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City State against national settlement:
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ABSTRACT[1] *This paper argues that the City of London has power like that of a City State in a country like the UK where financial elites dominate and competition of elites has failed. This is now a serious problem because expenditure cuts after the crisis are undermining the redistributive settlement of benefits and publicly funded jobs which were the life support of the ex-industrial areas under Thatcher and Blair. The only credible response is radical new economic policies which can usefully be launched through local and regional initiative.*

KEY WORDS: elites, mass democracy, economic policies

[1] Free download available from http://www.cresc.ac.uk/publications/city-state-against-national-settlement-uk-economic-policy-and-politics-after-the-financial-crisis

City State against the national settlement: UK economic policy and politics after the financial Crisis

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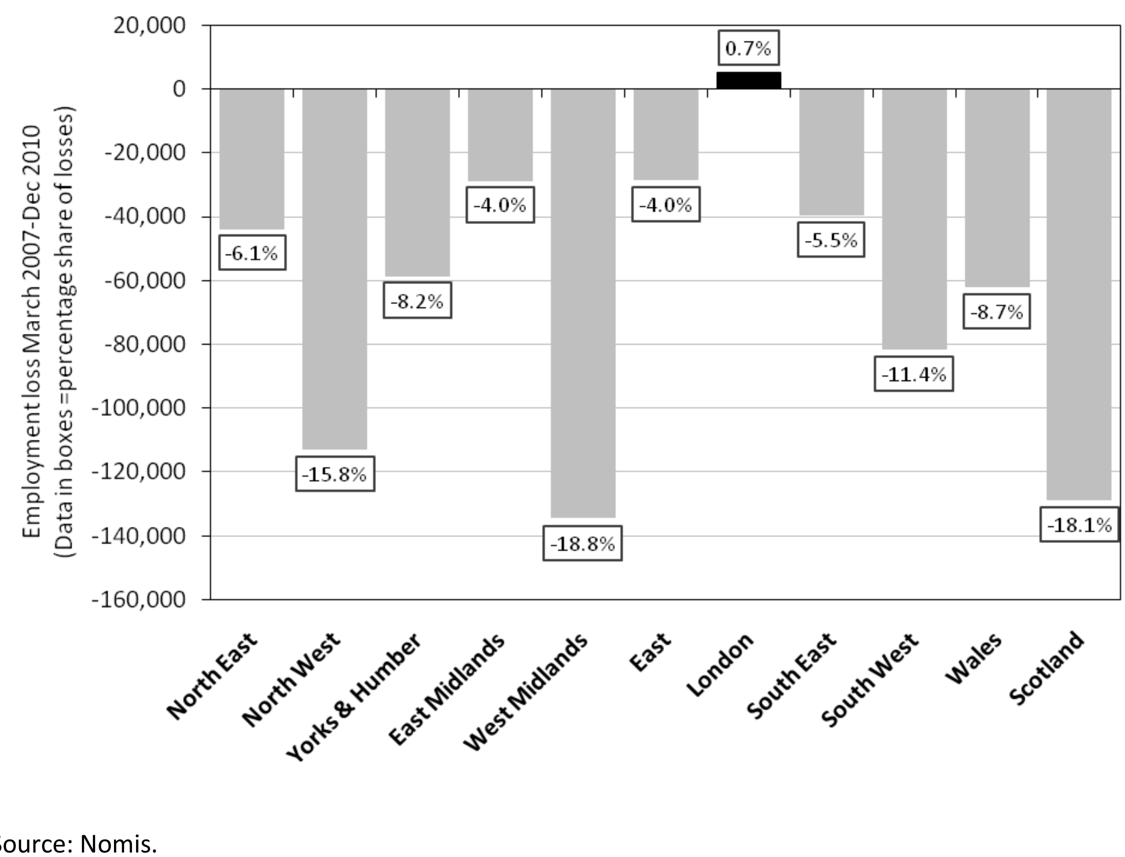
British radicals have long argued that our national predicament reflects the economic priorities of London-based finance and the political power of a southern metropolitan elite. An argument about this bias towards finance can be traced in the contemporary diagnosis of Edwardian radicals like J.A. Hobson; more recently it has been reworked by historians such as Eric Hobsbawm and commentators like Will Hutton. In this paper we extend this reasoning to political and economic developments since 2008. We argue that the financial crisis, and its aftermath, are a once in a generation break which will have consequences for us all. After 1979, Mrs Thatcher inaugurated a 30 year experiment through which both Conservative and New Labour governments balanced 'neo-liberal' reforms with an undisclosed, redistributive national settlement of publicly-funded employment and service provision. After 2008, the financial crisis and the ensuing politics of austerity will traumatically terminate a redistributive social settlement which disproportionately benefited ex-industrial regions of the North and West that have no autonomous capacity to create private sector jobs.

If the post-2008 break represents a major shift in the forms and consequences of economic and political power, the outcome so far consolidates the position of London as a kind of 'City State' within the national economy. The current shift has its roots in the economic and political changes of the 1980s when deindustrialisation undermined non-metropolitan elites while the deregulation of finance allowed the growth of London as an international financial centre. Fortuitously or not, the political changes of the 1980s and 1990s then allowed finance to speak and act for London. As London finance asserted new priorities in the pre-2007 boom, it also developed a legitimating narrative about how finance contributed tax revenues for national purposes. But the consequences of London's growing power were always different from how they were represented in this trade narrative. The benefits for the regions were much smaller and London has always been internally dysfunctional because of sharp inequalities between the dominant oligarchy and their working poor. And, in the new phase after 2008, London finance had the disruptive power to resist any reform intended to help make finance safe, as well as to vigorously support a politics of austerity where fiscal cuts would undermine the national settlement of government redistribution to the ex-industrial regions of the North and West.

As the expenditure cuts bite in 2011 and later years, the end of the national settlement inaugurates a redistribution of private affluence and public squalor because different regions and groups are not 'all in this together'. There is more private affluence for the privileged in and around finance in the metropolis but still very little trickle down for London's working poor; public squalor increases in the ex-industrial regions like the West Midlands and the North East as services and publicly-funded jobs are cut. These upcoming developments are adumbrated in the extraordinary picture which we present below of regional differences in job loss since the onset of financial crisis. London, or more exactly London finance, was *initiator and epicentre* of the post-2007 economic crisis. As such, the sector and the broader London area could be expected to pay the price in the form of high unemployment, declining property prices and such like. After all, this was what did happen in the coal mining valleys of South Wales in the inter-war years, or in Teesside's heavy industry towns after the early 1980s. This time it is different as exhibit 1 shows.

Exhibit 1: **Regional share of total UK jobs losses between 2007 and 2010**



Source: Nomis.

Notes: Data relates to employees. Excludes self-employed and N.Ireland. Total jobs losses from March 2007 and December 2010 was 712,500.

London is the only part of the UK economy which at the aggregate level has not experienced job losses in the first phase of the new age of austerity. As exhibit 1 illustrates, the modest increase in London employment is shorthand for the continuing vigour of many parts of the London economy; and the contrast is marked with other regions. In the worst economic downturn since the war, between 2007 and 2010, some 712,500 jobs were lost nationally but more than 85% of that total or some 621,200 were lost in the ex-industrial regions of the West and North with the heaviest proportional losses concentrated in the West Midlands, Wales and Scotland. By way of contrast, the East, East Midlands and South East regions each suffered job losses of no more than 50,000; and the number of jobs in London actually increased by just over 5,000.

But it would be wrong to conclude from this contrast that London is some kind of unitary whole so that the increase in jobs means that most of the people in a rush hour tube carriage have done well in the past few years. If we ask 'who is London?' and 'who benefits from its growth?', we find that many groups including native born Londoners have not got onto the up escalator. A recent report from the LSE (Gordon *et al.,* 2007) provides some startling answers to the question of which groups have gained jobs. Although the population of London has grown, net migration from the rest of the UK is negative (Gordon *et al.,* 2007: 34) because London is not drawing in workers from other regions into well-paid jobs as the Midlands and the South did in the 1930s or the 1960s.

Exhibit 2: **Growth of employment in London, 1997-2006**

	1997 Q4	2006 Q1	Change	
	(000s)	(000s)	(000s)	(%)
Total employed London residents	3,102	3,490	+388	+13%
Of which:				
UK-born	2,242	2,293	+51	+2%
Non-UK born	860	1,197	+337	+39%
Total employed with London workplaces	3,559	3,876	+317	+9%
Of which:				
UK-born	2,681	2,683	+2	0%
Non-UK born	878	1,193	+315	+36%

Source: Gordon *et al*. (2007), table 5.5 (p.54).
Note: The original data is drawn from the Labour Force Survey, grossed up from a sample of 7,000 employed respondents in London.

Nor are native born Londoners doing well because exhibit 2, which draws on Gordon *et al.'s* study, shows that the benefits to UK-born residents of London's growth are rather limited (2007: 54). There was an overall growth in employment in London of 13 per cent or 388,000 people between 1997 and 2006; however, more than 85 per cent of the new jobs are held by London residents born outside the UK. If we consider all net new jobs at London workplaces, including those who travel into London to work, all of the new employees were born outside the UK. At the top, aspirant graduate trainees and the working rich find jobs in finance and the professions. At the bottom, as unskilled migrants pile into low paid service jobs, the wages of the worst paid 20% have been 'quite substantially eroded' (Gordon *et al*., 2007: 62). If we look at this evidence, the issue of whether London as a whole is doing well is beside the point. Because the question is: who and what is London for? (if its growth comes from a sweated, casualised workforce providing cheap services for a small group of working rich and their employers and if immigrants claim most of the jobs at top and bottom).

If we were to add in wealth and assets, the story becomes yet more complicated because the gains from house property increases are widely diffused, though there is of course much variation in levels of home ownership across London where one-third of the inner London stock is still social housing. We might also add a consideration of the 'rich list' in-migrants, like Russian oligarchs, who have chosen to live in London and have one home there. But, if we consider the narrower issue of employment and earned incomes, London is different because employment is increasing but the high wage beneficiaries of London finance could probably be fitted into a couple of football stadia. Though we can and must talk of 'London' and how its growth has disrupted the rest of the economy and polity, it is clear that divergent experiences within London are as important as the differences between London at the aggregate level and the regions. And If London's success is partly about bottom in-migrants working for top in-migrants, this is hardly a brilliant success and definitely not a matter of national pride.

The analysis in this paper is primarily national, for very pragmatic – rather than nationalistic - reasons. The commonalities which link diverse national experiences are mediated through national politics, internal economic differences and variable place in the international order. Thus, the Greek, Irish or United Kingdom cases would need to be analysed separately and the national level is a primary arena of struggle. In analysing the UK case, we do not start from an essentialist definition of what a nation is, but instead explore how the British nation is being redefined, both through the politics of austerity and through the power configurations that shaped and sustained our settlement before 2007. The political outcome of financial crisis in the UK has paradoxically consolidated the power of London as a kind of 'City State' within the national economy and with its own internal inequality. The politics of austerity in the UK brings us closer to the end of the national, if by the *national* we mean a space of social redistribution and negotiated political compromise.

The article which follows is organised in a relatively straight forward way in three sections. The first section describes the rise of the City State and explains how and why the power of London finance was increased in the second half of the 1980s after financial deregulation and changes in local government. The second and third sections then consider consequences and how things play politically. The second section observes how the power of the City State was used after 2008 to prevent retribution or constructive reform of the finance sector. The third section considers the politics of austerity and the legitimation of public expenditure cuts which will undermine the established redistributive social settlement. A fourth concluding section then considers what is to be done.

1. The rise of the City State

> *'[A] political system consisting of an independent city having sovereignty over contiguous territory and serving as a centre and leader of political, cultural and economic life'*
> *(Encyclopedia Britannica, definition of City State)*

When social science has so many bad, procrustean concepts, it is often helpful to use a good provocative metaphor. In a literal sense, London is of course not a city state because it does not have the sovereignty to match the classic definition. But London does share characteristics with other city states, particularly those of Northern and Central Italy in the fourteenth century; so the city state metaphor highlights key distinguishing features of autonomy and authority which have strengthened London's distinctive identity in the last thirty years and made its relation to the national host increasingly problematic.

There are two key similarities between London and a classic early modern Italian city state like Florence:

- In economic terms, the city state is a node at an intersection, which grows by capturing trade flows of goods or money. London is now running an entrepôt trade in money at the intersection of the international time zones, just as Italian city states like Genoa or Venice had run an entrepôt trade in goods at the intersection of the trade routes from the East and the Mediterranean to the North and West of Europe. Compact size and the high profits from tolls on traffic, make trade more attractive than production and trade adapts to changing specialisation like the decline of Italian woollen production; while finance or the trade in money always supports and is often more lucrative than trade in goods. This was the case in fourteenth century Florence where Peruzzi and Bardi were major lenders to Edward III in England and managed many of the financial affairs of the rest of Europe (Russell, 1918).

- In political terms, the Italian city states were mostly republics with a tendency to mercantile oligarchy tempered with violent factionalism. The city state had to do deals with outside powers and interests and control the city's politics and cultural imaginary so that the oligarchy's interests were identified with those of the city. In Florence, deals with merchants and the papacy led to the growth of the *popolo grasso* (or greater guilds of merchants and bankers), who effectively displaced the old regime of magnates (Epstein, 1999). There are clear overlaps here with the rise of professional lobbying by the City after 1986 and its increasingly close relations to the Treasury or economics ministry and to front bench politicians in Conservative and Labour parties which were both increasingly dependent on City funding.

The trajectory is then one of restless growth and precarious over-reach insofar as the city state can be defined as a subject whose political capacity protects an oligarchy's pursuit of larger scale money making despite setbacks or structural problems. Florence's growth came from the ever-extravagant lending of its financiers and the annexing of land through military conquests, which were expensive for the State and funded through bonds. This expansion was highly problematic –the sizeable loans made to Edward III of England became worthless when he defaulted; as did Florence's own City government bonds when plundering could not bring in enough resources to cover the interest on its debt (Gilbert, 1999). In the case of London, there are very similar themes because its history since the mid-1980s is dominated by serial boom and bust around injudicious lending and unregulated credit creation, which has not been effectively blocked by re-regulation. The financial innovation of derivatives allowed vast private profits before 2007 and then created huge liabilities which were managed by socialising the losses and passing them onto taxpayers in the host nation and elsewhere.

This last observation however highlights the importance of differences between city states especially in their relation to larger hosts and adjacent political units. Classical examples of city state in ancient Greece preceded the creation of larger political entities like nations or empires; or, in medieval Italy, occupied a space created by the dissolution or break up of earlier empires. The general modern pattern is one of accommodation with a stable, larger host nation. Some modern city states like Berlin, Bremen and Hamburg in Germany, survive within federal national systems where power is mostly exercised elsewhere. The most recently created city state is the Vatican which dates from 1929 and represents a compromise between the Papacy and the unified Italian state. Local exceptions to rules and practice on taxes or political freedoms may often then suit the city state and its adjacent host; the French national host's rules on tax and gambling are supported rather than undermined by allowing local exceptions in the city state of Monaco. But, in the case of London's modern rise, we may now see a new kind of relation between city state and host nation because, as we argue below, London both benefits from (and contributes to) the weakening of such larger national entities.

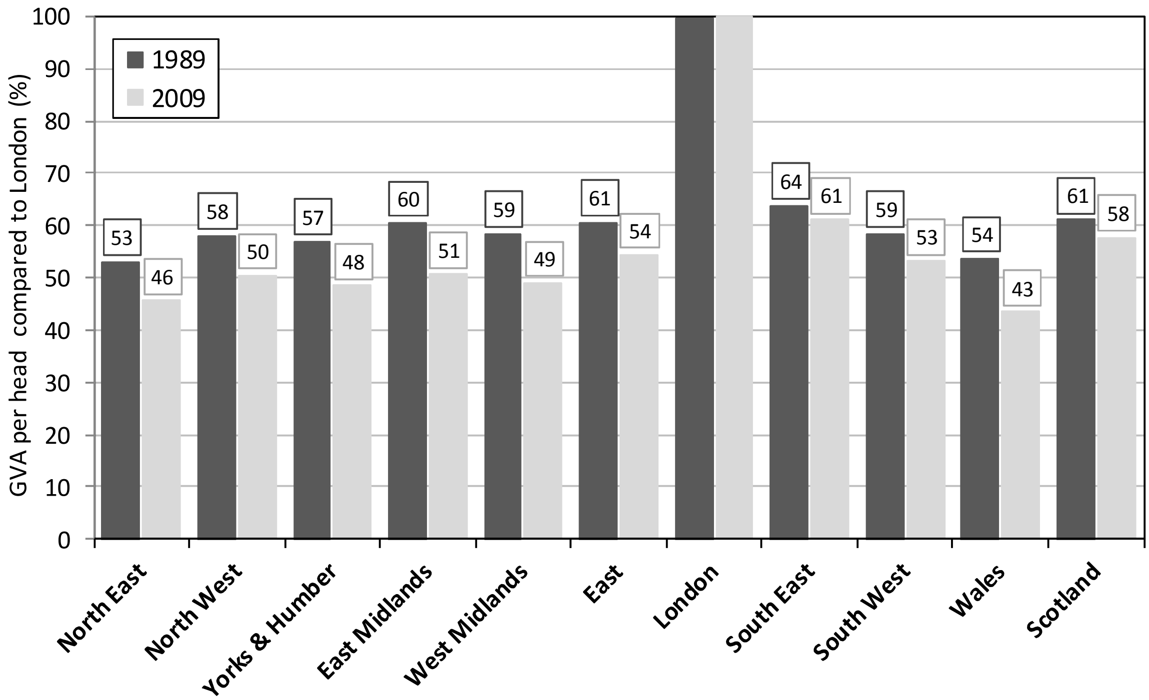
How did London become dysfunctional in this way? In the two decades or so up to the great crisis of 2007-09, three great developments –economic, institutional and ideological– all contributed to the emergence of London as a new kind of 'City State'. And they were facilitated by a culture of finance whose effect in the UK as in the USA was to normalise a highly financialized economy and represent it as a democratic opportunity in which all could and should be enrolled (Frank, 2001; Langley, 2007) Economic developments are the best known and most straightforward to document. Bagehot's characterisation of the City in the free trade heyday of British industry and empire credits financial markets with huge economic power. This was then constrained by the shift to national autarchy in the 1930s and the subordination of financial markets under the Bretton Woods settlement till the late 1970s; though the rise of the euro dollar markets established a business platform for later developments. Post-1979 developments allowed the rebuilding of financial power and the creation of what even mainstream politicians now concede is an 'unbalanced economy' (Froud, Johal *et al.,* 2011, pp.3-4). The atrophy of manufacturing stripped out many jobs, while the rise of finance created very few jobs. In manufacturing, the huge increase in import penetration more than outweighed export success so that, in real terms, the output of British manufacturing in 2011 was no higher than in 1979, while the employment base in manufacturing had declined over the same period from 6 million to just under 2.5 million. But finance was on a quite different trajectory because financial deregulation, after the Big Bang of 1986, opened new possibilities of running an entrepôt trade in money, just as funded saving and mortgages created a domestic feedstock. As a direct result the real value of the output of financial services increased three times between 1979 and 2011; and equally important, because one employee can lift a lot of money in wholesale finance, the numbers employed in financial services did not increase at all beyond a base of one million, even over 15 years of sectoral boom and expansion after 1992.

In part this then became a story about changing regional power and status because London (with finance) was drawing away from the rest of the national economy especially the North and West which had no visible means of job creation to replace lost manufacturing jobs. Exhibits 3 and 4 document different aspects of this transformation over two decades in terms of changing output and employment trends. Exhibit 3 compares gross value added (GVA) per capita[2] in the UK regions against London whose income serves as a base of 100 in both 1989 and 2009. The point of the comparison is that all regions (including the South East) fall behind London over these twenty years but the fall is greatest in the West and the North. Thus the three laggard regions of the North East, West Midlands and Wales fall by an average of 9

[2] Gross value added (GVA) is defined by the ONS as follows: 'Gross value added is the difference between output and *intermediate consumption* for any given sector/industry. That is the difference between the value of goods and services produced and the cost of raw materials and other inputs which are used up in production' (http://www.statistics.gov.uk/about/glossary/economic_terms.asp). GVA is also sometimes referred to as *net output.* GVA per capita is calculated by dividing the total GVA by the population.

percentage points against London GVA per capita, so that at the end of this period each one of these regions has a GVA per capita which is less than half that of London. The Welsh GVA per capita was 54% of that in London in 1989 and only 43% by 2009: if this trend were to continue, Welsh GVA by 2029 would be no more than one-third of London GVA per capita.

Exhibit 3: **Regional GVA per head compared to London in 1989 and 2009** (expressed as a percentage share of London's GVA per head)



Source: ONS

In terms of employment and job creation, the contrast between London and the rest of the South East, let alone with struggling regions like the West Midlands is stark. The official statistics on where the extra jobs come from are not very informative because state employees are now working alongside increasing numbers of publicly funded but privately employed workers in nursery education, care for the elderly and such like. In exhibit 4 , we have used the CRESC developed method for calculating publicly funded employment in the (private) para-state sector and then added these para-state totals to those of state employees (Buchanan *et al.* 2009, pp.16-9).

Exhibit 4: **Regional analysis of employment change between 1998 and 2008 split by private sector and state & para-state sector**

	TOTAL (net new jobs)	of which Private sector	of which State & para-state	Female total (net new jobs)	of which Private sector	of which State & para-state	Male total (net new jobs)	of which Private sector	of which State & para-state
	No.	%	%	No.	%	%	No.	%	%
North East	85,372	26.9%	73.1%	38,876	-5.4%	105.4%	46,496	53.9%	46.1%
North West	215,535	38.4%	61.6%	120,642	15.2%	84.8%	94,893	68.0%	32.0%
Yorks & Humber	182,627	33.2%	66.8%	111,534	6.5%	93.5%	71,093	75.0%	25.0%
East Midlands	138,857	40.0%	60.0%	50,394	-29.1%	129.1%	88,463	79.3%	20.7%
West Midlands	64,609	-79.0%	179.0%	42,559	-103.0%	203.0%	22,050	-32.6%	132.6%
East	204,884	45.9%	54.1%	98,644	21.8%	78.2%	106,240	68.2%	31.8%
London	404,438	67.2%	32.8%	196,405	56.0%	44.0%	208,033	77.8%	22.2%
South East	332,643	56.4%	43.6%	133,581	25.1%	74.9%	199,062	77.4%	22.6%
South West	289,744	54.7%	45.3%	141,769	32.4%	67.6%	147,975	75.9%	24.1%
Wales	144,955	45.6%	54.4%	73,615	21.4%	78.6%	71,340	70.6%	29.4%
Scotland	258,542	40.7%	59.3%	149,085	14.3%	85.7%	109,457	76.6%	23.4%
Total	2,322,206	45.4%	54.6%	1,157,104	18.4%	81.6%	1,165,102	72.2%	27.8%

Source: Nomis.
Notes: The table is a measure of employees not jobs (where an employee can have more than one job).

The story is that London was creating jobs (and not only para-state jobs) unlike any other region. Between 1998 and 2007, London created more than 400,000 jobs and more than two-thirds of these jobs were in the private sector and not dependent on public funding. This was significantly higher than the next best performing region, the South East, which managed to create 333,000 extra jobs of which 56% were private sector; and hugely different from the worst performing region of the West Midlands where private sector employment was declining and all of the 65,000 job net increase and more was publicly funded. Employment creation in the period of the British post-Thatcher boom turns out to be strikingly non-national.

If London was a machine for growing output and creating jobs, finance took much of the credit for these positive outcomes by presenting itself as the leading sector of the London economy. In reality, the role of London finance was much more ambiguous. Finance was in many ways

London's *dividing sector* because it concentrated prosperity within London and then within a few small areas of London. London's success after 1979 was partly secured by the centralisation of everything as well as finance in an increasingly London centric politics, media and culture which was fed by the relative decline of the provinces. Finance was then an active agent of increasing division and inequality within the London area and outside.

- London had the dominant cluster of financial services employment. Much of retail finance was dispersed across the whole country and large parts of retail banking were labour intensive because they required a branch-based sales force and back office support. Nevertheless, exhibit 5 shows the extent to which, by the moment of the great crisis, London as 'international financial centre' was the centre of UK financial employment despite the dispersion of retail finance employment. The 324,000 working in finance in London accounted for 31% of the national financial services workforce and more than 7.5% of the London workforce. The backward linkages from finance to supporting London professional services like law and accountancy were significant but much weaker than in the case of a manufacturing sector assembling a complex product. On our estimates each worker inside the finance sector supports no more than half a worker outside the sector (ABR, 2009: 35).

- Within London, wholesale finance concentrated affluence in some areas. Under the kinds of remuneration systems and business models prevalent in the finance sector (such as the 'compensation ratio' in investment banking, or the '2 and 20' fee structures in private equity and hedge funds – see Folkman *et al.,* 2007), a small number of working rich, senior bankers and financiers in and around the City of London earned ever increasing incomes. Their lucrative employment was highly concentrated in the local government area covered by the Corporation of the City of London –a correspondence that we examine in more detail in the next section. The new working rich of senior bankers, hedge fund partners and such like were a small group commuting from a few suburbs of choice to place of work in the old City in the square mile behind St Pauls or to the main new City location in Canary Wharf, with alternative investment colonising a Mayfair village. 'London finance' is actually shorthand for a highly concentrated geographical space which has very little connection with the rest of the metropolis except insofar as nondescript middle-class suburbs like Enfield or Beckenham supply PAs and poorer boroughs like Barking house immigrant supply office cleaners.

Exhibit 5: **Regional share of finance employment 2009**

	Total employees	Finance employees	Regional share of total finance employment	Finance share of regional employment
	No.	No.	%	%
North East	1,056,152	26,646	2.5	2.5
North West	3,132,161	106,596	10.1	3.4
Yorks Humber	2,337,932	81,757	7.7	3.5
East Midlands	1,997,963	34,922	3.3	1.7
West Midlands	2,411,388	77,728	7.3	3.2
East	2,556,955	74,688	7.1	2.9
London	4,285,930	323,894	30.6	7.6
South East	3,913,446	124,612	11.8	3.2
South West	2,478,955	82,283	7.8	3.3
Wales	1,271,254	31,403	3.0	2.5
Scotland	2,528,758	94,600	8.9	3.7
TOTAL	27,970,894	1,059,129	100.0	3.8
London and South East	8,199,376	448,506	42.3	5.5

Source: Nomis.

Note: Finance is classified as activities within Standard Industrial Classification (2009) 6411 to 6630.

The divisive development of London finance made it inherently vulnerable to criticism by (or for) the vast majority of those inside and outside London for whom wholesale finance was an opaque money trade from which they derived no tangible, direct benefit. This was doubly so because of the nature of the new City after deregulation. Foreign firms dominated the new City, which was a success in much the same way as the Wimbledon lawn tennis championship, because the City was located in London but could not find a British champion to cheer on. Most of the British financial services firms which joined the new competition after Big Bang in 1986 lost out and quickly sold on. Barclays Capital is the only successful and surviving large investment Bank which can claim to be British owned; and private equity is the only sub sector of finance where several British firms like Permira and Apax met the US challenge by successfully upscaling. More generally, the entrepôt trade in money has created something rather like an offshore financial centre which just happens to be located not on a sandy Caribbean island but on the banks of the muddy Thames; unlike Caribbean offshore centres, London imported migrant labour to fill low-pay, low-skill jobs, as well as well-paid expats for executive positions in and around finance.

At an organisational level, London finance is dominated by foreign institutions performing functions for international, especially EU, markets (The City UK, 2011: 8). The UK banking sector originates more cross-border bank lending than any other country – 18% of the world total in June 2010- and around half of European investment banking activity is conducted in London. There were 241 branches and subsidiaries of foreign banks in London in March 2010, more than in any other centre worldwide and a third of these banks were from the euro area. Foreign banks manage over one-half of UK banking sector assets, totalling over £7.6 trillion at the end of 2009, mainly on behalf of foreign customers. Even the stock exchange is increasingly dominated by non-UK companies.

Hence, the inevitability of the second aspect of London's rise as a city state: the defensive elaboration of an ideology legitimising London's pre-eminence in finance. This was done through a classic trade narrative which counted the many ways in which the London-based finance sector activity benefited the national economy (and passed over the many disconnects and negative outcomes). This was ideology in a more or less exact sense: a structure of ideas that legitimised the dominant position of the elite that controlled the most important financial markets, notably legitimising the particular governing structures that it enjoyed – a matter to which we return below. In the fifteen years of the new 'long boom' that ended with the financial crisis there developed a narrative, repeated endlessly by City voices and echoed by public policy makers: to wit, that London's pre-eminence as a global financial centre was both the engine for driving a successful post-industrial national economy and a source of the tax revenues that funded national public services like health and education. Intellectual support and academic respectability was provided by the best consultancy that money could buy: Oxford Economic Forecasting was by the mid-2000s providing an annual report on *London's Place in the UK Economy* which was written up in the supply side language favoured by the Treasury and international agencies like the OECD. The City of London press office broadcast Oxford's conclusions through press releases whose upbeat tone was sustained into the early stages of crisis. For example, the 2007-8 press release claimed:

> 'The report finds that London is pivotal to the health and success of the wider UK economy, acting as a pump for capital and innovation throughout the regions. London's cluster effect, particularly in financial services, has seen rapid productivity growth and a highly skilled labour force contribute to competitiveness on an international level'
> (City of London, press release, 17 October 2007).

This was of course overcomplicated for a lay audience, so the main PR effort went into placing event-related stories in broadsheet newspapers, which regularly updated a few key factoids about the tax contribution of the financial services sector (which was by claim or implication sustaining the government's programmes). The *Financial Times* echoed this line uncritically as the bubble inflated (e.g. *FT*, 17 October 2006, 20 November 2006, 26 March 2007, 27 March 2007) in articles which repeatedly associated financial services with one-quarter of tax revenues:

> 'The financial services sector is the largest corporate contributor to the Exchequer…. Banks, finance and insurance companies contributed a quarter of all corporate tax revenues in 2004-5, according to new Revenue and Customs figures, despite accounting for just 8 per cent of the UK's economy'
> (*Financial Times*, 20 November 2006).

Media repetition of the 'one quarter' factoid was enough to compel belief amongst front bench politicians who all swallowed the line that financial services was the goose that laid the golden eggs. But, as usual with trade narrative claims, the factoid was a half-truth which included a crucial but little noticed qualifier about *corporate* tax revenue.

Exhibit 6: **Analysis of taxes paid by the finance and manufacturing sectors**

	Total taxes paid by employers and employees		Sector's taxes as a share of government receipts	
	Finance £mill.	Manufacturing £mill.	Finance %	Manufacturing %
2002/03	25,333	63,167	6.4	16.0
2003/04	25,184	62,273	6.0	14.7
2004/05	29,661	62,516	6.6	13.8
2005/06	34,366	62,993	7.1	12.9
2006/07	38,488	63,503	7.4	12.2
2007/08	39,679	63,375	7.2	11.6
Total for 6 years	192,712	377,826	6.8	13.4

Sources: Nomis, HMRC, ONS and PriceWaterhouseCoopers.
Notes: Employer taxes summate corporate tax plus employer's national insurance. Employee tax summates income tax and national insurance.

This meant that the claim was strictly correct because the financial services sector was paying up to one quarter of corporation tax. But it was also grossly misleading because corporation tax was only one small part of government tax revenues; and the overall contribution of finance to all government tax revenues was proportionately smaller and not at all creditable if we make the comparison with other sectors such as manufacturing. Exhibit 6 presents the basic data for a broader comparison because it includes all taxes paid by employers and employees in the sector.

On this measure, finance contributed less than 7.5% of all government tax revenues; even at the height of the Brown boom years the finance sector's contribution to government receipts was only just over half of the contribution from manufacturing (6.8% against 13.4%). From this point of view, the question is how a sector which was as large and profitable as finance could pay so little tax. And the awkward answer is that London finance had been built on tax avoidance, ever since Siegmund Warburg issued the first Eurobond at Schiphol airport so as to avoid stamp duty (Ferguson, 2007). Tax avoidance was embedded in the character of the financial markets built as instruments of regulatory circumvention and tolerated in the governing of the City state after Big Bang.

Economic transformation and ideological elaboration are connected to the third vital component of the rise of the new city state: the reconfiguration of its governing arrangements so that finance could play a leading role. The abolition of the Greater London Council (GLC) in 1986 coincides with a parallel reconstruction of the government of financial markets - except that 'coincides' fails to convey how separate changes in governing arrangements were intricated in the process of London's rise. The abolition of the GLC finally dispelled the remnants of a Morrisonian conception of the government of London. The Morrisonian vision had delivered nearly a million social housing units in flats and garden city estates, a universal school system, an integrated city wide transport network, and a green belt around London; all in an attempt to govern the conurbation in the public interest according to broad strategic principles influenced by a democratically elected institution. After the abolition of the GLC, London government was the result of (highly unequal) struggles between boroughs and unelected Quangos such as the Docklands Development Corporation established in 1981. The DDC's vision of docklands regeneration delivered the Canary Wharf finance district, Surrey Quays shopping centre, ExCel Exhibition centre and infrastructure like London City Airport and the Docklands Light Railway, which carried those with jobs and money in and out of a new district which had very little to do with adjacent deprived working class communities.

1986 was also the date when the financial markets began the process of replacing the informal system of regulation orchestrated by the Bank of England with more formally organised institutions. The 1986 reforms created a complex system of self-regulatory organisations for individual markets presided over by a Securities and Investments Board endowed with some authority but carefully protected from the influence of democratic institutions like Parliament (Moran, 1991). The fallout from the fiasco of the Barings Bank collapse in 1995 saw the replacement of this system in 1997 by one with the Financial Services Authority (FSA) as its centrepiece. Post-crisis studies of the regulatory origins of the financial crisis, by Turner and others, now testify that the operational philosophy of the Authority made it subject to the interests in the market. This philosophy –dignified with the label of cooperative, light-touch or principles-based regulation – was justified on the grounds that London had to be competitive so that the nation could enjoy the many benefits of finance.

The recreation of a London-wide system of government in 1997 –an elected Mayor and an elected Greater London Authority –reinstated some capacity for strategic choice under the influence of democratic politics. Devolution had also, of course, likewise endowed Wales and Scotland, but, as our evidence shows, the institutional endowment was matched by nothing like London's economic weight, while the attempt to create institutional capacity by devolution in England's regions failed. But the results in London were business and finance friendly and not at all Morrisonian. An academic study of the planning process, even under the Livingstone mayoralty, documents the domination of that process by large corporate interests (Thornley *et al*., 2005). Successive coalitions in the London governing system have seen their role as that of promoting infrastructural investment –like the CrossRail project for an East-West link – designed to foster London competing against other global centres (especially in finance). If moving investment bankers between Canary Wharf and Heathrow was seen as a major problem, there was no concern with moving jobs out of Canary Wharf even though the concentration of finance drove a local economy which was marked by great and growing inequalities between wealth and contiguous poverty. Between 1998 and 2007, the Canary Wharf effect increased employment in Tower Hamlets borough but financial services employment was decreasing in all other London boroughs, just as it was also decreasing in the adjacent South East region (ABR, 2009: 37). When it came, the financial crisis changed very little. It was Ken Livingstone's Conservative successor, of course, who commissioned the Wigley Report (2008), produced by a Review Group entirely drawn from the key City lobbying groups like the Corporation (on which more see below) and key figures from the corporate elite; that Report, as we argue, repeated the case for policies designed to maximise London's attractiveness as a financial capital.

This was the governing assemblage with which London was endowed when the financial crisis erupted, and, as we shall now see, it is this institutional endowment which explains much of what has since happened to the City State, and to the corporate and non-corporate finance interests that dominate it, in the age of austerity.

2. The caravan moves on, 2008-12

'The dogs bark but the caravan moves on.'
(Arab proverb quoted by Montagu Norman, cited in Boyle: 1967)

At this point in our argument, we turn to how things have played since 2008. In this second section, we examine how and why London finance was able to defend itself so that it escaped retribution which would have clipped the wings of finance and equally escaped constructive reform which would have made finance safe. In the third and final section of this paper, we consider how London finance is implicated in political programmes for public expenditure cuts under New Labour and the Coalition which will undermine the national settlement. If the previous section has described the creation of a kind of assemblage, sections two and three describe how this operated very effectively after 2008 to redistribute adjustment and pain away from the finance sector and towards innocent bystanders of crisis like council employees or those on long term invalidity benefit, especially in the ex-industrial areas.

The autumn of 2008 and the winter of 2009 was nevertheless a moment of great danger for London finance. The state acquired a large chunk of ownership of the banking system; institutions of democratic politics, such as the House of Commons Treasury Select Committee, grilled some of the financial elite; leading executives of the failed banks were pilloried in the tabloids (see Froud *et al*., 2010). Yet as the politics of austerity unfolded in the general election campaign of 2010, and its aftermath, that brief moment of danger passed. 'The politics of austerity' in the ensuing years has seen the target of austerity politics shift elsewhere: to the public sector, and especially to the public sector foundations of the ex-industrial regions outside the metropolitan city state. Despite the voices raised in democratic critique of the financial elite, the brunt of the deprivations of the new age of austerity are being felt elsewhere (including in the more deprived parts of London): the dogs have barked, but the London finance caravan moves on. Both before and after the 2010 election, the Westminster governing elite agreed on the direction of, and shape of, austerity policy; the disagreements have been tactically-induced differences over the exact scale, and the exact timing, of the austerity measures.

The financial elite was already recovering the policy initiative even as the financial crisis was at its height. The Bischoff (2009) and Wigley (2008) reports, managed the feat of recycling the established stories about the social benefits of an over developed financial system: in the case of Bischoff it even began to identify new opportunities – such as provision for retirement –for markets to colonise (Bischoff 2009: 45); in the case of Wigley it vigorously advanced the case for policies to reinforce the attractiveness of London as a financial centre against the competition of other global metropolises. Neither Bischoff nor Wigley were simply products of private interests in the markets: strictly, Bischoff has to be cited as 'Bischoff and Darling' since, though drafted in the City, it was published by the Treasury, and co-signed by the then Chancellor, Alistair Darling; Wigley, though published under a Merrill Lynch imprint, was commissioned by the London Mayor's office as part of the campaign to defend the City's position as a globally preeminent financial centre. (We return to the integration between the Treasury and the financial elite below).

These reports set the tone for the subsequent evolution of policy. The terms of the coalition agreement in May 2010 proved decisive. CRESC research had advertised the reliance on public and para-public employment to support the non-metropolitan regions (Buchanan *et al*., 2009);

but Cameron and Osborne concluded that rebalancing of the economy meant, not less finance, but more manufacturing without much new policy support and with expenditure cuts which would shrink the public sector. A brief struggle over the terms of an inquiry into the future structure and regulation of the banking system soon marginalised the advocates of radical reform: the Cabinet committee on the future regulation of the banking system was to be chaired by the Conservative Chancellor, rather than the Liberal Democrat business secretary who had in opposition advocated radical structural change. The interim report of the Independent Commission on Banking established by the coalition, and published in April 2011, has mooted only the most cautious of structural and regulatory reforms (Independent Commission on Banking, 2011). The 'Merlin' project in 2011 negotiated between the banks and the Treasury has, through a voluntary agreement linking bonuses and bank lending to businesses, defused the potentially difficult issue of high bonuses (see Shapinker, 2011). By April 2011 it was plain that the banks had found no difficulty in circumventing even the limited voluntary restrictions on bonuses (Groom, 2011). Appearing before the Treasury Select Committee on January 10th, the new Chief Executive of Barclays could tell the Committee that the 'time for remorse and apology' on the part of banks for their part in the disasters of 2007-9 was now over. It was time, in other words, for the caravan to move on.

Explaining why the 'politics of austerity' took this form after the great crisis depends on recognising the importance of the *new* politics of the City state. The observation that the financial markets, and the interests embodied in them, are powerful in shaping of economic policy in the UK is hardly novel. But the striking development of recent decades has been the reconfiguration of the institutional mechanisms that convert this economic muscle into influence over policy. Three active forces are at work: the reorganisation and professionalization of the lobbying capacities of London finance; the changing institutional configuration within the core executive, notably the way this has affected the capacity of financial interests to make their voices heard at the heart of government; and the changing relationship between democratic actors, especially the major political parties, and City interests. Again these forces operated in a pro-finance cultural medium.

For much of the twentieth century the City was barely recognisable as a 'lobby'; its considerable influence over policy depended on social and cultural integration with governing elites, and on the Bank of England as a mediator between City interests and the core executive. The development of more open and transparent systems of interest representation, and the growing relative autonomy of the Bank of England from City interests, made this informal regime of representation increasingly anachronistic (Moran, 1981, 1986). The financial elite responded with professionalization and more formal organisation of its lobbying operations. Davis (2000, 2002) has documented the rapid growth of professional financial PR and lobbying services in the City in recent years. Under Angela Knight, a Treasury Minister in the Major governments of 1990-7, the British Bankers Association has been revitalised as a lobbying operation: it had originally been revived in the 1980s to speak as the voice of banking in Brussels, but now acquired a prominent role in domestic lobbying. (We further examine the connections between the City elite and the Conservative Party below).

The Corporation of the City of London – until near the end of the 20th century largely a body with narrow local government and social functions – has likewise reorganised into a systematic lobby for London finance. A key change occurred in 2002, when the constitution of the Corporation was reformed: it had hitherto escaped every reforming measure in local government since the original Municipal Corporation Act of 1835. The City of London Ward Elections (2002) does something unique in British local government. The business vote in all other local government systems of the UK had finally been abolished in 1969. The Act of 2002 not only retained the business vote in the City, but greatly expanded the range of the business franchise, so that business vote now actually outnumbers the residential vote in the City. The Corporation has applied its considerable historical endowments to building up its advocacy and economic intelligence capacities: it was the Corporation, for example, which provided much of the research work for the Bischoff Report (see Bischoff, 2009: 54; and see also Shaxson, 2011).

London finance thus entered the crisis of 2007-8 with a lobbying operation which, in its professionalism and command of resources, was vastly superior to that commanded in similar earlier crises, such as the secondary banking crisis of the 1970s. A parallel change had also taken place within the core executive – the second major force that shaped how the financial crisis was converted into public policy. A significant legacy of the Brown Chancellorship has been a great augmentation of the range and depth of Treasury power across the core executive (documented in Thain, 2004). A striking index of the change is provided by a comparison of the Treasury's role in successive banking crises: in the great systemic crisis that preceded that of 2007-8, the secondary banking crisis of the 1970s, it played only a marginal role, the key manager in those events being the Bank of England (Moran, 1986). But in 2007-8 the Treasury was the dominant manager in the crisis (Froud *et al*., 2010 and Froud, Moran *et al*., 2011). The crisis saw the use by the Treasury of public funds on a huge scale to support the stricken banks. After some hesitation, when the Treasury cast around for various institutional means of crisis management, by November 2008 it had settled on the creation of United Kingdom Financial Investments (UKFI) as the vehicle for managing the huge tranche of the banking system which it had acquired in the rescue operation. UKFI was from the beginning defined by its founding chief executive (John Kingman, then a senior Treasury official) as an 'arm's length' institution: that is, an institution operating at arm's length from the democratic state. Its relations with the 'city state' were very different – and much closer. Its successive chairmen have been City grandees, and its senior executives have been drawn overwhelmingly from the financial elite Moreover, its operating strategy has been defined in a familiar, pre-crisis language of the maximisation of shareholder value: it sees itself as promoting any practices in the banks – including the highly contentious bonus system – that will allow it eventually to dispose of its holdings on terms which maximise return to the taxpayers as shareholders (documented Froud *et al.,* 2010 and Froud, Moran *et al.,* 2011).

This second important forces shaping post crisis politics, therefore, involved the domination of the process by a Treasury which had greatly enhanced its position in the core executive during the Brown Chancellorship, and which in turn had developed close relations with the elite of the financial markets. The strengthening of the nexus between the core executive and the elite of the city state has been in turn reinforced by the third force: the rise of a financial nexus between the leading parties and City interests. The link is symbolised by the family backgrounds of the present Prime Minister and Deputy Prime Minister, both offspring of the City 'working rich': David Cameron describes himself as a 'fourth generation stock broker'. In the case of the Conservatives, the symbolism is particularly apt, for it points to key long term changes in the financial relationship between the Party and City interests.

Pinto-Duschinsky's (1981) landmark study of party finance shows that in the golden age of the mass party the Conservatives, contrary to many myths, raised most of their income through membership dues and fund raising activities at local level: for instance in the decade from 1967 only about 30 per cent of Conservative party income came from companies (Pinto-Duschinsky, 1981: 234). The bulk of income came from the constituency parties – large in the age of the mass party - and highly effective middle class fund raising operations. There were some obvious and unsurprising social and geographical biases in constituency party strength. But in the age of the mass party – at its post war peak the Conservative Party had 2.8 million members – both membership and fund raising had a wide base: the Party had large, wealthy constituency organisations in Scotland and the north of England. It thus had deep social roots, and funding sources, outside the metropolitan centre. These roots have now withered: there are presently about 200,000 individual members, most of them elderly. (At its peak there were more Young Conservatives than there are now members of the whole Party). These withered social roots have also had an important financial consequence: the Party in the country is no longer a significant source of income.

Moreover, increasing transparency about donations –beginning with the 1967 Companies Act and culminating in the regulatory regime now run by the Electoral Commission – has made large corporations hesitant to donate. The Party has to rely heavily on rich individual backers. The result can be seen in the financial history under David Cameron: in 2005, when Cameron became Leader, the financial services industries were the source of just under a quarter of total cash donations to the Party; by 2010 the figure had risen to just over 50 per cent (Bureau of Investigative Journalism 2011; Watt and Treanor, 2011). A large proportion of this money comes from the working rich created by the financial services revolution – high net worth individuals who have the means to make significant donations, and who as individuals do not feel constrained by the delicacies that hem in major corporations. A key threshold is a £50k annual donation, because this makes the donor a member of the 'Leader's Group', with an entitlement to meet 'David Cameron and other senior figures from the Conservative Party at dinners, post-PMQ lunches, drinks receptions, election result events and important campaign launches' (Conservative Party 2011). In 2010, 57 individuals from the financial services sector made donations sufficient to join the Leader's Group.

The withering of the Party's non-metropolitan roots is thus closely connected to its increasing reliance on the working rich created by the operation of London finance. The idea of acting against plutocracy becomes increasingly politically unthinkable for the interconnected reasons described above.

3. The social settlement undermined

The Thatcherite project is usually summarised in terms of it explicit, reforming, disruptive 'neo-liberal' elements (labour market flexibilisation, privatisation and asset sales, deregulation and freer trade in goods and money). These attracted much attention because they were explicitly justified policies which often targeted opposing interests, promised benefits and caused major changes often including collateral damage. But policy had another subtler conservative dimension under Tories and New Labour because it included an undisclosed and implicit 'one nation' social settlement of a redistributive kind which used the tax and benefits systems plus state-funded employment to head off social unrest and to maintain some kind of decent minima in the ex-industrial regions of the UK, especially the North East and West Midlands, which had lost much and gained little from the liberalisation and deregulation movements. The (small c) conservative settlement was just as important as the radical reforms but the settlement was undisclosed, and undiscussed because it was both politically unintended and practically hard to track through official statistics. In consequence, few now appreciate how currently planned publicly expenditure cuts threaten that established post-1979 settlement.

Front bench British politicians have taken the lead in proposing public expenditure cuts after the crisis. Even if the coalition government's political resolve does not falter, the scale of any expenditure cuts will change as public expenditure numerators and GDP denominators shift about in a recession. But, the complication of GDP growth rates and unemployment increases is irrelevant to the basic point. Both main parties have proposed massive public expenditure cuts: the new Tory/Lib Dem coalition, under Chancellor Osborne, has announced headline cuts of some £80 billion over several years; and the previous Labour government, under Chancellor Darling had proposed cuts of some £50 billion. The political consensus is for restrictive fiscal policy which is curiously combined with ultra-loose monetary policy. This has involved zero nominal (and negative real) interest rates plus quantitative easing which involved buying securities on terms which injected cheap funds into the banking system. But, it was London finance that made the new fiscal and monetary policies necessary for three reasons.

- First, the domino collapse of one bank after another was prevented in autumn 2008 by system guarantees, nationalisation of failed giant banking firms like RBS and Lloyds/HBOS and massive injections of liquidity. Taken together, the costly support of banking and finance precipitated cuts because the support costs wrecked public finances in the UK which was already running a public sector deficit of 3% of GDP before the crisis hit.

- Second, mainstream politicians in the UK justified cuts by arguing that Portugal, Ireland, Greece and Spain could not finance their deficits on reasonable terms because the bond markets insisted on a standard of fiscal prudence via expenditure cuts. What the bond markets did or did not require was uncertain because this was a matter of 'confidence' and practicalities about maturity schedules and the identity of foreign owners. But, in British political discourse the bond markets figured as the bogeymen enforcers of fiscal orthodoxy.

- Third, monetary policy with quantitative easing and such like was the unorthodox and expansionary element in the policy mix. But that was deployed to support the central objective of government policy after autumn 2008, which was to keep the banking system going at all costs. This required not only the socialisation of banking losses but also the restoration of the conditions of profitable banking so as to allow balance sheet repair and the continuation of routine lending. Put another way, the costs of crisis and adjustment were to be externalised and the combination of loose monetary and tight fiscal policy was the means to that end.

If the political commitment to safeguard banking and finance is clear, it is much harder to identify the lineaments of the social settlement and how it is threatened by the proposed expenditure cuts which will bite from 2011 onwards. The social settlement in any high income country involves a guarantee that economically unsuccessful and low income individuals, households, localities and regions will benefit from government redistribution that brings them up to some kind of decent national minimum standard. The outward and visible sign of this settlement is government sponsored redistribution. This is easiest to understand in the case of individuals and households where there is a tradition of explicit policy commitment to minimum income standards, whether through Beveridgean social security in the 1940s or the minimum wage since the 1990s. If we consider taxes as well as benefits, the corollary is what might be called vertical redistribution through transfer from high to low income households (complicated, of course, by differences in family size and type). It is much more difficult to understand the horizontal, spatial redistribution between areas, both because we have the contiguity of wealth and poverty in adjacent small areas of major cities like London; and because explicitly redistributive regional policy has been off the political agenda for the past thirty years or more. On the other hand, much of what government does, whether through benefit payments or provision of schools and hospitals, has distributive implications. The question of whether there is a regional social settlement can only be answered by looking at the flows of income and expenditure.

The empirical measure of redistribution adds further complications, especially if we wish to understand, first, horizontal transfers between regions as much as vertical transfers between individuals or households and then, second recognise how these two transfers are interrelated. The problems are conceptual and practical ones about how to understand multidimensional processes and how to rework limited official statistical sources so that mechanics and outcomes become clearer. The most straightforward way of measuring redistribution from official statistics is to use measures of consumption outcome. We can, for example, compare original and final income for households sorted into income groups (by quintile group or area average) which receive benefits in cash and kind and pay taxes which by subtraction and addition transfer income between groups. Household benefits can be calculated fairly precisely but only around two thirds of taxes paid can be allocated to households (which does not undermine the calculation because the remainder is spent on categories such as defence, public security, roads, foreign aid and the judiciary). But this tax and benefit transfer account of redistribution works much better for the analysis of vertical redistribution than for horizontal and spatial processes where the transfer of income and consumption demand tells only part of the story. It needs to be supplemented with a supply-side perspective on the state's role in supporting an otherwise surplus population through publicly-funded jobs as well as long term benefits in Britain's ex-industrial regions. Measures of publicly-funded job creation and of the benefit dependent population provide a supplementary perspective. In income transfer calculations education and health services figure as consumption benefits in kind spread across all households ; while in the complementary productionist view (publicly funded) education and health are a source of jobs spread across all regions but practically crucial in the ex-industrial regions.

From this point of view, the existence of a social settlement and the way in which it is now threatened by expenditure cuts becomes an empirical question. In terms of the more straightforward, vertical redistribution, the question becomes one about whether economically inactive and low income households will lose after the cuts because they can no longer expect to have their original incomes made up by transfers in the established way.

The answer to this question was confused when (future) Chancellor George Osborne claimed that 'we are all in this together' (BBC News, 6 October 2009), as he justified his proposals for expenditure cuts to the Conservative party conference. But it is fairly easy to disprove that claim by considering the basic figures on income transfer which show that low income households in employment, as well as those on welfare benefits, are the two most vulnerable groups. According to welfare lobbyists, some £18 billion of the total £81 billion announced cuts in public expenditure will be found over three years from 2011-14 from the welfare budget through a variety of measures such as capping housing benefit and reform of disability benefit. This means the costs of the crisis are being visited on groups hitherto reliant on state redistribution in the form of services and cash benefits to establish a decent minimum. Some government ministers would justify such benefits reform as a regime change to reduce welfare dependence in the economically inactive. But, as Exhibit 7 shows, low income and economically active households are also vulnerable to expenditure cuts.

Exhibit 7 is of interest because it shows us the established mechanics of vertical redistribution through government tax and spend transfer. It presents data on economically active households, ranked by income in quintiles from low income Q1 to high income Q5. The established mechanics depend on high income households paying a larger lump of tax and lower income households drawing more in benefits in cash and kind. This transfer machine works to produce a settlement as long as the government prevents tax avoidance and evasion in middle income groups and also maintains expenditure on cash benefits and benefits in kind for lower income groups. With £18 billion coming out of the welfare budget, this second precondition is now being tested.

This kind of settlement does not require a progressive tax system. Under the Thatcher Governments' tax regime, continued by New Labour, income tax rates were capped at 40-50% for high earners, with the state's revenue increasingly reliant on indirect, consumption taxes like VAT which are regressive. As Exhibit 7 shows, the system is not progressive overall, because the percentage tax take on gross income (i.e. original income plus cash benefits) is more or less constantly around one third for households with low, middling or high incomes. But a constant percentage take on a larger income base means of course that affluent households do therefore absolutely pay much more in taxes: the highest income quintile, Q5, pays £28,000 a year in taxes, and this does of course provide a fund which is potentially available for redistribution as benefits and services. Before the cuts, the state did transfer resources to the working poor in low income active households who historically get much more cash benefits than affluent households and also draw higher health and education benefits in kind. State-provided benefits are larger and account for a much higher proportion of final income in lower income active households: in Q1, for example, average cash benefits of £6.2k per household are four times as large as in Q5. Together, these two state supports of benefits in cash and in kind more or less double original income to £17k in the lowest quintile of active households (Q1) but add no more than 15% to income in Q4 or 6% in the highest Q5 quintile.

Exhibit 7: **Quintile analysis of non-retired household income, benefits and taxes and tax rate, 2008-2009**

	Non-retired households ranked by equivalised disposable income					
	Q1	Q2	Q3	Q4	Q5	All non-retired households
	£	£	£	£	£	£
Original income	7,599	20,258	33,678	47,435	81,878	38,170
plus Total cash benefits	6,183	5,444	3,320	1,874	1,255	3,615
less all taxes	5,058	8,649	12,561	17,589	28,129	14,396
Disposable income	8,724	17,053	24,437	31,720	55,004	27,389
plus Benefits in kind	7,836	6,912	6,082	4,795	3,744	5,874
Final income after benefits and taxes	16,560	23,965	30,519	36,515	58,748	33,263
Total tax on income and cash benefits	36.7%	33.7%	34.0%	35.7%	33.8%	34.5%

Source: ONS.
Notes: Benefit in kind relate to non-cash value of goods and services provided by government. The two largest categories are education (66% of the total), NHS (31% of the total). The group also includes travel subsidy and free school meals.
Note 2: ‘Total cash benefits’ is the summation of contributory and non-contributory cash benefits. The former group includes incapacity benefits and retirement income and equals 62% of the total cash benefits and the latter includes housing benefit, income support, tax credits and child benefit and equals 38% of the total cash benefits.
Note 3: Tax rate is calculated by dividing tax total against the sum of original income and cash benefits
Note 4: Households are ranked after equivalisation, a process which ‘ranks households by process that adjusts households’ incomes to take account of their size and composition'. The underlying data is not equivalised.
Note 5: Quintiles contain households ranked by disposable income and split into groups of 20% of households, with Q1 the lowest income earners and Q5 the highest.

If vertical redistribution was not an explicit objective, Thatcher and Blair both played Robin Hood by taking from the rich and giving to the (working) poor in a way that established a settlement if not an explicit entitlement. In doing so they also allowed London finance to claim credit for a redistribution which was much more broadly based on higher incomes households across the South East and beyond. Something of the same sort went on in terms of regional transfers and spatial redistribution which was however much more complex and cannot be understood simply in terms of income transfers and consumption. The regional spatial story is in one respect the same as the quintile vertical story because households in regions with high average incomes lose out because they pay a larger lump of tax. But the compensation for regions with low average incomes comes in several different ways. The North East does benefit from transfer payment effects because average household original income in the North East is no more than 50% of that in the South East and after transfers final income is 72% of that in the South East ; thus an original income gap of £18k is reduced to just over £9k. But the main mechanism of compensation in other ex-industrial regions under New Labour was publicly funded job creation plus willingness to park some of the economically active on long term benefits.

Let us first consider the effect of transfers. Exhibit 8 shows variations in original and final income for all households (economically active and inactive) by region from the most recent statistics. It shows how average household income in each region is reduced or increased in net terms after payment of taxes and receipt of benefits in cash and kind. The regional picture of net effects is a pattern of redistribution which takes from the rich even if it does not consistently increase household income in the poorer regions. In the richer regions, like London and the South East, average households are all substantial net losers from transfer intervention; while in poorer regions like the North East, Wales or West Midlands, average households gain albeit in a very variable way.

Thus average households in the three most affluent regions of London, the East and the South East are substantial net losers from tax and benefit transfer to the extent of £3 to £5k on an original average income base of less than £40k per household; and the primary driver of that outcome is higher tax payments driven by a higher original income, reinforced in the case of East and South East by lower cash benefits. Only in one disadvantaged region, the North East, does the average household make comparable transfer gains as large as £4k and the average household in the West Midlands actually loses from transfer.

Exhibit 8: **Regional household income and the impact of benefits and taxes 2008-09**

	All households arranged by Government Office Region (average per household)						
	Original income	(plus) Cash benefits	(plus) Benefits in kind	(minus) All taxes	Final income	Net gain or (loss) (benefits minus taxes)	Tax rate
	£	£	£	£	£	£	%
North East	19,308	6,369	5,675	7,870	23,482	4,174	0.31
North West	27,807	5,273	5,856	11,018	27,918	111	0.33
Yorks & Humber	24,534	4,970	5,198	9,997	24,705	171	0.34
East Midlands	29,518	4,792	5,574	11,721	28,163	-1,355	0.34
West Midlands	28,748	5,330	5,698	11,492	28,284	-464	0.34
East	34,329	4,160	5,223	13,361	30,351	-3,978	0.35
London	37,343	5,287	6,183	14,472	34,341	-3,002	0.34
South East	38,070	4,227	4,821	14,336	32,782	-5,288	0.34
South West	30,431	5,312	5,799	11,582	29,960	-471	0.32
Wales	25,527	5,770	5,216	10,177	26,336	809	0.33
Scotland	29,776	4,620	4,968	11,598	27,766	-2,010	0.34
All Households	30,485	5,045	5,513	11,920	29,123	-1,362	0.34

Source: ONS.
Note 1: The underlying study does not distinguish between income through employment from the State or the private sector. Approximately 55% of taxes are directly allocated to households. Government spend on military and civil defence, roads, justice, environment, foreign aid etc. are excluded. The underlying methodology assigns taxes and benefits to households where there is a robust conceptual basis for allocation.
Note 2: The underlying data includes all households. The North East has lower economically active rates and the lower tax takes reflect lower original income.
Note 3: Low income households are spread thinly across the UK and not specifically in one region
Note 4: Tax includes direct, indirect and intermediate taxes. Tax rate is calculated as a percentage of disposable income which is calculated as original income plus cash benefits.
Note 5: Includes economically active and non-active households.

On this basis, it is evident that there was some redistribution and maintenance of a settlement. However, this income transfer measure does not identify the key sources of support. To identify this key support, we must look not at consumption but at production and the sources of new or extra jobs which show how every disadvantaged ex-industrial region did benefit from publicly-funded job creation under New Labour employment.

The public funding for job creation was spread fairly evenly around the country through government expenditure mainly on health and education services. But, the jobs thereby created were of greatest value in the ex-industrial regions where private sector job creation had failed and publicly funded new jobs (plus long term benefits) kept local economies going, as exhibit 4 showed. This was not obvious in official statistics which counted the number of state employees in public firms in an economy of outsourcing and sub–contracting, where publicly funded private employment in a para-state sector was increasingly important. When CRESC researchers developed a method for calculating para-state employment, we calculated that by 2009 their number was equal to one third of the total of state employees (Buchanan *et al.* 2009). State and para-state together accounted for more than two thirds of the total job increase in the North East, Yorkshire and Humberside and the West Midlands; as against just 32% of extra jobs in London and 45% in the South East. If we break employment down by gender, the results are even more striking, because nationally state and para-state account for more than 80% of women’s jobs and more than 100% in the North East and the West Midlands.

The effects of publicly funded employment were reinforced by the willingness of successive governments to offer long term benefit to large numbers of workers in the ex-industrial areas. As the number of unemployed was a politically sensitive indicator, political pressures and humane GPs ensured that many of the long term unemployed ended up on invalidity benefits. In exhibit 9 we have calculated the number and proportion of the economically active population who are out of work and drawing some form of benefit on grounds of unemployment or invalidity (as a point of reference we also include a calculation of benefits against all aged 16-64 where the denominator includes the discouraged and those ineligible for benefit). The regional contrast is quite startling and the predicament of the ex-industrial regions is dire because here the settlement after deindustrialisation created a new Speenhamland which offered full maintenance for a wholly unemployed industrial population. The North East, and Wales have 20% of their economically active population parked up on out of work benefit, the West Midlands and Scotland around 17.5%. By way of contrast, the percentage on some form of out of work benefit in the South East is no more than 9.0%. London has a much higher rate of 16.1% on out of work benefit, indicating the extent of the deprivation which co-exists with great wealth in the City State.

Exhibit 9: **Number of people claiming any 'out of work' benefits split by Government Office Regions** (November 2010)

	Out of work benefits	Total economically active	'Out of work' benefit claimants as a share of total economically active	All aged 16-64	'Out of work' benefit claimants as a share of all aged 16-64
	No.	No.	%	No.	%
North East	265,610	1,259,000	21.1	1,682,000	15.8
Wales	292,740	1,455,000	20.1	1,895,000	15.4
North West	663,250	3,432,000	19.3	4,434,000	15.0
Scotland	478,000	2,695,000	17.7	3,400,000	14.1
West Midlands	467,940	2,671,000	17.5	3,448,000	13.6
Yorks & Humber	443,640	2,618,000	16.9	3,406,000	13.0
London	669,040	4,151,000	16.1	5,403,000	12.4
East Midlands	325,600	2,301,000	14.2	2,890,000	11.3
South West	326,160	2,704,000	12.1	3,286,000	9.9
East	349,760	3,007,000	11.6	3,680,000	9.5
South East	463,570	4,461,000	10.4	5,389,000	8.6
TOTAL	4,745,310	30,754,000	15.4	38,913,000	12.2

Source: Nomis, ONS.
Notes: The 'Out of Work' benefits category is defined by Nomis, using a DWP derived definition of 'Key out of work benefits'.

This last piece of political arithmetic about benefits completes the argument because, by joining the dots, we can now see the shape of an undisclosed social settlement which is inevitably threatened by expenditure cuts that limit publicly-funded job creation and encourage welfare reform. The settlement is reasonably robust on the revenue side where governments will persist with tax regimes that take a larger lump of tax from households in the upper half of the income distribution (not least because avoidance limits the yield of taxes on companies and the working rich). New Labour’s spending on health and education services was spread thinly across the whole national economy, just like the same benefits were available in all regions. But in the absence of any other signs of economic life in the de-industrialising regions, these universal provisions became a de facto regional policy. But deficit reduction and expenditure cuts now limit the recycling of tax revenue into publicly funded jobs and long term benefits for the jobless and instead we have cuts for at least three or four years on government projections which are almost certainly over optimistic about the prospects for growth. If the undisclosed settlement is now at an end, what is to be done? The final section of our paper takes up these issues.

4. A new agenda for the social Left

> 'So here we have a social Left which does not coincide with the "political Left". The latter has been absorbed by economic elites to such an extent that it is difficult to distinguish between the recommendations of the big business groups and the decisions of the politicians. The narrow filter of party democracy impedes meaningful participation. This is why it is now time to get our imagination rolling and seek new forms of articulation which reinvent the political community, putting our collective intelligence to the test'
> (Communiqué from Universidad Nómada, posted 22 May 2011 by anti-cuts space)

The financial crisis in the high income countries has begun to focus the two great issues of our times: first, how do we control the unaccountable political power of elites in mass democracies; and, second, how do we harness knowledge and expertise to solve worsening problems of mass insecurity and stagnating living standards. The problem is worse in Britain because of the City State led by London finance, but the issues are more clearly defined in countries like Spain after occupations of the public squares under a centre left government which took the blame for the cuts. As the Universidad Nómada puts it so clearly, the problem is that the 'political left' has been absorbed by business; that is especially so in Britain where the power of financial elites is consolidated by and articulated through the City State. The question of what is to be done by 'the social left' will be answered in various ways within different political traditions. The logic of the problem definition presented in this paper is that we need a different agenda which combines new policies with a different politics that makes the metropolitan party politics much less accommodating to financial elites and more considerate of the interests of the majority of the population.

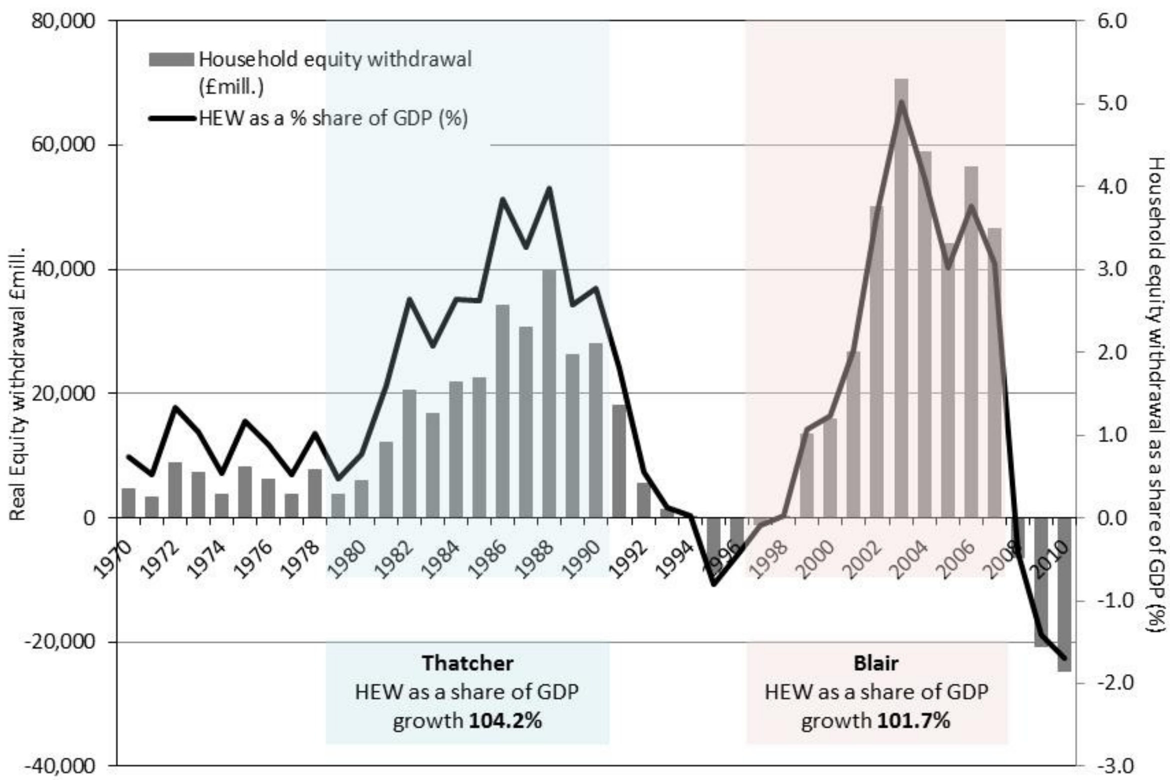
Our answer is located in the democratic liberal collectivist tradition of Beveridge and Keynes whose great post 1945 achievement in the UK was to align formal democracy under the mass franchise with substantive citizenship through guarantees of income and care for all. The model was one of using the mass political party to drive national reforms which mobilised technical expertise to make ordinary people more secure in their employment and its inevitable interruptions. This tradition is in crisis for all kinds of reasons, not least because the key national political actors no longer exist and the experts are confused. Liberal collectivism assumed that a progressive mass political party, like the Liberals in 1929 or Labour in 1945, would play a political heroic role in driving through progressive changes recommended by altruistic technocrats. Quite apart from the political changes, the experts are confused because the problem has changed in disorienting ways. Both Keynes and Beveridge rested their case for new kinds of interventions on the assumption that a national economy existed; as Esty (2004) argues, this was part of the English intelligentsia's response to the breakdown of an international order and the emergence of autarchy in the 1930s. In the current predicament, the beginning of wisdom in 2011 has to be a recognition that the national economy has ceased to exist and has been supplanted by a finance divided city state which can't pay and won't pay for ex-industrial client regions. The urgent task is to recreate a viable and sustainable national economy through imaginative policy interventions which will probably involve pressing a much more regional and local politics.

Any serious analysis has to begin by being more precise about our current problems. Our recent work in CRESC has focused on the national business model, i.e. the set of arrangements which generates a quantity and quality of employment necessary to distribute welfare and diffuse prosperity across regions and social groups. The UK's national business model is broken, as we argued in our original analysis of how the ex-industrial areas depend on publicly funded employment (Buchanan *et al*., 2009). On the basis of our subsequent analysis of UK manufacturing (Froud, Johal *et al.*, 2011) and of redistribution mechanics in this paper, we would draw a finer distinction between the UK growth model which in principle is intact and the UK redistributive model which is practically broken.

(a) An unproductive growth model survives and could deliver another cycle of UK output growth driven by housing and asset prices because its only precondition is loose credit.

Chancellor Osborne and the Coalition government are doing the wrong thing for growth by pressing public expenditure cuts and fiscal contraction (countervailed by a feeble industrial policy – see Froud, Johal *et al.,* 2011). Because, in its own terms, this can only come good on the OBR's implausibly optimistic assumptions about rising investment and export-led growth that are inconsistent with past performance. Whether the Coalition have boxed themselves in, is another matter: the Coalition's overall policy stance combines Treasury-led restrictive fiscal policy with Bank-led ultra-loose monetary policy via zero nominal interest rates and quantitative easing. This loose monetary policy was adopted so as to keep the banking system going because it provides cheap inputs for the banks and makes all kinds of wholesale carry trades profitable, just as it fattens retail margins. But, crucially and maybe unintentionally, it also delivers low mortgage repayments and maintains high house prices. The government's main achievement so far is to keep the housing market going and avoid a cyclical rerun of the 30% fall in real house prices after 1989. This economic achievement is precarious, because monetary policy is in the hands of an independent Bank of England committee with an anti-inflationary remit and the orthodox option of raising interest rates in an attempt to curb (commodity price driven) inflation. Bust in the housing market would delay the start of another asset price cycle led by housing. A recent IPPR report raises some questions about housing led cyclicality, but the political preconditions for another cycle remain favourable with all front bench politicians supporting home ownership and Ed Miliband publicly worries about frustrated first time buyers (*Financial Times*, 23 May 2011). So, in due course the UK could easily have another round of unproductive GDP growth driven by asset prices because, whenever credit is cheap and available, house prices will rise and equity withdrawal will feed consumption which delivers GDP growth via imports. Exhibit 10 below presents the basics of what happened in the last two cycles under the Thatcher and Blair premierships when the nominal value of housing equity withdrawal was larger than the growth in GDP. A Bank of England study (2004) admits, after examination of survey data, that between 40-50% of (gross) housing equity withdrawal became consumption demand.

Exhibit 10: **Total UK Equity withdrawal and as a share of UK GDP (%)**
(Equity withdrawal relates to sterling withdrawals and is in 2010 prices)



Source: Bank of England and ONS.

(b) The old settlement model for redistribution by government is irretrievably broken because its precondition is large and growing central government expenditures to support the ex-industrial regions.

The redistributive model, as analysed in this paper, combined two elements which benefited the ex-industrial regions. First, the creation of publicly funded employment, mainly in health and education; and second, willingness to pay unemployment or invalidity benefit for discouraged workers without factory jobs or the skills for mobility into (mainly Southern-based) service roles which are often taken-up by young EU immigrants. This always had limits because it was a structural process whose logic was an ever-increasing central public spend on redistribution to client regions. Compare and contrast the cyclical process of privately cashing out rising asset values which can be repeated whenever easy credit inflates asset prices. The expansion of central public spending would be led in good times by publicly-funded job creation and in bad times by the bill for maintaining increasing numbers on benefit. This made regional support expensive because it was achieved by increased spending right across the UK. Hence, the near 50% increase in real government expenditure between 2000 and 2007 (Buchanan *et al.,* 2009: 23). The government's bill for redistribution (and everything else) could be met by taxing or borrowing. Political resistance to higher taxes meant that New Labour was increasingly borrowing in the later stages of the boom. By 2007 the British public sector deficit had reached 3% of GDP which was the limit set by the Maastricht Treaty. The redistribution model had reached its natural limits before the banking crisis broke it completely. In an age of austerity, credit may be and eased ostensibly to help private business and incidentally to boost the housing market; but sustained growth in central public spending requires borrowing or higher taxation which is nearly inconceivable under the current rules of the game and that inevitably breaks the redistributive model for the ex-industrial regions.

These problems cannot be solved by simply throwing the policy levers in the opposite direction. If Osborne's fiscal plan for contraction will predictably fail to deliver deficit reduction plus GDP growth, the alternative is not an alternative fiscal plan for expansion. In a regionally divided economy, general reflationary expansion to expand employment and output would have mixed outcomes: most forms of fiscal stimulus would not effectively reach the ex-industrial regions where half a million jobs have been lost; meanwhile stimulus may be unnecessary in London where employment is increasing. The immediate problem in Britain (and, to some extent, in many high income capitalist countries) is distribution not growth because as the recent Resolution Foundation report (Plunket, 2011) observed, median wages were stagnant or falling over the growth cycle from 1990-2008 in the UK, USA and Canada. Of course, expansion is not irrelevant because employment levels and wages depend on output, but we do need the right kind of growth which benefits the majority rather than a few across Britain; it is a qualitative rather than a simple quantitative issue as it's about social and geographical (re)distribution and sustainability rather than an ephemeral growth based largely on house price inflation.

So what kinds of economic strategy and policies would be relevant to the inter-regional problems of the ex-industrial areas in the West and North of the UK and to the intra-regional problems of London? The focus of policy should be on jobs because jobs are the primary means of distributing welfare and an intelligible, tangible measure of progress. Our argument begins by considering strategy, where our preferred choice would be to put the main emphasis on job creation rather than job relocation and dependent clientism.

The ex-industrial regions of the UK, or the disadvantaged areas of North London, have no future as dependent clients because (regardless of whether it is economically feasible) expanded redistribution is not politically sustainable; indeed many of the existing problems of local government stem from the way this model is already embedded given that central government provides three-quarters of what it spends (IFS, 2007: 15). There is more scope for relocating public sector employment to the regions, on the model of the BBC moves to Salford. But such moves raise issues about cost savings and quality of services, as discussed in the Gershon Report (2004). Some relocation has been ineptly done, as when the relocation of much of the ONS from London to Newport (not Leeds or Manchester) resulted in a predictable exodus of statisticians from the organisation. Relocation is something we should be doing and doing better. Nevertheless, relocation is a subsidiary issue because the main strategic emphasis should be on creating jobs in the ex-industrial West and North where there has been little or no autonomous private sector job creation for the past thirty years. That problem could be addressed by the empowerment of regional and local government to deliver a social agenda, funded by new kinds of taxation, and reinforcing all this with a new tax regime for the private sector.

If we begin by considering institutions and objectives, there is a need to reinvent regional government for the delivery of broad social objectives. The problems within London or between the regions require an upper tier of strong regional authorities with a Morrisonian remit. This needs a new expertise plus elected representatives and democratic accountability which could work effectively if new institutions were connected with a popular agenda and social objectives. New Labour advocates of English regional government, like the Liberal Democrat advocates of the alternative vote, made the fatal mistake of disconnecting reform of institutions and electoral mechanics from any kind of broad social agenda. A new social agenda would involve the explicit identification of the major objects of expenditure which would improve security and quality of life in the next generation. The list of social objects might include large scale new build of social housing, universal care for the elderly, better transport infrastructure with moderate fares and low-carbon retro-fitting, recycling and maintenance. In each case, the aim would be to identify not only the objective but how it could be met with labour intensive, short chain production. The foodie middle classes are much concerned with the local provenance of the food they eat; in line with the Green New Deal (NEF, 2008) proposals, we would apply the same approach to broad social objectives. The critical institutional point here is that the absence of any effective system of sub-national government in England beyond London is robbing the regions both of a voice in policy arguments and a means of mobilising support for such distinctive economic policies.

Infrastructure is important because transport infrastructure would (with social housing) probably be one of the two major objects of expenditure in the first 5-10 years of a new social experiment. In the neo-liberal view, infrastructural improvement is generically important because it improves regional competitiveness and attracts development. This outcome is uncertain because infrastructure simply allows movement of people and goods in or out of a region. But, if we consider the City State problem, movement and connectedness through high speed, high capacity (rail) transport with modest fares between the UK's major conurbations is what is needed. There is no avoiding the fact that (parts of) London and the South East are, and will continue to be, the main engine of private expansion going forward. No amount of tinkering with regional government, social objectives and sources of taxation will change that. What we can do is to try to expand the radius of that overspill which is currently narrowly confined to the South East and could take in the ex-industrial West and North. If, for example, Birmingham to London by high speed rail takes one hour, or Manchester to London takes an hour and a half, then this is little different from low speed electric commuter trains to Kent or Sussex. Moreover, this would create new opportunities for public and private corporate sourcing in the regions.

While national infrastructure could properly be charged to central government, that would require tax or borrowing; and many of the remaining social objects require new local powers of taxation. Hence the new social agenda can only become a large scale outcome after: a reform of the basis for taxation by central government; plus, new tax powers for local and regional government now dependent on capped business rates and council tax based on obsolete values; plus a formula for tax redistribution and equalisation, so that the most benighted regions benefit from a transfer of tax receipts from rich areas to poorer ones. Tax reform should start from the principle that earned income and consumption are over-taxed while wealth, especially in the form of land and property, is under-taxed. Land and property taxes are particularly attractive because they are hard to evade or avoid when the reference asset is tangible and immobile. Taxes on property can also usefully discourage the reliance on unearned income which fuels asset-based growth that delivers little socially and brings disruption when the bubble pops. Redistribution of local tax revenue to benighted areas could be done on the basis of a formula which combined the two central indicators of ex-industrial failure (reliance on publicly funded employment and benefit dependence of the economically active). This would compensate, rather than establish perverse incentives in, localities like Walsall or Kirklees whose revenue base from property taxes has been eroded by thirty years of relative decline.

The scope for imaginative new taxes can be illustrated by considering the case of land value tax (LVT). The LVT is an annual tax on the market rental value of land, not the development that is built upon it. It is levied at a fixed rate and is charged whether or not the land has been sold. It is simple and cheap to administer, it can replace other taxes like council tax, and it can be collected locally with receipts mostly retained locally. It can also be tapered by area so that those in areas with high land values would pay more (Muelbauer, 2004). LVT is also socially justifiable. As early twentieth century radicals recognised, the (rental or sale) value of a plot of urban land reflects not the effort of the individual owner but the achievement of collective community development; it is entirely appropriate that society should then through taxes claim some share of the private benefit; and local authorities have first claim because their public investment in infrastructure generates significant private gains for owners without effort or risk (Maxwell and Vigor, 2005). Land tax also applies to all land, including unused land, which provides an incentive for the redevelopment of brownfield sites, where costs of redevelopment are generally higher than those of green field.

The strategy of regional government for social objectives with tax funding could be described as an explicit and considered attempt to reinvent the failed social settlement and thereby fix the broken redistributive model which would now become explicit and negotiated. If the state (local and national) takes the lead in this way, this must of course raise questions about the relative roles of public enterprise, for-profit private business and various kinds of mutuals. The short answer is that, if social action stimulates construction and infrastructure development, the public contracts would mostly be with private (for-profit) firms because they dominate construction, civil engineering and maintenance services. This would of course extend the numbers of publicly-funded private workers; and, in some cases, local authority direct works or not-for-profit mutuals might be preferred. In any conceivable world, the private sector is crucial because, even after its failure to respond to Thatcherite medicine, two-thirds of value added is in the private sector. Furthermore,) manufacturing is also the only sector which is sustainably capable of generating exports to pay for large scale imports; because, the exports of the financial sector come at the cost of huge liabilities to the taxpayer when things go wrong. We have elsewhere discussed the problems of manufacturing (Froud, Johal *et al*., 2011) but would now add the important, more general point that we need to retain a realistic view of what the private sector can do and think carefully about how the private sector could be fiscally encouraged to create jobs.

To begin with, it is essential to separate the imaginary and ideal characteristics of the private sector from the mundane and muddled actualities of what we have. It cannot be assumed that the private sector delivers efficiency and good management provided it is subject to competition or regulation: Britain has long had a problem of poor quality management (which has little to do with union power because that has been more or less non-existent since the mid-1980s in the private sector). The trajectory of British management is that it could not stand up to high wage European competition in the 1960s and 1970s long before Asian low wages became an issue. It has since retreated into site-based and formula activities like chain retailing and hotels or moved into sheltered utilities and services, classically dependent on state funding under contracts which often made profits relatively secure. Post-privatisation horrors include the railway network, as described in the McNulty report (2011), which explains that a five-fold increase in subsidy since privatisation is driven by inefficiencies with worse rolling stock usage and more expensive basic operations than in mainland Europe. Private enterprise has failed as comprehensively on the railways after privatisation as in the British coal industry before nationalisation. In some sheltered activities, for-profit private firms and contractual relations need to be replaced by different forms of ownership and organisation; and, if owners and operators are to be compensated, new ownership requires some expansion of public enterprise as well as of mutuals.

If the question is what 'can private firms do' the answer depends on incentives. The preoccupation with financial returns and the shareholder value framework with pressure from fund managers since the 1980s have probably encouraged management retreat and downsizing for profitability and certainly ensured everything is for sale if the bidder offers a premium. At this stage, what the UK economy needs from business (quoted and unquoted) is not profit but output because net output or value added at firm level provides the fund from which labour is paid and therefore sustains employment. In previous work on British manufacturing, we have recommended investment allowances and rebates of corporation tax for firms which increase output and thereby help to sustain employment and rebuild broken domestic supply chains. Much the same approach could, in variant form, be extended to other forms of tax such as business rates applied to many other sectors in the ex-industrial areas where increases in privately funded private sector output of goods and services would be a remarkable innovation. Two qualifications need to be added. First, there should be no tax rebates for firms heavily dependent on government contracts because the state should not pay firms twice via the contract and then again via the tax rebate. Second, some sectors, most notably retail and finance should be excepted. In retail, the emphasis should be on converting big box long chain operations to a more regional and local basis.

Could such policies work? They are lightly sketched and would need some development. But, we are at the end of a thirty-year experiment which has dismally failed to deliver economically for most of the North and West and some of the South and East. And, If the redistributive model is broken, something new is required by way of economic policies which break with the familiar generics of neo-liberalism about low taxes for enterprise (regardless of location or sector) plus training and infrastructural improvement (to improve competitiveness). In many ex-industrial areas of the UK the old neo-liberal nostrums have delivered little, so that it would not be difficult to devise economic policies which did a little better. But that does raise questions, not so much about the technical limits of intervention as about political preconditions. Here it would be a mistake to underestimate the opposition of the financial elites based in the City State or to overestimate the receptiveness of the metropolitan technocratic and political elites who have set our national agenda for the past thirty years.

The immediate and most serious political opposition to radical economic policies would come from London finance which has a threefold power: first, via the City State to interdict any reform of the financial sector which seriously changes behaviour and firm business models; second, to arrogate ownership rights and require financial returns from large corporates and private equity portfolio companies alike; third to insert costly middlemen who take their clip from most forms of borrowing or long term saving through pensions funds and such like. This is immediately best dealt with politically in two ways: first, by advertising the social uselessness of London finance, which does not deliver the value and returns it promises borrowers and lenders; second, by canvassing the redirection of credit away from the inflation of asset prices. The problem in recent years is that too much credit has been simply applied to the purchase of assets (mortgages to households; mortgage-backed securities to investors; corporate assets to raiders like private equity etc.). The over-supply of credit in these areas has the immediate effect of pushing up prices because there is more money than good assets in which to invest; in the medium term this also produces sharp and disruptive downturns as asset prices fall. Political demands for more lending to small business are not the answer if small businesses with cash flow often fear dependence on bank loans. Redirection should aim to tie private bank lending and bond issue into major social objectives such as infrastructure projects and new build of social housing, with risk reduced by back up state guarantees on default. It remains to be seen whether UK politicians can go beyond rhetoric about bank bonuses and small business and instead focus on rechanneling credit flows, scrutiny of bank business models and the general desirability of a smaller finance sector whose liabilities would be easier to manage in the event of trouble.

There are also broader questions about the receptiveness of national politicians whose collective party funding and individual front bench careers have depended on the British variant on the Nómad principle that the decisions of politicians should be consistent with the recommendations of finance. Against a background of mainstream concern with the unbalanced economy, some leading figures in the technocratic intelligentsia are rediscovering a problem about 'short termism'. This problem was highlighted in a recent article in the *Financial Times* (22 May 2010) by Richard Lambert, formerly *FT* editor and head of the CBI; Lambert referred to the technical analysis of capital market myopia in a new paper by Andrew Haldane, financial stability director at the Bank of England (Haldane and Davies, 2011). Meanwhile, the Labour Party's John Denham is promoting a more active industrial policy of a fairly consensual kind which will be of course very different from the radical policies and institutional change recommended above which are unlikely to be endorsed by Richard Lambert. Unless and until a significant group of policy insiders in London's technocratic intelligentsia buys into a more radical social agenda and breaks with the neo-liberal generics (favoured by the London finance), opposition Labour politicians will never have the independence to recommend new economic policies and will confine themselves to social differentiation through ‘Blue Labour’ and such like. Meanwhile the Lib-Dems in the coalition are performing their commitment to the old economic orthodoxy. This impermeability will remain a problem, even though it is possible that it is just such a breach with economic orthodoxy that is the key to Labour and Lib-Dem plans to increase their number of seats and win an election. After all, the beneficiaries of an economy fastened to a city state driven by financial markets are actually a small minority, even in London.

But, we are for the foreseeable future most probably caught in a world of elite closure where the (Labour) opposition front bench is part of the problem not of the solution. So, policy reviews or not, we should not put our trust in a rationalist model of influence whereby outsiders bring radical economic policies to the attention of the Labour front bench and win the argument for their endorsement. If this is a short term problem, it may also be a medium term opportunity: we need a new politics as much as new policies because radical alternatives will get nowhere until they break the metropolitan monopoly of power and knowledge. In this case, regional and local experiment should be encouraged so that alternative economic policies can be developed and performed regionally in ways which encourage a new political competition of elites. That competition is after all the basic precondition for healthy democracy which has been more or less abolished in the UK by deindustrialisation and the rise of the London finance and its City State. Some of the political preconditions for local experiment are in place. New Labour’s legacy is regional devolution in Scotland, Wales and Northern Ireland with limited tax raising powers; more recently, the Coalition’s Localism Bill gives local authorities more scope for action but without easing the severe funding constraints on local government. But all Councils will now be able to buy assets and their ‘power of competence’ gives local authorities the right to do ‘anything apart from that which is specifically prohibited’ (Department for Communities and Local Government, 2011 and 2011a).

Regional and local experiment is limited by the absence of financial resources and powers of taxation. But that should not prevent the beginnings of local experiment, including by developing new ways of auditing local and regional economies which initially bring together innovative concepts and measures to make the case for ever more change. Here are three possibilities. First, audit business clusters and supply chains in ways which raise the question of why the locality cannot frame taxes to encourage growth or defend existing specialisms. Second, publicise leakage of consumption demand from the local economy, measure food miles, audit what’s thrown away and the scope for repair and recycling. Third, identify all utility businesses with a local customer base and ask what they are doing in return by way of workforce training or job creation. If the national problem of elite power has no solution at the national level then the paradox is that we can best defend a settlement for the masses by local and regional action.

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