

## **THE CONSERVATIVE PLAN FOR A RESPONSIBLE ECONOMY**

**David Cameron, 17<sup>th</sup> October 2008**

### **INTRODUCTION**

Politics is about many things – the words you speak, the understanding you have of the problems we face, the vision you have, the policies you draw up and your ability to implement them.

But all of those rest on the shoulders of one thing – the decisions and judgement calls you make.

One important judgement call for us as an Opposition Party was whether to support the re-capitalisation of our banks with billions of pounds of taxpayers' money.

We did support that – and my Party backed the decision, united and strong.

Of course the details of the deal should be discussed robustly.

This includes looking at the Government's confusion over returning to 2007 lending levels and the debate over dividends.

But some people think that this decision - to support recapitalisation - means that we somehow now subscribe to the Government's entire economic policy and doctrine.

Let me make it crystal clear – we do not.

And the complete and utter failure of their economic record has never been more clear to see.

This crisis has highlighted just how mistaken Labour's economic policy has been.

The economic assumptions that Gordon Brown made in the last decade now lie in ruins.

His assumption that a government could preserve stability while running a budget deficit in a boom.

His assumption that global financial integration reduced, rather than increased, the risks in our domestic economy.

His assumption that you could build a sustainable economy on a narrow base of housing, public spending, and financial services.

His assumption that we could permanently spend more than our income and build an economy on debt.

His assumption that you could abolish boom and bust and that the good times would last forever.

Now we can see that each of his assumptions were false.

Any proper consideration of what the policies of the last decade have produced leads us to three simple words.

We need change.

What's happened over the last ten years is that Labour has broken our economy – and we must fix it.

## **MY ARGUMENT**

Some have argued that the lesson of this crisis – and indeed of these years - is that the free enterprise economy is now deprived of legitimacy, and that only increased, permanent state intervention can save us from a repetition of the problems we face.

These critics also assert that the centre-right has no solution and the change we need is a turn to the left.

They are wrong.

My argument today is that the change we need is the modern Conservatism that I have been advocating.

In Birmingham a few weeks ago I explained that the central political idea underlying my Conservatism is the idea of responsibility.

Not freedom, which some may wrongly assume is the animating force of Conservatism – but responsibility.

The problem with freedom is that it can too easily tip over into licence – the idea that people can do whatever they please regardless of the consequences for others.

And that is exactly what has happened to our economy.

Over the past decade, we have seen a total breakdown of economic responsibility.

From the government, as it has spent and borrowed without restraint.

And from our financial sector, which has taken decisions which have harmed the rest of our economy.

So it is not more freedom that our economy needs; it is more responsibility.

Just as this Party under my leadership has stood for social responsibility, now it must stand also for economic responsibility.

We've had irresponsible capitalism presided over by irresponsible government.

Instead, what we need is responsible free enterprise, regulated and supported by responsible government.

Today, I want to set out how we got to where we are – financial crisis and economic downturn.

I will show how a responsible government should act to mitigate the immediate effects of the crisis.

Because though Gordon Brown is trying to rescue the banks, we now need a plan to rescue the economy.

And I will show what we need to do to establish the centre-right alternative, which consists of fiscal responsibility, financial responsibility and a balanced economy.

## **HOW WE GOT HERE**

The crisis that we face has deep roots.

We all know the simplistic version.

People in America were given sub-prime mortgages they couldn't afford.

The banks devised new ways of chopping up debt and selling it on.

No one understood the assets they were buying.

So when the merry-go-around stopped, it all came tumbling down.

That's all true.

But it's only half the truth.

It's only by understanding the deeper causes of this crisis that can we hope to find the long-term cures.

The underlying dynamic was this global boom presented those in charge of economic management in Britain with a temptation...

...and they succumbed to it.

And the result was a combination of irresponsible capitalism and irresponsible government that has brought us to instability and our present crisis.

Over the past two decades, two billion people - a third of the world's population - left subsistence agriculture and joined the global economy.

The result was cheaper goods for all of us in the west, and an enormous increase in wealth among those who began to trade.

It's why some economists call the Consumer Price Index - or CPI - the "China Price Index".

The new middle classes in the east, and their governments, saved a huge proportion of their new wealth.

For example in China, for a time, the average family saved over half its income.

These savings were invested in the West, giving us and our governments the licence to borrow from overseas like never before.

In Britain we took advantage of this new debt without stopping to think of the consequences.

In other words, the emerging economies offered us a cheap loan, and we borrowed and spent like there was no tomorrow.

Low inflation meant that interest rates could stay low and the financial system found new ways of channelling this flood of money into asset prices and debt.

Government made things worse.

The Chancellor who prided himself on prudence came to believe that he uniquely in the history of economics had ended the trade cycle and abolished boom and bust.

So he thought the good days would never end, and borrowed and borrowed and borrowed, and racked up the biggest government deficit in the developed world.

And he stood aside as our households racked up over a trillion pounds of personal debt.

So when the boom did turn to bust and the value of assets fell our financial system was hit harder than most.

The Government couldn't complain about financial institutions lending too much money because the Government itself was borrowing too much from them.

Added to this was a regulatory mistake that I believe history will judge as one of the most irresponsible.

Rather than trying to restrain lending, in 1997 the Government removed the Bank of England's historic ability to ensure that banking credit was kept within responsible limits.

The one organisation with the experience, and authority, to call time on debt was taken out of the picture.

It is now clear that the resulting, irresponsible borrowing by both private and public sectors was unsustainable.

As the head of the Financial Service Authority, Lord Turner, has said, they "allowed a boom to go on for too long".

So why did our Government let this happen?

Was it negligence – or was it intentional?

There is a strong case for saying it was intentional.

New Labour took a new approach to economic and social policy.

Having previously opposed free market economics, they decided to accept it without question, seeing it as a ‘black box’ to produce ever-growing tax revenues...

...without properly understanding how it worked.

The intention was to ride the wave of debt-fuelled growth to fund top-down government programmes in an attempt to “guarantee fairness”.

Of course, these mistakes were not only made in Britain.

In other countries, too, excessive debt and irresponsible capitalism have led to serious crises, with implications for the whole world’s financial system.

The problems are now global and – as I argued back in March when I discussed the need for changes in the Basel Accords – some of the solutions will indeed need to be global.

We all agree about that.

But we mustn’t let that consensus hide the truth.

The underlying failures of policy were national.

The failure to regulate U.S. sub-prime mortgages was an American failure.

And the failure to regulate public and private debt in Britain was a British failure.

It was a failure Gordon Brown was warned about time and again.

And time and again he ignored those warnings.

Four years ago he was telling the city: “I want us to do even more to encourage the risk takers”.

Two years ago, he was dismissing calls for what he called a “regulatory crackdown” on the City.

And only last year, he was celebrating what he called a “golden age for the City of London”....

...Now he’s describing that very same time an “Age of Irresponsibility”.

“A Golden Age” to an “Age of Irresponsibility” – in less than a year. That’s what I call a Rock of Stability.

Does Gordon Brown really think he’s going to get away with that?

He cannot hide from his mistakes.

He cannot hide from the truth.

The truth that over the past ten years, Britain has built up more personal debt than any other major economy in history.

The truth that house prices rose higher in the UK than even in the US.

The truth that the boom has now turned to bust.

And perhaps most damning of all, the truth that while all economies have been hit by this financial crisis, Britain’s banking bail-out has had to be the biggest in the world.

So let me set out exactly where we've come to.

Gordon Brown's policies – his entire economic strategy - has fundamentally failed.

The first result of this failure in domestic policy in the UK was a debt-induced asset bubble in the private sector that has now burst, generating both downturn and serious threats to the stability of our financial system.

The second result of this failure in UK policy is that our Government – having spent all the money in the good years - is less able to help people in this country get through this downturn than the government of almost any other developed country.

The Government's deficit is so big that the cupboard is now bare.

The third result of this failure of UK policy is that excessive debt-fuelled fiscal expansion, allied to rising raw material prices, has driven the Bank of England to keep interest rates higher – for longer - than they would otherwise be in order to control inflation.

That's put further pressure on families, businesses and our financial institutions.

And let's be clear what all this all now means in the real economy.

We've got more and more families unable to make the mortgage repayments and losing their homes.

We've got more and more good businesses going to the wall because they can't get the credit.

And we've got more and more people losing their jobs through no fault of their own.

And to this Government and to these Ministers who say that anyone mentioning these things is somehow "talking Britain down", everyone knows what you're trying to do – to close down debate, to shut people's eye, to hide the truth...

...to mask your failures.

I will never pull my punches in explaining how this Government has brought Britain down.

### **WHAT IS THE CENTRE-RIGHT'S ANSWER TO THE IMMEDIATE CRISIS?**

The immediate consequence of all this is, of course, a combination of financial crisis and economic downturn.

Before I address the question of how to prevent this from happening again, I want to talk about how we deal with the immediate crisis – to reduce, so far as possible, the pain suffered by families and businesses over the coming months.

And I want to take head-on an idea that has been suggested in some quarters – the idea that the centre-right's whole economic philosophy is somehow undermined by our support for state action at this juncture.

We did support the action taken to re-capitalise banks.

Given the irresponsible levels of debt in our economy, it was the only way to minimise the downturn in the real economy – a downturn costly not only to families and businesses but also to the fiscal accounts.

And as I've said two weeks ago, "there is only one thing worse than state aid for banks, and that is doing nothing".

It was an action that had to be supported by any responsible, centre-right Party.

But stabilising the financial system is not by any means enough.

In the coming downturn, with unemployment already sharply rising, with real pain for many small businesses, many home-owners, many pensioners and many others besides – we cannot stand idly by.

Some of the strain is being taken by monetary policy – as the Bank of England responds to circumstances in its decisions on interest rates.

Another part of the strain will automatically be taken by the cyclical elements of the fiscal policy.

In a downturn, tax revenues will decrease and spending on benefits will increase – the so-called ‘automatic stabilisers’.

This will help to counter deflationary pressures.

And in the process, it will, of course, add to even further public sector borrowing – that is the inevitable consequence of economic downturn.

But it only re-enforces the point that we have consistently made that it was irresponsible for the Government to borrow so much when the economy was booming.

And to those who say we have not been consistent on this, I say go and read our 2005 election manifesto, which we fought on a commitment to cut waste principally to bring down government borrowing.

In some countries, like Australia and Sweden, people and businesses can also be helped through significant tax-cuts that are affordable because governments did save for a rainy day.

John Howard’s responsible fiscal policies now put people in Australia in a very different position from us.

But, even if upfront net tax cuts are much more difficult for us than for Australia, we can at least seek to minimise pain on families by preventing those taxes that most affect them from going up.

That's why we'll freeze council tax for two years by reducing wasteful spending on advertising and consultancy in central government.

There are, however, further, pro-active steps that government itself needs to take – and which any responsible party of the centre-right can and should support.

These are actions to change the law in order to prevent vicious circles of insolvency making the downturn worse than it need otherwise be.

That is why we have already proposed to reform insolvency law, to give sound companies breathing space when they face credit problems.

And we should immediately suspend the annuities rule, which forces people to buy an annuity at retirement or at age 75.

The current volatile markets mean that many pensioners are forced by this rule to lock in lower incomes for the rest of their lives.

Over the coming weeks and months we will set out many more ways to help families through the downturn.

## **SOCIAL AND ECONOMIC RESPONSIBILITY**

But short term action to get through the crisis is not enough.

We need a long-term plan to rebuild our economy.

In a single phrase, we need to change from irresponsible capitalism and irresponsible Government, to responsible free enterprise and responsible Government.

Just as I have made the case for social responsibility in our social reforms, our long term plan is based on the principle of economic responsibility.

The principles that underpin our social reforms and our economic reforms are the same.

That's hardly surprising.

After all, to understand how an economy functions, you need to understand far more than the exchange rate and the money supply.

The centre right understands that society and the economy are both made up of the same thing: people.

You need to get the incentives right, get the framework right, and give people responsibility to do the right thing.

You also need people to know that they will be punished if they do the wrong thing.

Just as we've argued in welfare, that if you don't accept a good offer of a job you should be denied your benefits...

...so too should we say to bankers if you don't succeed, you shouldn't get your bonus.

As George Osborne said in his conference speech in Birmingham, it's about demanding responsibility from all of your society – no matter what your wealth or income.

We set out our plan for economic responsibility at conference.

It has three central elements.

Fiscal responsibility - the Government must live within its means.

Financial responsibility - you cannot build an economy on debt.

And a balanced economy - as you cannot rely on unsustainable growth in a few areas to increase prosperity for everyone.

The free enterprise economy, which has lifted billions out of poverty, is the fairest, strongest and most effective wealth-creator the world has ever known and we would be so much the worse off if we abandoned it.

We shouldn't replace the free-market – we've got to repair it.

Repairing our public finances.

Repairing our financial services.

Repairing our skills, infrastructure, and enterprise culture – to create a balanced economy.

So let me set out exactly what we will do.

## **FISCAL RESPONSIBILITY**

First, we need to get our public finances back in order – the traditional role of the centre-right.

This means having the character and judgement to impose discipline.

That means discipline in opposition.

No spending commitments which will never be delivered.

No promises of upfront, unfunded tax cuts which will never happen.

Instead, responsibly focusing on what can – and cannot – be done.

And it means discipline in government.

Saying ‘no’ more than ‘yes’.

Not borrowing to try and buy yourself a by-election.

Living within your means.

Cutting the costs of social failure, reforming public services and clamping down on public waste.

Spending responsibly, borrowing responsibly and saving responsibly...

...so in the long-term we can cut taxes responsibly.

But to help governments stick to the right course, we need radical a plan for fiscal policy.

So we’ll have an independent Office of Budget Responsibility – which will hold every government to account.

And to those who say this is just a duplication of what’s already there, or just an admission of politicians’ inability to take tough decisions, I say: “wrong on all counts”.

It will have far more authority than a select committee or a Westminster think-tank.

But, it will not be a substitute for making tough decisions on tax and spending.

We will not, as some have wrongly assumed, be subcontracting this core function of government.

Quite the reverse: it is because we are so serious about taking those tough decisions on tax and spending that we want to be monitored by an independent authority.

They report.

Government's decide.

So there will be no more fiddling the figures, dodgy statistics, political motivations and machinations to mess around with taxpayers' money – just good, honest, responsible government.

## **FINANCIAL RESPONSIBILITY**

Second, we need strong, responsible and proper regulation of the financial systems that underpin our economy – another traditional role of the centre-right.

I believe in markets that work – not in the assumption that laissez-faire is enough.

As I argued back in March, “the modern, globalised economy, created to a large extent by laissez-faire economics, demands more than laissez-faire economics for success in the future....Even a free-marketeer understands that economic liberalism alone is not enough.”

Free markets need rules and frameworks, to make sure they work in the public interest.

We regulate utility companies – and there is a good reason.

If they fail, our lights go out – so we've got to make sure they work.

And it's why we need proper, responsible regulation of our banking industry too.

Because of the central role that retail banks and building societies play in our economy, they are just like utilities – if they fail, our economic lights go out.

So we need to improve the way our financial system is regulated.

For a start, we must ensure that the regulators have the capacity to do the job.

For too long, City firms have been able to poach the best regulators.

So we will ensure that we get more good staff at the FSA, paid for by an increased levy on the City, and introduce a system similar to the Shareholder Executive so that banks send their best people to the FSA on secondment.

But the changes we need to ensure financial responsibility run much deeper.

We need radical plan to change our approach to debt.

We need to reverse the fundamental mistake made a decade ago that meant that the authorities took no view at all over the level of debt in the economy.

That view has been central to the financial irresponsibility that allowed debt and asset prices to get out of control.

So we will introduce a new Debt Responsibility Mechanism to ensure that this does not happen again.

We will instruct the Bank of England to write regularly to the FSA, setting out its concerns about the sustainability of the level of debt in the economy.

The FSA will then be obliged to take that view into account when setting the amount of capital individual banks must hold.

So if the level of debt is growing unsustainably, the Bank will instruct the FSA to ensure banks either slow their lending or put aside more capital.

The Debt Responsibility Mechanism explicitly rejects the irresponsible attitude of the last ten years that we can just let rip on debt, and not care about the consequences.

It will be a fundamental and far-reaching reform of monetary policy.

If it had been in place over the last ten years we would not have seen taxpayers forced to recapitalise the banks – they would never have become so fragile in the first place.

But real financial responsibility will not be achieved simply through rules - we need a cultural change on the part of bankers too.

No longer must they think just that because they are abiding by all the rules, morality goes out the window.

Instead, they must recognise the massive responsibility they have to our society.

So just as important as setting the right regulation is introducing the right incentives to create the right culture.

The problems we currently face have come about because, for the past decade, the incentives have been distorted.

The Executives at the very top of our banks were paid according to the short-term profits they made, rather than the success of any long-term decisions they took.

So we've got ask the right questions about whether bankers have too many incentives to increase leverage to increase their returns.

Rating agencies were paid only if deals were done, so no wonder they gave out AAA ratings like they were going out of fashion.

And banks lending people money for their houses securitised the mortgages in order to get rid of the risk.

We could respond in two ways.

We could write detailed codes and establish an army of enforcers.

Or we could get the incentives right – to steer people in the right direction and then trust them to make their own decisions and live by the consequences.

So we should consider requiring the initiator of a mortgage to retain more of an interest in that mortgage.

We should ensure that the regulators take Executive compensation schemes into account when regulating institutional risk.

And we should look at the way that rating agencies earn their fees, with more transparency and perhaps some relation to the performance of the securities they rate.

All of these measures are about retaining the fundamental strength of the market – freedom – but endowing it with the fundamental value – responsibility – upon which it depends.

## **A BALANCED ECONOMY**

Sound public finances by restoring fiscal responsibility.

The right framework of rules and incentives in the financial markets so we restore financial responsibility.

These are necessary if we are to repair our free-enterprise economy for the long-term.

But there is a third requirement.

A responsible party has to include rebalancing our economy.

Over the past decade, seventy percent of our economic growth has come from just three things.

From housing – which is now declining.

From the financial sector – now in turmoil.

And from government spending – now slowing.

And in addition, much of the growth has been driven by immigration – an unsustainable basis when you consider the impact on public services and our national infrastructure.

Unlike many other countries in Europe, we can't turn to a strong manufacturing base to provide export-led growth, because manufacturing has shrunk by more than a million jobs over the past decade.

And we can't put our faith in the high-tech service sector – like in America – to drive growth, because we haven't created the right conditions for it to flourish sufficiently over the past decade.

We've got to change this – and build an economy that is balanced and resilient.

We have to broaden our economic base to include more science, more hi-tech services, more green technologies, more engineering and more high-value manufacturing, drawing upon a much wider range of industries, markets, people, towns and cities.

And how will get there?

We need a radical plan.

We need to do far better in bringing into everyday use technologies that are still in laboratories...

...and developing in the laboratory technologies that haven't even been thought of yet.

We need to reconfigure our energy systems, wean our economy off its dependence on imported hydrocarbons and turn Britain into a world leader in green innovation and engineering.

We need to decentralise our economy so the south doesn't overheat and instead every part of our country plays a significant part in our growth.

This won't happen overnight.

For a start, this means creating an economic framework that enables new businesses to flourish.

That is why we are committed to cutting the headline rate of small business tax to 20p, paid for by abolishing complex reliefs.

And that is why we have asked David Arculus, a leading businessman and former head of the Better Regulation Task Force, to head an independent task force examining ways in which a Conservative Government could cut red tape.

In the weeks ahead, we must not let this Government make the mistake of thinking that the answer to this crisis is to tax and regulate small businesses even more heavily.

But creating a balanced enterprise economy is not simply a matter of government getting out of the way.

As I have said many times before, while we must be aware of the limitations of Government, we should never be limited in our aspirations for Government.

It is not enough for Government to get out of the way – they've got to get involved.

Government must also do more to secure the skills, energy and transport infrastructure that will help create new jobs in new industries and new markets.

That's why we have set out a radical agenda of supply side reform in the education system, to create more and better school places in every community.

That's why we are committed to a bold series of environmental policies, from feed-in tariffs for microgeneration to unleashing a green coal revolution.

That's why we have proposed a series of policies to make it easier for innovative start-up businesses to win government contracts.

And that's why we have pledged to introduce a high speed rail system that will link cities across Britain and transform regional economies.

This is the right vision, the right plan, and above all, the right ambition, to create a balanced economy that is built to last.

## **CONCLUSION**

Britain has incredible resources at its disposal.

World beating companies.

Some of the best, brightest and most creative minds.

Universities that are envy of the planet.

But as we look at the wreckage of our economy after ten years of irresponsible Government, it's clear that if we're going to make the most of those resources we need change – not more of the same.

Gordon Brown is hoping that his whirlwind of summitry will mean that we will forget what has come before.

Forget that he stripped the Bank of England of its powers to supervise the city.

Forget he accelerated - how he actively encouraged - the risk taking culture in our banks.

Forget that he promised - time and time again - that he had abolished boom and bust.

Forget that – as we enter a downturn, where jobs, home and livelihoods will be lost – that he was the one who created this mess in the first place.

But I won't forget – and the British people won't forget.

A fire has engulfed the house that is our economy.

Stopping the fire from spreading – averting an even deeper financial crisis - has required everyone – opposition included – to man the pumps.

Now, no doubt, Labour will start to talk about emergency repairs.

But this isn't good enough. It's time to construct a house that is genuinely built to last.

And we will only build an economy that is strong and there to last if we...

...apply the same philosophy as I have been advocating in the social sphere for the last three years...

...the philosophy of responsibility.

To repair the broken society, in the long-term, we need social responsibility.

And to repair the broken economy, in the long-term, we need economic responsibility.

That means...

...a responsible fiscal policy, bolstered by independent oversight...

...a responsible financial policy, bolstered by a renewed role for the Bank of England...

...and a responsible attitude to economic development, that fosters more balanced economic growth.

And today, it's only the Conservative Party that is offering that change.