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The Article

UK investment: the key to Starmer's ambitions

Keir Starmer outside Number 10 Downing Street

As Sir Keir Starmer takes office, ushering in a new era in politics, he should bear in mind one of the most obvious and almost universal features of today's political landscape. While the State has all the spending obligations, ambitions and needs, in ever mounting volume, the private sector has the money.

Nothing very new about that. This was the economist J.K. Galbraith's mantra – "private affluence and public squalor" — in 1958. His then fashionable solution came from the centre-Left: more taxation and more borrowing. On the centre-Right, with equal and opposite predictability, it was to cut state programmes, denationalise swollen state industrial sectors and leave as much as possible to enterprise and the market.

In the 66 years since Galbraith, the world has tried both solutions and been happy with neither. Instead, the great minds have brought us to today's tangle, leaving the ideologies in a confused and constantly shifting fog of tension about the State's functions and the private sector's roles.

The privatisers of the Thatcher era thought they were dismantling the big state consensus. The Blairites who followed ("stealing my policies'", as Margaret Thatcher maintained almost to her last breath) were swept off their feet in the end by the world financial crisis of 2008-9.

The Cameron era was washed away by Brexit, as was Theresa May. All along there was a problem, or alleged to be a problem, about what was on the public sector balance sheet and had to be financed by borrowing. This was the famous PSBR (Public Sector Borrowing Requirement) about which we agonised round the Cabinet table, as to what was genuinely in the private sector and what was just thinly disguised public expenditure.

The monetarist true believers did not like this even being questioned. They insisted spending could only be one thing or the other. Nigel Lawson, although marvellously flexible in many areas, stuck to the same absolutism on this one. There was in the monetarist lexicon no grey area between public spending and private spending, and no fudging was admissible.

This was for them no pinhead issue. Whatever the political pressures and demands, this was sound finance on which the credit, and therefore the entire stability and prosperity of the United Kingdom, rested. This was the line that could not be blurred or broken.

Of course it has been blurred and broken since then — repeatedly. The easiest escape route, which an incoming Labour Government seized upon in 1997, was to redefine large areas of public expenditure as “investment”, which was therefore to be financed by prudent borrowing. It was, of course, important not to look at that word “investment” too closely. It could cover anything from national security and long-term national projects, to needs for the longer-term health of the nation. As long as it was not pushed too far and bond markets did not feel they were being taken for a ride, it was possible to get away with it.

But there comes a point where the limit is reached – although a much disputed one. That point is when the State finds it cannot tax more without killing investment and when it cannot borrow more without putting up interest rates. Because it is paying more in debt interest, and it cannot actually pay for the services previously promised, expected or demanded.

In turn, this limit erodes the monies borrowed in the first place. In turn the currency weakens. In turn inflation increases. In turn, real wages fall. In turn wage-earners strike. In turn productivity and total production fall. This is the doom loop to which references are now so frequent. The State can pass streams of laws and regulations far beyond either its competences or its resources. But it cannot deliver.

In his book The Coming Wave, Mustafa Suleyman sets out his view on where this is going. He believes that, as the world now stumbles from dilemma to dilemma in a tide of angry uncertainties, the whole “grand bargain” between the state and the citizenry – the state will secure and protect, the citizens will consent, obey the law and pay their taxes — is now coming unstuck.

But again, that is not new. Long ago, at the turn of the century, Robert Kaplan, in The Coming Anarchy, prophetically saw the whole democratic process dissolving. Down goes deliberative democracy, down goes trust in, and respect for, the system of capitalism, all tied together. The middle ground is abandoned, drained of compromise. Almost incidentally, Plato, Aristotle and Socrates get called in aid to confirm that this is where unanchored democracy leads – to its extremes

Now the wind shifts once more. The strong prevailing mood is now marked by the triumphant return to power of the Left in the UK, and the flip side of that coin, namely the rise of the Continental European right. Here are two polar extremes, both bent on discrediting common ground, old or new. The Left embraces a return to the even bigger state via re-nationalisation, assumption of new social functions, financed by new magic growth tree. The Right calls for state programmes and personnel to be cut back in ways unspecified.

But of course there is no magic growth tree in the public sector's backyard, anymore than there was or is a magic money tree to feed it. Socialist economics have been thoroughly discredited world-wide, with the actual word "socialism" only lingering in the brand name of state-capitalist China and all-but airbrushed out of history in mafia capitalist Russia.

If the great age of national investment renewal, so loudly called for, is going to take off, if the image of a Britain with potholes, crumbling schools, underpaid social workers, dismal train services, expensive energy, weak defences and underfunded everything else is to be banished — albeit an image grossly exaggerated in the media and at the hustings — new ways of paying for these things will have to be found.

One would have expected the great brains and strategists of the political parties to be immersed in new thinking of how the power and full resources of the modern state could be brought together in the most innovate ways to resolve the problem and harness private resources to public needs.

But in the recent UK Election campaign not a squeak of reference to this epicentral issue of future stability, democracy and social progress could be heard. The Manifestos were silent. Only a brave few, recognising that there would be no revolutionary concessions to reality from either side of politics, have spoken out.

In The Times Patrick Maguire has commented that new public-private cooperation is the only possible way Labour can take forward its plans somehow to grow new prosperity and find a new resource pool for all its ambitions. He points to other democracies, such as Australia, where new ideas for financing state infrastructure in close weave with private sector finance and implementation are being vigorously pursued.

Matthew Lynn, in Money Week, bravely tries to keep the flag of financial realism flying above the quagmire of vacuous pledges, which, as always, are overwhelmed by unforeseen external events (as William Hague reminds us, also in the Times) The UK, Lynn says bluntly and with what some might regard as appalling candour, "is perilously close to bankruptcy".

Lord Mandelson, with the tone of authority which he is so good at purveying, restates what party faithful know but dare not say: that only an alliance of a new texture, made possible by the miracles of digital technology and connectivity, between the State (itself requiring deep reform) and private enterprise, can begin to deliver the makeover and the giant infrastructure repair programme needed by a Britain of talent and brave intent but current weakness.

All this might be taken as a sign that at last the penny is dropping – except for one thing. The understanding of what is coming is fine, but the details of how we are to find some new vessel to steer between the Scylla of an overmighty yet increasingly inefficient state, desperately appeasing populism, and the Charybdis of private money power looking for, but not finding, sound investment, is just not there.

As Mandelson points out, the cash certainly is there. The trillions in pension funds which used to back British enterprise, now sit temporarily in bonds or go elsewhere, leaving the banks to say no again and again to all but the very big and the very safe. The same goes for the giant insurance finds. The Sovereign Wealth Funds look in vain for sensible and investible projects bringing reasonably reliable returns in a reasonable time period, and find little or nothing.

A classic current example hangs over us in the area of new civil nuclear capacity, essential to build up to get anywhere near Net Zero targets. There the invitation on offer is for private investment in giant gigawatt projects that take years to build, (far too long for wise private cash), and are full of political risk, design risk and financial risk. These are white elephants. The obvious alternative, now being pursued vigorously round the world, is the small modular reactor, where eminently financeable models can be built in a fifth of the time, mostly offsite and in much more resilient and flexible patterns.

Th outcome of this sort of choice is either that nothing gets built at all, or some vast new project is allowed through and then abandoned later – the worst of all worlds. Did I hear the words HS2? Are we now hearing the words "Sizewell C"?

We are stuck with having to depend on nervous and costly compliance-dominated banks, plus equally nervous pension and other funds, still hamstrung by rules and regulations from a past era and an EU legacy. Shared prosperity and a wider capital-owning democracy are goals which seemed to work for everyone (well, nearly everyone) in the second half of the 20th century. These flagship aims of postwar Conservative governance have been replaced by a warped version of modern capitalist society which works, but works for far too few and far too obviously for those at the top of the wealth pyramid.

Have we been in this situation before? Answer: yes, once, in the late 1980s and early 1990s, although on nothing like the present scale. Now the situation is turbo-charged by the digital revolution and populist politics. Attempts were made in John Major's time to break the spell. In that sense we have been here before, although not in half so critical a way as now. Enter the famous Private Finance Initiative, launched in 1992. Hey Presto, large areas of capital spending could now vanish off the public balance sheet without a blush.

PFI was clever, and addressed the right key issues. But it seemed too good to be true — and it was. Tory backbenchers deplored this departure from sound finance, but they were swept away in 1997 and a Blair-led New Labour embraced the PFI idea with enthusiasm, expanding it vigorously. By 2000 an estimated £69 bn of projects were in the pipeline, but not on the PSBR.

But the worm was in the apple and began to emerge. Adroit private contractors and their lawyers started piling risks, if projects went wrong, as they often did, as well as heavily inflated and very long term maintenance and upkeep obligations, on — yes — the Government, in other words the taxpayer.

Guidance from leading business voices was, as often, opportunistic and naïve. Never pausing to think that this kind of relationship, if very carefully and honestly handled, could last well into the future, the private attitude was too often "grab what you can from the state sector and leave them with as many risks as you can".

A moment's refection would have reminded business leaders that this kind of approach would lead to closure of the whole scheme, and this is what duly occurred – with losers all round.

By the time Gordon Brown took over as PM from Tony Blair, PFI was already becoming tarnished. From the incoming Conservative side George Osborne called for "a more honest and flexible approach".

Can it work again? Is it time to return to the PFI story and see how the best parts can be built on? Despite PFI's deservedly bad reputation, a 2009 study confirmed that 69 percent of all PFI-financed projects to that date had been delivered on time, and 65 percent at the contracted price.

By the end of Cameron's first term it had lost its attraction and was on the way to abolition. Yet the thinking was right. What sounds like a complex and technical issue of finance and public spending was, and remains, the gateway to national infrastructure renaissance. This is essential to underpin a fully modernised and competitive economy. It decides whether promises of radical improvement, both in public services, in living standards for all and in business conditions – now shorthanded as "growth", can be delivered. Beyond that, such private investment in public services decides whether the trust and cooperation needed to make democracy work in today's conditions can be redeemed.

But WHO decides? Here comes the final twist or sting at the end of this unfinished story. It is at least a sting for the Sir Humphreys. The national Budget decision function may appear to be about economics and budgetary balance, but it is in reality about the entire political strategy of government and the nation's overall direction and internal health.

There will be no new alliances of State and private finance on the scale required, no unlocking of private sector trillions, whether from home or overseas, from giant funds or much wider popular capitalist ownership of shares, (said to be one of the former Chancellor Jeremy Hunt's favoured causes) as long as the process is under Treasury monopoly control.

Issues about how resources – and not just Government resources that can be squeezed from tax and or borrowing – but the whole nation's resources – are to be mobilised and deployed should be central to the future. They should be decided at and from the top.

As the Ministry of Finance, the Treasury has many crucial functions which it exercises diligently, being in effect the accounts department of the entire State enterprise. But good accountancy, whilst vital, is not necessarily, or always, good strategy or purpose or politics. Nor does it always produce the best results on the public expenditure scene overall. Nor does it reinforce national coherence and loyalty.

The State is expanding and interfering but weak at the same time, and getting weaker at delivery in everyone of its many expanding spheres. This is also a time when Parliament, in an age of transparency, is much better equipped, if it so wishes, to call to account and examine the national resource strategy and both the political and economic issues underlying it.

Balancing national strategy between necessary longer-term plans and short-term fiscal and other restraints has become just too big and central a task for one department – in this case the Treasury.

In many other democracies, the USA being the best example, the hyper-political process of budget allocation and spending plans management, has long been split away from the Treasury’s roles. It has instead been placed right under the central leadership of government, where it surely belongs, along with suitably strengthened accountability to Parliament. This was the recommendation of some of us in 1970 (The New Style of Government), dismissed by the mandarins, and has been revived by Lord Maude of Horsham in his recent excellent Review of the Civil Service and Government Accountability (November 2023).

While the subject sounds technical it is in fact fundamental. Pinhead or theoretical it is not. With the end of ideology goes the end of rigid economic doctrines and theories being applied to fluid and fast-changing social conditions. Past practice drew a heavy boundary line, as forbidding and deterring as any real life barbed-wire-covered and heavily policed frontier, between the PSBR and its borrowing requirement and the private sources of capital.

Against this barbed wire, while some bigger expenditures got through, many a good long term project died. Either the business model didn’t add up, or circumstances in the short term had changed, or there just was not the money in government coffers, or it was all too difficult politically.

From my own time as Energy Secretary I cite the great gas gathering trunk system project, blocked by the Treasury, which would have considerably helped the nation with world gas shortages and astronomical prices since 2022. I cite, too, the 1979 new nuclear power programme of nine reactors, of which the Treasury sank all but one, Sizewell B — which has worked well ever since. In the end, well beyond Treasury bean-counting horizons, those other eight unbuilt reactors, and that unbuilt gas gathering trunk system, would have saved the nation billions, and much suffering to boot.

Until this key feature of Government and national, strategy, social, industrial, technological and global, is handled (that is, analysed, formulated, presented and decided) not predominantly by one Department, nor by Cabinet Office advisers cowed by Treasury warnings, nor by outdated economic theory, but by the highest and most central "mind" of all government, UK prospects will continue to wither. And with withering comes fracturing of the nation, disorder and much worse. Whatever the hopes and ideals of those in power at Westminster, so also will the UK's prospects for a stable political, and more settled economic future be indefinitely delayed.

Generalisations about the need for a changed relationship between the public and private domain, between State and private sectors, may be plentiful but they are insufficient. It is the mindset behind which matters. Links of the socialistic kind – "we are the masters now" – have to be left behind. But so do relations which start from a basic hostility to the State's changing role. We should be looking for methods and mechanisms which pull state and society together in new (and inevitably highly complex) linkages. The ideological antiquities of the 20th century have ceased to provide any useful guide. As Abraham Lincoln declared in another turbulent age, the stale dogmas of yesterday are useless in facing today's main issues. As Peter Hennessy, our master analyst in the development of Cabinet Government, has observed, they should be put in a dogma home.

A de Tocqueville-like insight into the way society now works, and the way this most intricate area of capitalism works, is badly needed, before it brings the whole process into disintegration, both political and social, as many already predict. But so far the opening and promoting of that kind of insight is either hidden, or missing, especially in academia. A key exception is Frank Vibert, deep-thinking associate at LSE, whose ideas on "Comity" – the reconciliation of different sets of rules between bodies and societies – points one way through the maze.

So pioneering and original, but also practical, thinking is around. But it is ignored by the bien-pensant, and by a mandarinate which believes in repeating what has been repeatedly tried, even when it repeatedly fails.

Until this procedure is changed, the UK's prospects and national vitality will continue to wither, and so will the prospects of a return to the nation's stability and coherence purpose, both political and social.

Deep in Whitehall sits the Infrastructure and Projects Authority. Once concerned with PFI issues, this is the body which should now be working night and day to resolve the central dilemma of public investment in the entirely new ways the digital age may make possible. It has been curiously shy in its work. The time has come for it to shed its shyness and take the intellectual lead which has been lost, asking for full political authority and support from the Prime Minister, Sir Keir Starmer, to do so. This is no pinhead matter of theory or ideology or even a technical matter of Government machinery. It is the barrier in the path of progress for our nation. Lifting that barrier will be the risorgimento for the UK to a new age of investment.