WHY THE GLOBAL ECONOMY NEEDS NATIONS

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About the author

Francis Maude, the MP for Horsham, was appointed Shadow Chancellor in June 1998. Born in 1953, he was educated at Abingdon School, Corpus Christi College, Cambridge and the College of Law, and is married with five children.

He started his political life as the MP for North Warwickshire from 1983-92, throughout which he took up a number of posts in the DTI, foreign office and the treasury, as well as becoming assistant Government Whip. In June 1992, he was created a Privy Counsellor in the Dissolution Honours List, and has been MP for Horsham since 1997.
Why the global economy needs nations

Introduction

Some commentators love globalisation rather as football pundits love the FA Cup Final. But while the more pundits there are, the more exciting the football gets, the more commentators there are, the more boring a subject globalisation can tend to be.

Tonight, I want to talk to you about how Britain can make the most of globalisation. What Britain's tactics should be to do best out of a global economy and why the global economy needs nations if it is to benefit the world. Globalisation is often presented in two entirely different ways

One is the subject of countless television advertisements: a feel-good story of distant relatives, thousands of miles apart, kept in touch by cheap telecommunications and easier travel. The other is less benign: a world in which impersonal global forces drive forward relentlessly, and in which competition makes life an ever tougher struggle.

Do both visions co-exist uneasily - or is one right? The truth, as usual, is more complicated. Because it is possible to take a more nuanced view of globalisation: a view which isn't polarised between the personal and the colossal. Even seven years ago, the collapse of the Exchange Rate Mechanism showed how powerful global capital flows can be. The legendary power of the
international bond markets, which in the modern day
demonology of the left, have replaced the silk-
waistcoated boss as the emblem of unbridled
capitalism, has not diminished since 1992. Yet at the
same time, a more welcoming image of a world of faster
communications and ease of business brought by
globally recognised systems is an attractive one.

The issue for politicians is not endlessly to ruminate on
the ills, but to work out how Britain can navigate the
currents of a global economy in order to thrive and
prosper. This is where the national response comes in.
But constructing that response depends on
understanding the issue at stake.

What is globalisation?

There are several strands to globalisation. The most
obvious is the exponential growth of the financial
markets in recent years.

Economic globalisation

Every day, about $690 billion is traded in the London
foreign exchange market - the largest of its type in the
world. Globally, around $1.5 trillion (one thousand five
hundred billion) is traded on the foreign exchange
markets each day.1 Two factors have made this not only
thinkable, but real. One is political: the removal of
exchange controls which were a ubiquitous
characteristic of the 1970s. The second is technological.
Today, at the click of a mouse button, electronic money

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1 Bank for International Settlements, International Banking and Finance
Developments, November 1998.
can be transferred effortlessly across thousands of miles. Both these changes have created a global finance market. Of course the very ease of transaction and the speed of communications means that there can be greater volatility. But both factors reflect progress. Perhaps I could illustrate this with a few examples:

• From 1976 to 1993, borrowing on the International capital markets has increased more than 800%. Half of the increase occurred between 1990 and 1993.²

• Last year alone, the world-wide value of foreign direct investment inflows rose 39 per cent, propelled by a surge of cross-border mergers.³

• The market for more complex financial derivatives, which was negligible in 1992, has a daily turnover today of $ 360 billion.⁴

If you believe, as I do, that decisions are best made when those making them are able to make free choices in the widest possible arena, then the fact of all this cross-national economic activity means that the sum of human prosperity is increasing.

**Cultural globalisation**

It is not only in the financial markets that globalisation has had an impact. The creation of world-wide markets for media, and the development of technology to transmit images across the world has tended to lead, some argue, to a standardisation of our cultural

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⁴ Figure for April 1998. Sources: Futures and Options Association; House of Commons Library.
experience through media with a world-wide reach. This is the "global village" - a world in which everyone hears the same news and gossip and sees the same pictures on television. This is the world of international brand-names and universal products - of Coca-Cola, the BBC and CNN. Perhaps this is less obvious in the UK, because English is the main medium in which these developments have been communicated. There are good effects of this and bad effects. The demonology suggests that the end of all this is the eradication of cultural differences. The notion of a drab uniform world in which everyone wears the same clothes, eats the same food, watches the same news and speaks the same language needs only to be stated to show both its horror and its improbability. The glory of globalisation is that it enables others to share in what is distinctive and unique in different cultures. After all, we don’t need to go to Bangkok to eat Thai food today. You don’t need to go to Beijing to hear Chinese opera. But whether you judge the particular effects to be good or bad, they are the results of a process which is both unstoppable and overall benign.

Is globalisation new?

But the process of globalisation is certainly not new. If we look back in time, it is possible to see that, if anything, the world was more globalised - in terms of voluntary migration and capital flows - a century ago. In 1890 British international trade by value amounted to 30% of GDP, five or so percent above the 1990 figure. For the whole of the nineteenth century, Europe was the starting point of a vast exodus, in which millions of people migrated freely across the world, to

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5 I am grateful to Geoffrey Wood and Forrest Capie for this observation which is supported by the Horioka-Feldstein index.
the Americas in particular. There were also huge migrations within and from Asia. And the development of the telegraph had made rapid communication possible across the world. As a synonym for speedy commerce and communication, then, today’s globalisation is not unprecedented.

**Britain is strongly placed to gain in the global economy**

Especially not for Britain. By virtue of our maritime history and historical development we were much more exposed than most countries in the 1890s and the scale of our overseas investments reflected that. At just over £8 billion in 1914, the total of British investment abroad was more than that of the United States, Germany, France and the Netherlands put together. Britain was a winner in the globalisation stakes. Today, once again, if we get things right here, Britain can be winner.

It has three historic advantages: the strength of UK-based multi-national companies; its role as the third largest international investor; and the City of London as the world’s biggest international financial centre. And many other countries have brought investment to Britain’s previously business-friendly environment. British ownership of companies abroad is roughly matched by overseas ownership of businesses here. Britain, as ever, with an economy more international in its orientation than its continental partners.

The gradual entrenchment of English as the global language of business means Britain is optimally placed to gain from the expansion of the internet, and other communications. While the reverse side may be that the British economy is more open to English-speaking competition from abroad, it would be terribly defeatist
to assume that the language issue is anything but an opportunity. Recent British film and music successes reveal an international appetite for English language productions.

Culturally, there are several historic characteristics which allow Britain to embrace globalisation with confidence. The early rejection of the medieval suspicion of innovation in favour of an enlightened culture which valued scientific discovery and commerce. The growth of English individualism, which placed great emphasis on the ownership of property. The pioneering of a free trade philosophy in Scotland following American independence.

The second factor has been our ability to absorb radical economic and social change effectively. Britain was the epicentre of the industrial revolution, which sparked revolution elsewhere in Europe. The natural reaction from those who sought shelter from the brisk winds of innovation was often violent. Many people feared they would lose their livelihoods as a result of the mechanical methods industrial production employed. Today it is pejorative to call someone a Luddite - a reference to the movement which opposed greater industrialisation.

Because, looking back - we can clearly see the advantages which followed from the increase in productivity brought by machine engineering. Although, as recent vocal opposition has shown, it is a battle we have to keep on fighting. Making the most of progress has been a great British strength. Nevertheless, the potential scale of globalisation troubles many people today.
What wider effects has globalisation had?

It certainly troubles many politicians and administrators. The amount of money traded on the foreign exchange markets in the City in just two hours of any working day is more or less the same as this year’s Government expenditure. Even from the starting point of Labour's mounting spending plans, governments cannot catch up with the money which the global capital markets can trade and the prosperity they generate. Apart from putting the state in its proper place, there are other practical benefits which have stemmed from globalisation.

Perhaps the most important, from a democratic point of view, is the freedom of movement for knowledge which the internet is gradually bringing. I suspect that the revolution in public awareness that this will bring is comparable only with the development of printing and literacy five hundred years ago. Perhaps it even exceeds it.

In political terms, the internet has made it harder to suppress information and scrutiny. With the exception of the security problems which this poses, the consequences of broadly available information can only do good. The internet allows consumers to make price comparisons across the world and tap into new sources of information and opinion. That and the single European Market are far greater aids to price transparency than a single currency could ever be.

Investors are also more aware of where to get the best return for their money - a factor which has favoured Governments which run competitive tax and regulation regimes. And the pressure has built up against Governments who prefer high tax and high spending
because capital can now migrate rapidly away from high tax jurisdictions. The Harvard Professor Martin Feldstein estimated in 1995 that it cost the USA three dollars to raise each extra dollar in tax. And countries with low or falling tax rates around the world, such as New Zealand, have continued to enjoy increasing growth - while high tax, high spending European economies falter. Facts like this have made it very difficult to sustain the view that high taxation - on any part of the economy - is practical any more. Tax capital and it runs away. Tax labour and property and the return on capital investments drops, forcing investors to look elsewhere. It should mean the end of the road for high taxing, high spending governments. Globalisation hasn't changed the laws of economics - but it has brought them into sharper relief.

It’s a new lesson that New Labour has yet to learn. Some assert that it also means the end of the road for the nation state. Because their only hope of creating a state-run utopia is by creating ever bigger and higher states. So you can see why statists claim that 'the nation state is dead'. What they don't add, is 'Long live the superstate'.

**Responses to globalisation**

So although the scale and the manner of globalisation have changed, the issues remain much the same: Do we embrace or do we fear the competition which the electronic revolution opens up? Do we take by storm markets opened up world-wide as a consequence of the end of the Cold War and other political change? Or do we seek refuge from what we see to be a threat?

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Too much of this debate has come from the left. This is not surprising since globalisation is really not much more than free trade on the global scale. Traditionally the left have feared and resisted free trade and markets. Free trade has been the great enemy, the tool of the bosses. So globalisation, the result of free trade writ large, for the left is the mother of all enemies.

For the old left, for whom it is axiomatic that state power, exercised through the nation state, should be used to frustrate the working of open markets and free trade, globalisation presents the chance to return to the old simplicities. If these new global market forces seem to be bypassing the nation state, the only answer they have is to make sure that they bypass the nation. That is the mindset that argues for a retreat from the world.

I remember years ago as an undergraduate asking a Marxist don, tongue in cheek, what would be the first steps he and his comrades took after the revolution had been successfully accomplished. "First we seize the ports. Then we impose import controls. It will be essential to establish a siege economy", was his apparently serious reply. If that was the view twenty-five years ago when market forces were pretty fettered anyway, now that global superhounds have supplanted the running dogs of merely international capitalism the case for retreat into national enclaves will seem even stronger.

The new left’s response is different, but it flows from the same impulses and instincts. They are just about realistic enough to realise that to retreat behind the seawalls of national protection would be economic death. Having concluded, rightly, that it is impossible for national governments to contain the apparently dark forces of global movements, they then draw a
pervasive, and wrong, conclusion. They argue that if national state structures are now impotent to restrain these forces, then we must have international state structures. They would seek to trump global forces with the nearest approximation they can get to global systems of government.

The old left’s view trusts democracy, and accepts that it only seems to work effectively in a national setting. It failed because of its resolute refusal to accept the essential benefits which free trade and private enterprise have brought. This approach was democratic but wrong.

However the new left approach places democracy much lower in the order of priorities. It seeks to put in place supranational frameworks in order to fight against the depredations of global change.

**Does global trade make national government irrelevant?**

It is worth examining these approaches to globalisation carefully. They suggest that national powers are all but worthless - because global trade makes national government irrelevant.

Anthony Giddens, Tony Blair’s latest guru, in the first of his recent Reith Lectures asserted that globalisation breaks down nations by limiting their own sovereignty. "Nations have lost most of the sovereignty they once had, and politicians have lost most of their capability to influence events. It isn't surprising no-one respects political leaders any more, or has much interest in what they say. The era of the nation state is over. Nations, as
the Japanese business writer Kenichi Ohmae puts it, have become mere 'fictions'.”

Well, you can see why Kenichi Ohmae said that. If you are in business today, in contrast to the 1960s and 70s, you no longer have to deal with a quite such a welter of complicated national product legislation, national capital controls and national tariff barriers. The end of capital controls, and the latest GATT and WTO round have seen to that.

Anthony Giddens interprets this matter of fact observation differently. He argues that globalisation must mean the end of the nation state. Certainly globalisation puts into stark relief the limitations of national governments' ability to act. This began to be exposed a long time ago.

The scientific advances of the Enlightenment changed the way in which we considered the world. At the same time - perhaps it was connected - political revolutions in the eighteenth century changed the face of government. Up until then, kings and queens were believed to be God’s anointed rulers: able to cure disease by their touch. Science showed that much of the mystique which surrounded power was fiction.

And the change in the balance of political power eroded monarchs' powers of life and death over their subjects. If globalisation has been the child of growing scientific and technological understanding, it's hardly surprising that the once mystical power of the state has seemed to suffer. When in fact, it has always been limited. This is

http://news.bbc.co.uk/hi/english/static/events/reith_99/week1/week1.htm
why economic strategies which rely on the power of the state, whether socialist or the economic authoritarian regimes of the right, can never work. That is exactly why the voters rejected a return to socialism throughout the 1980s and 1990s. Socialism simply didn't work.

But that's not to say that it went away.

Whereas the old left's solution was to shut out enterprise and trade by capital controls and tariff barriers; the new left's approach is to try bind it with silken cords. Both approaches hold one thing in common: they see globalisation as a threat, not an opportunity.

**Does international economy mean international Government?**

Those who see the state as central to the solution of any problem will inevitably believe that to solve the problems of the global economy you need a degree of international Government. Take an example of this mentality - the proposals for tax harmonisation within the European Union. A Government minister - the Paymaster General Dawn Primarolo, chairs a committee, the purpose of which is to agree minimum business tax rates within the EU. The idea behind tax harmonisation is to protect high-spending governments from losing revenue from business and investors to lower tax regimes elsewhere.

Looking around, the results of the belief can be seen elsewhere - in the European Union's economic and monetary union and the periodic desire for new and more powerful international financial architecture. Indeed in the candid words of one left-wing academic study group, writing before the last general election:
'Outside a single currency a Labour government will find it difficult to influence the international economic debate'. It all flows from the belief that state power is the answer.

But there are two different routes by which proponents get there.

**Mercantilism**

One influence is firmly mercantilist. Some people see trade as a process of dividing a cake of finite size. This belief - that trade is a zero-sum game - encourages a highly nationalistic approach to economics. It is the foundation of economic nationalism.

From that premise, you then use the power of the state in order to secure the largest practicable slice of the cake. National self-sufficiency in turn provokes a fortress mentality, which ironically cuts the size of the cake still further - since protection promotes inefficiency. Though outmoded in much of the Western world, this attitude still holds sway in many parts of continental Europe. Some of those countries now have a real problem with globalisation. They spent the 1990s enforcing austerity measures to meet the criteria to join EMU. And they ignored the wider necessity – deregulation. Failure to deregulate early enough has left them in a difficult position as globalisation puts pressure on unskilled workers’ wages and employment. To deregulate now would drive wages down further - and would be politically difficult.

The alternative is to seek salvation by ratcheting up social protection. Yet the greater the burden of regulation, the less effectively you can compete worldwide. Globalisation is the enemy of economic
nationalism. For those who want state control of economic processes, the nation state provides no answer for global economic processes. So for those whose preferences lie this way the answer is to replace the apparently failed national powers with supranational powers exercised through regional blocs. This is one of the motives which underlies the desire to turn the European Union into a United States of Europe: a federal superstate.

If you pool your apparently dwindling national sovereignty with that of other European countries, then, the argument goes, you will be exercising a greater power. If your own nationalism is inadequate, then replace it with European nationalism - as a counterpoint to globalisation.

One only needed to see election posters across France during the 1994 Euro-elections. They showed a European being squashed between a cigar-smoking Uncle Sam and a Japanese businessman. The posters called on French voters to “build Europe to survive” the threat of global competition.\(^8\) Nothing could illustrate more clearly the mindset that sees global free trade as a threat, and not the opportunity it is.

**Third Way**

Whereas mercantilism provides an antagonistic response to global economic forces, the Third Way, of which Giddens is an apostle, provides a different alternative. To put it far more succinctly than most of its proponents do, the Third Way is the idea that one can maintain economic dynamism – which depends upon low tax and sensible regulation – at the same time

\(^8\) I am grateful to Peter Lilley for this illustration.
as an ever increasing burden of welfare spending - which requires high tax and high regulation.

If you chase the end of the rainbow long enough, they think you really will find a pot of gold. It is the ideological equivalent of discovering the secret of perpetual motion. The tooth fairy really does exist after all. The only problem is that it isn’t true. Indeed the harder one looks for the Third Way, the more simplistic and glib its answer appears to be.

It seems to be based on mere assertions: the economy is much more international, therefore government and legislation should be much more international. It assumes blithely that multinational corporations must be constrained by multinational government. These are essentially statist assumptions, seeking to cap globalisation with bigger government. Indeed the third way is the only way to camouflage high spending, high taxing domestic socialism, by creating the international framework on which to hang international socialism - a process which succeeds precisely by circumventing the demands of national electorates.

This undemocratic reality was revealed in Gordon Brown's plans for a global financial architecture which he revealed in the autumn of 1998 following the Asian crisis. The main pillar of this financial architecture would be a world bank with the status of lender of last resort. This drew in the important question of moral hazard: because it was thinking that they had the backup of the existing arrangement - the International Monetary Fund - that meant that banks lent recklessly. The supporting buttress of the financial architecture would be regulations which demanded strict obedience to a code of conduct, enforced inside the new system. All borrowers and lenders world-wide would fall under
the control of a giant regulatory authority. Because a lender of last resort has to be autonomous to be effective, and able to release funds rapidly to prevent crises deepening.

To be effective, the idea of an international lender of last resort assumes that some kind of world government is possible - indeed already in existence - with the IMF as its financial ministry. The problem was that, naturally enough, most countries don’t want to be regulated from above. So the plan has been put on ice, although I doubt whether it has been forgotten by its progenitors, especially the British Chancellor.

He seems to want to regulate global free trade in the way that the Bretton Woods system regulated capital flows until the early 1970s. But for those of us who believe in reducing regulation and in the liberal market economy it was not so much a post-modern architecture for the future as a complicated gothic horror.

Not least because there are other approaches which have been tried and tested. They’re not necessarily particularly palatable to those whose natural instinct is to intervene. There are ways of easing the ebb and flow of the economic tide. You can have a floating exchange rate or a currency board. Both are probably more suitable than the currency pegs whose breakdown was the trigger for the financial crisis that started in Asia. That crisis illustrated in many ways how inadequate any international mechanisms are.

The IMF will always tend to offer a one-size-fits-all solution. But there was not a one size fits all problem. Every country that hit difficulties had a different set of problems. Thailand was different from Indonesia, which was different from Japan, which was different
from Russia, which was different from Brazil. The one thing they all had in common was that the problems they had all flowed from domestic policy errors. They each required domestic solutions. Just as each had a unique set of problems that flowed from a unique and distinctive set of domestic errors, each had to arrive at its own unique solutions. The proper role of the international authorities is, without creating moral hazard by protecting investors from their bad investment decisions, to prevent such domestic problems triggering systemic collapse.

The Right response

So far, we have several important findings. The first is, especially as far as Britain has been concerned, globalisation is not a new phenomenon. For much of the past it has been a leader in developing the global market. Second, globalisation has put into sharp relief the limitations to government. Wise rulers have always known their limits, from Canute on.

Encouraged by one of his special advisers – a rather scarcer breed in the early eleventh century – to show his strength by stopping the tide from coming in, he sat in the sea, contrary to the usual account, in order to prove that he could not; to show the limitations of his power. Socrates’ doctrine that the basis of wisdom is knowing the extent of one’s ignorance is a good one for governments. Good government knows its limits.

But politicians’ memories can be short. So regular democratic accountability is the only way to ensure that this requirement remains foremost in a government's mind. It is clear that any over-arching solution which
takes accountability away, is a move in the wrong direction. Globalisation does not need over-arching, one-size-fits-all solutions. A global economy requires co-operation, but co-operation between accountable national governments - if it is to retain the confidence of voters around the world. It does not require the national governments to be subsumed.

Our national response to the global economy should build on the simple principles of accountability and flexibility. It should bring the flexibility of domestically tailored policies to play on a much wider field. It should set local conditions which encourage global forces to see Britain as a benign environment in which to operate benignly. It’s a far cry from global governance - which has no cultural or democratic resonance. And it reveals a fundamental concern about the prospect of European political union - the absence of a meaningful connection between the decision-makers and the voters. It’s a crucial link. It should be the basis of the national response to globalisation.

**Monetary and Fiscal Policy**

Even in its early days, we are beginning to see some of the strains and tensions of Economic and Monetary Union. We can already see that a rigid, supra-national structure can require policy compromise. While Germany stagnates, Ireland overheats. A nationally based monetary and fiscal policy only has to take national priorities into mind. If voters don't like the results - they have the ability to throw a government out. A national policy ensures a role for democracy - not secrecy. And the ability to respond flexibly is a vital element of a national policy. And only through a national policy can there be the ability to transfer cash in size from richer to poorer areas.
Regulation

Another area where the global economy is a merciless judge of national policies is that of regulation. I served as the Chairman of the last Government’s Deregulation Committee, whose task it was to advise on the reduction of red tape to enable businesses to thrive. It should have been an opportunity to spring clean the statute book for the benefit of business. There is a tendency for all governments, of all colours, to regulate. Faced with the politician’s syllogism - “something must be done; this is something; we must do it” - the something that comes most readily to the politician’s hand is taxpayers’ money and the statute book.

And yet the penalty for over-regulation is severe, and is frequently paid by the intended beneficiaries. It may be regulation to protect consumers, or workers, or the environment. But whatever the benefits, there is nearly always a cost. We have recently seen the first estimate of the likely costs of the labour market measures introduced by this Government. The National Minimum Wage, the Working Time Directive, the Trade Union reforms – the first for a generation to move the balance of power back towards the unions – all measures whose proclaimed purpose is to help workers. But the actual result, as Patrick Minford and Andrew Haldenby have shown, is likely to be that workers lose their jobs - perhaps as many as 880,000 jobs lost.9 There shouldn’t be anything surprising about this.

After all, unemployment in the continental economies that already have this sort of social legislation remains stubbornly high. The Prime Minister constantly claims

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to want Europe’s economies to be more like America’s. I profoundly agree that it would be in their interest for that to happen. What a terrible pity it is, then, that his own Government is relentlessly making our economy more like the high tax, high regulation, high unemployment economies of the continent.

These reforms amount to a series of post-dated cheques on Britain’s future. They may not be presented immediately. But when they are cashed in, there will a woeful reckoning. Labour is mortgaging Britain’s future.

**Taxation**

If Britain is to compete in the world, Government must champion a competitive environment for businesses. Not only must supply-side policy be flexible, but taxes need to be low and flexible. We are looking at ways to make tax simpler. And the tax system must be transparent enough to encourage businesses to invest. The Conservatives are committed to greater transparency. We have called for honest taxes.

It isn’t good when there is such a gulf between what the Government says about tax and the reality. Ministers claim tax reductions. Yet the reality shows the slow upward creep of taxation, from 35.4% to 37.6% of GDP over the life of this Parliament. The Adam Smith Institute Tax Freedom Day – the point in the year when you stop working for the government and start working for yourself – this year fell on 27th May, a full week later than it would have done had Labour stuck to the last Government’s spending plans.

Which direction does that take Britain: towards the highly competitive American model, that has created a
million new jobs a year in the private sector over the last twenty five years? Or towards the high tax, high unemployment model of the continent, where a small increase in employment has been sustained only by ever-growing bureaucracy?

Conclusion

Some say that globalisation has rendered the nation state obsolete. They say that in the face of the global bond markets national economic sovereignty is a chimera, a self-delusion. I reject that. Let me say that for me sovereignty is not some abstract ideal, some relict of nineteenth century constitutional textbooks. I aspire to be the British Chancellor of the Exchequer. I want to have interest rates set in Britain to suit conditions in Britain. I want Parliament to be able to legislate for social regulation. I want to be accountable to Parliament for my conduct of British fiscal policy. I want to be able to ask Parliament to legislate for British taxes. I want Britain to be able to do all these things not from adherence to out of date theory, or because of an ostrich-like refusal to face global reality. It is because we recognise those realities, and because our ambitions for Britain and its people are boundless, that we want the power to enable Britain once again to soar. The power to set the right conditions for success. Conditions of low taxes, to reward success and encourage investment and risk-taking. Of sensible regulation, that doesn’t assume everyone is a crook or a fool. That encourages saving, so people can be independent of the state. A Britain that in place of resentment of success relishes successful people and businesses.