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Article (Accepted version) (Refereed)

Original citation:
Innes, Abby (2017). *Draining the swamp: understanding the crisis in mainstream politics as a crisis of the state*. Slavic Review 76, (S1) pp. S30 – S38. ISSN 0037-6779

DOI: 10.1017/slr.2017.155

Draining the swamp: understanding the crisis in mainstream politics as a crisis of the state
Abby Innes

Contemporary populist parties typically claim that the state has been turned into a 'swamp' by the mainstream political elites: a swamp that can only be drained by the new champions of the comparatively 'pure' people. This juxtaposition of corrupt elites and betrayed masses is arguably the defining mode of populism[1] so how can we explain the renewed resonance of that idea? How is it that we have moved from a relatively consensual post-war conception of the state as the primary force of social integration to the widespread conception that the state is a vehicle of betrayal?

The crisis of democracy in advanced capitalist states is deeply paradoxical. Europe and North America are wealthier than ever and yet more politically unstable, with more votes accruing to the political extremes than at any time since the 1930s.Critical scholars have long predicted a crisis but they have depicted the problem in terms of governments increasingly struggling to satisfy social versus business needs and failing, as if the state itself was a consistently neutral arbiter.[2] Thus Streeck argues that governments have worked through a number of strategies to manage the sharpening trade-off between the achievement of economic growth and social justice only to see each of these strategies run out of steam: they began with a tolerance of inflation in the 1970s, moved onto the accumulation of public debt in the 1980s and - via financialisation - into the active encouragement of private debt by the 1990s,[3] so-called 'privatised Keynesianism'.[4]

But something far more radical has simultaneously been taking place through the latter era, namely the transformation of the state itself via privatization, outsourcing, internal managerialism and agencification, the rejection of interventionist industrial policies and the concomitant development of quasi-markets in welfare provision, all within a context of liberalizing tax regimes. It is surely no coincidence that the countries that have seen the biggest rebellions against the mainstream elites are those that went furthest in transforming their states but also where a pro-market social democratic left was most implicated in driving that process.

The problem is that very few of these reforms have worked in the terms by which they were justified. Moreover, the increased porosity of state structures to business involvement - to levels unprecedented in the era of universal suffrage – has enabled an upsurge in political corruption in all the states adopting these changes, albeit to varying degrees. What Europe and North America have experienced in practice are varieties of state failure combined with corruption scandals that create the most damaging possible scenario: one in which the mainstream political elites are seen to abuse the powers of the state for private gain while simultaneously withdrawing its protections from the public.

Behind each story of increasingly bipartisan state reforms was a governmental determination to manage the intensifying pressure on public finances. But in practice the failures of these reforms have only exacerbated the fiscal and social tensions of de-industrialization already

[1] Yves Mény and Yves Surel, eds. *Democracies and the Populist Challenge* (New York: Palgrave Macmillan, 2002).
[2] See Wolfgang Streeck, "The Crisis of Democratic Capitalism," *New Left Review* 71 September-October (2011): 6-12; Peter Mair, "Representative versus Responsible Government," MPIfG Working Paper 09/8, 2009; For an exception see John Zysman and Daniel Breznitz, *The Third Globalization: Can Wealthy Nations Stay Rich the Twenty-First Century*, (Oxford: Oxford University Press, 2013).
[3] Streeck, "The Crisis", 6-12.
[4] Colin Crouch, "Privatized Keynesianism: An Unacknowledged Policy Regime,", *The British Journal of Politic and International Relations*, 11, 3 (2009) 382-399

emerging in the 1970s which were then amplified by the liberalisation of capital movements through the 1980s: pressures experienced as a radical shock in post-Communist Europe but as an intensifying challenge in Western capitalist states. The transformation of the state was typically begun in good faith and according to prevailing liberalising orthodoxies. But many of the assumptions behind these newly radicalised orthodoxies proved flawed, and not just in their internal theoretical logic but in the failure to anticipate what would happen when marketization could only be partially applied, as was bound to be the case in real world conditions. The necessary conditions for competitive and hence efficient markets are remarkably extensive and strict: their natural existence is rare and their near approximation has historically required the active interventions of the state. Highly incomplete markets in the meantime can produce unexpected and socially perverse outcomes, as the cases below show. The fantasy pushed by so-called 'supply-side' economists - that pure markets could exist if only the state would 'get out of the way' - has nevertheless persisted,[5] and when the global financial crisis threw these wider reform failures into relief mainstream political elites proved unwilling to acknowledge the magnitude of the crisis for at least two reasons. Firstly, because they shared responsibility for the failed policies but also because of the continuing absence of any alternative developmental model beyond the still prevailing utopia of eventual market 'completion'. The remainder of this essay offers a brief illustration of state failure in the four most surprising cases of the populist wave, namely in Hungary, Poland, the UK and the US: four former trailblazers at the historical leading edge of democracy.

Poland and Hungary were in the vanguard of the anti-communist revolutions of 1989 and had the strongest social basis for stable and 'mainstream' electoral competition. In the mid-2000s Hungary and Poland had the highest proportion of voters who identified themselves as social democrats in Central Europe,[6] *i.e.* on a par with Swedish rates. Why was it then that a growing segment, including former leftist voters, became susceptible to the idea 'that the nation cannot be in opposition', and turned from narratives that had championed the nation's place within the new Europe towards those that berated the EU as an oppressive force? Put at its simplest: both countries have seen an intensifying political crisis because of the necessarily partial nature of liberalisation: because really-existing communist production regimes could not be turned into textbook liberal production regimes in practice and necessarily partial liberalization created particular difficulties. Both Hungary and Poland actually developed hybrid political economies: highly liberalised and open economies with critically missing liberal institutions such as domestic sources of business credit, dispersed corporate ownership or venture capital. This path-dependent lack of internal institutions that efficiently complement each other has led to highly polarising socio-economic outcomes made worse by the retreating state, *e.g.* low unemployment protections in contexts of weakly dynamic labour markets and weak innovation capacity unimproved by state assistance - in stark contrast to high state investment in research in the USA, for example.

The social contract offered in the early 1990s in both Hungary and Poland was that a minimum income guarantee would be provided to the most vulnerable – pensioners and the unemployed – to forestall a backlash against marketization. This guarantee was predicated on the gamble that renewed economic growth would make the new welfare contract sustainable. But despite being the fastest and most consistently growing economy in the region Poland's social contract liabilities, its pension liabilities in particular, would prove both fiscally and politically sticky. By 2000 Poland was spending far more than the OECD average on income transfers and twice the average on disability pensions.[7] The increasing rigidity in

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[5] Zysman and Breznitz, *Third Globalization*, 23

[6] Comparative Study of Electoral Systems Dataset, Modules 1 and 2, in Ian McAllister and Stephen White, "Political parties and democratic consolidation in post-communist societies," *Party Politics* 13, Number 2, (2007): 197-216, 203

[7] Andrew Burns and Kwang-Yeol Yoo, "Public Expenditure Management in Poland," *Economics Department Working Papers* Number 346 (2002) ECO/WKP 32, OECD, Paris

Poland's public spending effectively crowded out the Polish state's ability to adjust its welfare system to insure its population against the new social risks of globalisation, and this despite successive governments cutting back entitlements to unemployment benefits to some of the lowest levels in the OECD. Poland has a politically polarising structure of poverty as a result, in which it already has British rates of relative poverty but at Chilean income levels, and those in poverty are the young, those with large families, and those in rural areas.[8] The Polish elderly meanwhile are relatively well off and politically mobilised, as witnessed by the massive public demonstrations against raising the pension age: an essential measure which the populist Law and Justice promptly reversed when returned to power in 2015.

As its new developmental challenges emerged Poland wrestled with persistent tensions on the supply side of its economy. Its dependence on foreign economic investment (though lower than elsewhere in the region) constrained successive governments' room to make its institutional regime more coherent. For example, the region-wide tax competition for foreign investment meant that Poland has steadily reduced its corporate and personal income tax rates but its ongoing welfare liabilities forced the persistent burden of taxation to be shifted onto VAT and more damagingly still, onto labour. The practical result has been an exceptionally high tax wedge on labour that has stalled domestic employment and pushed employers towards the use of temporary contracts, so that Poland now has the highest number of 15-24 years-olds on temporary contracts in Europe: a staggering 69% by 2013.[9] The neo-classical economics on which transition economics was based operated from deductive 'ceteris paribus' assumptions that implied that any liberalising reform created efficiency gains: but the really existing economies had 'cetera' that were far more dynamically problematic.

A similar unintended consequence of the radical opening of Poland's economy was the incompatibility of the needs of the emerging domestic market for business credit and the severe risk aversion of Poland's internationalised banking sector to lend to Polish businesses. Poland's small and medium sized enterprise have been starved of credit as international banks focused on lending to home country multi-national companies and the lucrative domestic mortgage and retail markets. It hasn't helped, politically, that the old EU member states had insisted that this region internationalise its banking system as an article of liberal faith while assiduously rejecting this option themselves.[10] However, the more salient political point is that the Blairite left in Poland is now as associated as the neo-liberal right with reforms that seemed to favour external constituencies at the expense of those domestic workers not employed within the foreign direct investment sector. Miller's Social Democratic government had lowered the corporate rate to 19% as part of its 2004 reforms, outdoing the proposals of even the radically neo-liberal Leszek Balcerowicz.[11]

The underlying dichotomy between the changing economic production regime and social justice is perhaps even better illustrated by the Hungarian story which demonstrates the 'damned if you do, damned if you don't' socio-economic experience of contemporary democratic governments in search of social cohesion. Successive Hungarian governments liberalised their tax regimes and opened their economy to foreign direct investment but maintained not just the minimal social contract for the most vulnerable but also relatively high social investment. They aimed to create a

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[8] Stanislawa Golinowska, Katarzyna Pietka, Christoph Sowada and Maciej Zukowski, "*Study on the Social Protection Systems of the 13 Applicant Countries, Poland*"' *European Commission/GVG Working Paper*, January (2003) www.cor-retraites.fr/IMG/pdf/doc-321.pdf

[9] *OECD Employment Outlook 2014*

[10] Rachel Epstein, "Assets or Liabilities: The Politics of Bank Ownership," *Review of International Political Economy*, 21: 4, (2014) 765-789.

[11] Hilary Appel Tax Politics in Eastern Europe (Ann Arbor: The University of Michigan Press, 2011), 66.

virtuous circle of human capital investment and higher valued-added production. But again the result was an exceptionally severe fiscal crisis when sufficient growth failed to materialise.

The Hungarian Socialist Party had tried to combine radical liberalisation with sustained state spending on education, training and public employment and Fidesz's first administration had offered mortgage subsidies and failed to reduce pension liabilities. As in Poland the result was the shifting of a high tax burden onto labour and employment and rising public debt to a cumulatively ungovernable level. Hungary increasingly combined the lowest employment rate in Europe with one of the highest tax wedges on labour and with the highest public spending overall of the Visegrád states. By 2006 this meant French levels of public spending at Polish levels of per capita income. When coupled with a post-2007 crisis in privately held foreign the last Hungarian Socialist government was left with nowhere to go but to unprecedented austerity measures. By 2010, given corruption scandals and public knowledge that the HSP had misrepresented the real condition of public finances it had squandered public trust.[12] Orban's Fidesz duly won on a promise of 'no austerity', only to implement exactly that alongside a shift to constitutional lock-in and increasingly concerted crony-state capitalism.

The Hungarian and Polish political systems were thus confronted with the challenge of maintaining popular legitimacy for radical reform in the face of socially exclusive modes of economic growth and rising fiscal pressure for ever-deeper public spending cuts. This was essentially the Western capitalist experience of de-industrialisation concentrated into a shorter time span and at the points where democracy's merits had still to be proved. In both cases the social democratic left saw the shattering of their electoral support as the parties (first in Poland, then in Hungary) appeared to vacate the leftist socio-economic space entirely. But the irony is terrible: these former young communist technocrats had become the region's most Blairite, pro-market social democratic parties in order to demonstrate their liberal virtue!

So what similarities exist between the political economic gamble of Post-Communist Central Europe and the rise of populism in already highly liberalised advanced capitalist economies such as the USA and UK? In the latter cases the evidence is again of a deepening crisis of the state's capacity to act effectively in the public interest, and the association of that crisis with the social democratic left as much as the more traditionally pro-market right. To take the case of the USA, the argument has been made since the beginning of the global financial crisis that a coalition of organized big business and increasingly co-opted political elites had replaced the post-war political consensus in which ideologically competing parties strove to support the American middle class and to enable the upward mobility of the poorest into that class. The phenomenal rise in business lobbying and recently uncapped corporate party funding in the US are described as spawning a 'predator state'[13] whose main function is to divert public money to private hands and as 'winner takes all politics'[14] in which large corporations concertedly intervene in politics to manage institutional and regulatory changes to their overwhelming advantage. A second-wave literature has duly begun on how the various dimensions of corporate state or 'regulatory' capture already are, or can be limited.[15]

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[12] Abby Innes, "Hungary's Illiberal Democracy' *Current History*," March 2015

[13] James Galbraith *The Predator State: Why Conservatives Abandoned the Free Market and Liberals Should Too* (New York: The Free Press, 2008)

[14] Jacob S. Hacker and Paul Pierson*, Winner Takes All Politics: How Washington Made the Rich Richer and Turned Its Back on the Middle Class* (New York: Simon and Schuster, 2011).

[15] Daniel Carpenter and David A. Moss, eds. *Preventing Regulatory Capture: Special Interest Influence and How to Limit It* (New York: Cambridge University Press, 2014).

The key to understanding the American case is the unprecedented undermining of opportunities for social mobility within a relatively liberal economy: America's historical social contract. As the tax expert James Henry noted, by 2013 some 22 per cent of all US children were living in poverty, the highest rate since the 1960s, and overall real per capita household incomes have stagnated since the 1980s, so that *all* of the increased income generated by the post 2009 recovery was consumed by the top 1 per cent. In the meantime "government assistance for the poor and the unemployed, as well as funding for public investments in education, roads, hospitals and schools was starved for funding." Henry concludes that this "was a policy-made phenomenon"[16] and as such it cannot be surprising that such outcomes have proved peculiarly crippling to the credibility of the mainstream parties.

This un-mandated breach of the prevailing social contract is repeated in the UK. It is actually the UK which initiated the era of hybridising state reforms with Margaret Thatcher's drive towards a more business-oriented approach to government preceding similar moves in the US, Canada and New Zealand.[17] Launched on the promise of 'better government for less money' these leading edge reforms were based on the idea that not only should the economy be liberalised but the state itself should be opened up directly to business involvement in both policy-making and delivery. The Blaire New Labour and New Democrat left then embraced these reform ideas as a new way to combine wealth creation with greater efficiency and responsiveness in public service provision. In practice, however, these experiments have produced contrary results. In the UK reported administration costs have risen by 40 per cent in constant prices, despite a third of civil service numbers being cut over the same thirty year period, whilst total public spending over the same period has doubled. Complaints and judicial challenges have soared and running costs have been driven up in the outsourced domains.[18]

The hybridised UK state has proved more expensive and, as the now sizeable public administration and policy literatures attests, largely less efficient, resulting in poorer social, economic and political outcomes. Hybridisation nevertheless continues to proliferate not just in the UK but globally and it is still actively encouraged by the World Bank, OECD and EU as the route to greater efficiency despite the mounting evidence to the contrary. (The risks of outsourcing, moreover, are starkest in the most poorly regulated states. In the Czech Republic the value of public contracts awarded through opaque, non-tendered channels between 2006 and 2010 is estimated at 276 billion crowns or roughly one-fifth of the current national debt: the Republic is a cautionary tale of how neo-liberalism can be instrumentalised by political elites for private gain.[19]) This deepening of state hybridization in the face of chronically poor results is profoundly dangerous because it creates an irreconcilable tension between our basic norms of democracy, dependent as these are on state autonomy, and the increasing permeation of that state authority by private businesses. Again, it is hard to imagine a process more productive of the idea that political elites are in collusion with business at the expense of the public interest. Moreover this increasing role for private businesses has typically been replicated throughout the wider state administration and its regulatory agencies. In the UK this has led to a level of administrative and informational fragmentation that rather than reducing bureaucracy has only radically complicated it, and exacerbated the so-called 'principle-agent' problems wherein the interests and information of

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[16] James Henry 'Let's Tax Anonymous Wealth', in Global Tax Fairness, Edited by Thomas Pogge and Krishen Mehta, (Oxford: Oxford University Press, 2015), 77

[17] Christopher Hood and Ruth Dixon, *A Government That Worked Better and Cost Less?* (Oxford: Oxford University Press, 2015), 15

[18] Hood and Dixon, *A Government*, 266

[19] Press Release, Prague 26 January 2011, ZIndex, the public procurement monitoring project, led by J. Chvalkovská, P. Jansky and G. Skuhrovec, Institute of Economics, Charles University, Prague. For the wider story see Abby Innes, 'Corporate State Capture in Open Societies', *East European Politics and Societies*, 30, 3, August (2016): 594-620

agents and the principles that delegate tasks to them potentially diverge. Thus, far from becoming cheaper this greater government complexity has necessarily increased the transaction costs involved. Flinders argues that institutional fragmentation has ended the capacity of UK central government to operate 'meta-governance' over state authority,[20] and that authority is increasingly wielded by private hands.

The theory of quasi-markets for welfare and public services[21] was based on a focus on the end-user and provider market and analytically ignored the inalienable persistence of the state procurement market: inalienable, that is, given continued taxpayer funding for politically mandated public services. Theoretically speaking the idea of quasi-markets ran with the standard welfare economics that supported it, rooted as that was in the conventional preoccupation with possible trade-offs between equity of outcomes and the efficiency of processes. But the ideas behind quasi-markets ignored the contract and property rights theory that would have identified the still procuring state as doomed to be at the wrong end of chronically inadequate private service contracts owing to the complexity of most of the goods in question. The predictable outcome is 'incomplete' - essentially unfair - contracts in which the (state) buyer lacks the information of the (private) seller and hence is vulnerable to hold-up and opportunism. In practice the UK's taxpayer funded quasi-markets are characterised by public service industry oligopolies with a tendency to sweat the guaranteed public funding while only producing perfunctory behaviour within hard to monitor contracts. This explains the higher costs, lower service quality and increased regulatory complexity of goods as pivotal to the public experience of the state as health, education and prison services. Ironically, quasi-market reforms of the capitalist state turn out to produce many of the pathologies of late communism's mixed markets, including a regulatory reliance on incentive-distorting indicative planning and chronic gaming practices. And again the results are experienced by citizens, most notably those on lower and middle incomes, as the opposite of what they were promised.

In the short term a cheering note is hard to find: it is not clear how this trend to social and political polarisation can be reversed without a radical shift in the political economic paradigm because our current production regimes offer up an increasingly divergent set of social interests. The knowledge economy encourages a dramatic shift in the dominant producer coalition landscape and its favoured welfare regime. There were distinct patterns in the Brexit vote and the US election of divergent voting preferences between the centres of the new knowledge economy – rooted in information and computer technology and services – versus those of the rural, industrial and mid-range technology economies. These trends support a worrying thesis,[22] which is that there are increasing structural divisions in advanced capitalist economies between those higher educated voters who feel able to self-insure in minimal or even failing state conditions and who prefer the flexibility of highly liberalised labour markets versus the rest, who have poor prospects in this system. There is a similar trend in the Central European economies fortunate enough to receive German-dominated high quality investment in the complex manufacturing sector, where those employed within these new sectors typically have better prospects than those outside them, but the domestic state is impoverished as a developmental entity.

So it is unclear where the new, consensual centre ground of public policy-making is to be found, and with it a legitimising role for the democratic state as a socially integrative force.

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[20] Matthew Flinders, Walking Without Order: Delegated Governance and the British State (Oxford: Oxford University Press, 2008)

[21] Julian Le Grand, "Quasi-Markets and Social Policy," *The Economic Journal* 101, 408 September (1991): 1256-1267

[22] Herman Schwartz 2017 forthcoming: 'Size, scope and why the American welfare model remains exceptional', draft chapter for Growth Strategies and Welfare States, eds. Anke Hassel and Bruno Palier

But historically we have accepted the authority of the state to act in *any* respect on the basis of its capacity to fulfil a social contract. As TH Marshall classically pointed out[23], we have done so on a changing conceptual basis: that the state should defend our civic, our political, and latterly in the post-war era, our social rights. The thing is, that expectation still exists and while the ‘new’ social democrats of the 1990s may have successfully parsed the language of social equality into the language of social justice, the results of public policy have increasingly failed to resemble any such a thing, and many voters have reacted with understandable disgust. In the meantime the new populists promise economic and cultural protection: from Scandinavia to the USA they now outflank the social democrats on the left but with added nativism. In government they have proved the worst crony capitalists of all.

[23] TH Marshall, Citizenship and Social Rights, and other essays (Cambridge: Cambridge University Press 1950)