Labour Economics

Thinking through Labour's
economic agenda

Edited by
Aveek Bhattacharya & Neil Lee

SMF Social Market Foundation

Labour Economics

Thinking through Labour's economic agenda

Editors
Aveek Bhattacharya and Neil Lee

FIRST PUBLISHED BY

The Social Market Foundation, April 2024
Third Floor, 5-6 St Matthew Street, London, SW1P 2JT

THE SOCIAL MARKET FOUNDATION

The Foundation's main activity is to commission and publish original papers by independent academics and other experts on key topics in the economic and social fields, with a view to stimulating public discussion on the performance of markets and the social framework within which they operate. The Foundation is a registered charity (1000971) and a company limited by guarantee. It is independent of any political party or group and is funded predominantly through sponsorship of research and public policy debates. The views expressed in this publication are those of the authors, and these do not necessarily reflect the views of the Social Market Foundation.

CONTENTS

ABOUT THE CONTRIBUTORS

Aveek Bhattacharya

Aveek Bhattacharya is the Interim Director of SMF, having joined as Chief Economist in September 2020. He holds a PhD in Social Policy from the London School of Economics, and is co-editor of the book *Political Philosophy in a Pandemic: Routes to a More Just Future.* He was an advisor to the Gordon Brown Commission on the UK's future.

Neil Lee

Neil Lee is Professor of Economic Geography at the London School of Economics and Political Science. He is also Professor II at the Inland Norway University, Chair of the Regional Studies Association, and an Associate Member of Nuffield College, Oxford. He holds a PhD in Economic Geography from LSE and has held visiting positions at Columbia University, the University of Oxford, and Science Po Toulouse. He has provided policy advice to the World Bank, OECD, European Commission, European Investment Bank and various national governments.

Giles Wilkes

Giles Wilkes currently divides his time between the business advisory Flint Global, where he is a Specialist Partner, and the think tank the Institute for Government, where he is a Senior Fellow. He has enjoyed two stints as a special adviser, in the Department for Business, Innovation & Skills and Number 10, a couple of years writing comment for the *Financial Times*, and ten years working in finance.

Anna Valero

Dr Anna Valero is a Distinguished Policy Fellow and Director of the Growth Programme at the LSE's Centre for Economic Performance, Deputy Director of the Programme on Innovation and Diffusion (POID), and an Associate of the Grantham Research Institute, LSE. Anna was a member of the Steering Group of the Economy 2030 Inquiry, a Commissioner for the Royal Society of the Arts - Core Cities UK Urban Futures Commission, and a Research Director for the LSE Growth Commission. She has held a number of advisory positions, including currently as a member of the Office for Budget Responsibility's advisory panel, the government's Green Jobs Delivery Group, and South Yorkshire Mayoral Combined Authority Economic Advisory Council.

Margarida Bandeira Morais

Margarida Bandeira Morais is a Postdoctoral Research Associate at the National Institute of Economic and Social Research (NIESR) and The Productivity Institute, and a Visiting Fellow at the London School of Economics (LSE). Her research focuses on regional development, innovation and institutions. She holds a PhD in Economic Geography from the LSE and previously studied at Utrecht University and Trinity College Dublin.

David Soskice

David Soskice is Emeritus Professor in the Department of Government at the London School of Economics, and was School Professor of Political Science and Economics from 2012-2022. He is a Fellow of the British Academy and of the American Academy of Arts and Sciences; he is a Member of the Academia Europaea and an Honorary Fellow of Trinity College, Oxford.

Andrew McNeil

Andrew McNeil is a Research Fellow at UCL's Department of Political Science working on the Mental Models in Political Economy project. Andrew's work was supported by a UKRI Future Leaders Fellowship (MR/X011089/1).

Baroness Alison Wolf

Baroness Alison Wolf CBE is the Sir Roy Griffiths Professor of Public Sector Management at King's College London and a cross-bench peer (Baroness Wolf of Dulwich). She completed the Wolf Review of Vocational Education (2011), and was a member of the Augar Review of Post-18 Education and Funding. She was seconded to the Prime Minister's Policy Unit as an expert adviser on skills and workforce from 2020-23, and contributed to the development of the Skills and Post-16 Education Act (2022) and the Lifelong Learning Entitlement.

Alan Manning

Alan Manning is Professor of Economics at the London School of Economics and is Director of the Centre for Economic Performance's research programme on Community. From 2004 to 2011 he was a member of the NHS Pay Review Body and from 2016-20 chair of the Migration Advisory Committee

Jonathan Portes

Jonathan Portes is Professor of Economics and Public Policy at King's College London, and Senior Fellow, UK in a Changing Europe. He was formerly Chief Economist at the Cabinet Office and before that at the Department for Work and Pensions. He is the author of *What do we know and what should we do about immigration*?

John Springford

John Springford is an associate fellow at the Centre for European Reform in London, having previously led its economics team as deputy director. He is also a visiting fellow at the Institute for Policy Research at the University of Bath. He was a specialist advisor on Brexit to the House of Commons Treasury Committee.

Paul Cheshire

Paul Cheshire is Professor Emeritus of Economic Geography at the London School of Economics and an Associate at the Centre for Economic Performance. He has acted as consultant to the World Bank, the UN, the OECD, the European Commission and the government of New Zealand as well as several UK government departments. He was an advisor to both Barker Reviews of planning and a Board member of the National Housing and Planning Advisory Unit. Most recently he was specialist advisor to the House of Lords Select Committee on the Built Environment for its enquiry into how to meet the demand for housing.

Dan Turner

Dan Turner is Head of Research for the Centre for Progressive Policy. He also works as a researcher at the Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School, and until recently served as the Senior Policy Advisor to the Mayor of South Yorkshire

Henry Overman

Henry Overman is Professor of Economic Geography in the department of Geography and Environment at the London School of Economics. He is also the Research Director of the Centre for Economic Performance and the Director of the What Works Centre for Local Economic Growth. He has provided policy advice to, amongst others, the European Commission, Department for International Development, Department for Business, Energy and Industrial Strategy, Department for Levelling Up, Housing and Communities, HS2 and the Department for Transport, HM Treasury, the Manchester Independent Economic Review, and the North East Independent Economic Review.

Jagjit Chadha

Jagjit S. Chadha is Director of the National Institute of Economic and Social Research. Previously he held academic posts at St Andrews, Kent and Cambridge, where he continues to act as a Visiting Professor. He has acted as a specialist adviser to the Treasury Committee and to many central banks. His monograph on monetary policy, *The Money Minders*, was published in 2022.

Sir Tim Besley

Sir Tim Besley is School Professor of Economics and Political Science and W. Arthur Lewis Professor of Development Economics at LSE. He has been President of the Royal Economic Society and the Econometric Society. He has given advice to the IMF, World Bank and EBRD and has served on the Bank of England Monetary Policy Committee, the National Infrastructure Commission and the Levelling Up Advisory Council.

INTRODUCTION

Aveek Bhattacharya
Interim Director, Social Market Foundation

Neil Lee
Professor of Economic Geography, London School of Economics & Political Science

> *In its 1997 manifesto, the Labour Party pledged that "An explicit objective of a Labour government will be to raise the trend rate of growth". 27 years on, as the party stands on the brink of a return to power, it has a similar goal: the first and most prominent of its five missions for the UK is to "secure the highest sustained growth in the G7".*[1]

Back in the 1990s, there was a clear route to achieving growth – by "nurturing investment in industry, skills, infrastructure and new technologies", and prioritising "educational and employment opportunities for all". This was rooted in economic theory – incoming Chancellor Gordon Brown was lampooned for embracing "Post Neo-Classical Endogenous Growth Theory", but it reflected a deep engagement with academic economics and a clear worldview and diagnosis. The terminology may have been abstruse, but there is a direct connection between Brown's jargon, with its implicit argument that human capital is critical to growth, and Tony Blair's catchier slogan: "education, education, education".

Labour's challenges are greater now than in 1997. But it is less clear how they will address them. There are a number of slogans and buzzwords floating around the Shadow Chancellor: "securonomics", "the everyday economy", "productivism", "modern supply side economics". Indeed, there are important texts where Rachel Reeves has tried to set out her economic thinking – last year's Labour Together pamphlet, *A New Business Model for Britain*[2], and last month's Mais lecture.[3] Yet these ideas remain underdeveloped or at least in need of elaboration.

In part, this gap may reflect the current state of the economics profession, chastened by the global financial crisis and the economic stagnation which has followed. Back in the 1990s, when the likes of Paul Romer were ascendent, programmatic schools of thought like endogenous growth theory, with clearer 'recipes', made the job easier for politicians. Yet more recent economics has focused on empirical contributions, as seen in the increasing importance of behavioural economics, rather than grand theory. No new economic theory has developed which offers clear, confident, but plausible macro policy agendas.

What, then, is Labour's view of how growth can be achieved? After 14 years in opposition, the Labour Party must have an underlying economic worldview that will shape its approach to growth. But it isn't yet clear from their speeches, pamphlets, and interviews exactly what they believe will drive growth and how they will achieve it. This essay collection, drawing together contributions from some of the UK's most notable economic analysts, all writing from a politically independent standpoint, as 'critical friends', is an attempt to identify and articulate this worldview, to examine its assumptions and implications, and to set out a way forward for Labour if they reach power. What does Labour see as the major limiting factors on the economy? Which levers is it likely to prioritise to kickstart growth again? What are the 'dogs that do not bark': measures it is neglecting?

What can we say about Labour's economic worldview?

Across the 13 essays in this collection, each exploring a different area of economic policy, there are some common themes and ideas, which offer some indication of Labour's thinking and priorities. First of all, the party seems to be banking on a 'sensibleness dividend', a bonus for simply not being the Conservatives, a possibility raised in both **Giles Wilkes**' essay on business environment and **Margarida Bandeira Morais** and **Neil Lee**'s on innovation. It seems likely that greater predictability, coordination, and competence will indeed reassure investors and markets – but it is not enough for a strategy for economic growth. As **Tim Besley** highlights in his contribution, whichever party comes next will require a central purpose if they are to succeed in rebuilding our economic model.

Secondly, there is a strong focus on industrial strategy, as elucidated by **Anna Valero** in her chapter on green growth, and **Giles Wilkes** on the business environment. Yet defining exactly what it means by industrial strategy is tough. It seems more defined by what it isn't – 'picking winners' – than what it is. Nevertheless, we can start to identify some vague outlines. Industrial strategy will likely involve sectors where the country or particular geographies have comparative advantage, and prioritising efforts to support them, and develop a plan for their growth. In government, Labour will likely try to leverage its perceived sensibleness and stability to develop a stronger partnership with business, and to ensure a more 'joined up' approach. This is all fine at this level of abstraction, but the real challenge – as Wilkes points out – will come if required to put it into practice in government, and particularly resisting the risk of capture by compelling or convenient business narratives.

A third idea, present across much of Labour's public communications is the notion that – taking inspiration from US Treasury Secretary Janet Yellen[4] – their approach would embody modern "supply side" economics. A number of the essays in this collection touch on the supply side. Perhaps the highest profile – not least given Yellen's link to 'Bidenomics' and the Inflation Reduction Act – is the energy transition, covered in **Anna Valero**'s essay. Labour's communications on this point can be unclear – its political rhetoric tends to focus on the Keynesian demand side benefits of investment in batteries, electric vehicles, or wind farms. But the modern supply side version of the argument is that shifting away from fossil fuels can help drive down energy costs in the medium to long run, boosting businesses reliant on energy.

Less noticed is the way that Labour's supply side approach extends to the labour market. There is some optimism within the party that strengthening workers' rights through its 'New Deal for Working People' can help to drive up productivity.[5] There are a number of ways this could happen. Offering greater security could increase worker motivation. Requiring employers to make stronger commitment to their employees could encourage them to invest more in their training and progression. The party would presumably feel more ambivalent about stricter worker protections encouraging firms to automate jobs, but such a shift would improve productivity. **Alan Manning**'s contribution considers such arguments, but with some scepticism, suggesting that labour protections will do more for workers than economic growth, and that that should be enough.

Another important potential element of a supply-side growth strategy is planning reform, which features in both **Paul Cheshire**'s contribution on housing and **Daniel Turner**'s on infrastructure. That links to a fourth theoretical concept that may be important to understanding Labour's economic approach: agglomeration, or the economic benefits of proximity to economic mass. Economists famously do not agree on much, but there is a consensus that agglomeration matters for economic outcomes – reflected in the growing attention given to the idea of economic 'clusters'. But this creates trade-offs, identified by **Henry Overman** in his chapter on 'levelling up', which highlights the challenges of reducing London's economic dominance. Overman argues that we can support growth beyond the capital, but that will only be possible with focus and prioritisation of relatively few locations, rather than promising all things to all places. Similarly, **David Soskice** and **Andrew McNeil** argue that any Labour government should back clusters in the North, building megacities from Manchester to Leeds.

A fourth key theme across our contributions is investment, one of Reeves's three imperatives in her Mais lecture. It is widely believed that increasing the UK's capital stock, both through direct public investment and by encouraging the private sector to invest more, is critical to our economic future. That notion features in **Giles Wilkes**' chapter on business environment, **Anna Valero**'s on green transition, and is central to Labour's efforts to increase the British assets held by pension funds. At times, the current economic discussion feels reminiscent of the 1950s and the Harrod-Domar model: invest more, increase capital and growth will arithmetically follow. It can feel a bit 'back to the future'. But it also comes with a trade-off – fundamentally, people will have to sacrifice some consumption today, either through higher taxes or higher savings (for example, increasing pension contributions) in order to support future growth.

A fifth idea which crops up time and again is security – most obviously in the widely used term 'securonomics'. It is clear that Labour has alighted upon this as a potent campaigning tool, promising a sense of safety and stability after a turbulent decade and a half. Its relation to growth is less obvious though. In areas like energy in particular (as Anna Valero observes), increasing security should reduce the likelihood and impact of negative shocks like the Russian invasion of Ukraine. But 'security' seems like a negative, defensive idea (as opposed to, say, 'abundance').

Some of the contributions focus on issues that seem relatively neglected in Labour's growth strategy. The most striking is education and skills, covered for us by **Alison Wolf**. Given the importance of human capital to the last Labour government's economic approach, the contrast with today feels sharp. The current party would likely object to the suggestion that it has deprioritised education, given that "breaking down the barriers to opportunity" is one of its five missions, and it has plans for reform like creating a Skills England body to align training with industrial strategy. Yet if we follow the money, there is little to suggest that the resources and learners in tertiary and adult education are likely to rise substantially. Labour's approach to education seems to be about social mobility, rather than economic growth.

Even those in the party would admit that they are not going to be pursuing a trade or migration led growth strategy. Many economies have prospered by increasing their openness to the global economy. Yet as **John Springford** (in his piece on trade) and **Jonathan Portes** (in his on migration) demonstrate, the perceived political constraints on being seen to reverse Brexit or increase migration numbers are such that Labour is unlikely to offer a dramatically different change of direction. Even less surprising is the fact that Labour is unlikely to take a dramatically different approach to demand management, the subject of **Jagjit Chadha**'s essay. For all the debates since the global financial crisis over the necessity of austerity or the imperative of Keynesian stimulus, the basic model of delegating control of the business cycle to the Bank of England with its existing inflation target is unlikely to be changed.

Labour's agenda if elected

Overall, we find no 'grand theory' of growth but a series of pragmatic, often technocratic, interventions which might drive growth. This reflects current fashions in academia, now more focused on pragmatic policies based on causal identification, rather than comprehensive theories. It might also reflect broader political trends: the last decade has seen the spectacular failure of some ideological experiments (Corbynism, Brexit, Truss), and the UK's difficult financial position means 'big ideas' feel like an indulgence we can no longer afford.

For all that, there are indications that its approach will try to foreground industrial strategy, particularly to address the energy transition, and learn from international efforts to do the same. The party at least claims to be prioritising the supply side, with particular focus on ensuring a more secure energy supply, better protected, and thus (they hope) more productive labour supply and looser planning regulations. The last of these should help develop the housing and infrastructure necessary to exploit agglomeration and build more effective clusters. Further, these goals would be supported by a more stable and reassuring policy environment, which ought to support confidence and investment.

Put in these terms, it is a coherent and plausible strategy, notable for what it *isn't*. It isn't driven fundamentally by increased labour supply, mass expansion of education or increased exposure to the disciplining force of international trade. We won't reach a verdict here on whether those are the right priorities, but we will make a couple of observations. The first is that there seems to be a tendency in the Labour Party to take politically convenient positions rather than critically interrogating them. For example, it seems as though part of the attraction of planning reform or labour market reform is that it does not cost the government any money. Environmental policy is necessary, and therefore it is not just good for the economy but ought to be the centrepiece of our economic strategy. Clusters are important, so we can build them all over the place and 'level up' the country. There are hints of wishful thinking in this political expediency.

Second, relatedly, if the strategy is to work, the party needs to follow through on it, even when it becomes hard, inconvenient, or expensive. Labour's backsliding on the scale of its green investment is, in this context, a worrying portent. To do effective industrial strategy it will have to say no to certain sectors and places. To meaningfully reform planning and unlock infrastructure and agglomeration effects, it will need to face down strong political resistance. To raise investment, it may have to tell people to sacrifice some of their living standards today in return for a brighter tomorrow. Those sorts of conversations might be foolish for a party still trying to persuade voters and win an election. But they are unavoidable for a government that wants to leave a significant mark on the economy.

Labour came to power in 1997 with a clear vision of how to grow an already strong economy, drawing on confident macroeconomic theory. The situation now is very different. The economy is weaker, and the need for growth is more urgent. However, as the essays in this collection demonstrate, there is little evidence that Labour has a grand theory underpinning their plans for growth. Instead, there is a focus on pragmatism, a hint of a supply-side approach, and a hope that a return to competence will be enough to stimulate growth. If Labour does make it to power, we had all better hope this will suffice.

---

[1] Labour, 'Secure the Highest Sustained Growth in the G7', September 2023, https://labour.org.uk/wp-content/uploads/2023/09/Mission-Economy.pdf.
[2] Rachel Reeves, 'A New Business Model for Britain: Building Economic Strength in an Age of Insecurity' (Labour Together, 24 May 2023), https://www.labourtogether.uk/all-reports/a-new-business-model-for-britain.
[3] Rachel Reeves, 'Mais Lecture 2024' (London, UK, 19 March 2024), https://labour.org.uk/updates/press-releases/rachel-reeves-mais-lecture/.
[4] Janet L. Yellen, 'Remarks by Secretary of the Treasury Janet L. Yellen at the 2022 "Virtual Davos Agenda" Hosted by the World Economic Forum' (World Economic Forum, Online, 21 November 2022), https://home.treasury.gov/news/press-releases/jy0565.
[5] Labour National Policy Forum, 'Final Policy Documents', July 2023, https://www.docdroid.net/sdjV99D/wr-366-23-npf-final-report-for-conference-v10-update-pdf#page=5.

CHAPTER 1 – BUSINESS ENVIRONMENT

Giles Wilkes
Senior Fellow
Institute for Government

> *After the next election, Labour is expected to assume responsibility for a business environment in a far from healthy state.*

From the perspective of expectation management, this at least sets the bar low: following a government that, after a few years of preparatory chaos, imposed a miserably bare-bones Brexit, most businesses would welcome nothing more than a spell of sanity and quiet. But it also renders urgent the need to do better. Everything a progressive government might want to achieve depends on a stronger economy and a restoration of business confidence. It is not enough for Labour simply to jettison the hooligans who wrecked the joint – they need a positive plan for how they mean to go about the repair job.

His Majesty's loyal Opposition has a deserved reputation for being tight-lipped on big policy topics. But it leaves plenty of clues about what it thinks about business policy, through documents like *Prosperity through Partnership: Labour's Industrial Strategy*[1] and *A New Business Model for Britain.*[2] There is the germ of a plan here, but plenty of unanswered questions and unacknowledged dilemmas.

First it is important to emphasise continuity, in spite of how disappointing the past 14 years have been. Like their predecessors Gordon Brown and Tony Blair in 1997, Rachel Reeves and Keir Starmer will initially continue the same broad fiscal approach as the departing government – in no small part to shrink the target for Conservative attacks.

These 1990s echoes should not be exaggerated. Thirty years ago, the team driving New Labour decided they must accept and move forward from Thatcherism, rather than fight impotently against it. There was to be no great expansion of the state, no re-nationalisation of the utilities, no reversal of the labour market reforms, or re-admittance of union leaders to the corridors of power. Essentially New Labour was to admit the success of the Thatcherites in modernising the economy, file off the rougher edges, and do more for public services with the fruits of growth.

This time, no one even ironically suggests that Labour must adopt Conservative policy prescriptions because of how brilliantly they have worked. Rachel Reeves is not (largely) aping Conservative fiscal plans in tribute to their perfect design, but for the very opposite reason: the public finances have been so badly managed that they leave her no room for manoeuvre. Yes, Labour is adopting the Conservatives' approach on inflation too – but the consensus on monetary policy has been fixed ever since 1998, when Bank of England independence was put into law. Labour has understood the need to defend the "pound in your pocket" for decades.

So, continuity, but this is imitation meant as anything but flattery.

The major immediate differences will therefore be found in micro, not macro, policy. Rachel Reeves has minted the term “securonomics” to encapsulate an approach that accepts the wealth-creating role of the market economy but emphasizes the need for resilience and security along multiple dimensions: workers, households, key industries and the environment are all to be made stronger in the face of an uncertain world. To achieve this, Labour means to be the most pro-industrial strategy incoming government since Harold Wilson’s in 1974, proud to use the term and eager to define what they mean by it.

It is not a phrase to have caught the public imagination (then, neither did “neoclassical endogenous growth theory” from the era of Ed Balls and Gordon Brown), but securonomics and the New Business Model have clear features. One is that obsession with security, a recognition that after COVID-19 and Ukraine the world is permanently more volatile, its supply chains more fragile, and overseas markets no longer so friendly and reliable. This leads to a suite of policy directions: domestic capacity building, the nurture of networks with friendly countries, a greater appreciation of the value of economic capacity rather than pure, bare-bones efficiency.

Another key aspect of Labour’s approach is a belief in the power of institutions, and the stability they can bring. “Certainty and Stability” is the first ‘tool’ Labour means to bring to bear on the UK economy, a policy response that reveals their diagnosis of how the country fell into this state. The Conservatives have brought uncertainty and chaos for over a decade, goes the claim: ill-planned austerity, followed by an unplanned Brexit, populist and unserious leadership, the creation and destruction of strategies, as if the bewilderment of business was the point. Labour promises solid institutionalism in contrast, through steps like the re-creation of the Industrial Strategy Council and an almost slavish respect for institutions like the fiscal rules. But in the margins one can hear an even simpler theory – the Tories are hopelessly divided, over climate change, Europe, taxation and more, and merely replacing them with Labour would deliver some kind of dividend.

However, stability alone isn’t enough. Labour’s industrial strategy represents a belief that recent crises have revealed an economy badly bent out of shape, prioritising the wrong activities, mired in low investment, regionally unbalanced and in need of more political direction. An economy cannot suffer from so many ills and be cured merely with a spell of quiet. The challenge of reversing a dozen years of productivity disappointment, while also addressing the demands of net zero, means the question is how the government will intervene, not whether.

The easiest part of any industrial strategy is the setting of objectives, and Labour’s are hard to disagree with: more regional equality, the robust pursuit of net zero goals, that emphasis on security, and a drive towards “technologies of the future”. These are not particularly original – mid-period Boris Johnson might have adopted them, happy as he was to steal the clothes of the centre-left. But documents like Reeves’ *New Business Model* reveal more of a thoughtful rationale, in contrast to the boosterish Johnson simply bellowing at people what he thought they wanted to hear. Like Blair and Brown before her, Rachel Reeves has a diagnosis that acknowledges the wealth-creating power of global markets and new technology. But more than they did, she argues that too much *laissez faire* left the fruits of growth narrowly concentrated. Unlike Conservative “level uppers” she can recognize how 1980s deindustrialization is what first left behind the left-behind areas. Under the Conservatives – but even New Labour at times – there was too much complacency about whether, without state direction, new industries would rise up to replace the old. The "knowledge economy" – championed by two-time business secretary Peter Mandelson – was not the force for widespread opportunity that techno-optimists hoped for. Public sector austerity did not open up space for the private sector to grow, but eroded the capacities needed for business to prosper: places with poor health and education, weak infrastructure, and cash-strapped local government do not boom, they decay.

With Johnson gone, the question of state intervention may provide the sharpest break from Sunak's Conservatives, who generally see government as an obstacle to growth, rather than its enabler. As Shadow Business Secretary Jonathan Reynolds emphasises, "an economic strategy where the state 'gets out of the way' is unviable".[3] Labour's fundamentally optimistic view is a kind of "both-ism" (an ugly term I prefer to the still-uglier "cake-ism") – that key public policy goals like lower inequality, lower carbon emissions and enhanced economic security are complements to higher growth, rather than to be traded off against it.

This both-ism can be seen in another important element of their programme, the suite of labour market reforms known as the *New Deal for Working People,* which promises new protections for workers, better job security and a higher minimum wage.[4] Seen from 15 years ago, this represents a huge leap forward: up until the early Coalition period, UK labour market policy was obsessed with the problem of persistent unemployment and the need for highly flexible labour market rules. But ever since 2015, when Tory Chancellor George Osborne shocked Parliament with his announcement of a National Living Wage, the consensus has been moving towards more rights and protections. Labour will go further and do so confident that the risk of rising unemployment was exaggerated for too long. Better rights might even encourage more investment in training and other productivity-enhancing ideas.

The standard charge against industrial strategy governments is that their plans amount to a scheme to replace private business with the public sector; bureaucrats with some Gosplan stifling the free market. This has always been an exaggerated scare – even if all of Labour's overhyped £28 billion capital expansion were of this nature, this would still be about 1% of the economy. An OECD analysis of industrial strategies finds the UK's direct interventions to be so small as to be almost unmeasurable.[5]

But the abstract nature of Labour's thinking generates a number of unanswered questions and dilemmas. Far more needs to be done to explain the 'how' of industrial strategy, taking it beyond the sluggish architecture of business councils, "deals", consultation documents, and competitive funding pots doled out at such a glacial pace. Too many of the industrial strategy roundtables I have sat around spend their time enthusiastically digging into the analysis – what sector? which region? what technology you are most excited by? – and just take the levers for granted.

To its credit, Labour's senior policymakers clearly appreciate the need for a lever-focused approach. Jonathan Reynolds rightly highlights the positive example of the Vaccines Taskforce (VTF) and how it succeeded in exploiting strategic procurement and regulatory coordination to achieve a clear, important goal. But nothing could be more *sui generis* than the creation of a COVID vaccine – a mission with such a gigantic, immediate payoff that not even the most sceptical Treasury official could question the expense. The VTF was a striking success, but not out of line with the UK government's generally good record at action in a crisis; see also the world-leading reaction to the banking collapse of 2008-9, or Treasury improvisation during COVID.

The operating methodology will be much trickier when the task is to choose where and how exactly the UK needs to specialize in fiercely competitive, capital intensive industries like hydrogen, nuclear, artificial intelligence and automotive production. Critics of industrial strategy have a point: without the bracing influence of the market, government-directed investments can lead to uncompetitive stranded assets or the pursuit of technological dead-ends like Concorde. Reliable demand signals can be a good idea – they have worked brilliantly for growing the UK's offshore wind capacity, for example – but can easily boost demand for overseas suppliers too (see, again, the offshore wind example).

'Partnership' is one answer to the delivery question: work with the private sector to evaluate what demands it thinks the market will generate, and then help to develop the supply capacity to deliver it. When this works well, a government working with business can lift economic activity onto a higher plane. Government offers more certainty and the provision of key public goods (like a well-trained workforce or critical infrastructure); in return, business commits to investment and to respect key demands of the government, such as local jobs and the provision of key R&D. It sounds very neat.

But even a concept as benign as partnership comes with implementation challenges and dilemmas. What does this partnership consist of? The roundtables and forums that characterise business relations in opposition do not actually do anything, beyond produce the occasional press release. In government, partnership implies something more – a mutual agreement to solid, meaningful action. How is this agreed and how binding are the agreements? And does partnership imply preference? After all, to work with one partner often means to exclude others. How are partners to be chosen, and how do you maintain competitive tension?

The question of competition goes beyond the direct agreements government may strike with business. There is impressive analysis[6] from the economist Richard Davies demonstrating a decline in economic dynamism in the past 15 years, perhaps exacerbated by the financial crisis. Less market entry and exit, fewer job moves, less business expansion or contraction – when these mechanisms are gummed up, the natural wealth creating force of the economy is weakened. To their credit, both Reeves and Reynolds note the slackening of competition, but solutions like strengthening the Competition and Markets Authority can only go part of the way to reversing the trend. A braver answer is to address the unnecessarily pro-smaller-business distortions in the tax system, as Davies and others have argued – but this would take a Thatcher-like willingness to deliver unpleasant truths.

Arguably the biggest factor holding back the UK economy is the dearth of investment. It is hard to find an economist willing to argue against the idea that weak UK investment[7] is a key reason for our weak productivity. James Smith of the Resolution Foundation puts the public investment shortfall at an accumulated £500 billion[8]; the economist Tera Allas has argued that the UK's capital stock per hour worked is barely half that of its peer group[9], which would put the gap at more like £3 trillion or more.

Had UK workers more capital to work with, their productivity and prosperity could rise dramatically. In a sense this is good news – such a longstanding dearth of investment ought to lead to a tempting list of high-value investment ideas for the next government. But it is no free lunch: investment must come either from lower consumption (delivered via higher taxes or bills, usually) or by welcoming foreign capital, which can create challenges for any government wanting to prioritise economic security or local concerns. The need for higher domestic savings create echoes of post-war policymaking, and chancellors (usually in the wake of a devaluation crisis) having to square with the public about the need for everyone to tighten their belt. Such frankness has been absent in the more recent past: politicians are happy to urge utilities to invest more without acknowledging what this must mean for consumer bills. It is hard to see Britain closing its investment gap without a little more candour.

The biggest constraint holding back investment, more even than finance, may lie in something much more basic: the state's withered capacity to deliver projects, either directly or in partnership with business. Good, value-adding investment is difficult, be it from the state, the private sector, or the two in partnership. In light of repeated setbacks and failures such as those besetting Hinkley Point C and High Speed 2, it is incredible to recall that postwar UK governments built new towns, multiple nuclear reactors, reservoirs, airports and a motorway network. Net zero, affecting every sector of the economy, might pose an investment planning challenge unlike any we have seen outside wartime, but there is little evidence the government has staff with the confidence and experience to go about this. This lost ability to deliver is a problem that goes way beyond the scope of this essay. In my view any solution might have to look hard at the very shape of the state, the powers that local authorities have, the balance of rights in the planning system, and our automatic reliance on market mechanisms. It is not the sort of problem that can be approached confidently without a strong governing majority.

Ultimately, Labour faces a difficult but rewarding task in building a better business environment. Britain has fallen such a long way from its potential that the path of progress is clearer than it might otherwise have been. But while none of the weaknesses it must address are difficult to identify, nor are any easy to fix. There is a dilemma at the heart of every issue they must confront – between acting with force and commitment on the one hand, and the need to trial, experiment, collect data, and design the policy on the other. As an opposition, it is understandable that they err on the side of caution – the number one task has to be seizing the reins. When they get into government, the urgency of the mission will need to take precedence.

[1] Labour, 'Prosperity through Partnership: Labour's Industrial Strategy', September 2022, https://labour.org.uk/wp-content/uploads/2022/09/Industrial-Strategy.pdf.

[2] Reeves, 'A New Business Model for Britain: Building Economic Strength in an Age of Insecurity'.

[3] https://labour.org.uk/wp-content/uploads/2022/09/Industrial-Strategy.pdf

[4] Labour, 'A New Deal for Working People', October 2022, https://labour.org.uk/wp-content/uploads/2022/10/New-Deal-for-Working-People-Green-Paper.pdf.

[5] OECD, 'Quantifying Industrial Strategies', OECD, accessed 29 March 2024, https://www.oecd.org/industry/industrial-policy-and-strategies/quantifying-industrial-strategies/.

[6] https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/09/Ready-for-change-report.pdf

[7] https://www.instituteforgovernment.org.uk/sites/default/files/publications/business-investment.pdf

[8] Felicia Odamtten and James Smith, 'Cutting the Cuts' (Resolution Foundation, 30 March 2023), https://economy2030.resolutionfoundation.org/reports/cutting-the-cuts/.

[9] Tera Allas, 'UK's Low Productivity Is Partly Due to Its Very Low Capital Stock', *LinkedIn* (blog), November 2023, https://www.linkedin.com/posts/teraallas_productivityweek-dataisbeautiful-activity-7134895192649658370-DslF/?utm_source=share&utm_medium=member_desktop.

CHAPTER 2 – NET ZERO AND SUSTAINABLE GROWTH

Anna Valero
Distinguished Policy Fellow
Centre for Economic Performance, London School of Economics & Political Science

Securing the highest sustained growth in the G7 is the first of Labour's five missions.[1] Achieving this will require improving the UK's productivity record after 15 years of stagnation, and this in turn requires significantly increased investment in fixed capital, innovation and skills to address longstanding shortfalls across the public and private sector.[2] Clean energy is the second of Labour's missions – with the stretching target of achieving a net zero power system by 2030.[3] Significantly increased investment and innovation is also implied by this mission[4], and while much of this is expected to come from the private sector, the public sector will play an important role.[5]

It is natural to consider where there are synergies between these two missions and Labour has explicitly linked them by making its "Green Prosperity Plan" a central part of its growth mission. Clean energy features as one of the four missions of Labour's industrial strategy[6] and building capabilities in clean technologies is emphasised in the Shadow Chancellor's "securonomics" supply-side agenda.[7] Across these policy statements Labour appears to be adopting a modern view of industrial policy[8], emphasising how government can work in partnership with the private sector and provide a sense of direction towards stated public policy goals, including a net zero energy system. Economic security in this context can be interpreted as both resilience to future shocks, as well as building the potential for UK firms, workers, and households to benefit from the deployment and development of the technologies and sectors of the future. This essay is focused on what green growth looks like for the UK, key opportunities and challenges it brings, and questions for Labour as it continues to develop related policy.

Is green growth possible?

Globally, there is no route towards long-run growth without addressing the climate crisis, but there are many synergies between growth and net zero objectives for the UK over the short and medium term too.[9] Investments in sustainable and productive assets will improve the supply side of the economy. Net zero investments in renewable infrastructure and energy efficiency will strengthen the UK's energy security, generating economic resilience benefits in the face of future shocks. A range of other benefits will flow from net zero investments, with lower operating costs of key net zero technologies following initial investment outlays, and the potential to create more liveable cities that benefit from cleaner air and improved health for their residents. Crucially, given the UK's strengths in key areas of clean-tech innovation as well as relevant services (e.g. green finance and consultancy), a purposeful industrial strategy can maximise the chances that its firms are able to serve growing domestic and global demand creating value added and jobs in the UK.[10] And given the locations of net zero capabilities across the country, support for clean technologies has the potential to contribute to more regionally balanced growth. While solving the UK's growth problems will require a broader approach that builds on key strengths in services[11], net zero should be embedded in a new economic strategy for sustainable and inclusive growth.[12]

However, realising green growth opportunities is challenging for a number of reasons. First, economics tells us that the presence of numerous market failures and path dependencies in innovation systems together require strong and coordinated environmental, industrial, innovation, skills and other policies – including the crucial role of public sector investment – to generate and shape required private sector investments at pace.[13] Second, the current UK context is especially challenging with the financial constraints faced by government, as well as many businesses and households being particularly acute since the pandemic, energy and cost of living crises and in a higher interest rate environment. And this is in the face of increased competition internationally as other countries double down on incentives for green investment – most notably via the Inflation Reduction Act in the United States and the Green New Deal in the EU. Finally, there are political challenges for the Labour party to navigate in the run up to the general election, with the Conservatives seeking to highlight divisions on net zero policies and spending, and Labour redrawing its commitments in response.

The role of public investment

A key question for Labour has related to the extent of public investment committed to its green growth objectives. The Green Prosperity Plan of 2021 initially set out plans for an additional £28 billion of public investment in net zero infrastructure per annum. In light of a more challenging fiscal position, the pledge was then restated in 2023 to represent a target to phase up to by the second half of the next parliament, subject to Labour meeting its fiscal rules, and inclusive of up to £10 billion of current Conservative commitments related to climate[14] as well as hydrogen.[15] Following much debate and apparent differences in opinion across the shadow frontbench, the £28 billion figure was dropped altogether in February 2024, with the current commitment redrawn to the order of £5 billion of extra investment per year over and above government plans.[16]

The current approach combines a less ambitious increase in public sector investment with more focus on crucial planning reform, and creating mechanisms to ensure that government spending leverages substantial private investment. Labour seeks to achieve this in particular with some of its investment (£8.3 billion over the next parliament) going into the establishment of Great British Energy – a new public energy company that will seek to accelerate and co-invest in key clean technologies – as well as a new £7.3 billion National Wealth Fund with a focus on crowding in private capital towards sustainable projects around the country.

While being wedded to a precise number might have been problematic for political reasons as well as uncertainty regarding the state of public finances to be inherited, the underlying economics suggest that 1% of GDP (£26 billion in current prices) is the appropriate order of magnitude of increased public investment to phase up to, in order to produce a net zero infrastructure, support relevant innovation, and achieve broader sustainability and adaptation objectives.[17] The context is that UK public sector investment as a share of GDP has been low and volatile compared to its main peers for some time[18], and measures announced in the 2023 Autumn Statement imply future cuts which are concerning from a growth perspective.

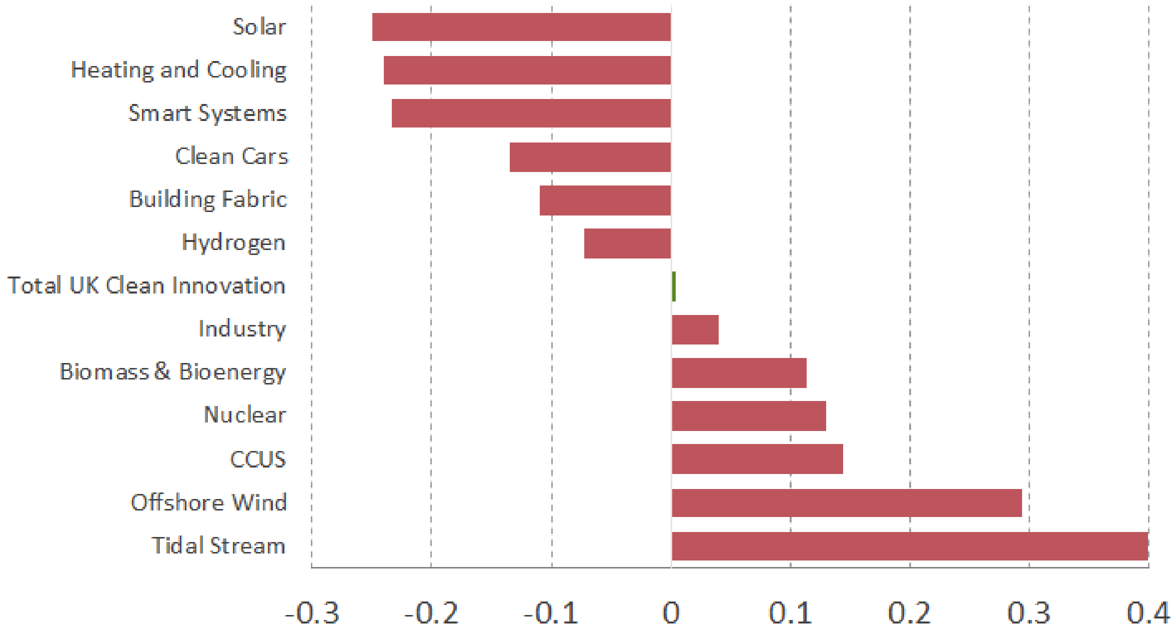
Given the lack of appetite for announcing broad-based tax rises in the run up to an election, a key challenge for any future government relates to reconciling the likely need for some level of targeted and temporary borrowing to fund investment for net zero as well as other key policy priorities with a necessary focus on fiscal discipline and appropriate fiscal rules. This can and should be achieved through a borrowing rule that differentiates day-to-day spending from capital investment, and earmarked borrowing for good quality public investment as well as measures to encourage saving as part of a credible growth plan.[19] The medium-term falling public debt to GDP rule is a key reason that public investment tends to be cut when public finances are tight, and a better medium-term focus would be on improving public net worth. This would involve a set of measurement and implementation challenges, but would help promote long-termism and a focus on quality in public investment decisions.[20] In her Mais lecture, the Shadow Chancellor Rachel Reeves confirmed Labour's commitment to the debt/GDP falling rule, but set out steps that might enable more public sector investment – in particular setting out a borrowing rule that would apply to day-to-day spending, a requirement for the Office for Budget Responsibility to report on the long-term impacts of capital spending decisions and more focus on the impacts on net worth in policymaking.[21] The broader point is that the UK's fiscal position remains challenging, and its fiscal framework does need to be reformed in order to support strategic priorities such as investing for growth.[22]

Policies to improve the business investment ecosystem

Over and above the UK's poor record on public sector investment, the evidence suggests that there are a number of other barriers holding back business investment in productive and sustainable assets in the UK, and that a broad set of enabling policies could overcome them. In particular: creating stable incentives for investment in capital and innovation in the tax system (which can be enhanced for clean technologies), addressing planning barriers (including for grid connections and renewables), efforts to channel more pensions wealth into UK assets, and support for small but growing businesses[23], as well as ensuring that the right skills are in place.[24] In seeking to crowd in private capital towards its missions and generate the intended benefits for society, the design of Labour's National Wealth Fund can draw on lessons from effective blended finance initiatives in the UK and overseas – crucially taking a collaborative approach that can align the interests of policymakers and investors.[25]

An industrial strategy seeks to influence the structure of the economy[26], and as such involves choices. When it comes to green industrial policies, a key question for Labour relates to how support, including via GB Energy, can best be targeted to specific sectors or technologies? A range of criteria must be considered, including the extent to which technologies are necessary for meeting domestic net zero targets, the potential to capture growth opportunities where the UK is, or can be, globally competitive in relevant products and services; and the nature of the market failures and barriers at play. Comparative analysis of a range of datasets and stakeholder consultation can help to reveal promising areas for the UK in face of technological and market uncertainty. For example, analysis of patenting highlights areas of innovative strengths across offshore wind, Carbon Capture Usage and Storage (CCUS) and tidal stream among other areas (see Figure 2.1), and the UK already exports a number of green products competitively too.[27]

Figure 2.1: The UK's relative strengths in clean technologies, 2015–18



Notes: This chart plots the UK's revealed technological advantage (RTA) for selected green technologies. RTA compares a country's share of total innovation in a particular technology area to the global share for the same category. Positive values above zero indicate that the UK is specialised in that area. These measures are built from the 'Y02' class of patenting relating to climate change mitigation and adaptation technologies. CCUS refers to Carbon Capture Usage and Storage. Source: Curran et al. (2022), Figure 4.

But there are also areas where the UK is not specialised in terms of innovation or trade (e.g. battery technologies), but where domestic manufacturing capabilities are necessary for security and resilience purposes including across supply chains.[28] Effective green industrial policies must therefore strike the right balance between the need for domestic supply capabilities and continued openness to trade.

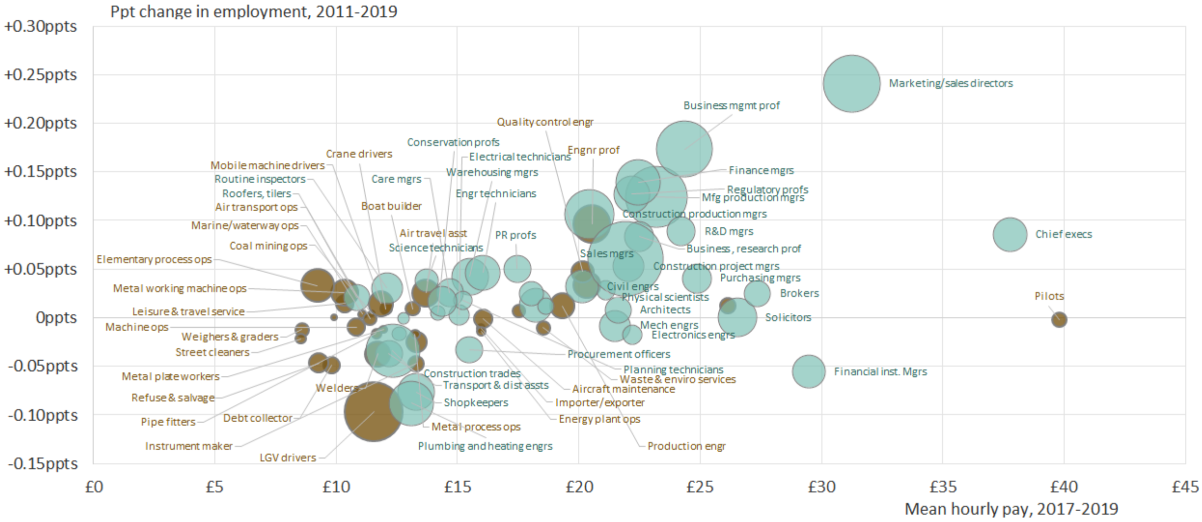
Stability, clarity and consistency also matter. A new independent productivity-focused institution could play an important role here. Such a body would provide independent expertise and credibility to recommend and shape effective, coordinated and lasting growth policies and a (green) industrial strategy, and crucially – consider how growth and net zero policies interact.[29] Labour emphasise the importance of stability in their plans for an industrial strategy, and have proposed bringing back the Industrial Strategy Council - previously set up and then disbanded by the Conservatives – and putting it on a statutory footing. It will be important to design this institution to ensure that it survives and remains influential through changes in government or ministerial priorities, complements other key institutions, and coordinates stakeholders and policymakers across the relevant parts of national, devolved and regional government.

Ensuring the net zero transition is an inclusive one

Net zero, like any period of systemic technological change, will create winners and losers. Understanding the distributional consequences for firms, workers and households is crucial for designing policies to ensure that benefits are felt broadly, and costs shared fairly. These are pre-conditions to being able to build and maintain public support for such a programme in the run up to a General Election and beyond.

Labour have emphasised that their clean energy mission will create good jobs in industrial heartlands and coastal communities. The net zero transition is expected to be a net creator of jobs overall[30], and green jobs do appear to be 'good' jobs on a range of metrics including pay, as illustrated in Figure 2.2.[31] But net zero is primarily a story of change in the labour market, as workers need to adapt to new tasks and skills.[32] While only a small share of jobs are likely to disappear altogether on aggregate (e.g. coal mining operatives), this will be particularly difficult for places reliant on high-carbon sectors. Clear transition plans are needed, with central government working with industry and local policymakers to anticipate change and build resilience. More broadly, a clear skills strategy is needed to ensure that the workforce is equipped with the necessary skills to support its strategic sectors and technologies, including net zero and digital.[33]

Figure 2.2: Change in employment share and mean hourly pay, "green" and "brown" jobs



*Notes: The bubble size indicates occupation's share of employment in 2019. Green jobs (green bubbles) refer to 'core green task' jobs (based on a mapping of occupations from O*NET, see Box 1) and brown jobs (brown bubbles) refer to 'brown changer' jobs (occupations particularly prevalent in emissions-intense sectors, see Box 2). Analysis of ONS, Labour Force Survey. Source: Broome et al. (2022), Figure 10.*

Finally, investments in energy efficiency, heat pumps, and electric vehicles bring with them lower costs down the line, but many households will struggle to afford the up-front investment. It is crucial that financial support is targeted towards those that need it most, and that net zero policy costs more generally are passed on fairly.[34] While politically sensitive given recent government delays in key areas[35] and the nature of the debate (for example, false claims that Labour were considering a "meat tax"[36]), it will be important to consider where regulations can be stronger (e.g. building regulations for new homes and landlords) and the role of behaviour change in driving net zero beyond the energy system (e.g. diet and travel). Net zero challenges and disruptions will vary across communities, and more participatory decision-making processes are likely to improve understanding and support for net zero and sustainability imperatives.[37]

Conclusion

The need to remain on track for net zero in the UK and globally is as urgent as ever, as is the need for the UK to restore growth and ensure that its proceeds are shared fairly.[38] Increased public and private sector investment and innovation are required for both objectives. Labour has rightly placed net zero at the core of their growth plan, and have set out key ingredients of a modern industrial strategy, but are now taking a cautious approach in terms of resources committed ahead of the general election. The reality is that any new government serious about delivering net zero, improved growth, and the sustainability of public finances over time, will need to phase up to substantially higher public sector investment than is currently planned by either main party. A successful approach will build on evidence on the barriers to investment that can be overcome through targeted public investment, regulation and incentives, and will include institutional reforms that strengthen credibility and long-termism in economic policy.

[1] Labour, 'Secure the Highest Sustained Growth in the G7'.

[2] Paul Brandily et al., 'Beyond Boosterism: Realigning the Policy Ecosystem to Unleash Private Investment for Sustainable Growth' (Resolution Foundation and Centre for Economic Performance, London School of Economics, 22 June 2023); John Van Reenen and Xuyi Yang, 'Cracking the Productivity Code: An International Comparison of UK Productivity', POID Special Report (Centre for Economic Performance, 27 November 2023), https://cep.lse.ac.uk/_NEW/publications/abstract.asp?index=10566.

[3] Labour, 'Make Britain a Clean Energy Superpower', June 2023, https://labour.org.uk/wp-content/uploads/2023/06/Mission-Climate.pdf.

[4] Brendan Curran et al., 'Growing Clean: Identifying and Investing in Sustainable Growth Opportunities across the UK' (Resolution Foundation and the London School of Economics, 23 May 2022); Dimitri Zenghelis et al., 'Boosting Growth and Productivity in the United Kingdom through Investments in the Sustainable Economy' (Grantham Research Institute on Climate Change and the Environment, 2024).

[5] Office for Budget Responsibility, 'Fiscal Risks Report', July 2021, https://obr.uk/frs/fiscal-risks-report-july-2021/.

[6] Labour, 'Prosperity through Partnership: Labour's Industrial Strategy'.

[7] Reeves, 'A New Business Model for Britain: Building Economic Strength in an Age of Insecurity'; Rachel Reeves, 'Time for Securonomics', *IPPR Progressive Review* 30, no. 3 (2023): 150–54; Reeves, 'Mais Lecture 2024'.

[8] Dani Rodrik, 'Industrial Policy for the Twenty-First Century', *Available at SSRN 666808*, 2004.

[9] Nicholas Stern and Anna Valero, 'Innovation, Growth and the Transition to Net-Zero Emissions', *Research Policy* 50, no. 9 (2021): 104293; Zenghelis et al., 'Boosting Growth and Productivity in the United Kingdom through Investments in the Sustainable Economy'.

[10] Curran et al., 'Growing Clean: Identifying and Investing in Sustainable Growth Opportunities across the UK'.

[11] Resolution Foundation and Centre for Economic Performance, 'Ending Stagnation: A New Economic Strategy for Britain', December 2023, https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/12/Ending-stagnation-final-report.pdf.

[12] Curran et al., 'Growing Clean: Identifying and Investing in Sustainable Growth Opportunities across the UK'; Anna Valero and John Van Reenen, 'Embedding Green Industrial Policy in a Growth Strategy for the UK', *IPPR Progressive Review*, 2023; Zenghelis et al., 'Boosting Growth and Productivity in the United Kingdom through Investments in the Sustainable Economy'.

[13] Stern and Valero, 'Innovation, Growth and the Transition to Net-Zero Emissions'; Zenghelis et al., 'Boosting Growth and Productivity in the United Kingdom through Investments in the Sustainable Economy'.

[14] Ben Zaranko, 'A Look under the Hood of Labour's Investment Plans', *IFS Comment* (blog), 5 September 2023, https://ifs.org.uk/articles/look-under-hood-labours-investment-plans.

[15] Tamara Kovacevic and Anthony Reuben, 'What Happened to Labour's £28bn for Green Projects?', *BBC Verify* (blog), 8 February 2024, https://www.bbc.co.uk/news/67801144.

[16] Ben Zaranko, 'The Changes to Labour's Green Investment Plan Explained', *IFS Explainer* (blog), 9 February 2024, https://ifs.org.uk/articles/changes-labours-green-investment-plan-explained.

[17] Zenghelis et al., 'Boosting Growth and Productivity in the United Kingdom through Investments in the Sustainable Economy'.

[18] Odamtten and Smith, 'Cutting the Cuts'.

[19] Anna Valero and Dimitri Zenghelis, 'Sustainable Investment Is Good Macroeconomics and Fiscally Prudent for the UK', *Grantham Research Institute Commentary* (blog), 9 February 2024, https://www.lse.ac.uk/granthaminstitute/news/sustainable-investment-is-good-macroeconomics-and-fiscally-prudent-for-the-uk/.

[20] Odamtten and Smith, 'Cutting the Cuts'.

[21] Reeves, 'Mais Lecture 2024'.

[22] Gemma Tetlow, Olly Bartrum, and Thomas Pope, 'Strengthening the UK's Fiscal Framework: Putting Fiscal Rules In Their Place' (Institute for Government, February 2024), https://www.instituteforgovernment.org.uk/sites/default/files/2024-02/strengthening-uk-fiscal-framework.pdf.

[23] Brandily et al., 'Beyond Boosterism: Realigning the Policy Ecosystem to Unleash Private Investment for Sustainable Growth'.

[24] Rui Costa et al., 'Learning to Grow: How to Situate a Skills Strategy in an Economic Strategy' (Centre for Economic Performance, Resolution Foundation & Institute for the Future of Work, 24 October 2023).

[25] Sarah Gordon, 'Investing in Our Future: Practical Solutions for the UK Government to Mobilise Private Investment for Economic, Environmental and Social Policy Priorities' (Grantham Institute, 21 October 2023), https://www.lse.ac.uk/granthaminstitute/publication/investing-in-our-future-practical-solutions-for-the-uk-government-to-mobilise-private-investment-for-economic-environmental-and-social-policy-priorities/; Sarah Gordon and Anna Valero, 'Finance for the Future: Practical Solutions for the UK Government to Mobilise Private Investment for Economic, Environmental and Social Priorities' (Resolution Foundation and the London School of Economics, 2023), https://economy2030.resolutionfoundation.org/reports/finance-for-the-future/.

[26] Réka Juhász, Nathan J Lane, and Dani Rodrik, 'The New Economics of Industrial Policy', *NBER Working Paper 31538*, August 2023, https://doi.org/I 10.3386/w31538.

[27] Curran et al., 'Growing Clean: Identifying and Investing in Sustainable Growth Opportunities across the UK'; Esin Serin et al., 'Seizing Sustainable Growth Opportunities from Carbon Capture, Usage and Storage in the UK' (Centre for Climate Change Economics and Policy, Grantham Research Institute on Climate Change and the Environment and Centre for Economic Performance, London School of Economics and Political Science, September 2021), https://www.lse.ac.uk/granthaminstitute/publication/seizing-sustainable-growth-opportunities-from-carbon-capture-usage-and-storage-in-the-uk/; Esin Serin et al., 'Seizing Sustainable Growth Opportunities from Tidal Stream Energy in the UK' (Centre for Climate Change Economics and Policy, Grantham Research Institute on Climate Change and the Environment and Centre for Economic Performance, London School of Economics and Political Science, June 2023), https://cep.lse.ac.uk/pubs/download/special/cepsp40.pdf.

[28] Valero and Van Reenen, 'Embedding Green Industrial Policy in a Growth Strategy for the UK'.

[29] Anna Valero and Bart van Ark, 'A New UK Policy Institution for Growth and Productivity – a Blueprint', Productivity Insights Paper No 027 (The Productivity Institute, 2023), https://www.productivity.ac.uk/research/a-new-uk-policy-institution-for-growth-and-productivity-a-blueprint/.

[30] Climate Change Committee, '2023 Progress Report to Parliament', 28 June 2023, https://www.theccc.org.uk/publication/2023-progress-report-to-parliament/.

[31] Anna Valero et al., 'Are" Green" Jobs Good Jobs?: How Lessons from the Experience To-Date Can Inform Labour Market Transitions of the Future' (Grantham Research Institute on Climate

Change and the Environment and Centre for Economic Performance, London School of Economics and Political Science, 2021).

[32] Molly Broome et al., 'Net Zero Jobs: The Impact of the Transition to Net Zero on the UK Labour Market' (Resolution Foundation, 20 June 2022), https://economy2030.resolutionfoundation.org/reports/net-zero-jobs/.

[33] Costa et al., 'Learning to Grow: How to Situate a Skills Strategy in an Economic Strategy'.

[34] Anne Owen and John Barrett, 'Reducing Inequality Resulting from UK Low-Carbon Policy', *Climate Policy* 20, no. 10 (2020): 1193–1208.

[35] Serin et al., 'Seizing Sustainable Growth Opportunities from Tidal Stream Energy in the UK'.

[36] Tamara Kovacevic, 'Would Labour Tax Meat? And Other Conservative Claims Checked', *BBC Verify* (blog), 4 October 2023, https://www.bbc.co.uk/news/uk-politics-66993211.

[37] Institute for Community Studies, 'Understanding Household and Community Participation in the Transition to Net Zero, Institute for Community Studies' (Institute for Community Studies, 2023), https://www.nuffieldfoundation.org/wp-content/uploads/2021/09/Net-Zero-summary-report-ICS-Nuffield-final.pdf.

[38] Resolution Foundation and Centre for Economic Performance, 'Ending Stagnation: A New Economic Strategy for Britain'.

CHAPTER 3 – INNOVATION

Margarida Bandeira Morais

Post Doctoral Research Associate
National Institute of Economic and Social Research

Neil Lee

Professor of Economic Geography
London School of Economics & Political Science

> *In 1997, the driving force behind Labour's economic policy was post-neoclassical endogenous growth theory – and, with it, innovation. Innovation was seen as part of a high-road strategy for competitiveness which was built on "British qualities of inventiveness, creativity and adaptability".[1] And innovation wasn't seen as an end in itself, but a means to an end: "to improve living standards for the many, not just the few".*

Almost three decades later, the goal remains the same. Labour speeches are often infused with a techno-optimism that underscores their belief in the importance of innovation for the economy. The Shadow Secretary of State for Science, Innovation, and Technology, Peter Kyle, has suggested that "when new ideas and inventions are made to work for everyone, the economy grows, and people's lives get better".[2]

But while innovation seems central to Labour's vision for economic growth, their policy agenda offers little in the way of radical change. They seem to be offering 'better' regulation, partnership with business, and long-term certainty. But this is incremental innovation rather than a major shift in policy. And, if the current model isn't delivering for growth, tinkering is unlikely to deliver much more.

Innovation in the UK

It is important to start with a level-headed view of the UK's innovation system; few policy areas are as susceptible to boosterism as innovation policy. It is often said that the UK is a science super-power, and the country does have some major strengths. We have strong universities, at least according to league tables, and the country is a popular location for foreign multinationals seeking centres for research and development (R&D). The UK has a dynamic business sector and a small number of highly R&D intensive domestic companies, notably GlaxoSmithKline and AstraZeneca. There are obvious strengths in deep tech (ARM and DeepMind), albeit now largely foreign owned, and some thriving sectors such as FinTech which are supported by deep pools of Venture Capital. Many similar countries are jealous of London's successful start-up ecosystem.

But there are also some real problems. Underinvestment in both private and public R&D is a pressing issue[3], with lower spending in the UK than in the US, Germany, or the Nordics.[4] The economy might be good at producing start-ups, but scale-ups often lack the finance they need.[5] There are gross regional imbalances in research activity: the lion's share of public (but not so much private) R&D spending, venture capital spending, and research activity are all focused on London and the South East. While there is some cutting-edge science, the distribution is skewed – much of our science base is not as world-leading as often assumed.[6]

It is also hard to reconcile boosterist claims about the UK's position as a science superpower with our relatively weak economic growth. One potential reason for this disconnect is the long-standing cliche that the UK is good at invention but poor at commercialisation. This is contested[7] but probably has a grain of truth – most parts of the UK perform much more strongly on innovation inputs than outputs.[8] More precisely, it is clear that while the UK's performance on spin-outs is reasonably strong, our record on scale-ups is weaker. One reason might be that we have deliberately focused our research funding on blue sky research[9], leaving the application, adaptation, and translational research to the private sector – which has, predictably, failed to do enough of it.

Moreover, innovation policy has suffered from many of the familiar British post-crisis issues of policy. There has been a failure to invest, hidden behind boosterist narratives, with worthwhile new initiatives often underpowered. For example, there is general consensus that the Catapult centres have been successful, but they remain too small. Technology policy has been subject to policy churn, making it hard for businesses to invest along with the state.[10]

Radical change for the UK's innovation system

Labour's answer to these problems is a combination of stability and improved public management. Their core strategic pledge is to increase investment in R&D spending, bringing it up to 3% of GDP (though how this will happen or by when is not entirely clear). They will provide UK Research & Innovation with certainty to allow them to deliver this, by providing 10-year funding settlements. And there will be tweaks to regulation: one of the few new institutions suggested is a new 'Office of Regulatory Innovation' designed to streamline innovations with the potential to impact health and the economy. They will also continue existing policies, such as R&D tax credits, Catapult Centres, and Made Smarter.

At the same time, innovation policy seems to be linked into a partnership model of industrial strategy (see Giles Wilkes' contribution), with the clear statement that science and technology will have a central role in delivering the five missions. That link is more explicit for some missions than others, with a heavy focus on the NHS (and life sciences more broadly). Overall, though, the vision is that "Our partnerships with critical sectors and businesses will reflect our progressive values – technology developed to make the whole country better off".[11]

There is a strong focus on start-ups, and a relatively developed part of Labour policy in this area was a start-up review which reported in 2022. Universities are seen as vital parts of the innovation system, with a promise to make it “easier for universities to develop self-sustaining clusters of innovation, investment, and growth in their local areas”.[12] There is also a clear desire to encourage spin-outs from universities and a belief that this would generate economic growth.[13] However, how they will do this is not clear. Finally, while the focus on investment is pertinent given the difficulties in access to finance, Labour should avoid over-hyping start-ups and venture capital, and look towards wider and more inclusive innovation strategies.[14]

Incremental policy innovation

The solution to policy churn is not to rip everything up and start again. But Labour seems to be putting a lot of focus on the idea that stability and a clear set of ‘missions’ will help the UK’s strengths in innovation translate into economic growth. If our existing institutions didn’t drive growth over the last decade, it’s not clear whether they will manage it in the next one. Indeed, some of this seems to be far from the frontier of innovation policy. There is relatively little developed policy on Artificial Intelligence, and – while this is admirably un-faddish – it does feel like the potential gains (and existential threats) raised by this new technology might be important if they make it to government.

A starting point for any successful innovation policy would be to take an honest view of what we are really good at, and what types of policy measures are necessary to improve the economic sectors we have, rather than the ones that we wish we had.

At this point, we need to recognise that while there are pockets of excellence, many British firms are not actually world-leading nor are they making good use of the basic technology that is available to them now. A medium-sized manufacturing firm has little use for a local university that produces only world-leading, blue-sky research, and whose graduates head straight to London. Instead, more focus on the diffusion, adaptation, and simple adoption of existing technologies is a better use of public resources. But while our innovation system may work for the superstar firms, it is not well suited to the more average firm which is more representative of our business stock.

Labour seems to have an approach to innovation which is based on the idea that if it isn’t broken they shouldn’t fix it. But while there are some major strengths in our innovation system, there are also some major problems, and these need to be fixed before innovation provides a route to meaningful growth. Labour needs to recognise this.

First, and it is painful to have to state the obvious: they should set a proper long-term strategy, building on what is good so far but setting clear goals and sticking with them (see Richard Jones’ ideas[15]). Potential areas of growth or new technology should be identified, communicated, with clear and consistent goals across government. This sort of coordinated approach is hard, but might help avoid problems, whether they are because of short-termism or contradictory policies in cross-cutting policy areas, such as we saw with counterproductive immigration rules.

Second, while the UK's R&D spending has been revised upwards, it needs to go higher still. For this to be commercially viable it needs to be done by the private sector, or at least be closely guided by it. But it needn't be focused solely on innovation at the frontier – the development of further applied research institutions (or expanding those which exist) would help firms compete. There are plenty of policies which are too small, such a Made Smarter or the Catapult Centres, which could be expanded.

It's also clear that something needs to be done to expand innovation outside of London and the South East. In the US, 31 Tech Hubs are being pushed out across the country – with local government identifying nascent clusters and national government providing $10 billion in funding.[16] The UK lacks the scale and deep pockets for the same programme, but could replicate this programme at a smaller scale.

Innovation is fundamental to our long-term economic success. There are problems in the system – around application, regional balance, the governance of our innovation policy, and its link to industrial strategy. But this is one area where there is both a clear route to growth and a set of institutions which form the basis of a successful strategy. Labour, if elected, will have plenty to build on.

[1] Labour, 'New Labour Because Britain Deserves Better', 1997, http://www.labour-party.org.uk/manifestos/1997/1997-labour-manifesto.shtml.

[2] Peter Kyle, 'Peter Kyle's Speech at Labour Conference', https://policymogul.com/key-updates/31440/peter-kyle-s-speech-at-labour-conference.

[3] Jagjit Chadha and Tony Venables, 'Boosting Productivity: Why Doesn't the UK Invest Enough?', *Economics Observatory* (blog), 16 January 2024, https://www.economicsobservatory.com/boosting-productivity-why-doesnt-the-uk-invest-enough.

[4] Abbas Panjwani et al., 'Research and Development Spending' (House of Commons Library, 11 September 2023), https://commonslibrary.parliament.uk/research-briefings/sn04223/.

[5] House of Commons Treasury Committee, 'Venture Capital: Nineteenth Report of Session 2022-23', 18 July 2023, https://committees.parliament.uk/publications/41030/documents/200122/default/.

[6] Paul Nightingale and James W. Phillips, 'S&T - Is the UK a World Leader in Science?', *James W. Phillips' Newsletter* (blog), 10 March 2023, https://jameswphillips.substack.com/p/s-and-t-is-the-uk-a-world-leader.

[7] David Gann and Nick Jennings, 'It's a Harmful Myth That UK Science Can't Translate Ideas into Practice', *Guardian*, 15 November 2018, https://www.theguardian.com/education/2018/nov/15/its-a-harmful-myth-that-uk-science-cant-translate-ideas-into-practice.

[8] Carolin Ioramashvili, 'Regional Systems of Innovation – How Does the West Midlands Compare With Its European Counterparts?', *City-REDI Blog* (blog), 21 June 2022, https://blog.bham.ac.uk/cityredi/regional-systems-of-innovation-how-does-the-west-midlands-compare-with-its-european-counterparts/.

[9] Richard A.L. Jones, 'Science and Innovation Policy for Hard Times: An Overview of the UK's Research and Development Landscape' (The Productivity Institute, December 2022), https://www.productivity.ac.uk/wp-content/uploads/2022/12/PIP014-Science-and-innovation-policy-for-hard-times-FINAL-151222.pdf.

[10] Richard Jones, 'The Shifting Sands of UK Government Technology Prioritisation', *Soft Machines* (blog), 12 February 2024, http://www.softmachines.org/wordpress/?p=2957.

[11] Kyle, 'Peter Kyle's Speech at Labour Conference'.

[12] Labour, 'Secure the Highest Sustained Growth in the G7'.

[13] Labour, 'Start-up, Scale-up: Making Britain the Best Place to Start and Grow a Business', 28 September 2023, https://labour.org.uk/wp-content/uploads/2022/12/WEB-17247_22-Start-up-review-v12-ALT-2.pdf.

[14] Dan Breznitz, 'What Silicon Valley Gets Wrong about Innovation', *Boston Review*, 21 October 2021, https://www.bostonreview.net/forum/what-silicon-valley-gets-wrong-about-innovation/.

[15] Jones, 'Science and Innovation Policy for Hard Times: An Overview of the UK's Research and Development Landscape'.

[16] Office of Public Affairs, 'Biden-Harris Administration Designates 31 Tech Hubs Across America', Press Release, U.S. Department of Commerce, 23 October 2023, https://www.commerce.gov/news/press-releases/2023/10/biden-harris-administration-designates-31-tech-hubs-across-america.

CHAPTER 4 – UNIVERSITIES

David Soskice

Emeritus Professor
London School of Economics & Political Science

Andrew McNeil

Research Fellow
University College London

In the documents the Labour Party has published on future policy plans, there is relatively little said about higher education. At least in publicly available documents, one concrete proposal is under the heading of Further Education, to establish a system of local Technical Excellence Colleges in England, together with a reform of the apprenticeship system. And Start-Up, Scale-Up argues for more transparency and help in university-originated spinouts. Doubtless there are so far unpublished policies.

But tertiary education and associated research is increasingly central to growth and levelling up, to income equality, and to equality of opportunity, as well as to key public services (healthcare and education). It brings to mind Wilson's '*White hot heat of the technological revolution*' which captured hearts and minds as Macmillan's aged government was collapsing. For we have been in the last decade in the full flood of a complex software-based revolution, quite different to that of the last century, and central to all the above issues.[1] Increasingly, most good jobs will require ICT competences as well as management and social skills in addition to relevant specialist skills, and hence higher education. So, from a longer term perspective – of the mid 2030s – we need to envisage an aspirational future in which most young people can go through, and adults return to, relevant and focused higher education, as opposed to the polarised contemporary world in which 50% of young people go to university and 50% do not. That implies a major change in the post-secondary educational system. And of relevance here, we believe that major structural change and expansion in the current university education and research system is needed. Labour have said relatively little about their views on higher education, so we focus instead on what they should do. How could Labour reform higher education for economic growth?

Policy discussion on universities in the UK has tended to be relatively insular, but there is much to be learned currently from tertiary education and research systems in Northern Europe, the Nordics, East Asia and South Korea, especially if we are envisaging major change in the higher education and research system. Given current problems in the funding of the English university sector, Labour will need to learn from these examples as they reform the sector.

This chapter is focused on two areas of improvement. First, it makes the case for a *dual university system,* with a *technological and professional system more closely linked to local economies and careers* to supplement the existing, more *academic system.* Then, it considers the paradox of the high quality of academic research in the top universities and the relative failure to translate it into commercial innovation – thus the need to integrate the top end of the academic system more closely into innovation outside the universities.

A dual system of technological and academic higher education

As with *nearly all* successful advanced states across the world, the UK needs a more clearly defined *dual tertiary system*, and a more practical, professional and technological university system and an academic system. Labour ~~needs~~ to look carefully at the very effective dual university systems – technological and academic – of successful northern European economies and regions: in particular Switzerland, Southern Germany, Austria, and Ireland. In Switzerland, Southern Germany and Austria, the technological universities are called Universities of Applied Science, and in Ireland Technological Universities. In both cases they offer a range of qualifications closely integrated into skilled work.

These technological university systems are more than teaching institutions: they play a key role in local innovation and technology diffusion, in raising productivity in the health, care, school and construction sectors, as well as in building complementary ICT and management competences. We suggest paying particular attention to the Irish Technological University system, in part because it has been set up relatively recently. These universities have a hub and spoke model, with a core institution and local outposts, and focus on vocationally and professionally oriented education in science and technology.

Participation rates in Irish tertiary education in the 25-34-year-old workforce rose from 30% in 2000 to 63% in 2022[1], and much of this increase was in (what became) the Technological University sector. Similar expansion of Technological Universities could pave the way for expansion of HE participation in the UK. Such a system would be key to both levelling up and to social mobility.

The bespoke technology university campuses would closely work with and play a major part in building the highly skilled employment organisations of the future in the health, education, care, construction, environmental and other areas. They can facilitate technology transfer, operating in a subsidised consultancy capacity with local organisations, including in the private sector, who wanted to 'get wired' and upgrade technologically. And for students they will offer low cost degrees with low cost non-tuition expenses (transport, housing) as well as low cost tuition; paid for by internships in relevant organisations, in a similar manner to degree apprenticeships. These degrees can also lead on to shortened academic degrees.

But it is not just the change in skills and the development of a highly educated workforce which matters, central though that is. For complex communicative software systems to be installed and to produce and diffuse marketable innovations, and in the public sector to radically improve the efficiency and effectiveness of (say) health facilities and schools requires that they be continuously re-customised along with major reorganisation of corporations and hospitals and other public sectors bodies.[2]

Linking research, innovation and growth in the top UK universities

The second policy problem Labour face is how to tie the research excellence of leading UK universities into innovation-based growth, as the top US research universities have done. There is much they can learn from the US.

(a) US growth and innovation has largely been clustered in powerful innovation-oriented large metro clusters (including Silicon Valley (San Francisco, San Jose), Boston-Cambridge, Manhattan, Seattle, Los Angeles, Washington DC, Austin, and Raleigh-Durham). Elsewhere (apart from energy-rich North Dakota) almost all other states have been low growth and relatively poor. The lesson is that the UK should focus core growth on large metro city clusters with strong research universities, with a record in attracting/retaining graduates, and pre-existing high value-added services strength. The obvious candidates are Manchester-Leeds; London-Oxford-Cambridge; Bristol-Bath-Cardiff; Newcastle-Durham; and Edinburgh-Glasgow. Call these *core metro city clusters.* The less obvious are Birmingham-Coventry; Liverpool; Sheffield; and Aberdeen-Dundee. Currently the Golden Triangle of London, Oxford and Cambridge is relatively successful, based on Oxbridge, Imperial and UCL, with a strong per capita unicorn performance, especially in fin-tech, insure-tech, ed-tech, med-tech and health-tech. The next most successful cluster (a long way behind) is Manchester-Leeds.

Lesson 1: Focus on backing clusters

Given the second digital revolution we are already in, the biggest growth and productivity challenge facing the UK is that of developing new successful clusters. Levelling up, with the help of the relevant system of hub-spoke technology universities, is a consequence, as is sustainability, and not a competitor.

But how?

(b) Powerful, autonomous city and regional governments, enabling divorce from dysfunctional federal government in Washington.

Lesson 2: Further decentralisation of powers from the Treasury to Whitehall to the key combined authorities.

(c) Research universities in the US are largely independent of federal government, though they get massive research funding especially through the National Institutes of Health. The top 20 research universities (largely in metro clusters) have endowments above or close to $10 billion (end of 2021 financial year), and the top 6 above $30 billion. These endowments have been used to compete against each other in newly breaking science areas (especially information technology (IT) and life sciences), and to nurture surrounding ecosystems which they partially finance/own.

Lesson 3: Top research universities need independence from government regulations, and a *protected semi ring-fenced status* in relation to regional/metro government. They also need serious endowments.

How might this work? The straightforward answer is that we don't yet know but it should be the subject of serious discussion. One can learn from the recent competition/cooperation between Harvard's technology-driven expansion into Allston and MIT's into Kendall Sq. attracting Google, Meta, Biogen, Microsoft in their wake. Think of an 'endowment' in the UK as an 'investment' by the state in a top research university in the chosen core metro city cluster. For example, invest £3 billion in Manchester and Leeds Universities as a 10-year loan, with the requirement that it is invested in frontier research in IT and the life sciences, that they actively promote spinoffs and complementary ecosystems, including attracting leading technology companies and also smart immigrant research students; that they train undergraduate and research students; and that this builds up an appropriate labour market. Review it after four years; if a successful system is being developed, add £3 billion more. After 10 years the government has the option of calling back some proportion of the loan, if success is too limited. Success would also involve evidence of the deep engagement of metro city and regional governments providing relevant infrastructure in terms of transport, housing, environment, culture, cooperating both with the universities and with each other.

This should not be treated as 'giving' money to the universities, but as an investment with high-powered incentives to build a system which would play a major role in economic growth.

(d) A central role in the US in the second digital revolution has been played by the major technology companies, AAAMM (Apple, Amazon, Alphabet, Meta, Microsoft), to which we should now add Nvidia.

Lesson 4: The UK has no technology companies remotely on this trillion dollar valuation scale. But they already operate here and should be very much further encouraged, especially to grow their presence in the Manchester/Leeds area.

Many of the ideas in this note will doubtless be seen as too radical. Underlying much of the above are two ideas: That there are a (very) limited number of existing metro city areas in the UK with top universities of huge potential – underexploited powerhouses; where they are partially exploited as in the Golden Triangle, we are third only to the US and China in the number of unicorns. This is where the comparative advantage of the UK lies. Labour should take advantage: in the technological revolution we are in, their exploitation is key to innovation and growth.

[1] Vani Borooah and Colin Knox, 'Inequalities in Undergraduate Participation and Performance in Irish Higher Education', *Higher Education Quarterly*, 2023.

[2] Wendy Carlin, Andrew McNeil, and David Soskice, 'The ICT Revolution, the Productivity Puzzle and the Political Economy of Uneven Growth', in *Macroeconomics* (Oxford: Oxford University Press, 2024).

CHAPTER 5 – EDUCATION AND SKILLS

Baroness Alison Wolf
Sir Roy Griffiths Professor of Public Sector Management
King's College London

Introduction

> *'Ask me my three main priorities for Government, and I tell you: education, education, education.' This is Tony Blair, of course, at the 1996 Labour Party Conference. It was the period when politicians, here and elsewhere, believed in education as a near-magic bullet, delivering both economic growth and equal opportunity. And it feels like a long time ago.*

In the years between, English education has been transformed in many ways. (Less so elsewhere in the UK.) A broad cross-party consensus, still holding, has delivered school choice and far greater school autonomy. Student loans were introduced, the cap was lifted on university student numbers, enrolments and graduate numbers grew. Childcare and early years spending soared, strongly tied to an embrace of 'active labour market policies' which offer greater benefits to working than non-working parents. English school pupils' performance also improved greatly, as measured by international surveys as well as national tests and examinations. England and Northern Ireland have the highest scores in Europe on Year 4 TIMSS maths surveys. England's PISA results, for teenagers, are all well above the OECD and European averages for maths, reading and science.[1]

And yet here we are in 2024, with stagnant GDP per head and low-to-zero growth predicted; a housing crisis; falling NHS productivity; spending pressures in every area of government; and a strong sense, across the electorate, that nothing is working. Unsurprisingly, education features far less strongly in Labour's emerging programme today than in the run-up to the 1997 victory. And its education mission focuses more on breaking down barriers to opportunity than on the economic role of education.

Long-term, opportunity is as essential to economic success as it is to social justice. It ensures both that talent blooms, and that people feel that employers, and government, treat them fairly. But long-term projects rarely contribute immediately to economic productivity. Far fewer children today reach 11 without the basic skills needed to succeed in a modern economy, but this is the fruit of 30 years' effort. Nostalgia for the social mobility of the post-war period is tempting: millions of people whose parents were manual workers moved into the white-collar middle classes. But as John Goldthorpe has demonstrated, this was not because the children of the well-off plummeted down the social scale.[2] It was because economic change hugely increased the number of middle class jobs. No growth means a lot less opportunity.

Few people now believe that simply expanding education will deliver growth – and rightly not.[3] But the structure and content of our education system (including 'skills' and 'training') nonetheless play a crucial role in our economy. And we can usefully ask how well Labour's current commitments are likely to foster growth.

This chapter focuses first on some specific economy-related ('human capital') policies which could have direct impact, and where Labour's announced policy is currently quite vague. These all target the 16+ and adult population and comprise 'skills' reform through apprenticeships, the Lifelong Learning Entitlement and improved mathematics education, along with securing the researcher pipeline which delivers future innovation. It then looks at the economic potential of other (semi) specific Labour pledges.

Reforming skills provision

Vocational and technical provision is by far the weakest part of our education system. This is acknowledged in myriad political speeches, from every political party. Labour's main recent contribution is the announcement that a new 'expert' body, Skills England, will oversee a national effort to meet skill needs. The announcement was duly welcomed by employer bodies, and the further education sector. But the same, of course, was true of the myriad other skills announcements that preceded it, under Labour, Tory and Coalition governments. Meanwhile, vocational education continued to languish.[i] And skill shortages have become ever more acute.

It is hard to implement major reforms in the space of a single parliament, and very hard indeed if an incoming government does not have specific detailed plans. In England, two programmes, embraced by Labour, are in place which have the potential, if improved, to transform skills provision: namely apprenticeship and the Lifelong Learning Entitlement. But only if an incoming government takes effective action.

Apprenticeships

The first priority must be reforming apprenticeship, which is currently in crisis. Our current centralised system is dysfunctional, with all key measures heading in the wrong direction. The funding system is the root of the problem. But it can be reformed, without primary legislation, and must be.

The British public, rightly, love apprenticeships. Given a choice between additional spending on schools, childcare, higher education and an apprenticeship, apprenticeship wins hands down.[4] It is the most effective form of initial training for many key occupations, including many where our economy has major shortages. It offers young people an alternative to university education, one with prestige and, often, high financial returns, above those for many university degrees.[5] Apprenticeship is especially well-suited to technician training, demonstrably linked to company productivity.[6] Locally-rooted apprenticeship systems also tie employers into a network which encourages the dissemination of innovation.[7]

---

[i] The IFS's annual reports on education spending in England document the real falls in expenditure, both absolute and relative, compared to other parts of the education system, including the widening gap between salaries in colleges and schools.
https://ifs.org.uk/education-spending/adult-education-and-skills

Unfortunately, we fund it in a unique and misconceived way. Apprenticeship levies and taxes are common, but no-one else has a system like ours.[8] Large employers, and only they, pay an apprenticeship levy which they can offset by apprenticeship spending. This has been one of the most effective 'nudge' policies ever devised: levy-paying companies have been super-incentivised, putting huge effort into shifting funds, and are on course to spend and offset the entire levy in the near future. That is an unanticipated disaster. The Treasury treats the levy as a hypothecated tax (although it isn't). So apprenticeship spending for the whole of the rest of the economy is capped at whatever levy-payers leave unspent. With this amount declining at unpredicted and rapid speed, there is less and less available for the whole SME sector.[ii]

Worse, funds are increasingly spent on older employees reclassified as apprentices. They are spent on higher-level courses (many never completed), which tend to be very expensive, soaking up levy funds, but mostly fail to address the yawning skills gaps in the economy. Only one in five apprenticeships is in a shortage occupation. Openings for young people have fallen fast.[9] Only 1 in 20 (6%) 17-18 year olds managed to obtain an apprenticeship last year.[10] And opportunities have fallen most in the most deprived parts of England.[11]

Labour has recognised that the levy system is deeply flawed. Unfortunately, its current proposal is that levy-payers can spend half their levy on non-apprenticeship training.[12] Without other changes this guarantees both that almost every penny will be spent immediately by levy-paying firms and that the number of apprenticeships will plummet. However, it is perfectly possible to repurpose levy spending as part of a thorough reform that would allow government both to reset apprenticeship and incentivise employer upskilling.

Employer expenditure on training has been declining since at least the early 1990s.[13] The diversion of 'apprenticeship' funding to existing, older employees may deliver some upskilling: but it is an extraordinarily ill-designed way to go about it. Apprenticeships are designed for new entrants preparing for a skilled position. Training content is nationally uniform, and tightly regulated. This is not the way to approach firm-level upskilling.

We can deliver far better outcomes, without major new government expenditure. A smaller levy on more companies; tax incentives and/or levy write-offs for training in and by approved providers; reduced support for older apprentices, and a culling of expensive apprenticeships in over-supplied occupations, would transform the system at no additional cost.

[ii] An increasing proportion of apprenticeships are at higher levels (including levels 6 and 7 – equivalent to a full bachelor's degree or a postgraduate Masters). Most of these take much longer to complete than lower levels, and so commit funding well into the future. Most higher level apprenticeships are in levy-paying companies, which in turn tend to be in higher-income regions and locations.

Reform also needs, urgently, to re-establish local involvement in delivery. Local involvement is a feature of all the world's best apprenticeship systems.[14] It is, rightly, flagged as part of Labour's devolution policy, but has been resisted under the current government. Done well, apprenticeship reform has huge potential for delivering more effective training, clearly signposted opportunities for young people, and a boost to growth.

Lifelong learning

An incoming Labour government will also find a structural reform ready to go, which they have supported, and which has huge potential for upskilling the adult workforce. The Lifelong Learning Entitlement (LLE), established with cross-party support, offers all school-leavers and adults flexible access to funds (equivalent to four years' university fees) for higher levels of study and training.[15]

The LLE is set to launch in 2025. But the risk is that we will squander this huge opportunity.

The Whitehall default is centralised micromanagement. It specialises in planning and directing any and all education provision other than full standard degrees. And micromanagement, unfortunately, characterises emerging government policy on the LLE, with cumulative constraints emerging on what it can fund.

Nothing in recent history suggests that central government can design qualification 'winners': a much more likely outcome is that higher education walks away. An incoming Labour government should instead move fast to encourage flexible provision, in colleges and universities, which responds to local labour markets and enables adults – including many graduates – to upskill.

One of the most important strands in overall Labour policy is its commitment to devolution. This is crucial to skills provision, which has been more bedevilled by changing central policies than any other part of the education system. These include successive new titles and badges for further education colleges, as a substitute for real resources. Labour's promise of 'technical excellence colleges' sounds worryingly like yet another of these, and there is a real risk that 'Skills England', which is to oversee a 'national' effort to meet 'strategic priorities', will perpetuate this centralised approach.[iii] Labour needs to see that risk off, and devolve skills spending for real. The LLE offers a powerful new lever, but one it will have to seize.

Mathematics

A third education and skills priority for any growth-hungry government is quantitative skills. The labour market's growing demand for mathematics is evident and critical. Maths GCSE brings a higher financial return in adult life than any other GCSE subject.[16] Maths A level does the same, and returns have been growing over time.[17] There is a huge shortage of 'craft' engineers, reflected in the very high returns to engineering apprenticeships, as well as of 'quants' to work in finance and data analytics.

[iii] The current government has a 'Unit for Future Skills' with a similar though more restricted brief.

Labour has announced plans for maths education which centre on upskilling primary school teachers. Ensuring that young pupils develop good maths skills is obviously critically important. England has recently done well, comparatively, but it is only too easy for this to reverse: a number of our close neighbours have demonstrated this in recent years. But modern economies are hungry for maths at levels well beyond Key Stage 2, and our older teenagers and adults do far less well in comparative studies.[iv] This almost certainly reflects the super-specialised nature of the sixth form (years 12 and 13), when so many students stop studying maths, or English, or science.

The current government's commitment to 'Maths to 18 for all' therefore makes eminently good sense on economic grounds. It promises direct short-term payoffs, and Labour should retain and deliver it. Moreover, it is achievable: this is not about a huge expansion in teaching A level content. Mandatory Maths and English for Year 12 and 13 students without a GCSE pass was delivered successfully in 2014 and has resulted in hundreds of thousands more passes.[v][18] Maths to 18 could be introduced from autumn 2027. And followed by English?

The research pipeline

Like all advanced economies, our prosperity depends on our ability to innovate. We cannot just play catch-up. But frontier research requires highly educated researchers. This in turn requires a high quality, high volume pipeline from undergraduate education, delivering graduate students who will study and work in this country. That pipeline is at immediate risk.

In higher education, there is a justified conviction that the current funding model is breaking. We have many of the world's best universities, so judged in large part because of their research prowess. But they rely increasingly on fees paid by overseas students. Home students' fees are frozen and declining in value; they cover a smaller and smaller proportion of the cost of teaching engineering and science. Vice-chancellors juggle cross-subsidies, while faced by growing competition for students from other countries. This year, there was a marked fall in the number of overseas students taking up apparently confirmed places.

Sorting out higher education will be difficult and slow, and Labour has wisely avoided any major commitments. But an incoming government can secure provision in the key areas which feed our future research strengths. It can do this quite simply by restoring direct teaching grants in high-cost subjects, so that home students' costs are covered. The Treasury happily chipped teaching grants into oblivion as fees rose in the early 2010s, forcing the sector into cross-subsidy and a race to expand numbers in low-cost programmes which turned a profit.

[iv] The OECD regularly surveys adult skills. See especially https://www.oecd.org/skills/piaac/

v Prior to the change, less than 15% of the cohort failed to achieve English and Maths GCSE at 16, but then did so by age 19. By 2021/22 this had risen to 37%. https://explore-education-statistics.service.gov.uk/find-statistics/level-2-and-3-attainment-by-young-people-aged-19#releaseHeadlines-charts;

One of the key recommendations of the 2019 Augar Review of post-18 funding was for a rebalancing back to direct support as well as fees.[19] The falling value of fees reduces universities' real income, but also the real cost of student loan write-offs that the taxpayer funds. Balancing this change, high-cost subjects, which feed the research pipeline, should receive substantial teaching grants once again. The current government rejected the Augar panel's recommendation. A fast and simple way to protect our research future is to implement it now.

Current pledges: childcare and curriculum

Post-16 provision is, obviously, just a part of the formal education and training system, even in an age of mass higher education. This chapter has focused on it, because it has the most direct and immediate impact on economic growth. But Labour's education policy announcements have, of course, ranged far wider.

Its education mission identifies wide-ranging reforms.[20] These include changes in the curriculum, to make it less narrow, measures to improve teacher recruitment and training (including better primary maths training, as noted above), a firm commitment to standards, and some reforms to Ofsted, which inspects schools. These should all be popular if they can be delivered, and also (or therefore) not especially radical.

Much more challenging is the commitment to a major reform of childcare and early years support. This is a part of the mission which the leadership has emphasised strongly: it is also a policy area which is potentially very expensive, and very hard to deliver effectively. Part of the problem is that governments today are trying to do three different things.

First, they want to support parents financially, including making it easier for them to have children at a time of demographic challenge (though as a policy to raise birth rates, subsidised childcare no longer seems to work, if it ever did). Second, they want to incentivise mothers to return to work, and so increase current and future production. This objective was central to policy from the 1990s onwards, but seems to have hit its limits: further expansion of childcare is unlikely to raise participation rates very much.[21]

Third, governments – and certainly Labour – want to equalise opportunity by providing really high quality programmes to disadvantaged children. The financial pay-offs here have often been exaggerated, based on the impact of a very few remarkable programmes, which no-one can replicate.[vi] But the underlying argument is sound: inequalities are already glaring and enduring at age five. Unfortunately, this third objective has all too often fallen victim to the other two. Very good pre-school programmes are intensive and expensive: but funding in practice tends to be equalised for all children, and provision is in practice consistently scarcer in poorer areas. Long-term, a programme that prioritised low-income children, and poured large sums into their pre-schools, might also pay economic dividends. But it will probably have to wait for that elusive rise in growth.

[vi] The economist Jim Heckman has been particularly influential in arguing for the pay-off to high quality preschool https://heckmanequation.org/ However, the very high returns often cited are associated with, in particular, the 'Perry Pre-school Program', a remarkable but small and expensive US programme for highly disadvantaged children. Many of the financial returns are because of falls in later criminality.

Conclusion

In her March 2024 Mais lecture, Shadow Chancellor Rachel Reeves told her audience – rightly - that 'Addressing the skills gap is a necessary…requirement for economic success.' She also emphasised the need for strategic decisions. Making genuinely strategic decisions on education and skills spending is something that most governments find extremely hard. But an incoming Labour government *could* prioritise skills shortfalls: by major reform to apprenticeships , supporting post-GCSE mathematics and the researcher pipeline, and ensuring access to flexible, locally responsive provision through the Lifelong Learning Entitlement. None of this would cost an unavailable fortune. And it could be transformative.

[1] Department for Education, 'PISA 2022: National Report for England', 5 December 2023, https://www.gov.uk/government/publications/pisa-2022-national-report-for-england; 'TIMSS 2019 International Results in Mathematics and Science', IEA TIMSS & PIRLS, n.d., https://timss2019.org/reports/achievement/.

[2] Erzsébet Bukodi and John Goldthorpe, *Social Mobility and Education in Britain: Research, Politics and Policy* (Cambridge University Press, 2019).

[3] Alison Wolf, 'Education and Economic Performance: Simplistic Theories and Their Policy Consequences', *Oxford Review of Economic Policy* 20, no. 2 (2004): 315–33.

[4] Rachel Wolf, 'What Are the Public's Priorities on Education Spending?', *Public First* (blog), 12 February 2024, https://www.publicfirst.co.uk/what-are-the-publics-priorities-on-education-spending.html; Aveek Bhattacharya, 'Not Just Other People's Children: What the Public Thinks about Vocational Education' (Social Market Foundation, 22 April 2021), https://www.smf.co.uk/publications/public-attitudes-to-vocational-education/.

[5] Chiara Cavaglia, Sandra McNally, and Guglielmo Ventura, 'Do Apprenticeships Pay? Evidence for England', *Oxford Bulletin of Economics and Statistics* 82, no. 5 (2020): 1094–1134; Sandra McNally, 'Apprenticeships in England: What Does Research Tell Us?' (Centre for Economic Performance, 2018), https://cep.lse.ac.uk/pubs/download/is02.pdf.

[6] James Harrigan, Ariell Reshef, and Farid Toubal, 'Techies and Firm Level Productivity' (National Bureau of Economic Research, 2023), https://www.nber.org/papers/w31341.

[7] Andreas Kuhn, Jürg Schweri, and Stefan C Wolter, 'Local Norms Describing the Role of the State and the Private Provision of Training', *European Journal of Political Economy* 75 (2022): 102226; Stefan C Wolter and Paul Ryan, 'Apprenticeship', in *Handbook of the Economics of Education*, vol. 3 (Elsevier, 2011), 521–76.

[8] Alison Wolf, 'Fixing a Broken Training System: The Case for an Apprenticeship Levy' (Social Market Foundation, 2 July 2015), https://www.smf.co.uk/publications/fixing-a-broken-training-system-the-case-for-an-apprenticeship-levy/.

[9] Chiara Cavaglia, Sandra McNally, and Guglielmo Ventura, 'The Recent Evolution of Apprenticeships: Participation and Pathways' (Centre for Vocational Education Research, December 2022), https://www.bollettinoadapt.it/wp-content/uploads/2022/12/cverdp039.pdf; Iain Mansfield and Toby Hirst, 'Reforming the Apprenticeship Levy' (Policy Exchange, 2023), https://policyexchange.org.uk/wp-content/uploads/Reforming-the-Apprenticeship-Levy.pdf; 'Apprentices', UK Parliament, 13 July 2023, https://questions-statements.parliament.uk/written-questions/detail/2023-07-13/hl9361.

[10] James Yarde et al., 'Post-18 Opportunities and Aspirations. Wave 2 Initial Findings--Briefing No. 2. COSMO: COVID Social Mobility & Opportunities Study.' (COSMO COVID Social Mobility & Opportunities Study, 23 November 2023), https://cosmostudy.uk/publications/post-18-opportunities-and-aspirations; UCAS & Sutton Trust, 'Where Next: What Influences the Choices of Would-Be Apprentices?', n.d., https://www.suttontrust.com/our-research/where-next-what-influences-the-choices-of-would-be-apprentices/.

[11] Cavaglia, McNally, and Ventura, 'The Recent Evolution of Apprenticeships: Participation and Pathways'.

[12] Labour Newsroom, 'Labour Announces Plan for Skills: Growth and Skills Levy Replacing the Apprenticeship Levy and Skills England', 27 September 2022, https://www.fenews.co.uk/skills/labour-announces-landmark-shift-in-skills-to-drive-growth-and-equip-our-country-for-the-future/.

[13] Imran Tahir, 'Investment in Training and Skills' (Institute for Fiscal Studies, 12 October 2023), https://ifs.org.uk/publications/investment-training-and-skills; Wolf, 'Fixing a Broken Training System: The Case for an Apprenticeship Levy'.

[14] Wolf, 'Fixing a Broken Training System: The Case for an Apprenticeship Levy'; Alison Wolf, 'An Adult Approach to Further Education' (IEA, 2 November 2009), https://iea.org.uk/publications/research/an-adult-approach-to-further-education.

[15] Department for Education, 'Lifelong Learning Entitlement Overview', 22 March 2024, https://www.gov.uk/government/publications/lifelong-learning-entitlement-lle-overview/lifelong-learning-entitlement-overview.

[16] Louis Hodge, Allan Little, and Matthew Weldon, 'GCSE Attainment and Lifetime Earnings' (Department for Education, June 2021), https://assets.publishing.service.gov.uk/media/60c36f0cd3bf7f4bd11a2326/GCSE_Attainment_and_Lifetime_Earnings_PDF3A.pdf.

[17] Michael Adkins and Andrew Noyes, 'Reassessing the Economic Value of Advanced Level Mathematics', *British Educational Research Journal* 42, no. 1 (2016): 93–116.

[18] Russell Group, 'Securing a Resilient Higher Education Funding System to Support Students and Boost the UK Economy', 2022, https://russellgroup.ac.uk/media/6094/rg-funding-resilience-briefing-note-2022.pdf; 'Universities Scotland Respond to the Scottish Government's Budget for 2024/25', Universities Scotland, 20 December 2023, https://www.universities-scotland.ac.uk/universities-scotland-respond-to-the-scottish-governments-budget-for-2024-25/.

[19] Department for Education, 'Post-18 Review of Education and Funding: Independent Panel Report', 30 May 2019, https://www.gov.uk/government/publications/post-18-review-of-education-and-funding-independent-panel-report.

[20] Labour, 'Breaking down the Barriers to Opportunity', July 2023, https://labour.org.uk/wp-content/uploads/2023/07/Mission-breaking-down-barriers.pdf.

[21] Mike Brewer et al., 'Does More Free Childcare Help Parents Work More?', *Labour Economics* 74 (2022): 102100; Christine Farquharson and Harrie Olorenshaw, 'The Changing Cost of Childcare' (Institute for Fiscal Studies, 2022), https://www.econstor.eu/handle/10419/264465.

CHAPTER 6 – LABOUR MARKET REFORM

Alan Manning
Professor of Economics
London School of Economics & Political Science

The labour market matters. A lot. Most households rely on it to provide them with an adequate, secure, standard of living and optimism that the future will be better than the present. The better the labour market delivers these objectives for households, the less the pressure on the public finances as tax revenues rise and less redistribution is needed to support those who fall through the cracks. So it is not surprising that a "New Deal for Working People" is a central part of Labour Party Policy.[1]

Policy needs to focus on both the quantity of work available but also the quality. In some cases, Labour is clear about what it would do. In others, it has merely pledged to look at an area. While that can come across as over-cautious, bold policy prescriptions often run the risk of making recommendations that are not based as solidly as they could be on evidence about what works. Sometimes it is easier to identify problems than to find solutions; in these cases a long-run strategy with some experimentation is what is required.

The quantity of work

Headline unemployment rates seem relatively low though the poor quality currently of our labour market statistics means its hard to be sure. But the fraction of the working age population who are not in work because of some health issue or disability is too high. Effective reforms that reduce the numbers on sickness/disability benefits without being punitive (this part is very important) have the potential to improve the quality of life for many but also to save a lot of money for the government. There is scope for a more efficient administration of the system (e.g. removing backlogs in Access to Work decisions) but a (big) snag is that there are no simple solutions that will obviously work. Many other countries are grappling with similar issues.[2] But the fact that it is hard simply means we must try harder. Many people with mental health problems struggle to get back into work, yet the lack of work is probably exacerbating their illness. It seems very hard to get people off benefits when they have been on them for a long period so policy should aim to limit spells on benefits. One idea worth considering is to give people the right to return to a job after a spell of sickness/disability; think in terms of maternity rights but for sickness/disability.

But good policy is not just about the quantity of work. As Labour Party policy puts it, we need to be aiming for "better jobs and better work".[3]

The quality of work: wages and prices

Wages obviously matter to people.

Raising productivity is the key to raising wages. The prosperity of people in a country like the UK depends on the skills of its people and the technology and capital with which they work. Labour is right that we need policies to raise productivity and skills, though they are discussed elsewhere in this volume (see chapters by Alison Wolf and David Soskice & Andrew McNeil).

But intervention is also needed to ensure there is an appropriate balance of power between workers and employers in the labour market. The National Minimum Wage and National Living Wage have been very successful in raising wages at the bottom of the earnings distribution; this is one of the few positive developments of the past 13 years. The UK is now near the top of the international league table for the ratio of minimum to median wages.[4] Because this rise does not seem to have produced large job losses, it is tempting to press ahead with further rises, but, there will come a point when it would be unwise to raise the minimum wage further. Labour proposes to alter the Low Pay Commission's remit to take account of the cost of living and abolishing the lower rates for younger workers.[5] Yet there are good reasons for having higher minimum wages for older workers: their labour market can support a higher minimum, they are more likely to be long-term minimum wage workers and to have dependents (poverty is bad but child poverty is worse).

Workers' living standards depend on real wages (wages divided by prices), but discussion often focuses on raising wages as the route to improvements when lowering prices is a possible alternative. Labour's policy to build more houses should reduce housing costs relative to income increasing real incomes, even though it is not directly a labour market policy (see Paul Cheshire's contribution). An increased supply of housing would also reduce the amount of welfare expenditure going on housing support. It is also really important that the shift to net zero ultimately results in lower, not more expensive, energy prices.

The quality of work: a new deal for workers

The Labour Party is right that we need a New Deal for Workers. The past decades have shifted too much risk onto workers from both employers and the state. Lower-income households find these risks hardest to bear resulting in stresses that are a major cause of insecurity.

Work-life balance

Juggling work and family is a major challenge for many households. Changes are needed around child and social care, where too much of the burden currently falls on households. Changes here are likely to cost money so are hard when the public finances are in an unhealthy state.

Collective voice

Worker collective voice needs strengthening. Antiquated restrictions on union organising (e.g. compulsory postal ballots) should be swept away. One way to strengthen unions is 'top-down', for example giving trade unions the automatic right to participate in collective bargaining. Alternatively, the next government could pursue a 'bottom-up' strategy in which collective voice is made easier, but trade unions have to earn to be the channel through which voice is achieved. There should be serious consideration given to having some form of mandatory elected worker representation on boards of large companies. The elected representative may come from the unions and, if this job is done well, then perhaps that would help build support for unions more generally. The research on this kind of arrangement suggests it does no harm (though produces no big benefits either).[6] The Good Work Agreements suggested by the Resolution Foundation's Economy 2030 Report are another good idea.[7] More generally, a cooperative approach involving social partners to address sectoral issues in a holistic way is needed in a number of sectors; the idea of a Fair Work Agreement starting in social care is a good one. This should be wide-ranging including, for example, immigration policy (see the piece by Jonathan Portes in this volume).

'Non-standard employment contracts'

The prevalence and increase of 'non-standard' employment contracts (e.g. temporary, zero-hours and gig work) is often exaggerated so it is important that one does not think changes in these areas will affect the lives of most workers. Changes in these areas must not be to the exclusion of other changes that provide wider benefits. But changes can be very important to those affected so should not be neglected either.

Many employers have become more cautious about the hours they pay their employees. Institutions like zero-hours contracts (ZHCs) shift risk onto workers. Some workers like the flexibility of ZHCs so they should not be banned but employment contracts should specify minimum guaranteed earnings. This is better than minimum guaranteed hours because avoids need for multiplication when earnings are what matters. ZHCs would remain legal but making their downsides being more prominent should discourage their use.

Bogus self-employment should be banned but also policed more effectively. It's not just bad for workers, it's bad for the public finances as self-employment is often chosen because of tax advantages. In an ideal world there would be tax neutrality between the categories of employment, though this is politically hard. Some have argued that the legal distinction between worker and employee should be replaced by a single status. Serious consideration should be given to this but single status risks people being shifted from worker status to self-employment, actually weakening rights if it is hard to police bogus self-employment. If worker status is retained then it is really important that the lesser obligations to the employer mean something in reality.

There needs to be much more effective enforcement of Labour and Immigration laws; a single enforcement authority is the way to go. A recent report from the Competition and Markets Authority shows we need to pay more attention to labour market competition e.g. banning non-competes.[8]

Improving social insurance

Workers generally only gain protections against unfair dismissal after two years of qualifying employment. This is much longer than necessary for an employer to come to evaluate workers and should be reduced. The Labour Party have proposed ‘day one’ protections, though they acknowledge these need to be combined with some probationary period; otherwise the risk is that employers become very conservative in hiring. As in most employer-worker relations the right balance is needed. If workers have to wait too long to accrue rights this risks making them cautious about moving jobs (when rights would be lost) leading to a less dynamic economy.

Statutory Sick and Maternity Pay are simply too low to provide much in the way of insurance to many. The higher-paid often benefit from more generous employers but these benefits are most important for the lower-paid. They should be raised, finances permitting.

Discrimination

The work of Anthony Heath and co-authors has shown that, beyond any doubt, there is continued discrimination against those with minority-sounding names and that this shows little sign of having improved.[9] This is an obvious injustice yet little has been done to address it; the EHRC has been asleep at the wheel over the issue and the Sewell report mentioned it only to trivialise it.[10] The solution may not be obvious but it is obvious there should be a search for a solution and the Labour Party’s proposal for mandatory ethnic pay gap reporting is unlikely to be enough.

The threat of new technology?

We want technical change; this delivers the gains in productivity that are so crucial. The UK has too little new technology, not too much. Innovation always means change, there can be losers from that, and policy should make sure they are not left behind. But arguments that Artificial Intelligence is a fundamental threat to the nature of labour markets are likely nonsense; past fears about new technologies have always turned out to be exaggerated and I can see no reason why this time is any different. Ignore those who argue we need a radically different labour market.

Conclusion

Labour is right that the aim should be to make workers feel that the government is on their side, not on their back. That the government helps them navigate the trials and tribulations inevitable in life, provides security for their families, and the prospect of improvement not just for them but for their children.

[1] Labour National Policy Forum, 'Final Policy Documents'.

[2] OECD, 'Disability, Work and Inclusion: Mainstreaming in All Policies and Practices' (OECD Publishing, 2022), https://www.oecd.org/social/disability-work-and-inclusion-1eaa5e9c-en.htm.

[3] Labour National Policy Forum, 'Final Policy Documents'.

[4] https://stats.oecd.org/Index.aspx?DataSetCode=MIN2AVE

[5] Pippa Crerar, 'Labour Sets out Plan to Link Minimum Wage to Cost of Living', *Guardian*, 19 August 2022, https://www.theguardian.com/politics/2022/aug/19/labour-sets-out-plan-to-link-minimum-wage-to-cost-of-living.

[6] Simon Jäger, Shakked Noy, and Benjamin Schoefer, 'The German Model of Industrial Relations: Balancing Flexibility and Collective Action', *Journal of Economic Perspectives* 36, no. 4 (2022): 53–80.

[7] Resolution Foundation and Centre for Economic Performance, 'Ending Stagnation: A New Economic Strategy for Britain'.

[8] Competition and Markets Authority, 'Competition and Market Power in UK Labour Markets', 25 January 2024, https://www.gov.uk/government/publications/competition-and-market-power-in-uk-labour-markets.

[9] Anthony F Heath and Valentina Di Stasio, 'Racial Discrimination in Britain, 1969–2017: A Meta-analysis of Field Experiments on Racial Discrimination in the British Labour Market', *The British Journal of Sociology* 70, no. 5 (2019): 1774–98.

[10] Commission on Race and Ethnic Disparities, 'The Report', March 2021, https://assets.publishing.service.gov.uk/media/6062ddb1d3bf7f5ce1060aa4/20210331_-_CRED_Report_-_FINAL_-_Web_Accessible.pdf.

CHAPTER 7 – IMMIGRATION

Jonathan Portes
Professor of Economics and Public Policy
King's College London

> *Labour will inherit levels of immigration that will be high by historical standards, but are likely to be falling quite sharply. After peaking at 745,000 in 2022, net migration fell to 672,000 in the year to June 2023, and will fall further as the impact of arrivals from Hong Kong and Ukraine drops out of the figures, student emigration rises to reflect the earlier rise in student immigration, and new restrictions on dependents of students and care workers are implemented. While forecasting migration is highly uncertain, these factors along might be expected to reduce net migration to 300,000 per year or below.*[1]

Reductions in the headline figures should allow Labour the space to adopt a more considered approach to economic migration, especially those coming to work and study. This would also reflect the view of the majority of the public, and Labour voters in particular. Most recent research shows that even those who would like to see migration fall overall, or who are concerned over irregular arrivals seeking asylum, have much more supportive attitudes towards those coming to work in health, social care and other sectors where there are perceived labour market needs.[2]

While there is little or no detail on specific policy changes, Labour's basic thinking is clear. Their view is that work-related migration is too high, but that is primarily a symptom of the failure to train and invest in British workers.

> *"We are crystal clear as to why employers are looking abroad - because for 13 years the Conservatives have failed to train up Britain's home-grown talent to fill the UK's one million job vacancies, and they have failed to get millions of inactive working-age people back to work."*[3]

In other words, immigration may be, in the short-term, necessary both to boost growth and support public services – but this is a second-best solution, driven by failures of the education, skills and welfare systems.

From an economic perspective, does this make sense? Would increasing domestic labour supply, both overall and in specific sectors, reduce the demand for migrant workers? Yes and no. The case is strongest in sectors where the government, directly or indirectly, controls both the quantity and the price of labour – most obviously the NHS and care sectors. If the government funded more training places for doctors and nurses, that would certainly feed in, over time, to lower demand for migrant workers. Perhaps even more effective would be improving pay and conditions for existing workers (wherever they were originally from) to reduce the numbers leaving. In the care sector, which has seen by far the largest expansion of work visas since the introduction of the post-Brexit migration system, the connection is even more direct. As the government's own independent advisory committee put it:

> *We continue to maintain that the only long-term sustainable solution to the workforce problems in the sector is to pay all care workers in the UK properly which would require a significant increase in public funds, and we remain deeply disappointed that the UK government continue to exhibit no ambition in this area.*[4]

So the good news is that Labour could indeed deliver on its ambition to reduce migration by improving pay and conditions, and increasing training and investment in British workers. The bad news is, however, that this would translate directly into significant increases in public spending, running directly into Labour's self-imposed fiscal constraints.

What about the private sector? Here, things get more complicated. Labour has in the past argued that employers facing labour or skills shortages, real or perceived, should only be able to recruit internationally when they have plans to recruit and train in the UK, arguing that the latter should, at least over time, reduce the need for the former. While this sounds intuitive, there's little to suggest that in general this trade-off holds. Both the arguments put forward by the "pro-migration" side of the debate (that the UK economy "needs" high levels of migration to address both generalised labour shortages and those in specific sectors) and the "anti-migration" side (that such shortages can and should be addressed domestically, alongside tighter controls on migration) can be seen as just another version of the lump of labour fallacy, described by Alan Manning as the "lump of vacancies fallacy".[5] In the private sector as whole, and in sectors where output and demand can adjust relatively flexibly as labour supply changes, both migration and increased domestic labour supply are likely to lead to increased labour demand.

Meanwhile, the UK has had over the past 25 years numerous strategies which aim, either at a regional or sector level, to put in place plans for training and workforce development. None have succeeded, but there is little evidence that this has anything to do with migration. Research commissioned by the Migration Advisory Committee (MAC) found "no evidence that migration has had a negative impact on the training of the UK-born workforce. Moreover, there is some evidence to suggest that skilled migrants have a positive impact on the quantity of training available to the UK-born workforce".[6] Instead, the culprits are poor planning, insufficient investment (from both government and business) and excessive short-termism (ditto). Remedying these issues should indeed be a priority for a new government. Given the history, this will be difficult and expensive enough without complicating and delaying it by requiring sectors or businesses to put into place additional plans to link the delivery of training to recruitment from abroad.

Moreover, in a dynamic economy characterised by rapid technological change, it is difficult enough for businesses to make plans for their workforce training needs: it is (as the MAC has also repeatedly made clear) impossible for civil servants or economists in Whitehall to second-guess or monitor such plans. This is particularly the case in the sectors that (outside of health and care) make most use of skilled worker visas – ICT, finance and business services, consultancy, and higher education.[7] There are thus strong practical arguments against such policies.

And more broadly, there is a risk that this approach is simply another version of the lump of labour fallacy. In these sectors – high productivity, tradeable services, which are essential to any coherent growth strategy for the UK as a whole – levels of migration are likely to go alongside (as they have in the recent past) with high levels of employment of and demand for UK workers. Making it harder for employers to recruit migrant workers, then, will not increase job opportunities for Brits; by making it harder for businesses to grow, it will do the opposite. The policy rationale for the post-Brexit migration system – broadly endorsed by Labour – was to "welcome the talent, hard work and skills that we need as a country", and thereby to support "wage growth and productivity improvements".[8] Meanwhile, the end of free movement would reduce low-skilled migration, encouraging firms in the most affected sectors to improve productivity.

While it is very early days yet, and the data is clouded by both the pandemic and its after-effects, the evidence so far is reasonably positive. New migrants to the UK, especially from outside the EU, do seem to have somewhat higher wages than before, and to be progressing more rapidly; and there is some evidence that higher non-EU migration is associated with higher productivity growth.[9] The number of migrants coming on more specialised visas targeted explicitly as promoting growth, as entrepreneurs or innovators, has also increased, although remains a small fraction of the total.

Meanwhile, the end of free movement has certainly reduced the number of lower paid workers from the EU, although this has largely been offset by higher non-EU migration, many coming on student visas or as dependents.[10] While this may have reduced the pressure on business to increase productivity in these sectors, these visas are only temporary; if such workers do not move into skilled work, they will have to leave, and in the meantime they have no access to public funds. The net medium-term economic and fiscal impacts are therefore likely to be positive for such workers, even if they are in low-paid jobs. In contrast, then, to many other areas of public policy, the post-Brexit migration system seems to be, on its own terms, broadly aligned with its stated objectives. Certainly there is no case for radical change.

To conclude, then, while Labour's objectives are commendable, and in some areas its critiques of current policy have considerable merit, its policy solutions are unconvincing. What, then, would a migration strategy that was both pro-growth and pro-worker look like?

- First, and most important, Labour should offer certainty and stability for both business and migrant workers. Labour has rightly emphasised that the uncertainty resulting from frequent policy change over the last few years has undermined business confidence and investment in the UK, on everything from HS2 to net zero. The same applies to immigration. Rather than making sweeping changes to the post-Brexit migration system, Labour should pledge the opposite, so that businesses can plan on the basis that the broad contours of the system will remain in place for the foreseeable future.
- Instead, the priority for reforms should be measures that give workers and businesses greater flexibility and certainty; for example, easing the process for visa extensions and settlement, freezing (and ideally reducing) excessively onerous fees, especially for settlement and citizenship, and reversing planned increases to the threshold for a spousal visa. Such changes would have minimal impacts on net migration, but would benefit both workers (and their families) and business overall, by making the labour market more flexible, while reducing the scope for exploitation and abuse and making it less likely that workers are forced to leave the UK.
- The sector where the connection between pay, conditions, training and workforce development on the one hand and migration on the other is strongest is health and care. Measures to improve the former would, over time, reduce both demand and political pressures that increase the latter.
- More broadly, there is a strong case for addressing exploitation and abuse in some, mostly lower-paid, sectors. While this is not exclusively a problem for migrant workers by any means, there is little doubt that these issues are concentrated in migrant-heavy sectors like care, agriculture, and delivery services, and migrant workers with insecure (or no) visa status are most severely affected; moreover, British workers may also be disadvantaged if they are "undercut" by underpaid or exploited migrant workers. Here, then, improving rights, both legal and in practice for migrants will be complementary to doing the same for British workers. Addressing this requires more enforcement capacity, but giving migrant workers more rights, and making it easier for them to access and enforce such rights, would also help.
- Similarly, on student migration, the priority should be stability and predictability. The introduction of the Graduate Visa has enabled universities to maintain international student numbers, despite the Brexit-induced hit to EU-origin students. The government has asked the MAC to review the Graduate Visa, and the MAC has noted that by no means all of those on this visa are working in high-skilled or high-paid jobs. But, while accurate, this in itself is not a strong argument for major restrictions, as opposed to measures to limit abuse. Since neither visa holders nor their dependents have access to benefits, even those working in lower paid jobs are likely to be making a positive fiscal contribution. At the same time, they are helping to address some of the frictions in the labour market that resulted from the end of free movement (for example, in accommodation and hospitality). Meanwhile, only those who do move into higher paid work are likely to be able to stay long-term. And major restrictions would further undermine the financial stability of large numbers of universities.

- Finally, and more broadly, the likely fall in net migration over the coming years should help Labour to wean the political class and the media off its obsession with headline numbers – an obsession that does not appear, by and large, to be shared by the broader public.

[1] Tessa Hall, Alan Manning, and Madeleine Sumption, 'Projecting UK Net Migration' (Centre for Economic Performance, 2023).

[2] Heather Rolfe, Sunder Katwala, and Steve Ballinger, 'Dilemmas of Control: What Does the Public Think about Immigration and How Should Politicians Respond?' (British Future, September 2023), https://www.britishfuture.org/wp-content/uploads/2023/09/Immigration-attitudes-tracker-report-2023-final.pdf.

[3] Stephen Kinnock, 'The Conservatives Are Losing Control of the Immigration System', *Daily Telegraph*, 24 May 2023, https://www.telegraph.co.uk/politics/2023/05/24/labour-scrap-foreign-worker-discount-hire-britons/.

[4] Migration Advisory Committee, 'Migration Advisory Committee Annual Report 2023', 2023, https://www.gov.uk/government/piublications/migration-advisory-committee-annual-report-2023.

[5] Alan Manning, 'UK Labour Shortages and Immigration: Looking at the Evidence', *LSE Business Review* (blog), 10 September 2021, https://blogs.lse.ac.uk/businessreview/2021/09/10/uk-labour-shortages-and-immigration-looking-at-evidence/.

[6] Migration Advisory Committee, 'EEA Migration in the UK: Final Report', 2018, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/741926/Final_EEA_report.PDF.

[7] Ben Brindle and Madeleine Sumption, 'How Will the New Salary Thresholds Affect UK Migration?', *The Migration Observatory* (blog), 6 December 2023, https://migrationobservatory.ox.ac.uk/resources/commentaries/how-will-new-salary-thresholds-affect-uk-migration/.

[8] Home Office, 'The UK's Future Skills-Based Immigration System', December 2018, https://www.gov.uk/government/publications/the-uks-future-skills-based-immigration-system.

[9] Madeleine Sumption, Jonathan Portes, and Ben Brindle, 'Upward Mobility? Earnings Trajectories for Recent Immigrants', 20 September 2023, https://migrationobservatory.ox.ac.uk/resources/commentaries/upward-mobility-earnings-trajectories-for-recent-immigrants/; Hoseong Nam and Jonathan Portes, 'Migration and Productivity in the UK: An Analysis of Employee Payroll Data', *IZA DP No. 16472*, September 2023, https://docs.iza.org/dp16472.pdf.

[10] Jonathan Portes, 'Unintended Consequences? The Changing Composition of Immigration to the UK after Brexit', *IZA Discussion Paper 16728*, January 2024, https://docs.iza.org/dp16728.pdf.

CHAPTER 8 – TRADE

John Springford
Associate Fellow
Centre for European Reform

Keir Starmer has ruled out rejoining the EU's single market or customs union if he becomes prime minister, let alone the Union itself. That decision makes it unlikely that a Labour government would be able to raise Britain's trade volumes or foreign direct investment significantly, and will force it to seek other means to fulfil its mission to become "the fastest growing country in the G7". However, a Labour government could pursue a unilateral trade strategy that would raise the orientation of the domestic economy towards exports, even if it would be unlikely to offset the sizeable costs of Brexit.

The economic impact of Brexit is now well understood, and the consensus among the economics profession and the wider public is that it has been negative and large. Despite Britain only slowly imposing border controls, goods imports and exports are significantly down on a counterfactual 'doppelgänger' UK, made up of a combination of countries whose trade performance most closely matched Britain's before it left the single market. Since the transition period ended on 1st January 2021, Britain's exports to the EU have grown much more slowly than EU member-states' exports to each other. It missed out on a boom in European trade as lockdowns were lifted and pent-up demand for manufactured goods was unleashed.[1]

Britain's exports of financial and transport services have grown significantly more slowly than the average of other advanced economies since it left the Union. This is not surprising, since these are the areas of the single market for services that were most developed (UK exports of information, telecoms, insurance, pension and professional and business services have performed well).[2]

These effects come on top of business investment flatlining since 2016, and a rise in the cost of imported goods as a result of sterling's large depreciation after the referendum.[3]

On the other side of the ledger, it remains highly unlikely that the UK's independence from EU trade and regulatory policy will lead to gains that will come anywhere near to offsetting the costs of imposing barriers to trade with the EU. In the unlikely event that Britain signed trade deals with the US, China, India and the other Anglosphere and 'BRICS' countries, that would offset about 5% of the costs of Brexit, according to modelling by NIESR.[4] The UK's accession to the Comprehensive and Progressive Trans-Pacific Partnership, and its deals with New Zealand and Australia, might raise its GDP in the long run by about 0.1-0.15%, according to modelling by the Department of International Trade.[5] That is set against the government's forecast of a 5% reduction in national income compared to a Britain that remained in the EU.[6]

As for diverging from EU regulation, that would make sense under two conditions: when EU rules can be improved upon; and when the benefit of new UK rules will not be overwhelmed by the cost of UK exporters being prevented from selling products to the EU. Given the size and proximity of EU markets, and the complexity of supply chains, it is unlikely that those conditions will be met in most goods markets. Significant divergence from the EU's environmental and labour standards would prompt a reaction from the EU under the level-playing field provisions of the Trade and Co-operation Agreement (TCA). In services, there are more opportunities, especially in finance; but deviation from EU norms of privacy and data confidentiality in the tech sector might imperil data transfers across the Channel.

In a September 2023 interview with the *Financial Times*, Keir Starmer said that "almost everyone recognises the deal Johnson struck is not a good deal — it's far too thin", and that Labour would "attempt to get a much better deal for the UK".[7] But because he rules out a customs union or participation in the single market, any gains in trade volumes and investment will inevitably be small, and the negotiations are likely to be difficult.

Labour have announced that they will seek to improve the TCA with a veterinary agreement with the EU, whereby the UK aligns with some or most of the EU animal and plant health rules, and produce can then be shipped across borders with fewer or no checks to ensure they meet each jurisdiction's health rules. It is unclear whether the EU would decide this was in their interest politically or economically, and the price would probably be a dynamic mechanism for the UK to align with changing EU rules, and European Court of Justice jurisdiction over any breaches of the agreement.

Labour have also suggested that they might seek mutual recognition of professional qualifications, so that UK professional services workers can more easily work in the EU. Protectionist impulses in the EU might make this difficult: under the Canada-EU free trade agreement, only one profession has been mutually recognised – architecture – despite may negotiating rounds on the issue.

However, while the gains will be small compared to the losses from leaving the EU, there are many other areas where deeper co-operation under the TCA have been mooted – energy, labour and youth mobility, innovation and research, and given Starmer's red lines it makes sense to pursue a better free trade agreement.

Energy would be a good place to start: both the UK and the EU are seeking to rapidly curb fossil fuel imports and to electrify their economies, especially after Vladimir Putin's invasion of Ukraine raised European gas prices. They both have a strong interest in creating a European trading system that allows imports of electricity to provide back-up for intermittent renewables, and the North Sea is a shared resource that will require common planning to provide an efficient grid supplying multiple countries. Linking the UK and EU emissions trading systems might also allow the UK to avoid charges and bureaucracy under the new carbon border adjustment mechanism. However, agreement would have to be struck on the degree to which the UK would align with changing EU rules – it is currently expanding its emissions trading system to domestic heating and road transport – and the role of the Commission and the European Court of Justice in enforcing the application of EU rules in Britain.

In each area where the TCA could be expanded, the EU will have to decide that it is in its political and economic interest to do so, and consider whether the terms of any changes to the agreement will survive the next Conservative government in Britain. For its part, in order to lower TCA-imposed barriers significantly, Labour will have to consider whether rule-taking mechanisms will be viable politically. This will be more difficult than it appears.

However, by pursuing a three-pronged and largely unilateral trade strategy, Labour could seek to improve the trade orientation of Britain's domestic economy and provide a foundation that might allow bigger integrative steps with the EU later, if the politics allows. The first prong would be to minimise unnecessary or accidental divergence with EU rules, which could lead to further trade losses. This would require new regulation to be decided on a cost-benefit analysis that includes potential losses of trade with the EU (as opposed to a politically-driven strategy to remove as many EU laws as possible from the statute books). Teams in the Foreign and Commonwealth Office, Department for Business and Trade, and the Treasury could study the Commission's proposals for new EU regulation and conduct impact assessments on the costs and benefits of Britain unilaterally aligning with them. Where it is beneficial the government could speedily pass matching laws. In doing so, if changing political opinion domestically and in the EU allows for shared regulation in return for an end to border checks, Britain will be ready to do so. Such an approach would also provide regulatory stability, encouraging investment by the UK's exporting firms.

The second principle is to seek agreements with non-European countries to the extent that they do not promote divergence with the EU. So far this has not been a major issue – shared regulation and mutual recognition are usually limited in free trade agreements, since they do not create institutions to legislate for shared rules or to enforce the application of them. But if the UK were to negotiate a free trade agreement with the US, there would be pressure from Washington to change EU-era rules that the US Trade Representative's Office believes discriminate against its producers. Agri-food rules are a particular bugbear, because the EU has tougher standards on farming and food processing than the US.

The third principle is to use domestic policy more forcefully to make it easier for British firms to export. There are many policies to consider, from direct help to exporters to raising dynamism in the domestic economy, creating larger, more productive companies that expand into overseas markets.

The government could take more of the risk of exporting onto its balance sheet, by providing cheaper finance for exporters or lending to foreign entities that are considering buying British products. It could invest in port capacity and efficiency, and in road and rail transport between ports and population centres, raising imports and offsetting some of the costs of more stringent border checks on EU goods.

Labour could make it cheaper for skilled immigrants to come to the UK by eliminating the NHS surcharge and lowering visa fees – immigrants are over-represented in business start-ups, and immigrant populations are associated with higher services trade with their countries of origin.[8] More funding for early-stage biosciences and green technology would strengthen the UK's existing advantages in pharmaceuticals and medical technology, and energy engineering. And Labour could seek to make British cities denser and reduce commuting times through road pricing and better public transport, thereby creating larger labour markets and improving matches between employers and workers in the services sector – a sector in which the UK retains a comparative advantage internationally. These policies might also make the country more attractive to foreign companies as a location for investment.

None of these measures would do much to offset the large, negative impact of Brexit, but taken together, they would prevent the situation from getting worse, and create a foundation to pursue more integration with the EU if the politics allows. They would play to the UK's strengths in professional and business services, biosciences and engineering – sectors that have been less affected by Brexit, and in which global trade growth has been steady. Starmer may have decided that reversing Brexit is too politically risky, but there are incremental, stabilising steps that he can take, in the hope that the politics on both sides of the Channel allows bigger moves later.

[1] Jun Du, Emine Beyza Satoglu, and Oleksandr Shepotylo, 'How Did Brexit Affect UK Trade?', *Contemporary Social Science* 18, no. 2 (2023): 266–83; John Springford, 'Brexit, Four Years on: Answers to Two Trade Paradoxes' (Centre for European Reform, 25 January 2024), https://www.cer.eu/insights/brexit-four-years-answers-two-trade-paradoxes; James Moberly and Sven Jari Stehn, 'The Structural and Cyclical Costs of Brexit' (Goldman Sachs, February 2024).

[2] Springford, 'Brexit, Four Years on: Answers to Two Trade Paradoxes'.

[3] Jonathan Haskell and Josh Martin, 'How Has Brexit Affected Business Investment in the UK?', *Economics Observatory* (blog), 13 March 2023, https://www.economicsobservatory.com/how-has-brexit-affected-business-investment-in-the-uk; Holger Breinlich et al., 'Exchange Rates and Consumer Prices: Evidence from Brexit', *CESifo Working Paper, No. 8001*, 2019.

[4] Arno Hantzsche, Amit Kara, and Garry Young, 'The Economic Effects of the Government's Proposed Brexit Deal' (National Institute of Economic and Social Research, 26 November 2018), https://www.niesr.ac.uk/wp-content/uploads/2021/10/NIESR-Report-Brexit-2018-11-26-4.pdf.

[5] Department for Business and Trade and Department for International Trade, 'UK-Australia FTA: Impact Assessment', 16 December 2021, https://www.gov.uk/government/publications/uk-australia-fta-impact-assessment; Department for Business and Trade and Department for International Trade, 'UK-New Zealand FTA: Impact Assessment', 28 February 2022, https://www.gov.uk/government/publications/uk-new-zealand-fta-impact-assessment; Deparment for Business and Trade, 'CPTPP: Impact Assessment', 17 July 2023, https://www.gov.uk/government/publications/cptpp-impact-assessment.

[6] HM Government, 'EU Exit Long-Term Economic Analysis', November 2018, https://assets.publishing.service.gov.uk/media/5c00058b40f0b65af36c5d6c/28_November_EU_Exit_-_Long-term_economic_analysis__1_.pdf.

[7] George Parker, 'Keir Starmer Pledges to Seek Major Rewrite of Brexit Deal', *Financial Times*, 17 September 2023, https://www.ft.com/content/6bdc4e88-c2ed-44ad-aa7d-c70bc358e027.

[8] Robert W Fairlie and Magnus Lofstrom, 'Immigration and Entrepreneurship', in *Handbook of the Economics of International Migration*, vol. 1 (Elsevier, 2015), 877–911; Gianmarco IP Ottaviano, Giovanni Peri, and Greg C Wright, 'Immigration, Trade and Productivity in Services: Evidence from UK Firms', *Journal of International Economics* 112 (2018): 88–108.

CHAPTER 9 – HOUSING AND PLANNING

Paul Cheshire
Emeritus Professor of Economic Geography
London School of Economics & Political Science

The problem

> *The extreme damage caused by unaffordable housing, not just as it restricts access to decent housing but because of the harm it does to equality and social cohesion, is now part of our common discourse. In 2021 to 2022, housing was the largest component of household spending, at 17.5%. The poorest 30% of households spend proportionately twice as much as the richest 10%.[1] House price inflation has overwhelmed all other price increases and hits the poorest the hardest. The increase in the real price of houses redistributes wealth to homeowners, driving a wedge between the old and the young and eroding our social fabric. Less widely discussed is the damage our dysfunctional planning system does to the wider economy – a point discussed later.*

Since 1997, the median house price to median income ratio (the standard measure of affordability) has increased from 3.6 to 8.1 (in London, to 13.3).[2] Londoners may be the richest Britons, but their housing is the most unaffordable. It is only older Londoners who are part of the professional or super-skilled elite who have a real advantage in terms of disposable incomes.

The cause of our housing crisis is simple: not building enough houses. We have an accumulated construction deficit going back 70 years.[3] We built over 3 million fewer houses in the 30 years since 1990 than in the 30 years before 1990. A policy-imposed lack of housing land is the main problem, but pervasive height controls further restrict space. In 1955, eggs cost 28p a dozen. If their price had risen at the same rate as the price of housing land, eggs would have cost £91.28 by 2008 – the most recent year for which there is comparable land price data.[4]

1955 is a watershed year because that is when a Conservative minister, Duncan Sandys, introduced the Metropolitan Green Belt – quickly followed by green belts around almost all large English cities. By 1973, green belts covered 1,681,000 hectares of England – practically the same area as today.[5] Their name sounds green but that is not their purpose. Green belts are only to stop 'settlements merging': to prevent development. They have no recreational or environmental aims although they have had the no doubt accidental effect of slowing the move of Labour voters to the home counties and leafy shires.

Historically, land for urban use was in virtually limitless supply as modern transport systems were rolled out. Its real price hardly changed from 1892 until about 1960.[6] This production of urban land ground to a standstill from 1955. Unlike comparable investments in the past, the £20 billion spent on Crossrail, produced virtually no new urban land. As soon as it reached the edge of Southall, the Green Belt boundary stopped building.

The issues to address

The long-term failure to build enough houses, however – the crisis of supply – does have more than one cause. It results from the combined effects of:

1. Restrictions on the supply of land for housing but more widely on the supply of housing space: almost all Britain is covered by binding height restrictions;
2. Restrictions on development[vii] – the Council says 'no';
3. The additional uncertainty, so risk, our discretionary system generates; and
4. The lack of fiscal incentives for local communities to accommodate new development. (see Cheshire, 2018, for a fuller explanation of these)[7]

The problems with housing do not just damage the welfare of house buyers or renters and generate serious inequality, they damage productivity and growth. Most obviously this is by reducing labour supply in the most productive locations and damaging agglomeration economies. Larger cities specifically increase peoples' productivity, all else held constant. The research demonstrating this was well established even a decade ago.[8] Green Belts, however, seriously restrict any growth in agglomeration.

A map of housing affordability shows how London is the epicentre of unaffordability but that there are major problems over most of southern England, the west country, the East Midlands and East Anglia.[9] Less affordable housing increases the supply price of labour in our most productive economies and also increases commuting distances (commuting costs real resources) as people leapfrog Green Belts to find affordable housing space: or just as they fail to find suitable housing in more restrictive local authorities (LAs).[10] There has been no work done in the UK to quantify the total value of this loss but in the US – where restrictions are more recent and less binding – Hsieh and Moretti simulated the impact of a relaxation of land use restriction in just the New York and Bay Areas to the national median.[11] Over the period 1964 to 2009 they estimated this would have boosted average wages of all workers by $3,685.

Less obviously, our desperate housing market, by diverting both investment and entrepreneurial talent into playing it, rather than into productive investment or skills, distorts incentives and almost certainly damages our real economy in subtle ways. The Swiss do not put energy into trying to gain money from housing, they put it into real investment and skills. I – a quite well paid university professor – have made more money from capital gains in the housing market than all the salary I have ever been paid: and that has been without trying – just using my knowledge when having to buy or move.

[vii] Hilber and Vermeulen, 2016, estimate that had local authorities in the South East been as relatively flexible as those in the North, house prices in the South East would have been 25% lower – and that is just the period 1974 to 2016.

These are indirect negative effects on the real economy, but research has shown substantial direct damage too. In the retail sector, estimates show a loss of total factor productivity as a result of Town Centre First policy in the supermarket sector of 32%[12] and an even bigger effect in clothing retail of a 47% loss. The costs of office space are increased very substantially also. Cheshire and Hilber estimated that a combination of height restrictions and more generalised restrictions on development, created the equivalent of a tax on office construction costs of up to 800% (in London's West End) or nearly 500% in the City.[13] This burden on office costs was not confined to London. Although the actual costs of constructing a m^2 of office space in Birmingham in 2004 were only half those in Manhattan, that m^2 cost 44% more.

In addition, the combination of tight restrictions, especially on building heights, and the discretionary, politicised character of our planning system, means developers resort to expensive stratagems to convince politicians buildings should be given permission because, for example, they are of the 'highest architectural quality'. This allows the small group of famous architects who have won one of their profession's three major lifetime achievement awards to earn substantial rewards to squeeze far more space on a given site – mainly because on average their buildings are 14 floors taller than those of normal architects – dazzling decision-makers with their awards. Cheshire and Derricks show this process of gaming planning decisions leads to a deadweight loss of about £148 million on a representative City of London site.[14]

Since other research shows, all else equal, people are more productive in taller offices[15], the extra costs and the restriction on building tall in British cities likely do not just produce deadweight losses but also reduce the productivity of office workers overall. The average office building in Chicago – where heights are not regulated – is 30 floors taller than in London. Taller buildings cost more to build, all else equal, but people working in them are more productive, so employers are willing to pay.[16]

Labour's proposals for reform

The problems discussed above are such that only radical reform can really solve them. This is not just to solve the long term housing crisis but to promote economic growth. To boost growth, planning reform is one of the few costless hits. It does not require significant public money: just a clear analysis and political will. For the growth agenda, reforms need to focus on:

1. Improving labour mobility to help people move to where jobs are most productive and help productive employers recruit the labour they need;
2. Promoting agglomeration economies by reducing (not, as at present, increasing) the costs of urban growth;
3. A step change to allowing taller buildings;
4. Reducing regional disparities by reducing housing costs in London and South East England (not by increasing the price of housing in poorer regions);
5. Eliminating some current planning policies research has demonstrated reduce productivity while producing no benefit – notably Town Centre First Policy.

To this one could add:

6. Reforming our regressive and inefficient property taxes/system of local government finance.

The inequities of our council tax are well documented (see Cheshire and Hilber for a review and reform proposals).[17] Stamp duty actively penalises both mobility and using the existing housing stock more efficiently – it is a tax on moving; unlike many more progressive countries, the UK has no tax on housing wealth. Such taxes are highly progressive but need not be burdensome and would go some way to redressing the inequality driven by the rise in real house prices over the past generation as well as providing a small boost to funds available to finance public services.

Judged against these criteria Labour's proposals fall short. In identifying what Labour's proposals are, the documents I rely on are Keir Starmer's October 2023 conference speech, plus, more helpfully, the notes given to journalists which provided detail to fill out the headlines: and secondly speeches by Shadow Minister, Matthew Pennycook.

The rhetoric of both Keir Starmer and Angela Rayner is strong but the proposals for reform are not radical in that they accept the status quo – just try to improve it. This may sound carping because it is also true that what Labour is proposing is the most radical set of reforms since the very odd British planning system was set up in 1947. If implemented with vigour and a willingness to ignore the powerful vested interests our woeful planning system has created over the years, Labour's proposals would improve the situation. They still fall well short, however, of the radical reforms needed to generate a proper balance between local and wider social or national interests; or moving away from our unpredictable, discretionary system to a 'rules-based' system as in Continental Europe, making lobbying or gaming redundant and eliminating a major source of development risk. More risk, after all, means for projects to be viable, expected returns have to be higher. It is in the social interest that public policy should minimise development risk (and not increase it) since mitigating risk consumes real resources and ensures fewer houses or commercial premises are built. At the same time higher risk favours the larger developers over the SME builders.

Apart from some minor playing to the gallery such as i) 'planning passports for urban brownfield land' (there is not remotely enough fallow urban brownfield land to begin to address our housing crisis and what there is, is disproportionately where housing is least unaffordable), ii) increasing stamp duty (which should in fact be abolished – see point 6, above) on overseas house buyers (while the planning system needs more resourcing there are far too few overseas buyers to make any material difference) and iii) 'giving first dibs' to first time buyers (more or less meaningless), there are four substantial proposals:

1. Retain the 300,000 a year housebuilding target and restore mandatory housing targets for local authorities (LAs); this works together with
2. Forcing LAs to have up to date local plans embodying housing targets compatible with meeting 'housing need';
3. Have a strategic review of the Green Belt; and
4. Build a new generation of New Towns

Assuming we stick to our existing system, if it is to work LAs have to have a plan which incorporates both housing targets and identifies the land on which to build the houses. At present, as Labour correctly points out, we have the mantra of a 'plan-led system' but without plans. Only a third of LAs actually have a valid plan at all and that proportion is projected to fall to 22% by 2025.[18] Even when a plan exists, decisions frequently ignore it because it is discretionary.

In 2020, before Michael Gove abandoned housing targets and the only – albeit very weak – mechanism to insist on them, the 'affordability test', only 45% of LAs had a valid plan. Since then local plans have fallen by the wayside. NIMBY councils have learnt there is no enforcement and that not having a valid plan is a useful political defence. Any houses that get built are on the basis of successful (and very expensive) appeals allowing the development to happen: so all new building is "Whitehall's" fault.

The Labour Party's proposals have quite a cunning solution. The notes accompanying Starmer's speech explain the intention is that an incoming Labour minister will immediately instruct all chief planning officers to accept proposals to build if their LA does not have a valid plan and is not meeting key housing targets. Housing targets for LAs would be reinstated. Labour would also introduce an enforceable "presumption in favour" where development proposals conform to the local plan and – more effective probably – empower the Planning Inspectorate to draw up local plans where these are "significantly and egregiously delayed".

None of this would make much difference unless vigorously and rapidly followed through, but the threat of automatic approval if there was no plan and the Planning Inspectorate drawing up local plans if the LA failed to do so, should concentrate even the most NIMBY minds into producing local plans that realistically could deliver their housing targets. All that does presume, however, not just more determination than politicians have historically been willing to deploy, but also significantly more resources for seriously under-resourced LA planning departments and the Planning Inspectorate. The resource implications are almost certainly far greater than any revenues that could be generated by taxing overseas purchasers of British property.

The other proposal that could be a game changer is a strategic review of the Green Belt. Matthew Pennycook has most explicitly addressed this. In a speech to the Fabian Society (which produced its own radical proposals[19]) he went further than Starmer's rhetorical "build on the Grey Belt". He admitted housing needs could not be met by building on brownfield land alone, but parts of the Green Belt had to be released. But he went further by arguing this had to be done in a "strategic way" and "Labour would bite the bullet" on that. If carried through this really could make a difference since a strategic review of the extent and social and environmental value of the Green Belt would surely conclude that releasing small areas with no environmental or amenity value near to commuter stations – perhaps any stations – would not only have zero welfare cost but could support rail oriented development for several million new homes.[20]

The third substantial proposal Labour has come up with is a “new generation of New Towns”. The criteria set out to pinpoint sites for these – near transport hubs in areas of significant “housing need” where there are no negative environmental or amenity concerns – make sense; as does their idea of creating “heat maps” of these factors to come up with suitable locations and setting a six-month deadline for the selection process. Less convincing is their hope that the LAs concerned will bid for them – or even co-operate.

Making the whole proposal inoperable is the idea of setting up New Town Corporations with planning powers and powers to compulsorily purchase land with limited “hope” value. Labour have made three separate attempts since World War II to capture land value uplift or establish bodies to buy development land at existing use value, each using compulsory purchase powers.[21] All have failed because “hope” value – that is the hoped for value of the land if it got planning permission – was not extinguished. So first landowners sat on land expecting the compulsory purchase threat to go away. It did because the Conservative Party never signed up to it so it was reasonable to expect at some future election the threat would disappear. Second, when it came to it, the costs of planning consultants, valuers and lawyers arguing about what the “existing use” value was and what the land’s “hope value” would be, exhausted any development value the land might have had. It all went to the professionals.

Unless there were a more radical instrument for acquiring the land for New Towns and a willingness to decide at a national level where they should be located and then impose the decision, the proposal is likely to dribble away into the dust as did the eco-towns launched by Gordon Brown in 2007.

It might work if national government using technical criteria selected sites and the proposed New Town Corporations were given full planning powers *and* the sole right to develop on all the land identified. They would then be charged to draw up plans for the new communities and, jointly with commercial developer(s) who have the essential expertise, offer to buy land identified in the plan at a ‘generous’ markup on current market value. Then their partner developers could develop the land as they were able to buy it voluntarily. Generous offers would have two big benefits: they would acquire land (prices would have to be adjusted to work and as the system kicked in would likely fall as land owners realised it was the only reward they could get over existing use value); and they would ultimately cost far less than futile legal battles over ‘before’ and ‘after’ land values.

The 1947 Town and Country Planning Act, still the foundation of the planning system, worked by expropriating “development rights” from freeholders without compensation. These development rights are owned by the state which has designated LAs to act as its agents in granting any permission to develop. So it would seem that the development rights could be assigned to the New Town Corporations thus extinguishing all hope value for existing landowners since they could only sell for anything above the land’s existing value to the development corporation. While compulsory purchase powers might exist in the background, the aim should be not to use them but offer a sufficiently higher price for the land, compared to its current market value, to induce substantial numbers of owners to sell freely. Making “generous” offers would not only save money but might allow New Towns to be built.

Dogs that don't bark – some policies that should be there but are not

The following policies seem missing from Labour's proposals. A common feature is that none of them would cost any public money – indeed suggestion five would increase net tax revenues:

1. There is no consideration of the costs of having a planning system that not only has vanishingly few plans but in which all plans are discretionary – so no one knows what might be the outcome of their development proposals. Why not move to a 'rules-based' system as in most of continental Europe; or at least trial it in a big city region, such as Manchester? As the Conservatives found in 2020, there might be short-term political stress, especially from professional NIMBYs and local councillors who enjoy the power a discretionary system gives them, but this would pass and the whole planning system would become an order of magnitude less divisive and economically damaging.
2. There is no mention of the costs of inflexible height restrictions. These restrict housing supply in the largest cities but more importantly, as applied to commercial buildings, increase the costs of space and restrict agglomeration economies. They restrict the density of employment in the business hubs but, also, lead to the suppression of a potential productivity gain. Urban economists have an increasing understanding that people working in taller buildings are – all else given – more productive. The implication is – let developers build taller buildings. An intelligent review could easily identify sensible changes to make our current system less costly while avoiding damage to city views of real social value.
3. There is no mention of damage done by Town Centre First policy. This in effect prevented retailers choosing the most productive sites and, as a result, had an extraordinarily damaging effect on total factor productivity in the sector. That might be acceptable if there had been tangible gains. But research has conclusively shown that in fact this policy to 'protect town centres' directly led to a reduction in town centre retail employment[22] and did not increase shopper footfall[23] – even if it did help the chains take over the high street.
4. Labour's commitment to green growth has proven expensive but a change that could have a transformative impact on the carbon footprint of the residential sector is obvious and completely free: probably has no significant political cost even. There are 1.5 million homes in Conservation Areas, and it is all but impossible to install double glazing or solar panels on any of them. It is also much more costly to install insulation or heat pumps. Over the past 30 years the contribution of the residential sector to the UK's total CO_2 emissions has swollen from 13% to 18.5%.[24] All that is needed is a simple review of Conservation Area regulations to relax them to make investment in energy saving viable without sacrificing any significant part of their contribution to the preservation of our historic townscapes. Given that houses in Conservations Areas are old and leaky they certainly account for a very much higher proportion of total residential CO_2 emissions than they do of the housing stock.
5. A final change would be a strategic review and subsequent reform of property taxes and the system of local government finance. Our current property taxes are regressive and a tax on mobility. Their structure also means the extraordinary

capital gains accrued to housing have slipped right through the tax net. Here, while reform would require analysis and political courage, it could not just improve outcomes and boost growth but add to net tax revenues. Simultaneous reforms to local government finance to generate revenue incentives for local communities to permit development would significantly soften NIMBY pressures.[25]

Conclusions

Labour's proposals are not radical in that they accept the thoroughly unsatisfactory status quo of the planning system, they do not address the issue of local incentives to permit development and avoid any discussion of the serious obstacles our planning system presents to commercial development or infrastructure. But they are more radical than any proposals for reform in the last 50 years. Within the constraints of a fragmented system with no mandatory elements, they come up with some quite effective instruments for pressing a national and social interest on the most NIMBY local councils without elaborate new bureaucracy or laws.

Change – even getting LAs to produce and adopt acceptable plans (which they should have had anyway) – takes time. So does building houses. So it is not likely 300,000 houses will be built in any year before about 2030 at the earliest – even with the most stringent and urgent application of the proposals. They need at least to re-think the New Town proposals, but a serious review of Green Belt policy could produce substantial dividends, some relatively quickly. If the reforms are sharpened up and implemented rapidly and with greater firmness of purpose to confront vested interests in the context of housing and planning than has been shown by any government since 1947, then they should increase supply and make things a little bit better.

But real reform requires both a rules-based system of planning and a system that embodies a proper understanding of basic economic analysis. That land in the Green Belt in a north London Borough with planning permission but no planning obligations costs £37.5 million a hectare while adjoining land without permission costs perhaps £30,000 a hectare tells one something very powerful about the misallocation of resources our current system generates.

[1] Housing Analysis Team, 'House Price to Workplace-Based Earnings Ratio', Office for National Statistics, 25 March 2024, https://www.ons.gov.uk/peoplepopulationandcommunity/housing/datasets/ratioofhousepricetoworkplacebasedearningslowerquartileandmedian.

[2] Housing Analysis Team.

[3] Samuel Watling and Anthony Breach, 'The Housebuilding Crisis: The UK's 4 Million Missing Homes' (Centre for Cities, 22 February 2023), https://www.centreforcities.org/publication/the-housebuilding-crisis/.

[4] Paul Cheshire, 'Planning May Be a Political Hot Potato but Radical Reform Cannot Wait', *LSE Politics and Policy* (blog), 15 November 2023, https://blogs.lse.ac.uk/politicsandpolicy/planning-may-be-a-political-hot-potato-but-radical-reform-cannot-wait/.

[5] Paul Cheshire and Felipe Carozzi, 'Housing Sprint: Land Report' (Saïd Business School, 12 July 2019), https://eprints.lse.ac.uk/102339/3/Cheshire_housing_sprint_land_report_published.pdf.

[6] Paul Cheshire, 'Turning Houses into Gold: Don't Blame the Foreigners, It's We Brits Who Did It', *Centrepiece* 19, no. 1 (2014): 14–18.

[7] Paul Cheshire, 'Broken Market or Broken Policy? The Unintended Consequences of Restrictive Planning', *National Institute Economic Review* 245, no. 1 (2018): R9–19.

[8] Paul C Cheshire, Max Nathan, and Henry G Overman, *Urban Economics and Urban Policy: Challenging Conventional Policy Wisdom* (Edward Elgar Publishing, 2014).

[9] Cheshire and Carozzi, 'Housing Sprint: Land Report'.

[10] Paul Cheshire, Christian AL Hilber, and Hans RA Koster, 'Empty Homes, Longer Commutes: The Unintended Consequences of More Restrictive Local Planning', *Journal of Public Economics* 158 (2018): 126–51.

[11] Chang-Tai Hsieh and Enrico Moretti, 'Housing Constraints and Spatial Misallocation', *American Economic Journal: Macroeconomics* 11, no. 2 (2019): 1–39.

[12] Paul C Cheshire et al., 'Convenient Stores? What Do Policies Pushing Stores to Town Centres Actually Do?', *IEB Working Paper 2022/09*, 2022.

[13] Paul C Cheshire and Christian AL Hilber, 'Office Space Supply Restrictions in Britain: The Political Economy of Market Revenge', *The Economic Journal* 118, no. 529 (2008): F185–221.

[14] Paul C Cheshire and Gerard H Dericks, '"Trophy Architects" and Design as Rent-seeking: Quantifying Deadweight Losses in a Tightly Regulated Office Market', *Economica* 87, no. 348 (2020): 1078–1104.

[15] Hans RA Koster, Jos van Ommeren, and Piet Rietveld, 'Is the Sky the Limit? High-Rise Buildings and Office Rents', *Journal of Economic Geography* 14, no. 1 (2014): 125–53.

[16] Crocker H Liu, Stuart S Rosenthal, and William C Strange, 'The Vertical City: Rent Gradients, Spatial Structure, and Agglomeration Economies', *Journal of Urban Economics* 106 (2018): 101–22.

[17] Paul Cheshire and Christian AL Hilber, 'Home Truths: Options for Reforming Residential Property Taxes in England' (Bright Blue, 2021), https://eprints.lse.ac.uk/110734/1/Cheshire_home_truths_reforming_residential_property_tax_published.pdf.

[18] Lichfields, 'Timed Out?', 21 July 2023, https://lichfields.uk/content/insights/timed-out.

[19] Christopher Worrall, 'Homes for Britain: Planning for Growth' (Fabian Society, March 2023), https://lghfabians.org.uk/wp-content/uploads/2023/03/Homes-for-Britain-Web.pdf.

[20] Paul Cheshire and Boyana Buyuklieva, 'Homes on the Right Tracks: Greening the Green Belt to Solve the Housing Crisis' (Centre for Cities, September 2019), https://eprints.lse.ac.uk/102337/1/Cheshire_homes_on_the_right_tracks_published.pdf.

[21] Cheshire, Nathan, and Overman, *Urban Economics and Urban Policy: Challenging Conventional Policy Wisdom*.

[22] Raffaella Sadun, 'Does Planning Regulation Protect Independent Retailers?', *Review of Economics and Statistics* 97, no. 5 (2015): 983–1001; Jonathan Haskel and Raffaella Sadun, 'Regulation and UK Retailing Productivity: Evidence from Microdata', *Economica* 79, no. 315 (2012): 425–48.

[23] Cheshire et al., 'Convenient Stores? What Do Policies Pushing Stores to Town Centres Actually Do?'

[24] Department for Energy Security and Net Zero, 'Final UK Greenhouse Gas National Statistics, 1990-2022', GOV.UK, 6 February 2024, https://www.gov.uk/government/statistics/final-uk-greenhouse-gas-emissions-national-statistics-1990-to-2022.

[25] Cheshire and Hilber, 'Office Space Supply Restrictions in Britain: The Political Economy of Market Revenge'; Gregory Burge and Keith Ihlanfeldt, 'Impact Fees and Single-Family Home Construction', *Journal of Urban Economics* 60, no. 2 (2006): 284–306.

CHAPTER 10 – INFRASTRUCTURE

Dan Turner
Head of Research
Centre for Progressive Policy

All grand theories of growth require the next government to do more on infrastructure

> *Infrastructure underpins our economic, domestic, and social lives. As Deb Chachra, author of the recent book How Infrastructure Works, puts it, "our infrastructural systems underpin our personal agency" by "giving us freedom from what would otherwise be the daily labour of meeting our most basic human needs".[1]*

Regardless of the economic philosophy of the next government – whether it be a simple 'do no harm' approach, a return to Brownite economics, or an embrace of 'productivism' and 'modern supply side economics' – improving our infrastructure will be a necessary condition for Labour's economic success.

Take the electricity system for example: both parties have committed to a net zero energy system by 2030 (Labour) or 2035 (Conservatives). At the same time, the wider net zero effort will increase demand for electricity as local combustion is phased out of use. By one estimate, that means we need to achieve a seven-fold increase in the amount of grid infrastructure built each year.[2]

Success will require a generational shift in delivery, with all the political challenges that brings

But the UK has underinvested in these underlying capabilities for decades. Average net public investment has run at an average of 1.5% a year since 1979, compared to 4.5% between 1949 and 1978.[3]

Rachel Reeves' 2023 Conference speech emphasised "getting Britain building again" and announced an Infrastructure Council for good reason. Labour will need to engineer a generational shift in attitudes to infrastructure: changing the physical complexion of the UK; unlocking and mobilising new sources of funding; and supporting local advocates of change in communities across the country.

Infrastructure brings network externalities that would otherwise be inaccessible

In this contribution, I focus in on the role of transport infrastructure in particular, building on recent work with Anna Stansbury and Ed Balls.[4]

Improving transport improves what Duranton and Puga refer to as the economies of “sharing, learning, and matching”[5] (as well as wider social benefits by increasing connectivity across communities). It enables more frequent, lower cost interaction between people, and larger pools of workers and customers for firms.[6] We observe benefits from particular infrastructure projects,[7] and broader network benefits as more infrastructure projects unlock value elsewhere.[8] The catch-all term for the economic benefits of being close together is the ‘agglomeration effect’.

The UK misses out on the gains of infrastructure seen in the US or Western Europe

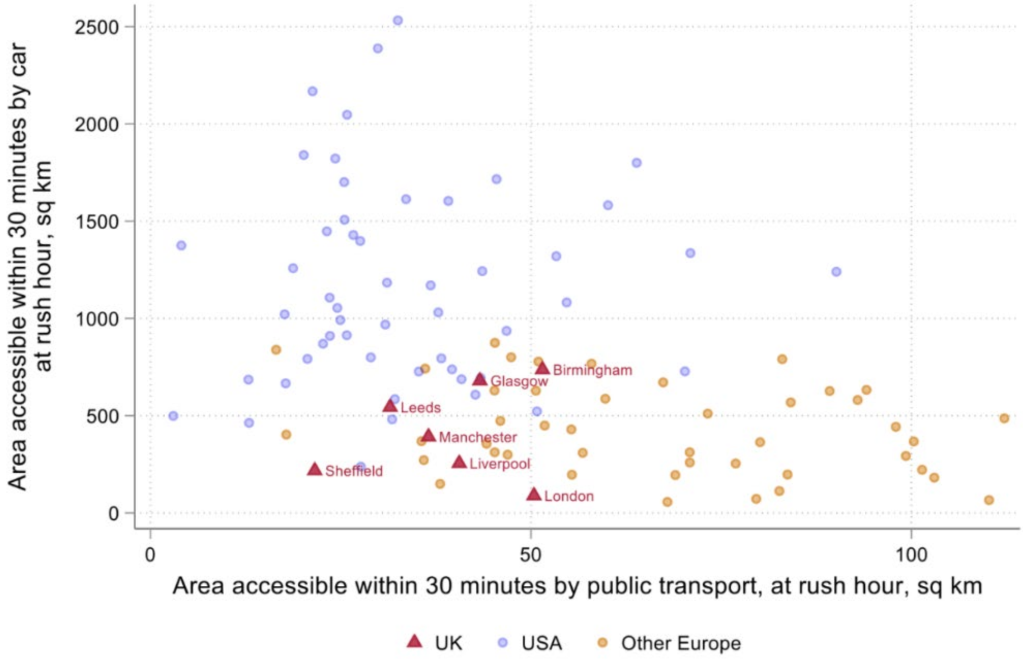
One of the ways the UK stands out relative to our international peers is that these agglomeration effects appear to be weak, or even non-existent. Outside of the South East of England, the size of an urban area and its productivity seem to bear little resemblance to one another.[9]

Transport infrastructure could be one explanation for this. If the *effective size* of the UK’s metropolitan areas were held back by poor connectivity – reducing the number of people who can make it to economic hotspots at peak times – then improving transport infrastructure could turn that around.

And we have good reason to think that the UK’s urban areas do lack the effective scale of comparable American or West European cities, held back by poor transport infrastructure.

We find that the UK finds itself in a “worst of both worlds” situation (see Figure 10.1): fewer, more congested roads than in equivalent US cities (on the vertical axis); and less developed, slower public transport networks than West European cities (on the horizontal axis). As Figure 10.1 shows, UK cities are less well connected by public transport than western European cities, and less well connected by roads than American cities.

Figure 10.1: Area accessible by road and public transport, UK, US and Western European cities

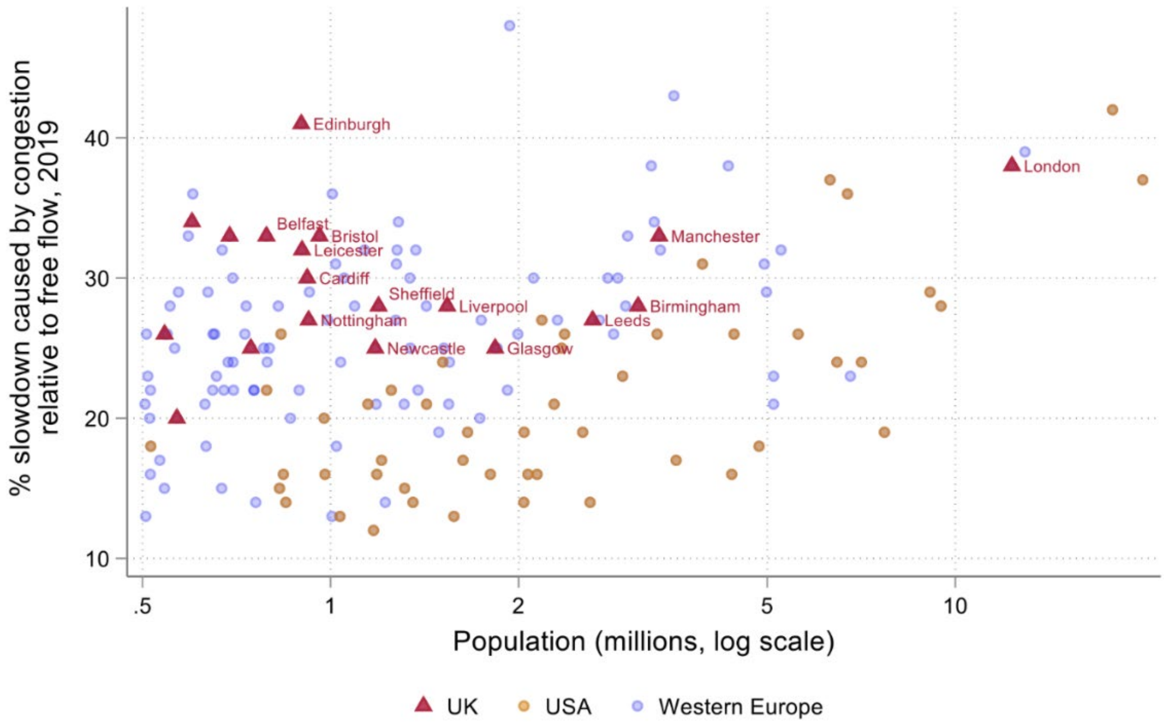


Source: Conwell et al. (2022).[10] Estimates calculated from Google Maps, on Wednesday 8:30am.

This problem is exacerbated by the relatively low density of British metropolitan areas compared to international peers.[11]

We can also demonstrate that this low stock of infrastructure bites in British cities, holding back economic activity, by looking at rates of congestion. Congestion indicates latent, unmet demand for transport infrastructure, as firms and workers are prepared to bear the cost of time stuck in traffic, or the discomfort of an over-crowded train. As Figure 10.2 shows, we find that the UK's roads – hosting 76% of commuters[12] – are more congested than their peers.

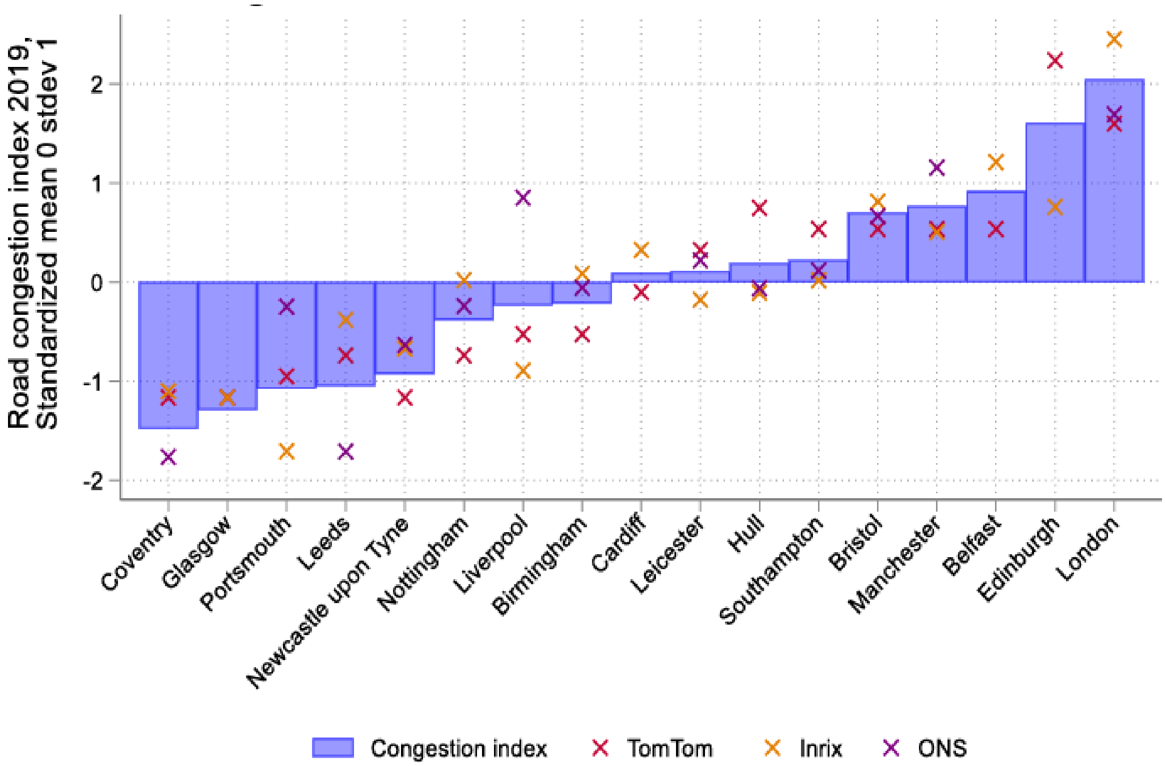
Figure 10.2: Road congestion in UK, US and Western European cities



Source: TomTom 2021 Congestion Index, OECD.

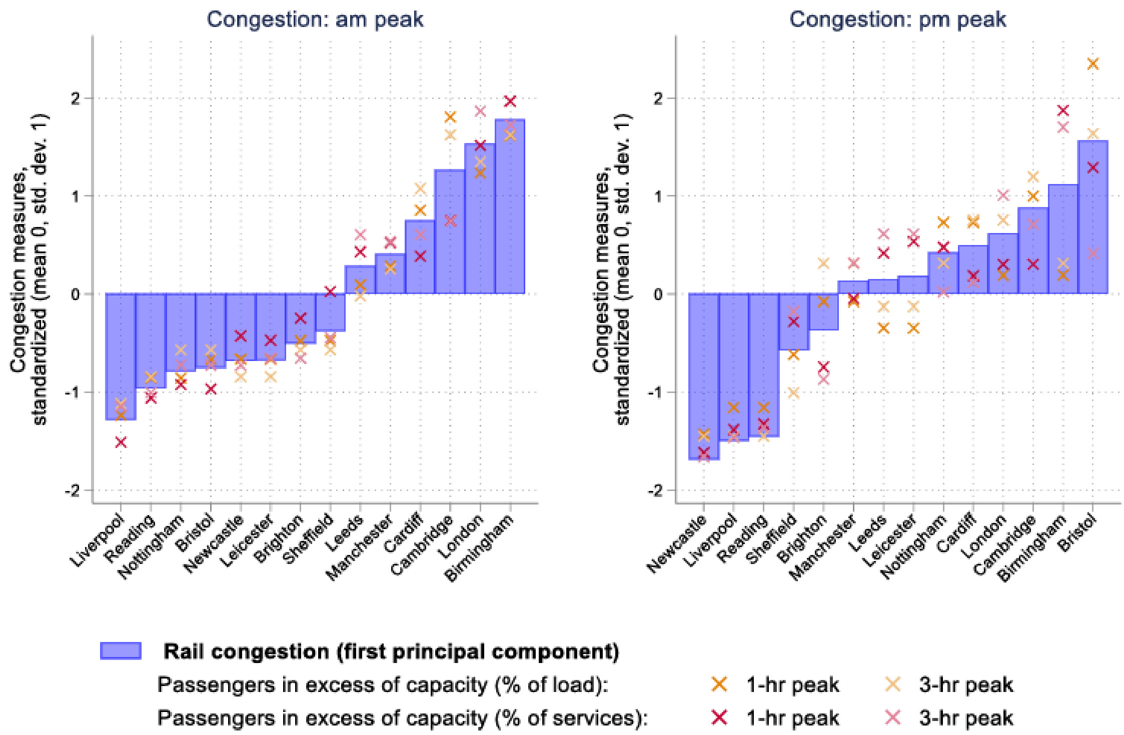
As the different positions of UK cities on the horizontal access above shows, there's also place-by-place variation in levels of congestion – which go well beyond London and the South East. We demonstrate this again in Figures 10.3 and 10.4 below, based on composite indexes measuring city-level congestion for road and rail.

Figure 10.3: Road congestion in UK cities, 2019



Source: TomTom, INRIX, Department for Transport Congestion Statistics

Figure 10.4: Rail congestion in cities in England and Wales, 2018-19



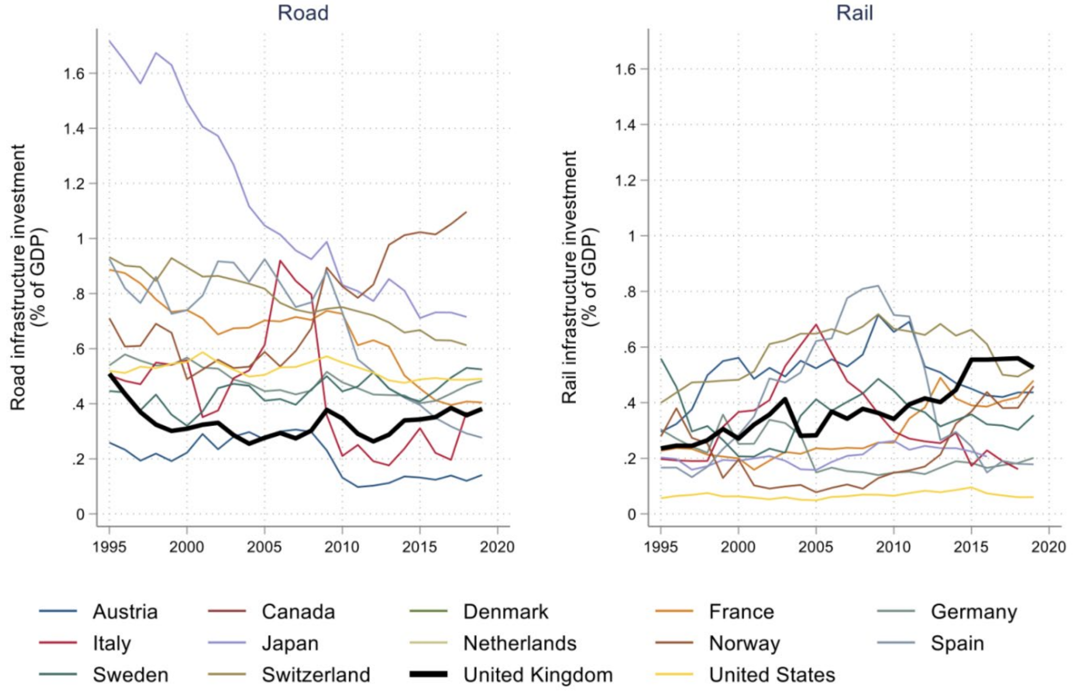
Source: Department for Transport Rail Passenger Use Statistics

Finally, there are hidden costs due to the low *reliability* of infrastructure in some parts of the country relative to others. Office for Rail and Road data on passenger rail performance also reveals a regional divide in the *reliability* of rail as well as its availability, with Southern train operating companies (as well as the more distinct MerseyRail and ScotRail networks) performing significantly better than other rail companies serving the North and Midlands.[13]

National and regional performance today reflects the spending choices of the past

How did we end up here? As in other forms of infrastructure, the UK has spent relatively little on transport in recent decades (Figure 10.5).

Figure 10.5: Transport investment as a share of GDP across countries, 1995-2019



Source: OECD

Road investment in particular has been among the lowest of any industrialised economy over the last three decades according to OECD data: the UK spent an average of 0.3% of GDP per year on road infrastructure investment over 1995-2020, compared to 0.5% in Germany and the United States, and 0.65% in France.[i]

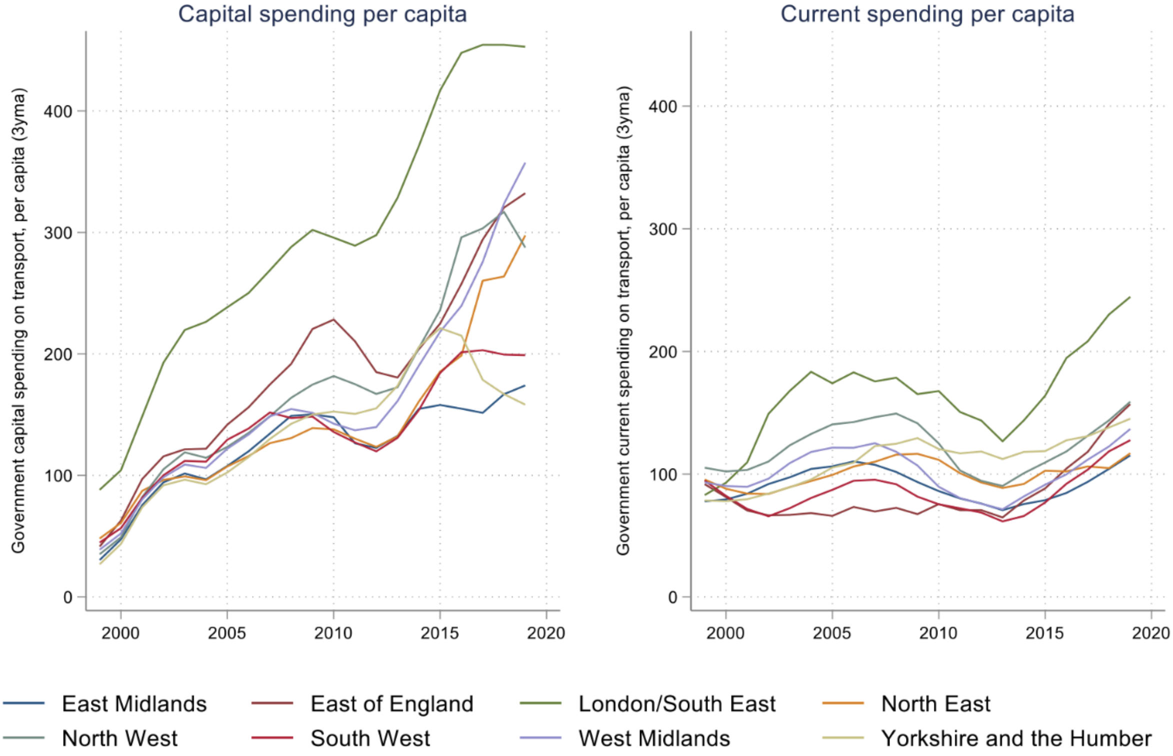
If the UK had spent the same share of GDP on road infrastructure as France over the past quarter century, the additional spending would have been the equivalent of ten extra Elizabeth-line scale projects.[14]

What money has been spent in recent decades, including the recent surge in rail spending, has gone disproportionately to London and the South East (Figure 10.6).

---

[i] Part of this discrepancy is likely a result of the UK's relatively small landmass, meaning fewer kilometres of road are required to connect the population in an equivalent fashion. Germany for example has about 50%. larger landmass than the UK, as well as around 50% more kilometres of road (data from statistikportal.de and the UK government road length statistics).

Figure 10.6: Transport spending per capita across English regions



Source: Office of National Statistics, Country and Regional Public Sector Finances Expenditure Tables

Taken together, then, the UK is building too little transport infrastructure. That is holding back growth, though precisely how it does so may vary by location. Some places – Bristol, Cambridge, Edinburgh – face London-style levels of congestion, suggesting their creaking transport has failed to keep pace with wider economic transformation (as some argue London's had in the 1990s).[15] In other places – Belfast, Cardiff, Birmingham – poor infrastructure sits alongside relatively unproductive economies, as one of several barriers to growth or the source of a potential "transport trap" preventing city centre economies from taking off.

But simply raising public spending on infrastructure risks waste and political challenge

Rachel Reeves is right to stress that Labour could act to reduce the cost of new infrastructure, and to make developments more attractive to local communities by capturing more of the value of infrastructure locally.

Such reforms could help the next government do more with the resources they have available and help avoid the political storms that would be triggered by cutting projects in the South of England to fund compensatory projects elsewhere.

Therefore, a broader policy programme would consider:

1. **Reforms to lower the cost of infrastructure delivery:** recent research from Britain Remade[16] and others finds that per-unit costs of transport delivery are between two to six times as expensive in the UK as for continental peers. Costs could be brought down by pursuing smaller scale, less complicated projects; streamlining the planning system; and increasing investment in public and private development capacity and capabilities.
2. **Tailoring transport to local needs:** The optimal balance of spending (on rail and road, 'transformative' or 'incremental' projects, or capital and current spending) will vary place by place. For instance, where road congestion is more of a constraint than rail, and where congestion is severe, there may be case for investing more heavily in bus subsidies to get cars off the road with the existing infrastructure. A more granular understanding of how challenges vary across the country, through partnership with devolved institutions, could therefore unlock value.
3. **Linking transport infrastructure into a spatial strategy for regions or the country:** the limited effective city size of UK cities is only partly a result of the limited scope of transport networks – it is also partly driven by low housing density relative to peer European cities. This suggests that improvements to transport infrastructure may need to come alongside increased housing density to fully reap the benefits of agglomeration.

Infrastructure is pivotal, but given the scale of the UK's challenges, we should be modest about what infrastructure alone can deliver

Infrastructure investment alone will only go so far in shifting the trajectory of an urban area, or a nation. The OECD estimates our core cities are 20-30% below the effective city size of peers in other countries. Even if we could create "normal" agglomeration effects in UK cities,[ii] we would close a small fraction of the productivity gap between our lagging and leading urban areas, and between the UK and peer countries.

Infrastructure will be a necessary part of any plan for growth in the UK in the 2020s, but it will not be sufficient. Labour will need to be able to tell a story for each region and nation, setting out how infrastructure investment complements that place's economic opportunities and supports parallel investment in skills, innovation, and on the demand-side.

[ii] With an average estimated agglomeration elasticity being 0.046 (or, put differently, a doubling of effective city size is associated with a 4.6% rise in productivity), from Graham, D J, and S Gibbons (2019), "Quantifying Wider Economic Impacts of Agglomeration for Transport Appraisal: Existing Evidence and Future Directions", Economics of Transportation 19: 100121.

[1] https://time.com/6330317/rethink-infrastructure-essay/

[2] https://www.economist.com/britain/2024/01/04/britain-needs-an-unprecedented-expansion-of-the-electricity-grid

[3] https://www.productivity.ac.uk/research/macroeconomic-perspectives-on-productivity/

[4] Stansbury, A, Turner, D, and Balls, E (2023), “Tackling the UK’s regional economic inequality: binding constraints and avenues for policy intervention”, *Contemporary Social Science* 18(3-4).

[5] Duranton, G and Puga, D (2004), "Micro-foundations of urban agglomeration economies," in: J. V. Henderson & J. F. Thisse (ed.), *Handbook of Regional and Urban Economics, edition 1, volume 4, chapter 48*, pages 2063-2117 Elsevier.

[6] Rice, P, A J Venables, and E Patacchini (2006), “Spatial Determinants of Productivity: Analysis for the Regions of Great Britain”, *Regional Science and Urban Economics* 36(6): 727–52.

[7] See e.g. Sanchis-Guarner, R, T Lyytikäinen, H Overman, and S Gibbons (2017), “New Road Infrastructure: The Effects on Firms”, VoxEU.org, 27 July.

[8] Coyle, Diane, and Marianne Sensier. 2020. ‘The Imperial Treasury: Appraisal Methodology and Regional Economic Performance in the UK’. Regional Studies 54 (3): 283–95. https://doi.org/10.1080/00343404.2019.1606419.

[9] Özgüzel, C (2020), “Agglomeration Economies in Great Britain”, OECD Regional Development Working Papers 2020/04.

[10] Conwell, L, F Eckert, and A Mushfiq Mobarak (2022) “More Roads or Public Transit? Insights from Measuring City-Center Accessibility”, Working Paper.

[11] Rodrigues, Guilherme and Breach, Anthony. 2021. ‘Measuring Up: Comparing Public Transport in the UK and Europe’s Biggest Cities’. Centre for Cities. https://www.centreforcities.org/wp-content/uploads/2021/11/Measuring-UpComparing-Public-Transport-in-the-UK-and-Europes-Biggest-Cities.pdf.

[12] ONS 2017 Commuting to Work database.

[13] https://dataportal.orr.gov.uk/statistics/performance/passenger-rail-performance/, tables 3123 and 3133.

[14] The cumulative real terms value of 0.35% of UK GDP from 1995-2020 was just over £180bn; the final cost of Crossrail was around £18.5bn.

[15] Turner, D., Weinberg, N., Elsden, E. and Balls, E. (2023), “Why hasn’t UK regional policy worked? The views of leading practitioners”, Mossavar-Rahmani Center for Business and Government Associate Working Paper No. 216.

[16] https://www.samdumitriu.com/p/britains-infrastructure-is-too-expensive

CHAPTER 11 – LEVELLING UP

Henry Overman
Professor of Economic Geography
London School of Economics & Political Science

The mission

> *Labour's first mission in government will be to: Secure the highest sustained growth in the G7 – with good jobs and productivity growth in every part of the country making everyone, not just a few, better off.*

The challenge

If Labour wins the next election they will inherit several interlinked levelling up challenges. Setting aside the most trivial – the inevitable search for a new name for the objective that would come with a change of government – this piece will focus on three of those challenges. Two are economic: the large and persistent spatial disparities in productivity and in incomes. The third is broader: the sense that too many places have been 'left-behind' as prosperity has become increasingly spatially concentrated.

On productivity, the headline facts are clear: disparities in productivity are large.[1] In 2019, London produced £76,000 of gross value added per job, more than twice that produced in Powys and Torbay. These spatial disparities are also persistent. London's productivity was 40% above the national average in 2002 and 50% above in 2019. By contrast, Powys and Torbay were 20% less productive than the national average in 2002 and were 30% less productive than average in 2019.

Over the past twenty years, few areas have seen large changes in their relative positions – productivity disparities increased slightly in the decade up to the financial crisis and have been broadly stable since. These changes were mostly due to a small number of the best-performing areas pulling away and a handful of struggling areas falling even further behind.

Disparities in income are similarly large and persistent. Economic stagnation in some areas, combined with prosperity in others, has contributed to the sense that places are being 'left behind'. The effects of government austerity – which reduced individual benefits and spending on public services – fell particularly hard on these places, exacerbating the problems generated by low incomes and economic decline.

Labour thinking on re- and pre-distribution

Key aspects of this problem – on public spending and on incomes – should be bread and butter to Labour because they involve redistributing from richer to poorer households. Increased public spending – assuming this is a Labour ambition, if not a detailed commitment – will start to undo the damage done by the cuts of the last decade, especially if funding formulas benefit more disadvantaged areas. And the damage done has been substantial[2], which is why, I suspect, the current government emphasises levelling up spending that partially offsets the cuts and tries to improve 'pride in place' in some hard-hit places – although this may also have been a sticking plaster, given the limited budgets involved.

Redistribution via more progressive taxation and a more generous benefits system – where similar caveats on spending commitments apply – will also help because spatial income inequalities are partly the spatial manifestation of individual ones. Analysis for the Deaton inquiry shows that who you are matters far more than where you live for explaining wages and employment.[3] Graduates do better; families reliant on benefits, less educated workers, and those with mental and physical health problems struggle, everywhere. Redistribution will help.

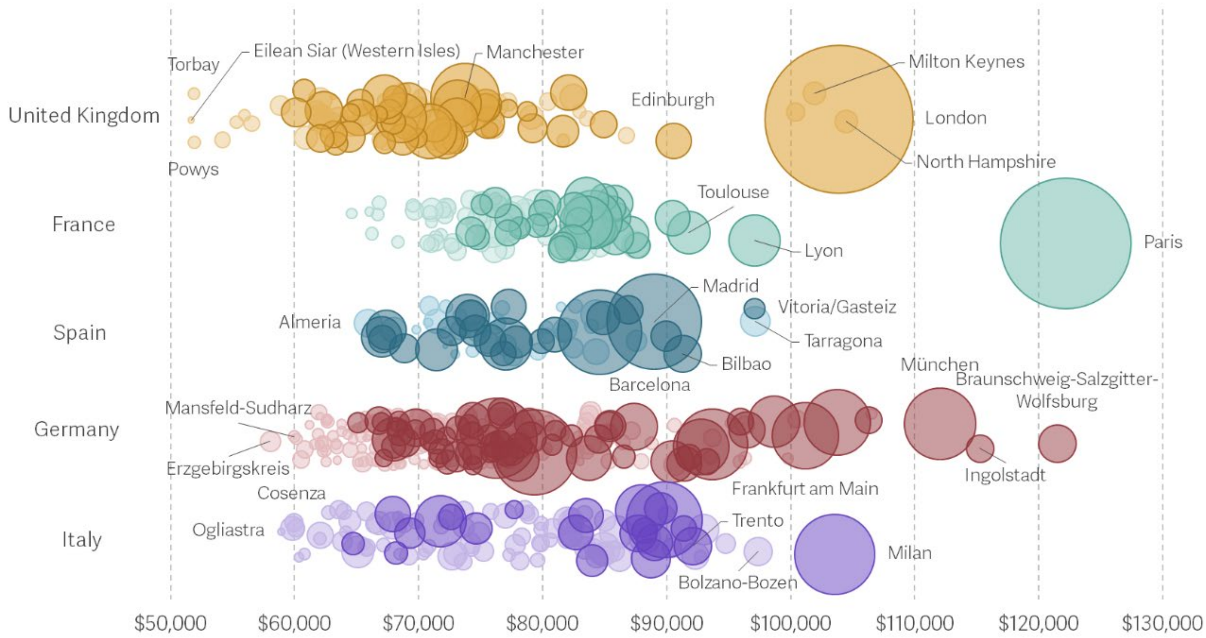
Aspects of the problem that are amenable to pre-distribution – changing what happens in the labour market or wider market economy to benefit poorer households – also fit well with traditional Labour thinking. The minimum wage and the broader good jobs agenda are good examples. Less obvious, but as important for real incomes, are Labour plans for housing. Redistribution, for example by re-establishing the link between Local Housing Allowance and local rents (every year, not just one-off as in the 2023 Autum statement) helps affordability at the bottom of the income distribution.[4] But increased housing supply is needed to address the more general problem. And on this, Labour's proposals on local plans, a strategic review of the green-belt, and new towns appear to be the only game in town.

Labour thinking on productivity and growth

So far, so good. But now we come to the much trickier question of how to 'secure the highest sustained growth in the G7' at the same time as achieving 'productivity growth in every part of the country'. Set aside the silliness of 'the highest' – which reflects the kind of British exceptionalism thinking that helped get us into this mess – the problem with the faster/everywhere formulation is that it doesn't reflect the market forces driving our economic geography and the resulting trade-offs that policy must face.

Two figures help explain the problem. The first, Figure 11.1, illustrates spatial disparities in productivity in the UK, France, Germany, and Italy.[5] Ignoring the underlying market forces, the faster/everywhere formulation looks unproblematic. Shifting the entire distribution of places to the right would narrow the nation's productivity gap with France and Germany (and widen it with Italy). There are national policies that could help achieve this – we highlight many of them in our recent Economy 2030 inquiry – including more efficient and equitable taxes, changes to corporate governance, greater investment in further education, reduced policy uncertainty, reforms to the planning system and devolution of powers to local areas.[6] These changes aren't politically easy, but progress on them is feasible within the lifetime of a parliament.

Figure 11.1: Productivity disparities across countries – GVA per worker (PPP adjusted), by country and area: 2018

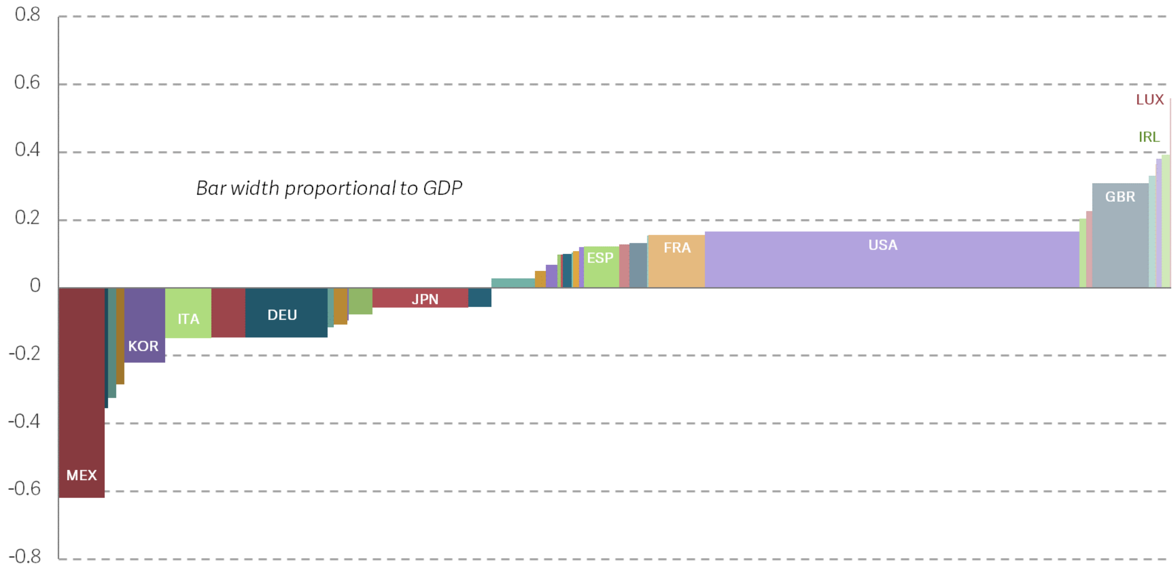


Source: Economy 2030 Inquiry Bridging the Gap, based on analysis of OECD Regional Economy Database.

Notes: 2018 levels of GVA per worker across areas for our set of comparator countries (adjusted to allow for comparability across different currencies). Metro areas are shown in darker bubbles. Foreign and extra-regio territories have been dropped. Bubbles proportional to number of workers in each area.

Unfortunately, the market forces that drive our economic geography complicate things. To understand the challenge, a useful starting point is Figure 11.2 which highlights our economic strengths – the UK is a services "superpower", exporting more services than any country in the world, save the US.[7] As Labour notes in its growth mission launch paper: "British firms excel in tech, in life sciences, and in the cultural industries. We are the second largest exporter of services in the world, and home to Europe's leading financial sector".[8]

Figure 11.2: Revealed comparative advantage in services by country, 2019



Source: Economy 2030 Inquiry Enduring Strengths, based on analysis of data from Harvard Growth Lab, Atlas of Trade Complexity; OECD-WTO, Balanced Trade in Services; IMF, World Economic Outlook 2022.

Notes: The vertical axis measures a country's Revealed Comparative Advantage in services, with a positive number meaning the country is specialised in services.

The UK's large and persistent spatial disparities illustrated in Figure 11.1 are, in part, a consequence of this specialisation. Our specialism makes productivity gaps inevitable because tradeable service sectors – such as law, design, accountancy, and creative industries – benefit considerably from dense locations with a large pool of highly educated labour. No surprise that Germany with its specialisation in advanced manufacturing, has more spatially even economic development. And given the strong persistence of economic strengths we should not expect the underlying patterns of specialisation to change soon.[9] 'Be like Germany' is not a sufficient basis on which to develop an economic strategy for narrowing productivity disparities the UK in the 2020s.

Labour thinking on tricky trade-offs (what role for London and the South East)?

Given our specialisms, improving UK productivity means bigger high value-added services sectors, and a wider range of cities succeeding with them. Doing this means being honest about the implications – more uneven development on some dimensions, not less – and the scale of change required.[10]

On scale, note that the changes required involve large amounts of public and private investment: French workers, for example, use over 40% more capital than UK workers, enough to account for the whole productivity gap with the UK.[11] For a more-or-less fully employed economy like the UK's, increasing investment at more than a glacial pace will mean less consumption, or more overseas borrowing.[12] This highlights difficult macro-economic choices that a move to a higher investment path will entail.

The scale of the investment means an economic strategy also faces important spatial trade-offs. First, how quickly do we want national productivity to improve relative to spatial disparities narrowing. Second, which places to invest in most aggressively (since not all places can be prioritised simultaneously). Estimates for the Economy 2030 inquiry suggest that reducing Greater Manchester's productivity gap with London to 20% would require a £2.1 billion investment in helping build 126,000 additional homes; an extra £2 billion of transport funding up to 2032 (on top of £3 billion already committed); enough business investment to increase GM's business capital by 15% (a £30 billion aggregate increase) and an increase in its graduate workforce by as many as 180,000 workers.[13]

Would a more equal distribution of investment help or hinder national catch-up? No one knows for sure. Getting Greater Manchester growing faster would help, although it is likely that investment in the London metro area – a highly productive area that accounts for 25% of UK employment – to increase its productivity towards levels seen in Paris, will be needed to narrow the gap between the UK and other countries. And investment is not the only area where we face such trade-offs. One argument for planning reform, for example, is that it means more housing in our most successful areas allowing people to move to good jobs and opportunities, rather than vice-versa.

My feeling is that this brings us back to a long running problem that Labour has been grappling with since at least the mid-1990s. To what extent do you let London and the South East drive economic growth and fund public services and investment? Given our recent poor economic performance, and the desperate need for additional taxation to fund spending – including for levelling-up – my view is that this must be the immediate priority. Easy for an academic to say, tricky for any political party.

One politically more palatable option might be to compromise and let some of our other large cities, such as Manchester, play a similar role. Unfortunately, I don't think this removes the London and the South East question. The productivity gaps, as illustrated in Figure 11.1, are just too large to pretend that these other cities can generate enough growth in the future that we can forget about London. It also opens up the question of which second cities to prioritise? The Levelling Up White Paper dodged this question by pretending that we could have a globally competitive city in every region. A realistic economic strategy would need to do better. If we were to prioritise one of these other cities, Greater Manchester is the strongest contender – its recent economic performance is relatively good, local governance is the best-developed outside of London and local leadership has historically been willing to grapple with the difficult within city trade-offs that supporting significant growth would require.

What about other cities, towns, and rural areas – in short, everywhere else? In part, the answer is that growth in London and Manchester will help pay for the funding of better benefits, public services and investment that is needed in these areas. In part, this is redistribution, which will increase incomes and improve the performance of public services that many people rely on. But this isn't just a handout – improved infrastructure and better education and health outcomes in poorer areas should improve productivity – another example of pre-distribution, changing what happens in the labour market or wider market economy to benefit poorer household. Lots of the national policies I highlighted above could also help increase productivity across the UK.

None of this is meant to distract from my central point – an economic strategy requires realism about where we are and must confront the trade-offs that we face. The other option is to pretend that these trade-offs don't exist. To some extent, this is the path of least resistance and the one that is arguably being followed by current and recent Conservative governments. That works fine if the objective is low level, spatially targeted redistribution to partly offset the impact of austerity and the electoral consequences of so many places continuing to feel that they have been left-behind. Sticking with this approach is tempting, politically, but not conducive to developing an economic strategy that is serious about improving productivity, securing more good jobs, and achieving higher growth.

[1] Paul Brandily et al., 'Time for a Strategy to Boost Productivity in Manchester and Beyond', *LSE Politics and Policy* (blog) (The London School of Economics and Political Science, 2 October 2023), https://blogs.lse.ac.uk/politicsandpolicy/time-for-a-strategy-to-boost-productivity-in-manchester-and-beyond/; Paul Brandily et al., 'Bridging the Gap: What Would It Take to Narrow the UK's Productivity Disparities' (Centre for Economic Performance & Resolution Foundation, June 2022), https://economy2030.resolutionfoundation.org/wp-content/uploads/2022/06/Bridging-the-gap.pdf.

[2] Centre for Cities, 'Cities Outlook 2019', 28 January 2019, https://www.centreforcities.org/wp-content/uploads/2019/01/19-01-28-Cities-Outlook-2019-Full.pdf.

[3] Henry Overman and Xiaowei Xu, 'Spatial Disparities across Labour Markets' (Institute for Fiscal Studies, 2 February 2022), https://ifs.org.uk/inequality/spatial-disparities-across-labour-markets/.

[4] Alex Clegg, 'A Temporary Thaw' (Resolution Foundation, 12 September 2023), https://www.resolutionfoundation.org/app/uploads/2023/12/A-temporary-thaw.pdf.

[5] Brandily et al., 'Bridging the Gap: What Would It Take to Narrow the UK's Productivity Disparities'.

[6] Resolution Foundation and Centre for Economic Performance, 'Ending Stagnation: A New Economic Strategy for Britain'.

[7] Joshua De Lyon et al., 'Enduring Strengths: Analysing the UK's Current and Potential Economic Strengths, and What They Mean for Its Economic Strategy, at the Start of the Decisive Decade' (Centre for Economic Performance & Resolution Foundation, April 2022), https://economy2030.resolutionfoundation.org/wp-content/uploads/2022/04/Enduring_strengths.pdf.

[8] Labour, 'Secure the Highest Sustained Growth in the G7'.

[9] De Lyon et al., 'Enduring Strengths: Analysing the UK's Current and Potential Economic Strengths, and What They Mean for Its Economic Strategy, at the Start of the Decisive Decade'.

[10] Brandily et al., 'Time for a Strategy to Boost Productivity in Manchester and Beyond'.

[11] Juliana Oliveira Cunha et al., 'Business Time: How Ready Are UK Firms for the Decisive Decade?' (Resolution Foundation, 15 November 2021), https://economy2030.resolutionfoundation.org/reports/business-time/.

[12] Oliveira Cunha et al.

[13] Paul Brandily et al., 'A Tale of Two Cities (Part 2): A Plausible Strategy for Productivity Growth in Greater Manchester and Beyond' (Centre for Economic Performance, Resolution Foundation & Centre for Cities, September 2023), https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/09/A-tale-of-two-cities-part-2-Manchester.pdf.

CHAPTER 12 – FISCAL AND MONETARY POLICY

Jagjit Chadha
Director
National Institute of Economic and Social Research

> *I come from a generation of economists who were schooled in the view that monetary and fiscal policy sets the marginal outcomes in the economy. And if that is still the case, these policies have a lot to answer for given the state of the British economy in this election year: low growth, widening regional disparity, and a sustained period in which price stability has been undermined. Any incoming government will have to provide a clear and credible response to the continuing failures of demand management that have peppered us since the financial crisis and prioritise the careful construction a new settlement. In short, this means a re-focus of central banking on the central and singular question of price and monetary stability and adopting a growth agenda for fiscal policy that does not scare the markets. The latter is more difficult to negotiate than the former.*

Generally monetary policy controls nominal demand through the choice of the path of interest rates and fiscal policy provides public goods and can decide on the extent of income and wealth inequality, subject to choosing the magnitude of tax. Within that separation there are not only a large number of policy choices, as there are always alternatives, but also scope for considerable interactions between the two: as our £895 billion Quantitative Easing (QE) programme illustrates so clearly. Under which lower borrowing costs seemed to trace out a demand curve for public debt and has left us with a large fiscal headache. Of course, as we learnt even more directly to our national cost during the September 2022 mini-budget, changing the mix should be done thoroughly and carefully with the support of our economic institutions. In short, we cannot understand the stance of either leg of demand management without recourse to the other. We will always need careful co-ordination with the oversight of independent institutions.

While the objective of monetary policy for price stability is clear and has a national consensus, the objective of fiscal policy is not and does not. It would be useful for any incoming government to reassert immediately their support for an operationally independent Bank of England to pursue an inflation target consistent with price stability. But since the explicit adoption of fiscal rules and the establishment of the Office for Budget Responsibility (OBR) in 2010, we have conflated the objective for fiscal policy with the instrument. The instrument is the level of debt, and the objective should be some notion of national well-being summed across the whole population. Once we mistakenly adopted the objective in terms of debt alone, well-being played a distant second best. And the deflationary impetus set up by the path of fiscal consolidation since 2010 has made it harder for monetary policy to escape the zero lower bound and so encourage the more efficient deployment of capital. It also meant that those with assets benefited from large increases in their value, that has acted against labour mobility and harmed intergenerational equity. At least following the recent inflation shock, monetary policy is in the right place and the QE programme is finally being dismantled.

But how do we shift the focus on fiscal policy away from instrument obsession? There are two specific problems, concerning initial conditions and national requirements. The first is that we have an extraordinarily high level of public debt as a share of income for peacetime, which has been ratcheted up over this extended period of economic crisis. The costs of borrowing, as well as the sensitivity to those costs have escalated. Secondly, it is clear that not only is there is a national demand for the better provision of many public goods but also that we are suffering from a shortfall in the quality of our public infrastructure relative to our international peers.

If we respond to the latter without convincing those who hold our bonds that the economy can easily service those bonds, our room for manoeuvre can quickly disappear. We therefore need to simplify the tax system and aim to raise revenues in the medium term in line with total managed expenditures. At least in the short run, that will imply higher taxes on some households. At the same time we need to convince domestic and international investors that borrowing for public investment will be well targeted and managed in manner to support long term growth and create the kind of stability that will bring in complementary private sector investment. (It is tempting here to think about establishing a substantive development bank.) And it is this investment that will then ultimately bring about higher paid jobs, reflecting an improvement in productivity.

But reforming tax systems and issuing bonds for growth will not be easy, and progress will be uncertain. There will certainly be one option presented by HM Treasury to an incoming government, which will be fiscal conservatism with a focus on reducing total managed expenditures and improving public sector productivity, and perhaps using some of the resulting fiscal space to provide a limited and sporadic increase in public investment. It may even be presented as the case that “There Is No Alternative”. But such a strategy, which I might describe as piecemeal, is unlikely to work. It has not worked since 2010.

A fundamental change in the mix will require a new government to pin its plans and movement towards its goals in a clear annual statement about the State of the Nation. Such an address will allow us to track performance and understand how taxes and bonds are used to support national well-being. Economic and social research can be deployed and encouraged to understand and measure developments at the national and regional level and foster a more honest debate about our national progress. The best way of delivering such a change in national strategy will be to set this plan out in the run-up to the election so that it can be delivered on the basis of a mandate. At present both parties are mired in “Budgetarian” thinking of fixed envelope of expenditure. We cannot allow the Whitehall to default to the status quo.

An expansion of the aims of fiscal policy will also require a careful re-wiring of the remit of the OBR, which could be developed into an institution that provides scenarios to explore the relative merits of alternate policy choices rather than just providing twice yearly examination marks. Such analysis can guide the paths of revenue and expenditure as we face the risks from an ageing population, increasing health and social care, and the need to jump start the green transition. It could convince financial markets, but more importantly the people, that we are engineering solid economic progress. The current set up, while valuable, has encouraged a sole focus on public debt levels and has been associated with a secular decline in public sector net worth: it has not prompted a build-up of national assets, if anything the reverse.

Without a rethink, the UK economy seems likely to remain in the doldrums, which implies very little material progress for much of the population. It might be that we can spin such an outcome as reasonable given the economic scarring and supply side vulnerability following Brexit. But it does increasingly look like the absence of productivity improvement is itself a function of poor economic management at the firm, town, regional and national level – what I have called elsewhere in the small and in the large. An exhausted body politic and a lack of firm direction has contributed to our continuing poor economic performance. The question we face is whether an incoming government will have the foresight to act and commit itself to a better future before we end up in a full-blown fiscal crisis with more austerity imposed by external forces.

CHAPTER 13 – COHESIVE CAPITALISM

Sir Tim Besley
School Professor of Economics & Political Science
London School of Economics & Political Science

Building a strategy

> *A growth strategy requires a vision of the economy and society that it seeks to promote. Despite having lived through a major financial crisis and a global pandemic, little progress has been made by any UK political party in articulating this vision or sense of common purpose. After the World War II, the imperative to recover from the war led a group of advanced liberal democracies to seek out a new political and economic model. This model was grounded in a commitment to a democratic political system with protections for individual rights, a market-based economy supported by effective regulation to maintain competition and address market failures, and a supportive state committed to social protection and widening opportunity. It was reinforced by an international economic order designed to facilitate trade and promote shared liberal values.*

Growth expanded human capabilities and freedom.[1] Opportunities were enhanced through education and expanded access to universal public services. This led to a period of considerable social and economic progress and cemented the case for a broadly democratic capitalism even when large parts of the globe still rejected that model. The cohesive states that emerged fostered a sense of common purpose built on liberal political institutions and a focus on sharing the benefits of economic prosperity.[i] It was a needed break with the past, given the immediate pre-war experience where many democratic institutions proved fragile, and it ushered in a new form of *cohesive capitalism*.

Of course, the model was not perfect and had critics from both sides of the spectrum. Some viewed the model as still too market-oriented; there were continuing plans to increase the scope of state intervention through the "common ownership of the means of production, distribution and exchange" as expressed in the Labour Party's clause 4. Others regarded the model as excessively reliant on the competence of the state to manage the economy. A particular bone of contention was the extent to which the state could competently manage productive activities and operate Keynesian policies in financially responsible ways.

[i] To reinforce this point, Besley, Persson and Dann show, using a range of indicators, that a distinctive group of states emerged to form a cluster where repression was held in check and expanded state capacities supported economic growth and opportunity: https://cepr.org/publications/dp16256.

The neoliberal consensus

It was the economic turbulence of the 1970s that gave an entrée for a neoliberal vision that has become the playbook for economic policymaking for more than a generation and which has broadly been adopted by both main parties. Thatcherite ideas have left an indelible mark on the policy landscape through their promotion of flexible labour markets, privatisation, and a reduction in state subsidies to industry. The economy has changed dramatically in the period of neoliberal economic management with a shift away from manufacturing towards a service-oriented economy. Many business services such as finance, law and other aspects of commerce are world-leading, making the UK one of the largest exporters of services. And, although much debated, this new approach paid dividends in terms of productivity growth leading to a period of convergence to productivity levels in comparator nations such as France, Germany, and the US, after a prolonged period of falling behind.[2]

But there were downsides too, including a sharp rise in inequality in the late 1980s that has largely persisted since. Regional inequalities have also grown, particularly where there were concentrated declines in industries that closed during this period of restructuring. Successive governments have failed to tackle long-standing deficiencies in educational attainment at the lower end of the distribution even while the university sector has thrived. Infrastructure investment did not keep pace with the needs of a modern economy, suffering from indecision and delay. And long-standing inadequacies in access to finance to support growing businesses have remained. Governments consistently failed to encourage adequate investment in housing which has increasingly shifted wealth towards homeowners, entrenching intergenerational inequalities (see Paul Cheshire's chapter). After some initial efforts towards simplification under Nigel Lawson, the tax system, whether on earned income, treatment of pension saving or housing, has become ever more complex and incoherent. Reorganization of public services has been episodic and has lacked an underpinning vision of what the state can feasibly deliver. The structure of governance is a sclerotic mix of over-centralization due to Whitehall's deep mistrust of local government and fragmentation of the powers that exist.

A new narrative

Ensuring an effective state means investing in three core state capacities: fiscal, legal, and collective capacity. Building fiscal capacity requires fundamental tax reform to make sure that we have the revenues needed to support spending.[ii] There is an imperative to articulate our collective needs and to ensure that they are affordable in the long-term. Making this credible requires acknowledging that this will likely involve some hard decisions about priorities. This means understanding better where the responsibility of the state and citizens lies. We need the supportive regulatory and legal structures that will encourage investment in housing, infrastructure, and private businesses. Delays and indecision in planning and implementation by the state fuel cynicism that undermines trust in state institutions. Private investment in infrastructure, for example, will not happen without a clear and decisive articulation of the overarching strategy.

[ii] The ideas in the Mirrlees review remain relevant.

These three elements of state capacities: fiscal, collective, and legal are not separate but are joined. Moreover, they are important enablers of inclusive growth. A fair and efficient tax system that funds a range of core services built on a sense of common purpose allows the benefits of prosperity to be shared. Without a strong private sector, it is infeasible to fund public services. Thus, cohesive capitalism recognizes that growth is only a means.

Growth does not guarantee that people feel valued in their working lives or empowered to make choices. While the market system is a source of empowerment by increasing opportunities in labour and product markets, its legitimacy rests on it being perceived as fair. Market relations may reduce the social ties that have bound communities together and while there have been huge benefits from open global markets, they can be destructive to jobs and communities in ways that have fuelled right-wing populism of a form that many thought had been banished from advanced liberal democracies. While political and economic elites have gained a huge amount from such openness, they have been too ready to dismiss the anxieties felt by some as the views of bigots and deplorables.

The need for political economy

Many economists are fierce critics of neoliberalism. But the voices of economists were rarely listened to when they criticised many of Thatcher's policies. They were similarly ignored when it came to Brexit. But for economic analysis to be effective, the context in which it lands has to be appreciated and understood. Modern *political* economy recognizes that institutions, norms, and values shape which of our policies are likely to be taken up. And there are opportunities for reform; the Labour Party chose to give the Bank of England operational independence in 1997 and the Conservatives created the Office of Budget Responsibility in 2010. Such initiatives can become embedded in policy-making norms; illustrated by the fact that the short-lived Truss administration's failure to consult the OBR undermined the credibility of their proposed budgetary measures.

Cohesive capitalism is rooted in political economy, requiring that the preconditions for effective policy-making are in place. This means building a sense of common purpose. The first phase of cohesive capitalism was heavily reliant on a well-meaning political elite with a largely deferential population. Although there is now a greater opportunity for political participation and all parties have increased their representation of women and some minority groups, there is little political engagement with most members of the population.

The next government will be facing increasingly hard choices with major resource implications. Almost surely, there will be a need for increased defence mobilisation and spending in coming years. Health and social care need to adapt to an aging population. A green transition will require public and private investment on an ambitious scale to reach net zero. New technologies will continue to challenge customary ways of doing business with social, political and economic implications.

To meet such challenges, what is needed are greater levels of cohesion to support policymaking legitimacy and to get citizens to understand the trade-offs that will be faced. This is required to make policies particularly sustainable over the long-term. Shifting policy norms is possible; it was unthinkable to our ancestors that the state would become the primary provider of medical care and old-aged support, but this is now an accepted principle of the social contract between state and citizen.

A new vision of economic policy could seek to engage with citizens rather than policy being imposed by elites. Whether it is deciding on infrastructure priorities, the design of housing communities or priorities for public services, there is scope for greater citizen engagement through new forms of democracy such as citizens' assemblies. This may seem remote from growth policy, but it is not; a new vision for growth requires making hard policy choices and confronting trade-offs.

Lessons for the green transition

An approach to growth based on the cohesive capitalist model needs three core elements: purpose, delivery and finance. To be concrete, I will illustrate these in the context of the challenges of creating a green transition which has the potential to increase productivity *and* improve quality of life. Labour's pledge to spend £28 billion was based on a misguided approach. The focus needs to be on clearly articulated set of strategic goals and a plan for delivery from which financing requirements should follow.

The first pillar is purpose, i.e. creating a sense of national purpose and making the necessary investments and behavioural changes a widely agreed-upon priority. The consensus on the need for a net zero strategy is remarkable, but it was largely based on a shift in elite opinion. The work of the Climate Change Committee showed that this approach was economically feasible without outlandish assumptions about technological change or levels of public investment. But progress has been slow. Comparatively, little effort has been made in how to bring those who are going to live through this transition on board. Without that, the political consensus is likely to be fragile; democracy prevents elites from pursuing strategies that push against the tide of public opinion as we saw in the Uxbridge by-election. Cohesive capitalism in the past was dependent on the actions of well-meaning elites but also required galvanizing public support; the experiences of common sacrifice following the second world war helped to do this and the Conservative Party quickly subscribed to the changes in state capacities and supported them. Although the need for a green transition is urgent, there is a role for a period of consensus building and this must also be realistic since there will be those who will have to make sacrifices for the greater good and dishonesty undermines trust. The narratives that will support this require emotionally intelligent leadership. But it also means thinking far in advance about how to share the burden fairly and put measures in place that recognize this.

The second pillar is delivery. A green transition cannot be owned by any government department or tier of government; it cuts across energy, transportation, housing, taxation as well as local and national government (see Anna Valero's contribution to this volume). Central to building a cohesive approach is creation of the right state capacities that have the institutional power to deliver. We saw this recently in the case of the vaccine program, a national success built on a carefully thought through delivery strategy involving everything from public procurement to volunteers. The task of creating a green transition is much more complex although it can be broken down into deliverable sub-components. Nowhere is this challenge larger than converting home heating to electric heat pumps. Enlisting an alliance of local and central government, energy delivery companies, those who will assist in training workers and rolling out a subsidy plan to ensure a fair transition requires coordination and creation of capacities of the state that are currently fragmented. A scheme that allows customers to lease heat pumps will not only smooth the cost but create opportunities for securitizing the assets. Perhaps this would be a role for a new "public purpose corporation" like Great British Energy but it would require the executive powers to act at pace and avoid the kludgeocracy of government.

The third pillar is finance. But the need for finance flows from purpose, not vice versa. Historically, the state has built fiscal capacity by demonstrating competence that is guided by common purpose. In the past, this was built on warfare, but the post war period created states that moved beyond this so that the peace dividend was ploughed back into public programs.[3] That required building robust state capacities fit for delivering what was needed and a strong sense of purpose. Creating a budget or a financial pledge in terms of pounds or shares of spending in GDP is back-to-front and fails to learn the lessons of history. Some reforms of the existing tax system will help but once the transition is properly underway and the government has articulated a sense of purpose, there will opportunities for private investment. Government has a role to play in de-risking investment, especially when it gets a grip on policy risk and provides a credible strategy that appeals to investors and the wider public.

Pursuing a green transition will bequeath a better world for future generations in the form of a less polluted environment and restored natural capital. This will contribute directly higher living standards as well increasing energy security and lowering energy costs once the transition is complete. But it has to be built in a cohesive way, first building a sense of a common purpose.

[1] Amartya Sen, *Development as Freedom* (New York: Oxford University Press, 1999).
[2] Philippe Aghion et al., 'Investing for Prosperity: Skills, Infrastructure and Innovation', Report of the LSE Growth Commission (Centre for Economic Performance & Institute for Government, 2013), https://cep.lse.ac.uk/pubs/download/special/cepsp28.pdf.
[3] Margaret Levi, *Of Rule and Revenue* (Berkeley, CA: University of California Press, 1989); Charles Tilly, *Coercion, Capital and European States, AD 990-1992* (Oxford: Blackwells, 1990); Timothy Besley and Torsten Persson, *Pillars of Prosperity: The Political Economics of Development Clusters* (Princeton, NJ: Princeton University Press, 2011).