has to be tackled. However, we are equally conscious that there is such a thing as state failure. Historically, state failure has been more damaging to nations than market failure has ever been, since state failure tends to be on a large scale and market failure on a smaller scale. Wherever possible, therefore, we believe in tackling market failure where it occurs by market mechanisms: tax the polluter, not ban him.

3. Similarly, we believe that there is a role for the state, which need not necessarily be narrowly drawn. For example, the provision of education is essential for efficient production. There is good *a priori* reason to think it will be underprovided if people have to fund it for their own children. They will have no reason to weigh what economists call 'externalities', that is, the benefits to society as well as the benefits to the individual child. Less obviously, the social value of education will predispose most social marketeers in favour of an equal opportunities/life chances agenda, since this will tend to maximise the yield (at least in economic terms) that society gets from its given endowment of talent.

2 J Kay, *The Truth About Markets: Their genius, their limits, their follies* (Allen Lane, May 2003).





Now a first and natural thought on seeing the above list is: so what? Doesn't everybody now believe in these things? Certainly this is a consensus that embraces David Cameron, Tony Blair, and (almost certainly) Gordon Brown and Menzies Campbell. You could believe all these things and be a *Guardian* reader, and you could believe all these things and be a *Telegraph* reader.

For one feature of the philosophy of the social market is its extraordinary advance over the past quarter of a century. Then, remember, it was rejected by the Her Majesty's government, Her Majesty's opposition and Her Majesty's third estate. It was adhered to mostly by a small gang within a tiny minority party. Today, however, it enjoys virtual hegemony in the realm of ideas, certainly in Britain and largely in Europe.

This is a source of pride for those who have been social marketeers throughout this period. But it needs also to be a source of concern. *Pace* Francis Fukuyama,[3] mankind is an intellectually restless species, naturally inclined to seek things different from what he has in case they are better. Even in those countries that enjoy the benefits of being governed by social marketeers, human happiness is far from complete. Many serious and urgent issues remain unresolved. It is, therefore, inevitable – perhaps desirable - that from time to time fundamental critics of the social market in action will come forward. These are the 'enemies' of the social market who figure in the title of this essay, and I deal with some of the more prominent among them later.

First, however, I want to make another point that emphasises the strength of the social market philosophy. It is not, repeat not, an ideology. For, unlike proper ideologies, it can incorporate quite substantial differences of view on important issues. This is for two broad reasons. One is that some issues are simply outside the subject area on which its philosophy can offer guidance: peace or war are examples. The other is that its very nature is to embrace pragmatism: that is to say, to test its philosophical implications in the crucible of

3 F Fukuyama, *The End of History and the Last Man* (The Free Press, January 1992).





evidence and argument. So it is, therefore, that in some areas social marketeers may differ sharply among themselves, without that meaning that they are any the less social marketeers. Here are some examples:

1. Social marketeers can have different views of the degree of economic inequality that is tolerable in society. This disagreement can be one about ends: how much inequality is necessary to permit freedom and encourage diversity? To take one example, Martin Wolf, author of the splendid *Why Globalization Works,*[4] is an ex-social democrat turned liberal social marketeer. I remain a social democrat as well as a social marketeer. The difference between us is that he cares a lot about economic liberty and I care a lot about economic inequality – that is all.

Alternatively, differences on inequality can be about means rather than philosophical ends. How much equality is compatible with the preservation of adequate economic incentives and international competitiveness? It can also be about politics. How much of the gross national product has to be given to the middle classes and upwards if they are to vote for a social market government? So, for example, the ex-minister Stephen Byers has questioned whether inheritance tax should be abolished in the interests (for so it seems to me) of bribing the middle class of middle England to vote Labour.

2. Social marketeers can, similarly, have different views on the effectiveness of government and – a related point – on the proportion of the nation's income that should be represented by public spending (and thus, ultimately, has to be raised by taxation).

4 M Wolf, *Why Globalization Works* (Yale University Press, July 2004).

Again, this argument can be conducted in philosophical terms as to what is desirable, or in economic terms as to the degree to which public tax-and-spend helps or hinders the functioning of the economy.

A related issue on which they can also disagree is whether and how well government can work. There are many cases where, in theory, government intervention might right market failures, but are such interventions generally successful? Do they do net more good than ill? Can government deliver what it seeks to deliver? What kind of government interventions are more likely, and what kinds are less likely, to produce the results it seeks? How much truth is there in the contentions of the public choice theorists, namely that so-called impartial civil servants are, in fact, in the business of maximising their own utility by maximising the size of their empires? Some of these issues are examined further later in this essay.

3. Social marketeers can have different views on the degree of personal liberty desirable in society and of the balance between individual freedom and responsibilities. You can imagine a social market society that is also a libertarian society, and you can imagine a social market society that is also quite restrictive of individual liberty (for example, as part of a strategy to deal with terrorism). At their extremes, both might give rise to difficulties for the social market society: the extreme libertarian by favouring too little state power and the authoritarian by creating too much. Short of those extremes, however, either is compatible with a strong social market approach.

4. Social marketeers can have strongly differing views on matters that fall outside the remit of the social market altogether. It is possible to be a social marketeer and to be (for example) for or against the war in Iraq, for or against the institutions of the European Union, for or against replacing Trident, and for or against the right to die of the terminally ill. For this reason, on these matters, the SMF should follow Wittgenstein's advice: 'whereof one cannot speak, thereof one must remain silent'.[5]





Is this, then, a motherhood-and-apple-pie philosophy, to which anyone can subscribe? Why did we reject one candidate for director on the grounds he was not a social marketeer? Where do the dividing lines lie between free marketeers, social marketeers and social democrats?

In truth, there are no such clear lines. A moderate free marketeer can also be a social marketeer, as he or she will be if he or she recognises the social underpinnings of the market. A moderate social democrat can also be a social marketeer, particularly if he or she is of the species of social democrat who is sceptical about the virtues of state power.

However, the social market is not all embracing (and thus meaningless). There are a number of propositions that cannot be made compatible with social market philosophy. Of course, these include supporters of long-defunct ideologies, such as Marxism and Fascism. But, less obviously, are certain philosophies, some

5 L Wittgenstein, *Tractatus Logico-Philosophicus,* trans. C K Ogden (1922).

fashionable, that are the enemies of the social market and must be defeated by social marketeers in argument or in political practice.

They are:

- Those who believe that the inevitable consequence of the social market model applied to the economies of the West is that, globally and forever, the rich get richer and the poor get (absolutely) poorer.
- Those who are opposed to economic growth, either on environmental grounds or on the grounds that prosperity is not a good thing.
- Those fundamentally opposed to globalisation, as the expression of the market philosophy internationally.
- Extreme anti-state libertarians, disciples of Hayek, who believe that the social market is 'the road to serfdom.' An indifference to society and social considerations is not compatible with a social market creed.

These are the enemies.

The social market is a creed that permits plenty of diversity. This is a virtue, especially since it enables it to adapt to change and circumstances. But it does not mean that the social market is infinitely adaptable.

Moreover, as will be clear from the remainder of this essay, true social marketeers share a cast of mind. They are optimistic, but also sceptical. They are interested in evidence and about what works in practice. They can be quite radical, but they are not blind to the





dangers of radicalism, and in particular to the dreaded rule of unintended consequence that dogs ameliorative projects.

It is not easy to define a social marketeer but I recognise one when I see one.

## 2. THE MARKET: ITS VIRTUES AND FLAWS

The centrepiece of Skidelsky's essay is its spirited defence of the virtues of the market. To quote (at some length):

The most powerful argument for the market economy is that it decentralises decision making and makes possible the uncoerced co-operation of people for their mutual benefit. It achieves this not by relying on altruism, which is in short supply, but in making the pursuit of individual plans the means for satisfying the plans of others. It was Adam Smith who first fully saw in the mechanism of market exchange the basis of a spontaneous social order. The individual is 'led by an invisible hand to promote an end which was no part of his intention. By pursuing his own interest, he frequently promotes that of the society more effectually than when he really intends to promote it.'

The conditions for free exchange in markets are the same as, though less extensive than, the conditions for freedom generally: freedom of movement and choice of job; freedom of contract; properly defined and enforced property rights. The market system thus provides a powerful protection for political and civil liberty,

> because it minimises concentrated political power and disperses power in general. Furthermore, the market system provides a wider basis for co-operation than the political system, because it transcends national frontiers. It is thus an international system of liberty. In addition, its impersonal nature makes it both colour and gender blind; it is the best safeguard in the long run against racial and sexual discrimination.[6]

These virtues deserve rehearsing. However, at the time Skidelsky was writing, the command economies of Eastern Europe were in the middle of their sudden collapse. By comparison with their failings, the wonders of the market shone like stars glimpsed through breaks in a cloudy sky.

More than seventeen years later, memories of communist societies are starting to fade. Though today's critics of market economies rarely advocate a return to them, absence has made their hearts grow fonder. Churchill once said that democracy was the worst form of government except all others, and the same might be said of capitalism as the way to run economies.

Seventeen years, however, have also brought to the fore virtues of markets that Skidelsky did not foresee and which should be celebrated. In particular:

- Markets are good at the swift exploitation of technological change. This is true of the changes themselves (think of the growth of Microsoft and the eclipse of IBM), but it is perhaps even truer

6 Skidelsky, op.cit.





of the extension of technology through the application of human imagination. Markets are also good, if ruthless, in distinguishing successful from failed innovation. The dotcom boom was a first example; the current decimation of gaming stocks in the face of US legal prohibitions is another.
- Markets, it turns out, can be applied widely to public services without undermining the essential virtues of such services. This tackles a problem that Skidelsky worried over: the inefficiency of exit mechanisms as the sole way of making public services responsive. If effectively implemented, contestability, the use of quasi-markets and, in some cases, the extension of individual choice to public services allow us now, if we wish, to accommodate a substantial public sector within the social market approach.
- Markets, thanks to globalisation, have become more international. For instance, the world's foreign direct investment levels have more than tripled since 1989. This makes it easier to resolve one of the dilemmas of economics: how do you combine the exploitation of economies of scale with the avoidance of monopoly?

Markets rule, OK? Not quite. With remarkable foresight, Skidelsky pointed out the paradox: though markets work, they are not popular. 'Despite [the market system's] powerful intellectual support, and practical achievements, it remains a fragile institution, not much loved: the Utopia of some intellectuals but the villain of others; feared by most producers, taken for granted by most consumers.'[7] The lack of affection of people for markets has become a cliché, particularly for Tory politicians, as the reported views of David Cameron, their leader, and George Osborne, their shadow chancellor, show.

7 Skidelsky, *ibid.*

This concern has been heightened by recent work by Richard Layard, among others, on happiness. Layard points out that survey research has found that, after a long period in which reported happiness clearly increased, it has stagnated since around 1970. If the social market is such a success how can this be?

It could, of course, simply be that happiness is not a good measure of how a society is perceived by its inhabitants. Look at the variations in polities around the world – vast. Look at the variations in self-reported human happiness – rather small. For all of human history pre-Bentham, and for many non-utilitarian philosophers since then, the idea that human happiness should be the goal of human societies would have appeared quite weird.

But even if the Layard data does not prove that market societies are failures, it does add to the general perception that markets are not the popular institutions that, from their results, you might expect. Why?

Skidelsky himself made some attempt to analyse this unpopularity. Some of the causes he identified, however, seem less plausible today. For example, he cited the tendency of market economies to go through periods of very high unemployment. After fifteen years of pretty well uninterrupted economic growth in Britain, which have lead to something near full employment, this does not seem a plausible explanation.





Another possible explanation is sociological. The functions of the market system elevate flux, change and uncertainty in people's experience, particularly in the global economy we live in today. There is no such thing today, it is said, as a job for life. The market also has profound implications for the work-life balance. If I, as an individual, am not prepared to work harder and compete harder, or I am forced to care for an ill spouse or child, my employer will find someone else who is.

Meanwhile, the market economy requires a degree of mobility that is disruptive of social and personal stability. The old working class communities of East London, celebrated by Michael Young and Peter Willmott[8] are no more. Market forces are promoting the international migration of labour, and the international migration of labour, whatever its economic benefits, tends to cause social stress.

Not all social changes due to the market are negative. How many people's lives were ruined by the stultifying effects of sharing tiny houses with both their parents and their children in the post-war era? What of the vibrancy created by the existence of various and varied cultures within nations?

It is also possible for public policy to seek to remedy some of the deficiencies. For example, the Department of Trade and Industry, in its publication *Work and Families: Choice and flexibility,*[9] extends provision for paternity leave, highlighting the importance of more socially friendly employment policies.

8 M Young and P Willmott, *Family and Kinship in East London* (Routledge, 1957).
9 *Work and Families: Choice and flexibility – additional paternity leave and pay* (Department for Trade and Industry, March 2006).

An even more fundamental criticism of the market maintains that, however productive it may or may not be, it is in some sense immoral. For some, it is enough to condemn the market that it leads to big profits for big companies. For others, it is enough that it leads to those companies existing. For example, Sarah Anderson and John Cavanagh of the left-of-centre Institute for Policy Studies in Washington DC have argued that 51 of the world's 100 biggest economies are corporations.[10]

As Martin Wolf points out, such studies are statistical junk.[11] They confuse the value of firms' output with GDP, when the proper measure should be the value firms add – that is, output, net of inputs. Corrected for this, an UNCTAD study suggests that just 29 of the world's top economies were corporations, and only two of the top 50.[12] Other studies make the howler of confusing the capital value of firms on stock markets with the annual output of countries.

In any case, what is morally wrong with big companies? They tend to be more stable than small companies, pay better, provide more extensive fringe benefits and value their reputations highly. They react quickly – indeed they often overreact – when criticised for, for example, allegedly poor environmental policies or for employing child labour.

A criticism more damaging to the market is the sense that its mechanisms are of themselves unfair. When someone is

10 S Anderson and J Cavanagh, *Top 200: The rise of corporate global power* (Institute for Policy Studies, December 2000).
11 Wolf, op.cit.
12 'Are Transnationals Bigger than Countries?' in Wolf, op. cit., United Nations Conference on Trade and Development, TAD/INF/PR/47 (12 August 2002).





diagnosed with cancer, a common first question is 'why me?' Doctors can give a partial answer, perhaps involving damaging behaviours, such as smoking, and perhaps involving bad luck, such as a poor genetic inheritance. But in their despair, people often find it hard to accept bad luck.

In the market economy, something similar applies. Of course, individual success owes something to industry, intelligence, courage tempered by caution and so on. But, if we are honest, it also owes much to luck. Just as we do not think winning the lottery is a particularly moral way of acquiring wealth, so it is with the market. And, of course, the market gives rise to many more relative losers than relative winners, all of whom will be inclined to blame the system for their failure.

Philosophers of the market have struggled with such questions, and have devoted great effort to defending the market's morality. Hayek, for example, maintained (perhaps excusably when Fascism was about) that any interference with free transaction in the marketplace was an unacceptable intrusion on to liberty. (Hayek also worried that markets could devour the moral code that underlies them.) Those who do not share such extreme views, however, must fall back on results. If the market works so well for so many, that in itself is a moral defence. If we have to put up with a few moral flaws, bribes here, hospitality there, and personal avarice everywhere, that is a price worth paying for the benefits with which markets shower us.

This, however, would be refuted by those who advance the most profound assault on markets. They are critical of the way we live at a deeper level. They claim that we are dwelling in overly materialistic societies, where the search for material wealth distracts from more fundamental human needs of a teleological or religious nature.

Since market societies are undoubtedly driven by materialism, this criticism, if right, is indeed fundamental. However, is it the case? For in many ways there has rarely been a society in which so many people have so much access to so much that can nourish the soul.

To take an example at random, surely at no point in human history have there been published so many works of fiction of such exceptional merit available to all at such reasonable prices? To take the USA alone, berated as the bastion of empty capitalism, alive and writing today are John Updike, Robert de Lillo, Philip Roth, Richard Ford and Toni Morrison, whose *Beloved* was recently voted top of them all by her peers.[13] For the elite, forced now to divert itself from contemplation of the eternal verities to make its way in the world, something, no doubt, has been lost. But many more people now have the opportunity to broaden their horizons than at any time in human history.

13 A O Scott, 'In Search of the Best' (*New York Times Book Review,* 21 May 2006).





Moreover, just as the market as an economic institution looks better when you consider the alternatives, so too does the culture it begets. How many readers of this would honestly prefer to have lived in Afghanistan under the Taliban, spiritual nirvana though it may have been to the believers?

There is, however, one criticism of the market that is more to the point. It is that it generates a degree of inequality – not just of opportunity but also of outcomes – which explains some of its unpopularity. This is a criticism to which Layard himself attaches great importance, and it is the subject of the next chapter.

## 3. INEQUALITIES, SOCIAL JUSTICE AND THE MARKET

For some supporters of the market, inequality simply does not matter. Indeed, Hayek went further. He accepted the need for government to set boundaries and act, from time to time, as a referee. However, beyond that, he argued that any attempt by the state to interfere with market outcomes represented an unwarranted interference with property relations. This would inevitably lead to the *Road to Serfdom,*[14] as he titled his major work. Something similar was echoed in 1998 in the words attributed to Peter Mandelson, Tony Blair's long-time guru, who said of New Labour: 'We are intensely relaxed about people getting filthy rich.'

However, for less extreme supporters of the market, inequality does

14 F A Hayek, *The Road to Serfdom* (Routledge Press, March 1944).

pose a problem. One famous test for assessing social justice is John Rawls's reflective equilibrium test.[15] This requires one to imagine a world from behind a 'veil of ignorance', where we are completely unaware of our socioeconomic status or the proportional chance of our future status.

Let us apply this test to a state, let us call it Hayekia that was ten times as rich as the USA is now. Imagine that in that state, unlike the US, citizens enjoyed perfect equality of opportunity from birth. Imagine, however, that 99% of income and wealth there was enjoyed by the top 1% of the population.

Apply the Rawlsian test to Hayekia. How would you feel about the prospect of living in such a society, not knowing in advance whether your position was to be with the super-rich or the rest? Intuitively, a place with such grotesque inequalities would be a most disagreeable place.

Equally, however, imagine a society – call it Bennin – one-tenth as wealthy as the US is now. Imagine again that there is perfect equality of opportunity, but opportunity amounts to little. For in this state, every family (adjusted for family size, etc.) enjoys precisely the same low income. Again, you undertake a Rawlsian reflective equilibrium test. Besides being very poor, this society would also be very drab. I doubt if there would be many takers for this either.

Between these two alternatives lie a number of theoretical societies, with different degrees of inequality. A pragmatic question immediately arises: is it likely that the less equal societies will be richer, as rich, or

15 J Rawls, *A Theory of Justice* (Belknap, 1971).





poorer than the more equal societies? It would be perfectly reasonable to be an instinctive egalitarian, but also to believe that an egalitarian society will lack incentives and thus be poorer. In those circumstances, uncomfortable trade-offs fall to be made.

Inequality of income corrupts equality of opportunity, and gross inequality of income corrupts equality of opportunity grossly. This has two aspects. First, the worse off may not be able to take advantage of opportunities that are theoretically open to them. They cannot afford the fees for college without incurring huge debts. They cannot risk leaving their job to try starting a business.

Second, if inequality is great, then the better off will have a huge advantage at the start of life's race. One example is that equality of opportunity cannot exist while parents are free (as I suppose in a free society they must be) to buy better education for their children. Another and disfiguring one arises from the importance of inheritance, which means that some people do not have to rely on their own efforts. Obviously, opportunity for someone who will never have to save for a pension because they have inherited from their parents is much wider than that for someone with no such advantage.

This kind of thinking underlies the work of the economist Amartya Sen. For Sen, the way to think about inequality is in terms of functional capabilities[16] – for example, the ability to live to a ripe old age and the ability to get involved in the democratic life of a country. Poverty clearly deprives people of capability in this sense, and so does gross inequality. Sen's view relates the critique of inequality to a belief in

16 A Sen, 'Equality of What?' (*The Tanner Lecture on Human Values, Stanford University,* May 1979).

freedom, not in the narrow sense of freedom to take tea at the Ritz but in the wider sense of life options and possibilities.

But even if these different societies all had precisely the same GDP, there is room for disagreement as to which is preferable. Some people will be instinctively attracted to the more equal, and some to the more unequal. Even Tony Crosland, whom I served as political adviser, and who defined the goal of socialism in terms of increasing equality, was always clear that this had strict limits:

> I do not myself want to see all private education disappear; nor the Prime Minister denied an official car, as in one Scandinavian country; nor the Queen riding a bicycle; nor the House of Lords instantly abolished; nor the manufacture of Rolls-Royces banned; nor the Brigade of Guards, nor Oxford and Cambridge, nor Boodle's, nor (more doubtfully) the Royal Yacht Squadron, nor even, on a rather lower level, the Milroy Room, lose their present distinctive character: nor anything so dull and colourless as this. But where *en route,* before we reach some drab extreme, we shall wish to stop, I have no idea.[17]

Social marketeers generally (rather like Tony Blair) have been uncomfortable using the word 'equality'. Much preferred in most of their writings has been the phrase 'social justice'. 'The market economy', says Skidelsky 'must be part of social arrangements seen to be "fair".'[18] He then argues that this means at least dealing with the fact that in a market economy 'rewards are skewed in favour of those who start with advantages of birth', which is not controversial. He then goes on to say that 'social democrats' (he does not say if he identifies

17 A Crosland, *The Future of Socialism* (Macmillan, 1957), p. 217.
18 Skidelsky, op.cit.





with them) 'have further pointed out that even if full employment is maintained the market value of the work of the low paid may be too low to secure them the minimum resources needed for self-respect and autonomy.'

These conditions show how limited the notion of social justice is that Skidelsky embraces. So long as opportunities are equalised, and so long as poverty, which arises from the absence of work and wages, is tackled, its requirements are met. Such a society will be tolerable to some social marketeers but not others. But even Mr Blair or Mr Mandelson would be unlikely to regard this as a society that they would cheerfully embrace: opportunities matter, but so do outcomes.

Economic equality is ostensibly measurable – for example, by the Gini coefficient, which is a measure of inequalities of income. It has yawed up and down since Skidelsky wrote, without a clear and sustained direction of travel. However, many fear that inequality is now on the increase, and some now argue that unacceptable inequality of outcomes is an inevitable consequence of the market.

There are two aspects to this argument, and it is important to separate the two. The first is: is our society so unequal as to be

intolerable? The second, however, is: will the inequalities derived from the market system increase or decrease over time? If the former is the case, then inequalities now might be tolerable because they will (or can be made to) diminish with time. If the latter is the case, then at some point we are going to be faced with societies so unequal as to be intolerable, and some fundamental rethinking is therefore required.

To make matters still more complicated, there is both a national and an international dimension to these questions. It is, for example, perfectly possible to believe that inequality within developed countries is diminishing, while at the same time believing that the gap between rich and poor internationally is increasing. One noticeable consequence of globalisation is that the latter concern is more prominent than the former. Idealistic youth everywhere rush to development intergovernmental organisations (IGOs) desperate to work, not only to make the poor richer, but also to decrease international inequality.

I can deal with neither aspect thoroughly in the course of a short essay, but, in particular, I do not deal with the international aspects, on which I am no expert. However, Martin Wolf is an expert, and anyone who wishes to explore the arguments should start with his book and with his debate with Professor Robert Wade of the London School of Economics.[19]

Clearly, inequalities between countries are wide. The gap in $GDP per head between

19 M Wolf and R Wade, 'Are Global Poverty and Inequality Getting Worse?' (*Prospect*, January 2002).





rich countries and poor counties is growing. Inequalities within developing countries are huge, and probably inequalities within individual countries, developing and developed, are (at the moment) widening. They are certainly far wider than was the case in the essentially subsistence economies of a couple of centuries back.

Against this thesis, however, I make only a few simple points:

1. First, the green revolution, born of technological innovation, has made a huge impact on primary poverty. The United Nations Development Programme (UNDP) shows that, since 1990, the proportion of people in developing countries living on less than $1 a day (the standard poverty level) has decreased by 6.6 percentage points. It is a matter for debate whether what matters most to you is the amount of poverty in the world or the amount of inequality, but a big reduction in primary poverty is surely indisputably a good thing.

2. Though there is a mixed picture globally, some developing economies are clearly doing very well. Of particular interest is the example of India, now growing at 8% a year. For the transformation of the Indian economy began with its adoption of increasingly social market principles – in particular, freeing up markets to external competition while investing heavily in education. China is growing equally rapidly as a result of liberalisation, though here, post-Mao, there is also an increase in inequality. Since these countries previously had below-average incomes per head, and since they

contain 37% of the world's population, their rapid growth tends to reduce aggregate inequality between individuals in the world as a whole.

3. The inequalities within developing countries, particularly in Africa and particularly concerning plutocratic elites, are a worrying phenomenon. However, it is not plausible that they are primarily the fault either of the global trading system or of the social market economies of the developing world. Rather, these are failures of governance – emphasising the validity of the social market insight that stable, non-corrupt government is a *sine qua non* of a successful economy.

4. What seems undeniable is that one of the biggest obstacles to development, and therefore the further erosion of poverty, lies in the protectionist policies of the developed countries, and, in particular, the absurd cosseting of their agricultural industries. The true level of protection afforded to European industry is some 9% if non-tariff barriers are taken into account.[20] In 2000, Europe subsidised each of its cows to the tune of $913, though this was outstripped by Japan at $2,700 according to UNDP's *Human Development Report 2003*.[21]

Internationally, therefore, the case against the social market economy on the grounds that it promotes poverty and inequality does not stand up. The same is true of the wider charges against globalisation (which is, arguably, the international expression of key tenets of social market philosophy).

20 P Messerlin, *Measuring the Costs of Protection in Europe* (Institute for International Economics, 2002).
21 *Human Development Report 2003* (United Nation Development Programme, June 2003).



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Meanwhile, the World Bank study *Globalization, Growth and Poverty: Building an inclusive World economy* summarises the facts on globalisation.[22] Twenty-four more globalised economies are compared with 49 less globalised economies on a population-weighted basis. In 1980 the more globalised economies enjoyed a GDP of $1,488 a head compared with $1,947 in the less globalised countries. By 1997, however, the globalised economies had overtaken the less globalised: income per head amounted to $2,485 compared with $2,133 for the less globalised.

Globalisation, as Wolf conclusively demonstrates, has reduced individual poverty, and has increased individual prosperity. Its effects on equality are more complex, but any unambiguous statement that it has promoted inequality is unlikely to be true.

From the global, let us move on to the local. So far as our own country is concerned, and it is after all for Britain that we are trying to prescribe, what has happened to equality? And here I discuss not merely economic equality, important though that is, but social equality.

Over the past 50 years, since Crosland wrote *The Future of Socialism,* I would sum up what has happened thus:

22 *Globalization, Growth and Poverty: Building an inclusive World economy* (World Bank, May 2001).





First, there has been a revolution in social equality, towards precisely what Crosland meant by a 'classless' society. A cat today may speak to a king, and does not lose status if he or she purrs with a regional accent. Nurses call patients by their first names, as increasingly do patients addressing their doctors. Relations between men and women are generally much freer and women enjoy much the same freedom in their sex lives as men; families are far less hierarchical, with more equal and open relations between parents and children; and even racism, though it is widespread, is today a hole-and-corner affair.

Second, and related, there has been a decline in the influence of social class. When R H Tawney wrote his great work *Equality* in 1931,[23] it was not inequality in the economic sense that he was primarily attacking but class.

Times have moved on. Even defining class is much harder than it used to be. Academics differ over the extent to which something called the working class exists and, if it exists, what it is, and, whatever it is, whether and how quickly its numbers are declining.

In any case, it is no longer possible to define social class sensibly in terms of relations to the means of production (as Marx did). Lifestyles are much less homogenous within classes, and much less differentiated between classes.

Third, whatever the Gini coefficients may say, there has been a convergence between the living standards of the better off and the worse off. I was brought up in the 1950s when my father ran a modest

23 R H Tawney, *Equality* (London School of Economics, 1931).

small business in Gloucestershire. He (my mother did not work) was able to afford a large house with a tennis court, a new car every year, a gardener, an au pair and a cleaner and, at one point, two sons at public school. Someone in an analogous position today would enjoy no such affluence, but you may be sure that their gardeners and cleaners, where they can still afford them, are far better off.

On the other side, there has been a new phenomenon: the emergence of large numbers of people who are very rich. There are more of them and their share of the nation's wealth is much greater. Rents of ability – whether among businessmen, celebs or sportsmen – have reached staggering proportions. Polly Toynbee in the *Guardian* quoted a figure of just over £21 billion paid out in one year in bonuses alone.[24] That seems an inflated figure, based on bonuses throughout the economy, not all of them going to the very rich. However, according to the Centre for Economics and Business Research, bonuses in the City alone for 2006 are expected to total £8.8 billion, up from £7.1 billion in 2005.[25]

Defenders of the inegalitarian social market are unfazed by such bonuses. They are, they say, the product of normal market mechanisms in particular trades where the rewards of outstanding talent to companies, as well as to individuals, are huge. These industries – media, sport and financial services – just happen to be industries on the up at the moment. Such sumptuary sums are defended as necessary to get these people to perform as they do; or as a side effect of globalisation and a global market for talent; or as an unfortunate side effect of a free and market-based society. I prefer the word 'greed'.

24 P Toynbee, 'There's Only One Way for Labour to Challenge the Tory Shopping Trolley' (*The Guardian,* 20 October 2006).
25 'Soaring City Bonuses "Hit £8.8bn"' (*BBC News,* 30 October 2006).





Moreover, the grotesque rewards now going to the super-rich are arguably a serious cause of discontent in society. It is true that the people have not yet descended on the capital to besiege the temples of capitalism, while the Marie Antoinettes within cry 'let them drink Krug'. But the total sums involved now are large enough to matter. If those City bonuses were divided equally among the population, each man, woman and child could enjoy an extra £1,250.

I do not sense a popular consensus, such as true Blairites detect, that voters believe such wealth is fine and dandy since it arises from market forces. A moral and political backlash against such wealth is not certain – the moral inhibitions on excess were considerably weakened during the Thatcher years. Personally, however, if and when the backlash starts, I will be there throwing bricks with the people.

Lord Layard in his work argues that inequality is one of the most potent causes of the unpopularity of markets.[26] He points out that most people's happiness does not depend only on how well off they are themselves, but also on how well off they are relative to other people.

26 R Layard, *Happiness: Lessons from a new science* (Penguin Press, 2005).

Layard does not take this so far as to argue against the market, but he points out that some institutional arrangements can help to vitiate this effect. For example, high marginal income tax rates on the better off reduce the degree to which higher pay lifts them further clear of the rest of humanity. Such rates, therefore, help to align the social gain from higher incomes and wealth with the gain to the individual concerned.

This is a specific argument about the more general question that arises: if this is a serious flaw in the capacity of the social market to create a content society, what can we do about it? According to pessimists, the answer is: absolutely nothing. The global marketplace dictates the rates that such people can earn, and should they not get them here, they will migrate elsewhere.

Against this, however, is that this is not a phenomenon universal among developed countries. In Scandinavia, for example, such excessive rewards would be regarded as simply unacceptable. Until recently at any rate, much the same was true of Germany. It is open to argument that their economies have suffered as a result, but it would take a brave man to say that, over the long term, Sweden's economic performance was inferior to Britain's.

People want lots of money, not only because of what they can buy with it, but because they believe it gives them status and prestige. If, as I trust, there is a moral backlash against this kind of excessive wealth, it may become less attractive to have it. Perhaps this explains the recent surge of acts of conspicuous charity among the rich, from Bill Gates of Microsoft and Hank Poulson, ex-Goldman Sachs.

If the moral climate changes, so too may the political climate. We used to have a much more progressive tax system and – *pace*





Mr Byers – so we could again. Indeed, arguably we need to if the social market is to survive the forces sustaining inequality.

## 4. THE ROLE OF THE STATE

One of the key insights of the social marketeer is that markets alone are not enough. At the most basic, markets can only function if there is an adequate legal framework. For example, property rights have to be protected and contracts enforced. Law is also necessary in the 'law and order' sense. Markets cannot flourish amid banditry. Markets also have a tendency to spawn monopoly and other market failures, which require state action.

This may seem perfectly obvious. However, it has not always been so appreciated. For example, Richard Layard and John Parker[27] were far too optimistic about the Soviet Union post-communism because they saw the virtues of the market but failed adequately to appreciate the framework it needed in which to flourish. Some of the more avid promoters of the American business model have fallen into the same trap.

Skidelsky, of course, is too subtle a thinker to follow suit. Nevertheless, nearly twenty years on, and writing with Thatcherism still the dominant ideology of its day, it is not surprising how grudgingly he conceded a role to the state.

27 R Layard and J Parker, *The Coming Russian Boom: A guide to new markets and politics* (Free Press, 1996).

For example, Skidelsky recognises that there is a potential role for the state in the provision of public goods. Public goods are goods that, once one person is consuming them, everyone can consume at little or no extra cost. An example is national defence. Yet most of Skidelsky's treatment of public goods is designed to keep them to the minimum.

Skidelsky objects, for example, to the democratic process as an adequate way of determining how much of such goods should be supplied. He points out some degree of exclusion is possible for some public goods (for example, in roads and hospitals) where the choice then lies between queuing and pricing. And he holds up the torch for private philanthropy as a way of supplying public goods – pointing to the way the arts in the United States are more supported by it than by the state.

Skidelsky goes on, plays down externalities and lauds private insurance markets as an alternative to public provision. In fact, the only argument for the state's role to which he appears to attach great significance is the one that, without state intervention, there may be a problem of unemployment – which, we have already noted, has not so far turned out to be the case.

Much of Skidelsky's argument is now regarded as settled policy. Nobody believes in state economic planning for developed economies – though from 1945 to the 70s, many did. Income policy is even more wildly unfashionable. Most people believe that, in the long run, most economic activities are most efficiently carried out by privately owned companies. Though some political steam can be raised opposing further privatisation, virtually no one advocates an extension of public ownership.

Equally, in some areas, the pendulum has swung back. Take, for example, the minimum wage. When Skidelsky wrote, most economists, like all Tories (and me!), thought it would increase unemployment.





Cautiously introduced, however, at a low level, this has proved not to be the case. In the hidden corners of the economy where it has most effect, the market is very far from perfect. The minimum wage seems to have removed excess profits from some operators in these areas and transferred them to workers without leading to widespread job losses.

In some areas, a new role for the state is now widely accepted. Take green issues for instance – the subject of the next chapter. It is widely accepted that the consumption of carbon producing energy, whether directly through aviation or indirectly through electricity generation, has to be managed. For the prices faced by the individual do not reflect the social environmental cost. There are considerable adverse 'externalities' involved in the consumption of such energy, which could at the extreme even lead to the elimination of the human race. This is the conclusion of the report by Sir Nicholas Stern on global warming,[28] discussed fully below.

Today there is a wider understanding of the value of public goods. Indeed the term 'public value' is now fashionable. It applies, for example, to the BBC. It produces that good at zero marginal cost, which means that, if individuals do not get it, then those who do not lose such value as they would have derived from it. Its output is non-rivalrous - that is to say, the fact that I get it does not diminish its value to you. Indeed it may even enhance it, since I can then discuss the programmes I have watched with you around the water-cooler. However, to maximise this value it has to be paid for by a compulsory charge enforced by the state, or by taxation. This then is a role for the state that most social marketeers might embrace.

28 Sir Nicholas Stern, *Stern Review: The economics of climate change* (HM Treasury, October 2006).

There is today a greater appreciation that the social return from the consumption of certain goods may exceed the return to the individual from consuming them. Education, as discussed above, is a good example.

It is true that there is a strong return to the individual from an investment in education, which is why there is a case for student loans rather than student grants. But there is a social return too. This is particularly true since much of education is consumed by people before they have accumulated personal income or capital, and before they are old enough to make mature decisions as to the appropriate level of personal investment they should make in it. So there is a strong case for state subsidy to education, particularly to school education. Within this, some social marketeers will argue for choice, as did the Social Market Foundation in a recent publication,[29] perhaps in the form of education vouchers. Others will argue for more equal provision designed for the talent-maximising outcome, equality of opportunity. SMF authors have even argued, with great force though little regard for political reality, for the allocation of secondary school places by lot rather than parental choice.[30]

More controversially, the limitations of private insurance alternatives to public provision are recognised today. For example, health care could be provided by private insurance (though doubtless with a safety net of state support for those who could not afford the premia). However, in theory and in US practice, this turns out to be a less than ideal system. Private insurance runs into the problems of adverse selection (those who know they are likely to be ill will be more likely to buy

29 J Williams and A Rossiter, *Choice: The Evidence* (Social Market Foundation, December 2004).
30 M Haddad, ed., *School Admissions: A report of the Social Market Foundation Commission* (Social Market Foundation, July 2004).





more of it than those who suspect they won't). It is subject to moral hazard (once you have paid for cover, you will be tempted to indulge in behaviour that make you more likely to claim). Perhaps most severely, you are likely to need it most at that stage of life – extreme old age – when you are least likely to afford it. Only the most myopic social marketeer will believe that people show perfect foresight in planning their personal expenditures over their lifetimes.

More controversially still, there may be a role for the state not merely in redistributing income through taxation but in redistribution from the provision of services. It can be argued, for example, that it matters rather little whether one person has three yachts when another has no boat at all; or that one person may consume several tubs of *foie gras* while another eats pig's liver. However, the same may not be true of other goods. Health is again an example. Ill health is regarded as a matter of ill luck, and it would seem unfair if one man's ill luck had very different consequences to another's.

We are happy to see the rich treated in hospitals where the food is good and the nurses obsequious, provided they are paying directly for those privileges. We are not happy if they are enjoying incomparably better medical treatment than the rest of us. And so most people, most of the time, are treated on the National Health Service.

Of course, as privatisers hasten to point out, the NHS does not in practice provide equality. But that is not (or should not be) the

issue. The issue should be whether health services are more equally distributed by the NHS than they would be in an unconstrained market system; and the answer is that they are.

That said, some think equality in health will be increased by reforms such as increased patient choice and competition between providers. Others do not; I am myself sceptical about patient choice. About such things, social marketeers and others can argue. But it is clearly possible to be a social marketeer while at the same time believing that inequalities in health provision should not reflect the inequalities of resources in the marketplace.

Another role that many social marketeers would give to the state is in providing some safeguard against the consequences of excessive change. The market moves with sometimes breathtaking speed, which can leave some people, through no fault of their own, as its victims. Factory A in Bolton dies because factory B in China outcompetes it, under free trade. That is good long-term for Britain, since the resources will in time be put to better use elsewhere. But it is bad short-term for Bolton, whose economy has taken a knock.

The state can have a role in compensating the losers, for example, through job seeker's allowance. Or it may provide alternative jobs, at least in transition, in the state sector, or subsidise the private sector temporarily to do this. Again, there is plenty of room for debate between social marketeers as to how active in such situations the state should be.





As it happens, I tend to a minimalist view. What starts as a temporary and well-justified intervention ends in a permanent and stultifying one – not least for the individual it is aimed at helping. But the opposite view is perfectly compatible with being a social marketeer. The SMF is currently exploring the appropriate role of the state in providing support to the individual adversely affected by wider economic change.

By contrast, however, some beliefs about the role of the state are incompatible with social market thinking. For example, though it may be the job of the state to ensure provision, it does not follow from that it has to provide itself. In many areas there has been a shift from direct provision to buying-in from the private sector. For example, today most care homes for the elderly are privately provided. When I was on the Royal Commission on Long-term Care of the Elderly, we looked at the research as to which sector provided better care. The answer from Audit Commission research was that there was nothing systemically different between the two: sometimes private care was better, sometimes public. However, on average, publicly provided care was more expensive, perhaps by as much as 40%.[31]

Another belief that is largely incompatible with the social market is that of labourism: namely a set of beliefs that puts people's needs as workers ahead of their needs as consumers. In theory, this seems perfectly arguable: we after all spend more of our time at work than even shopping and so might think it more important that, for example, we should not be forced to work too hard even though that enables us to consume more. In practice, we remember still what a society that paid regard to that theory was like: lives governed by trade

31 *With Respect to Old Age: Long Term Care – Rights and Responsibilities* (Royal Commission on Long-term Care for the Elderly, 1999) (http://www.royal-commission-elderly.gov.uk/); Audit Commission report cited: *The Coming of Age: Improving care services for older people* (Audit Commission, 1997) (http://www.audit-commission.gov.uk/Products/NATIONAL-REPORT/3466C456-36CA-46a9-8E64-C9DC612B077E/TheComingofAge.pdf).

union bosses, uppity shop stewards and businessmen harassed by both. The switch from an emphasis on the role of the individual *qua* producer to the role of the individual worker's state *qua* consumer is one of the most dramatic changes of the last 50 years. It is unlikely to be reversed.

One final point: many social marketeers would today embrace a wider role for the state than did Skidelsky. However, that does not mean that they buy one argument frequently heard, particularly on the left. This identifies something that is claimed to be 'market failure' and then uses that identified failure as sufficient to justify state action to remedy it. That was the error committed by the member of the SMF's staff with which this essay started.

For a social marketeer however, it is not enough merely that market failure exists. It is essential, too, to realise that there are costs to state intervention aimed at remedying it. Indeed, those costs often exceed the costs of the market failure that they are designed to remedy. State failure can be worse, and more difficult to put right, than market failure.

A full analysis of possible sources of state failure would require an essay longer than this one of itself. But possible state failures include:

1. Democratic failure. Democracy may or may not be the least worst system of government that there is. But its nature is such that it leads to certain kinds of failure. For example, democracy is notably excitable. So, for example, a certain kind of incident occurs, perhaps uncommon but arousing popular fears. Up goes the cry: 'something must be done' (or, worse, 'they must do something'). Rushed action is required to calm the public and the public press: for example, regulations to clamp down on the alleged abuse. There may, however, be neither time nor patience to consider the costs



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of these regulations, and to balance them against the alleged gain. The Dangerous Dogs Act 1991 is a case in point.

The economist Richard Pryke once argued that rail safety regulations increased mortality.[32] He pointed out that such regulations were often expensive; that they therefore led to higher fares; higher fares in turn discouraged people from travelling by train and encouraged them to take to their cars instead; and, since cars are a much more dangerous form of transport than trains, the net effect was that more people died. Whether his argument was empirically right or wrong, its logic is impeccable.

2. Bureaucratic failure. One school of critics of state failure, for example, takes it as its axiom that empire maximisation takes the place in the public sector filled by profit maximisation in the private sector. Certainly budget maximisation is a common trait. Bureaucracies have other flaws too. They do not welcome risk. So, for example, they will be tempted to regulate heavily to ensure that failures that would be laid at the door of the bureaucrats do not occur.

Politicians too have similar flaws that lead to similar failures. No one gets promoted in government for doing nothing. Ministers are demoted when they take risks that go wrong. An active politician can get the credit for what he does, and with luck move on, leaving his successor to pick up the consequences of the mistakes he has made.

The combination of democratic failure and bureaucratic failure can be more potent than either of them taken in isolation.

32 R Pryke and J S Dodgson, *The Rail Problem* (Martin Robertson, 1975).





In the real world, the dangers of market failure have to be constantly weighed against the dangers of state failure if it attempts to deal with them. As state failures tend to be on a large scale, and once they have occurred difficult to undo, the wise social marketeer will wish the onus of proof to be strongly on those who urge state action to demonstrate its superiority, in practice as well as in theory, to inaction.

That said, at the end of the day, there are many views of the role of the state that are compatible with being a social marketeer. You may be more or less of a liberal in social policy, and more or less of a liberal on crime and law and order. You may prefer a state that taxes and spends, say, 30% of GDP to one that taxes and spends, say, 50%, or vice versa (though it would, I think, be hard to reconcile the social market with a state that spent 10% or 90% of GDP). You can be pro-choice or anti-choice in public services and be a social marketeer; confident in democracy or dubious about it, and be a social marketeer; pro- or anti- more widespread co-payment or charging for public services, and be a social marketeer. But you could not be a social marketeer and (like Marx) look forward to the withering away of the state. The relationship between the state and the market will always be contested; but without the one, the other cannot thrive.

# 5. GLOBAL WARMING, THE ENVIRONMENT AND THE SOCIAL MARKET

It is possible, just possible, to imagine a zero growth social market society. In such a society, the birth of new businesses and products would have to exactly balance the death of old businesses and products. Its inhabitants would have to be content with aggregate living standards, which did not increase over time. As inevitably in a market society, some of them would be enjoying better standards, others would be suffering lower standards. Entrepreneurs as a class could only gain if workers as a class lost. State services could not be improved by more spending, unless those in the marketplace accepted that they would spend less. It is possible, just possible, to imagine such a society; but it is implausible that it could exist even temporarily, let alone survive in the long-term.

It follows that the social market philosophy is vulnerable to the more extreme versions of the green challenge. In particular, if the most millenarian of the believers in climate change are right, then we had better abandon the market and get back to our mud huts (though not, of course, burning wood to keep us warm). This, incidentally, was a challenge that Skidelsky did not consider when he wrote his seminal essay – quite understandably since, in 1989, global warming was barely an issue. The science was in its infancy and the great debate had hardly started.

As it happens, however, global warming is not the first such challenge to the economics of growth to arise in our lifetime. It is hard now to recall the international furore that arose with the publication, in 1972,





of *The Limits to Growth*.[33] Backed by enormous computer models based at MIT, and adopted by a band of scientists called the 'Club of Rome', the no-growth philosophy spread widely. So, for example, the *Ecologist* magazine published a 'blueprint for survival', which argued that growth must cease and the population of Britain decline to 30 million.[34]

Intellectual life was rife with ideas that seemed plausible at the time, and it would be cruel to go through the fallacies of the Club of Rome approach *seriatim*. An example is the absurd assumption that we would run out of energy.

The issue was well analysed by Bjorn Lomborg in his 1998 book *The Skeptical Environmentalist*.[35] Lomborg pointed out, quite rightly, that the Club of Rome doomsayers predicted that the world would run out of oil in 1992 – which it palpably had not.

The Club of Rome and its intellectual supporters had simply failed to understand the nature of energy reserves, and still do not. Its reply to Lomborg is: we did not say reserves would run out, we said that existing proven reserves would run out. But that is precisely the point on which its argument fails. For it is clearly not worth any company's while to look for energy reserves that are not going to be required for 20 or 30 years.

So, for example, Russian gas hardly entered into the Club of Rome equations.

33 D Meadows, *et al, The Limits of Growth* (Club of Rome, Universe Books, 1972).
34 'Blueprint for Survival' (*The Ecologist,* January 1972, Vol. 2, No. 1).
35 B Lomborg, *The Skeptical Environmentalist: Measuring the real state of the World* (University Press, Cambridge, 1998).

Nor did the Club understand the role of price mechanisms and how a rising price for energy would itself trigger energy-saving measures. An over-simplified model incorporating an exponential growth in energy use produced a result that history has proved to be junk.

Yet today we are seeing a similar panic over global warming. To be fair, global warming is a much more plausible threat to market economies than ever was Club of Rome quackery. For one thing, the science is more soundly based. The Intergovernmental Panel on Climate Change directly involves some 400 experts from 120 countries with a further 2,500 experts involved in peer-reviewing its findings. It published some 2,600 pages of detailed review and analysis in its 2001 report but its conclusions can be summarised in a sentence: global temperatures could rise by between 1.4% and 5.8% by the year 2100.[36]

With the publication of a further report in 2007, Achim Steiner, the executive director of the UN Environmental Programme (UNEP) declared the argument over global warming over. 'February 2 will perhaps one day be remembered as the day the question mark was removed,' he said. 'Anyone who would continue to risk inaction will one day in the history books be considered irresponsible. The scientists now say with "very high confidence" that human activities are to blame

36 *Third Assessment Report: Climate Change 2001* (Intergovernmental Panel on Climate Change, 2001). An updated version of the report published in 2007 repeated these assertions stating that 'temperatures were probably going to increase by 1.8-4C by the end of the century.' *Climate Change 2007: The Physical Science Basis – Summary for Policymakers* (Intergovernmental Panel on Climate Change, 2007).





for warming, and most 20th century temperature rises are "very likely" to be caused by human activity.'[37]

Of course, it is not enough to prove that global warming is occurring, or even to prove that we humans are responsible. It is possible to accept both things but to doubt if it is worthwhile combating it.

Lomborg, *bête noir* of the environmentalists, is sceptical about whether it is worth paying the price to combat global warming. He points out that the cost of putting the environment first, mostly that of fixing global warming, will come to (on the IPCC's own account) some $107 trillion by 2100, while the total costs of global warming amount to only some $4.8 trillion.

He points out that, for a fraction of this sum, it would be possible to eliminate some of the pressing problems affecting poorer economies. For example, a shortage of clean drinking water and sanitation is, perhaps, the single biggest cause of human suffering and disease globally. He points out that (given the will) this should be an easily solvable problem at a cost of, perhaps, no more than £200 billion, or less than four years' global development aid. This comparison of the costs of different measures is one to which social marketeers will be instinctively receptive.

37 D Biello, 'Final Report: Humans caused global warming' (ScientificAmerican.com (www.sciam.com), 2 February 2007).

This assumes that the consequences from global warming are within the estimates that Lomborg uses. However, much worse scenarios are plausible. Wide margins of error are involved in the estimates. At the top end they are genuinely scary. It is plausible to argue that, at some stage, the world will reach a tipping point at which temperatures rise rapidly, at a time when it is too late for human action to control them. In these circumstances, it is worth paying a fairly large premium for an insurance policy against such a catastrophic outcome, even though much of it will turn out to be a poor investment should the lower estimates turn out to have been more firmly based.

However, need the cost be so high? First, it has to be recognised how ludicrously far the world is from energy-efficient policies. For example, international treaties mandate a zero tax on aviation fuel. The aviation industry likes to point out that its emissions are a relatively small contributor to total carbon emissions – some 1.6%. However, as the Stern report points out, it is also the case that emissions at altitude are uniquely harmful, causing perhaps three to four times that amount of damage.

It is also the case that air transport is disproportionately consumed by people in rich countries, and disproportionately by better-off people within those countries. By contrast with anti-global warming policies that harm development, taxing aviation fuel would not only cut warming, it would redistribute income from the better off.





Second, and in some measure caused by an inappropriately low price for energy, the scope for alternative sources of energy remains enormous. These can be the solar panels, wind farms and tidal barriers beloved of fluffy environmentalists (save those who also care what our rural areas look like); or they can be atomic power; or they may result from technological developments unheard of yet.

We know that market mechanisms are extremely powerful. If the price of carbon-based energy goes up substantially, we shall, by hook or by crook, use less of it. If, at the same time, we use what carbon we do use more efficiently, and here carbon trading is a key market instrument, we need not suffer much damage to our living standard in the process.

Market mechanisms are also powerful in bringing about social change. We shall be increasingly reluctant to spend large portions of our life travelling from our homes to work, and homeworking will mean smaller personal transport emissions. It seems plausible that, in the future, economic growth will become less energy-intensive. Sooner or later we will all have enough things made of steel, aluminium and plastic (all of which we will get ever-better at recycling). What we will want more of are personal services – whether privately funded (massages) or publicly funded (nursing). This shift will be particularly apparent in the developing world. China, one of the great world warmers at the moment, will one day want to move beyond its industrial base to a more modern product mix. Indeed, China is already showing

a considerable concern about global warming as it recognises the dangers to its water systems that it could pose.

These developments can be helped by public policy. The Bush regime has been unfairly slated for its initial reluctance to embrace global warming. The science needed to be tested. Nor is it politically easy to force energy-saving measures down the throats of the public, particularly the US public. A defect of democracy relative to dictatorship is that it requires patience. It is at least arguable that an earlier environmentalism from Washington would have created a lasting backlash.

However, now it has become reasonably clear what is required, and on what scale. A major breakthrough for environmental thinking is the monumental report prepared by Sir Nicholas Stern for Gordon Brown, referred to above. Stern believes in tackling global warming, but he also believes in using market mechanisms to do so. It turns out from his calculations that, done this way, the cost of the necessary insurance policy is relatively modest. 'The benefits of strong and early action far outweigh the economic costs of not acting… if we don't act the overall costs and risks of climate change will be equivalent to losing at least 5 per cent of global GDP each year, now and forever. In





contrast, the costs of action… can be limited to around 1 per cent of global GDP each year,' he says.

'Tackling climate change is the pro-growth strategy for the longer term and it can be done in a way that does not cap the aspirations for growth of rich and poor countries,' Sir Nicholas goes on. And he lists some of the instruments that can ensure this happens: for example, emissions trading, technological cooperation, and action to reduce deforestation.[38]

This should not lead to complacency. Changing from an energy-extravagant economy to an energy-prudent economy will be costly. It will require changes in lifestyle, which are not to be underestimated. In particular, there will be social problems if the less well off are being deprived of their holidays in Majorca while the rich fly to their African ecolodges. It is thus important to keep an eye on social justice when implementing measures to combat global warming. And it is particularly important to consider international social justice. Relatively modest costs for people in the developed world may be major costs for people in the developing world – who must accordingly, and within the limits of what is politically possible, be given priority in the use of what carbon energy the world can afford to consume.

38 Stern, op.cit.

## CONCLUSION

One of the great virtues of market economies is their adaptability. They can accommodate large economic, social or technological changes without fracturing. The Social Market Foundation's own research priorities, set out in the appendix, are designed to facilitate those changes.

Much the same is true of the theory of political economy known as the 'social market'. Indeed, more than half a century after its emergence as Europe's dominant social philosophy, its bounds have extended and its intellectual grip is as strong as ever.

The social market, unlike Marxism or Fascism, is not an ideology in the sense of presenting a set of beliefs that stand together or fall together. Rather, it is a way of looking at the world. It is compatible with a wide range of individual political viewpoints, though not (as we have seen) with all political viewpoints.

In this essay, I have endeavoured to show how the social market view of the world has evolved since Skidelsky's seminal 1989 essay. Of course, it may be about to collapse. If (for example) inequality within and between countries were to take off, or if the state becomes insufficiently powerful to put right its defects, or if the problem of global warming deteriorates (or is allowed to deteriorate) into a crisis,





then the social market may join the other defunct political theories of several millennia of human development.

For the reasons given in this essay, I do not expect that to happen. The social marketeer is essentially an optimist in temperament, seeing problems but rarely prophesying Armageddon. That fits it well to continue to be the animating philosophy of most of the free world, as well as of the world that in future will become free.

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# APPENDIX: SMF RESEARCH PROGRAMME 2007-08

Our research programme focuses on five core areas which are both social market in nature and which will be at the forefront of political debate over the coming months and years:

**The impact of globalisation and the insecure society.** There is no real alternative for the economic prosperity of the UK but to embrace liberal international markets in goods and services. The SMF has always provided a home for champions of open markets and of the benefits of globalisation and will continue to do so. But a social market approach to these issues also means championing an engaged state and an effective social safety net in the interests of a socially cohesive and just society. Achieving the latter is important in and of itself, but it is also a pre-requisite of a properly functioning economy. We will be conducting and commissioning work in the following areas:

- The UK's response to growing economic protectionism in Europe and the US.
- The need for immigration to be managed and legal.
- A review of current welfare provision and the development of an alternative approach to eligibility based on the ideas of weak and strong reciprocity.
- The government's response to off-shoring or to significant job losses in particular communities.
- The potential for the development of the market in unemployment protection.

**Government effectiveness and UK competitiveness.** Globalisation increases the need for government action on competitiveness, rather than rendering it redundant as some argue. Of particular importance is government action on education and adult skills and inward investment in pursuit of the development of the knowledge economy. However, it also emphasises the need for a transparent and predictable framework for government activity. We will conduct or commission research in the following areas:

- Fiscal policy, through an examination of the transparency and scrutiny of the fiscal rules.
- Productivity, and in particular an evaluation of the effectiveness of measures to promote productivity in comparison with our international competitors.
- Foreign Direct Investment, its national and local impact and how to attract it.
- Planning policy, in particular in relation to major infrastructure projects and local competition issues.
- Knowledge of markets, their advantages and their limits in the civil service.

**A decade of reform: public services and the social market.** The SMF has been a major proponent of the need for reform of the public services in the interests of social justice and public efficiency. Past SMF research has advocated the importation of market incentives into public service monopoly systems; in particular the replacement of command and control structures by quasi-markets and the use of performance management techniques and incentives for staff. We will be examining the impact of reform over the last 10 years and continuing to propose reforms which increase both equity and efficiency. We will undertake research in the following areas:

- A major research programme project looking at the future of the National Health Service.
- An overview of the success of the public service reform programme including an assessment of where market-based reforms have worked, a critique of how choice-based reforms have been communicated and positioned politically and how a focus on service users can be further developed.

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- An examination of government's role in developing and managing markets in public services where there is a mixed economy.
- The impact of the reform programme on the public service workforce.

**Market incentives and human behaviour.** Policymakers continue to persist in one of the myths of classic economics – that each person is a rational actor motivated solely by their own interests, and therefore over-rely on fiscal incentives to change behaviour. This programme of work will investigate how the lessons of behavioural economics can be applied to the field of public policy, particularly in relation to climate change, public health and savings policy. We will undertake an examination of how new learning from behavioural economics can help policymakers design more effective policy, particularly in the three areas identified above.

**Capability, poverty and culture.** The deeply embedded nature of disadvantage in the UK is clear. Although government has had some impact on reducing poverty, for example in relation to its child poverty targets, overall the picture is mixed, as it is on social exclusion and social mobility. This is despite the political will and finances that have been invested. Some of the initiatives taken by government, particularly in education, have not yet had the chance to bear fruit. It will not be until the generation currently in education reaches adulthood that we will have a proper understanding as to how much of an impact these measures have had on reducing intergenerational poverty. We will conduct or commission research into the following areas:

- The government's response to growing tensions between those able to afford a home and those who are not.
- The design of better private and social housing to combat social exclusion, crime and poverty.
- An examination of the cultural determinants of achievement.

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