



**LSE**

Growth  
Commission

# Investing for Prosperity

**Skills, Infrastructure and Innovation  
Report of the LSE Growth Commission**

Philippe Aghion  
Tim Besley  
John Browne  
Francesco Caselli  
Richard Lambert  
Rachel Lomax  
Chris Pissarides  
Nick Stern  
John Van Reenen

in partnership with

**INSTITUTE  
FOR  
GOVERNMENT**

CENTRE for ECONOMIC  
PERFORMANCE

**House of  
Commons  
Feb 2013**

# THANKS TO OUR FUNDERS....



Knowledge  
Exchange  
HEIF 5

# SET UP (IN JAN 2012)

IN PARTNERSHIP WITH THE INSTITUTE FOR GOVERNMENT

- Co-Chairs Tim Besley & John Van Reenen
- Financed by HEIF 5 and ESRC
- Commissioners:
  - Philippe Aghion
  - Lord John Browne
  - Francesco Caselli
  - Sir Richard Lambert
  - Rachel Lomax
  - Lord Nick Stern
  - Nobel Laureate Chris Pissarides





# WHY AN LSE GROWTH COMMISSION?

- Focus on long-term structural issues beyond debates about austerity
- Numerous reports on growth. What's different?
  - Focus on evidence (report short but “feeder” reports in detail on website)
  - Commissioner background: academics from UK and overseas, but also business & policy-makers
  - Political economy: why things have not been fixed before? What institutions could be built to last?



THE CASE FOR A BRITISH  
BUSINESS BANK  
SEPTEMBER 2012

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NO STONE UNTURNED



GROWTH  
The National Institute of Economic Research



# INTRODUCTION

- **Optimistic story, UK has many assets**
  - Rule of law, flexible labour market, competition, universities, openness
  - Reversal of relative decline in last 3 decades
- **...But also deficits**
  - Policy instability
  - Growth not inclusive: Inequality
- **Leads to failure of long-term investment**
  - Human capital (especially bottom third)
  - Infrastructure (especially transport & energy)
  - Private investment & Innovation
    - Outcome is low productivity
- **Wanted: A Manifesto for Growth**

# SUMMARY

- **Human Capital**

- Improve teaching through freer entry & more exit
- Flexible ecology to deepen academy system
- Reduce disadvantage by information, inspection, finance

- **Infrastructure**

- New institutional architecture of Infrastructure Strategy Board, Infrastructure Planning Commission & Infrastructure Bank

- **Investment & Innovation**

- Increase retail banking competition
- Business Bank

# **The Economic Story of the UK**

Human Capital

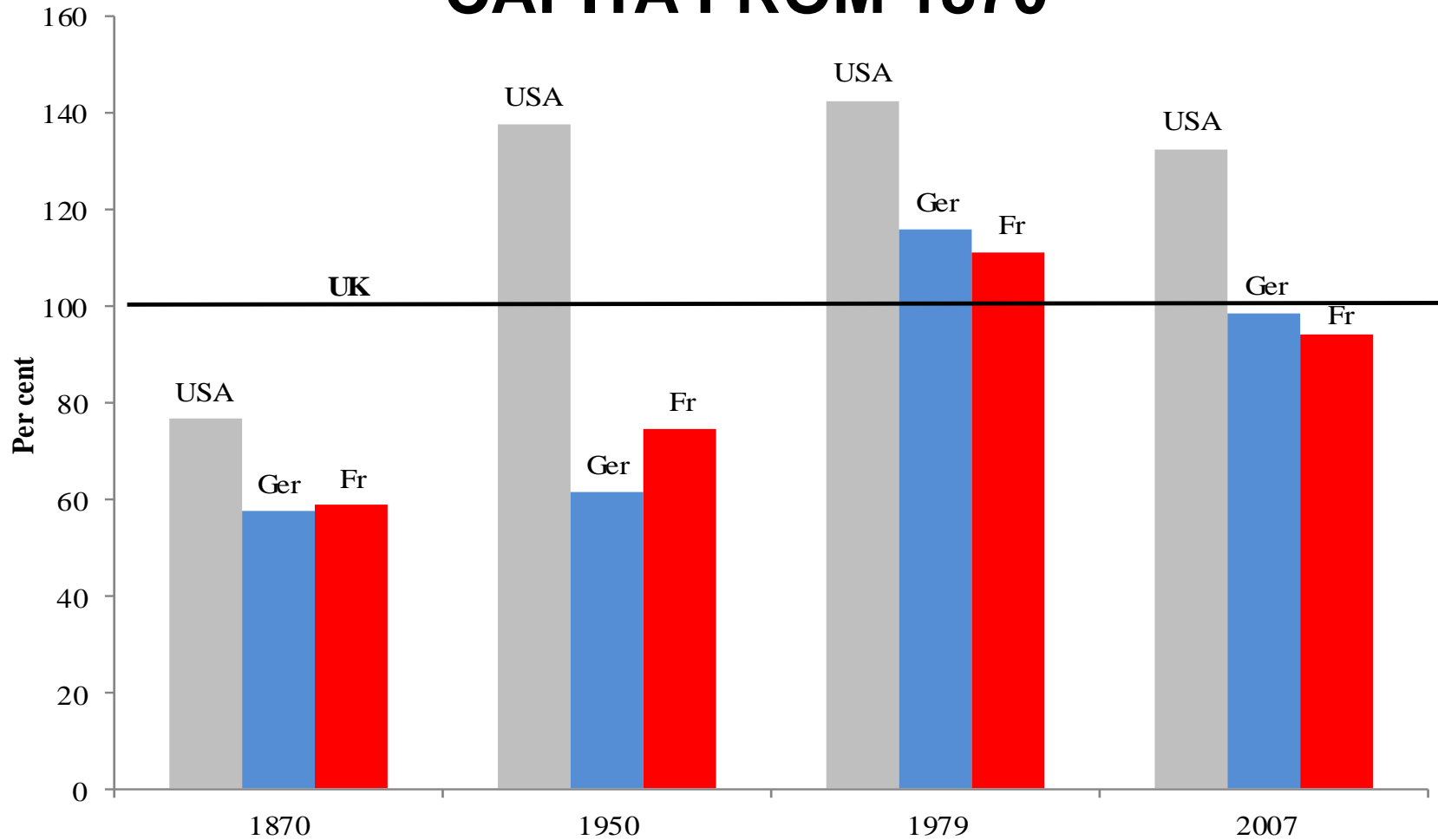
Innovation & investment,

Infrastructure

Measuring Progress

Conclusions

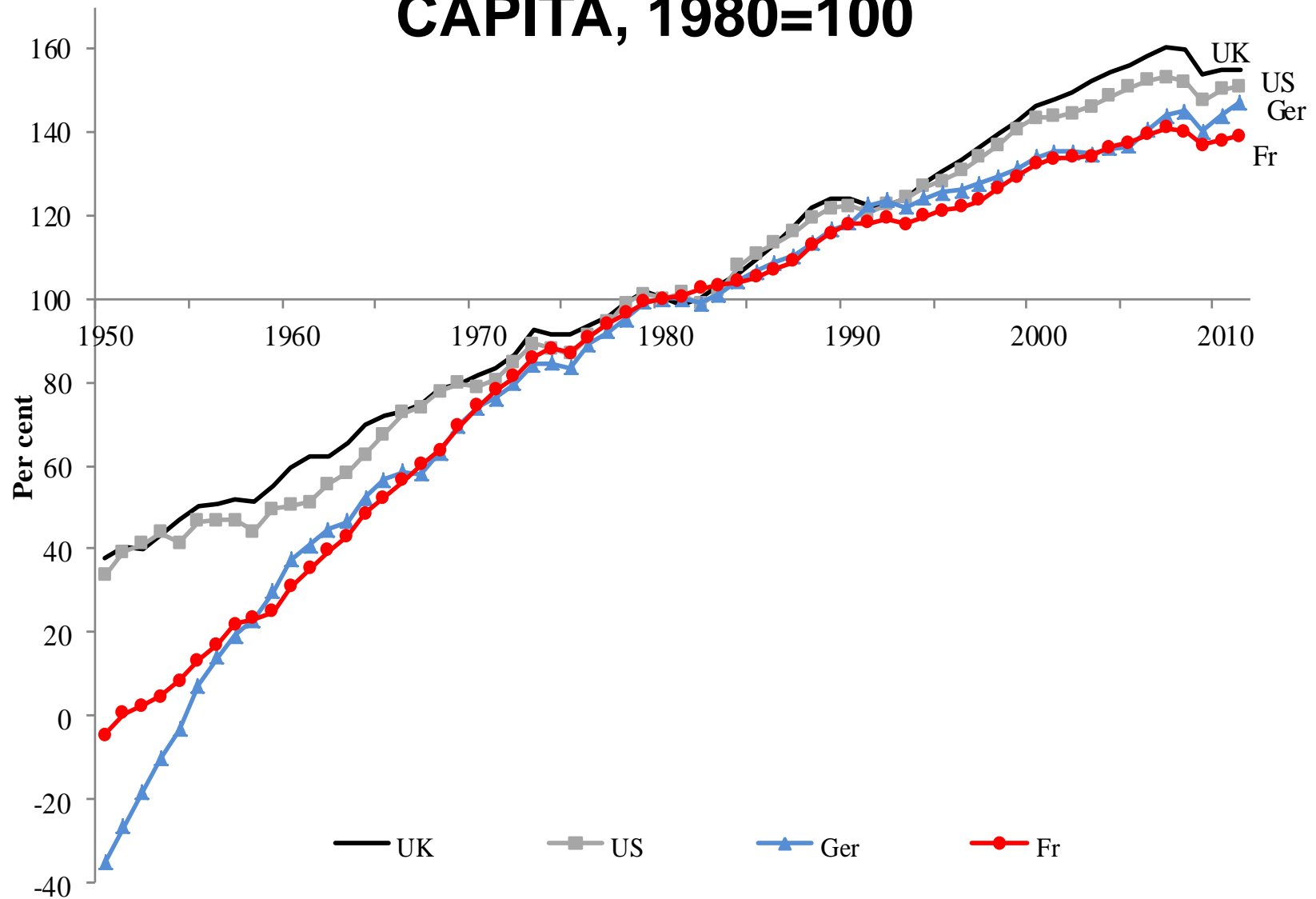
# DECLINE AND REBOUND: RELATIVE GDP PER CAPITA FROM 1870



**Source:** LSE Growth Commission

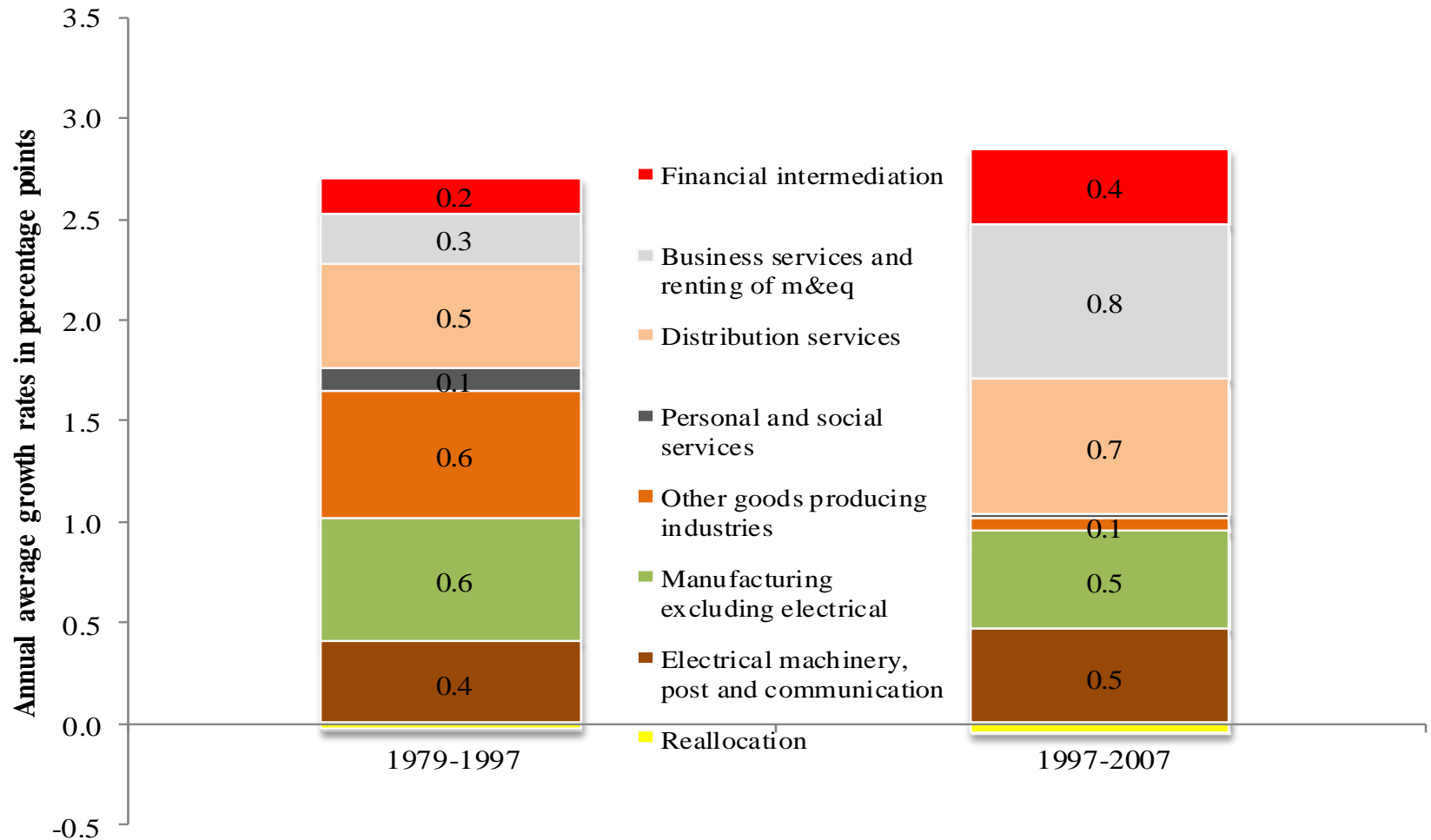


# A REVERSAL OF MISFORTUNE? GDP PER CAPITA, 1980=100



**Source:** LSE Growth Commission

# PRODUCTIVITY GROWTH (GDP PER HOUR) : IT WASN'T ALL FINANCE



**Source:** LSE Growth Commission

# WHAT WORKED

- **Policy Changes**

- Tougher competition through privatization; independent regulators; competition policy
- Flexible labour markets through reforms to employment services, benefits & union law
- Increases in university education (5% had degree in 1980 compared to 31% in 2011)
- Openness to FDI & immigration

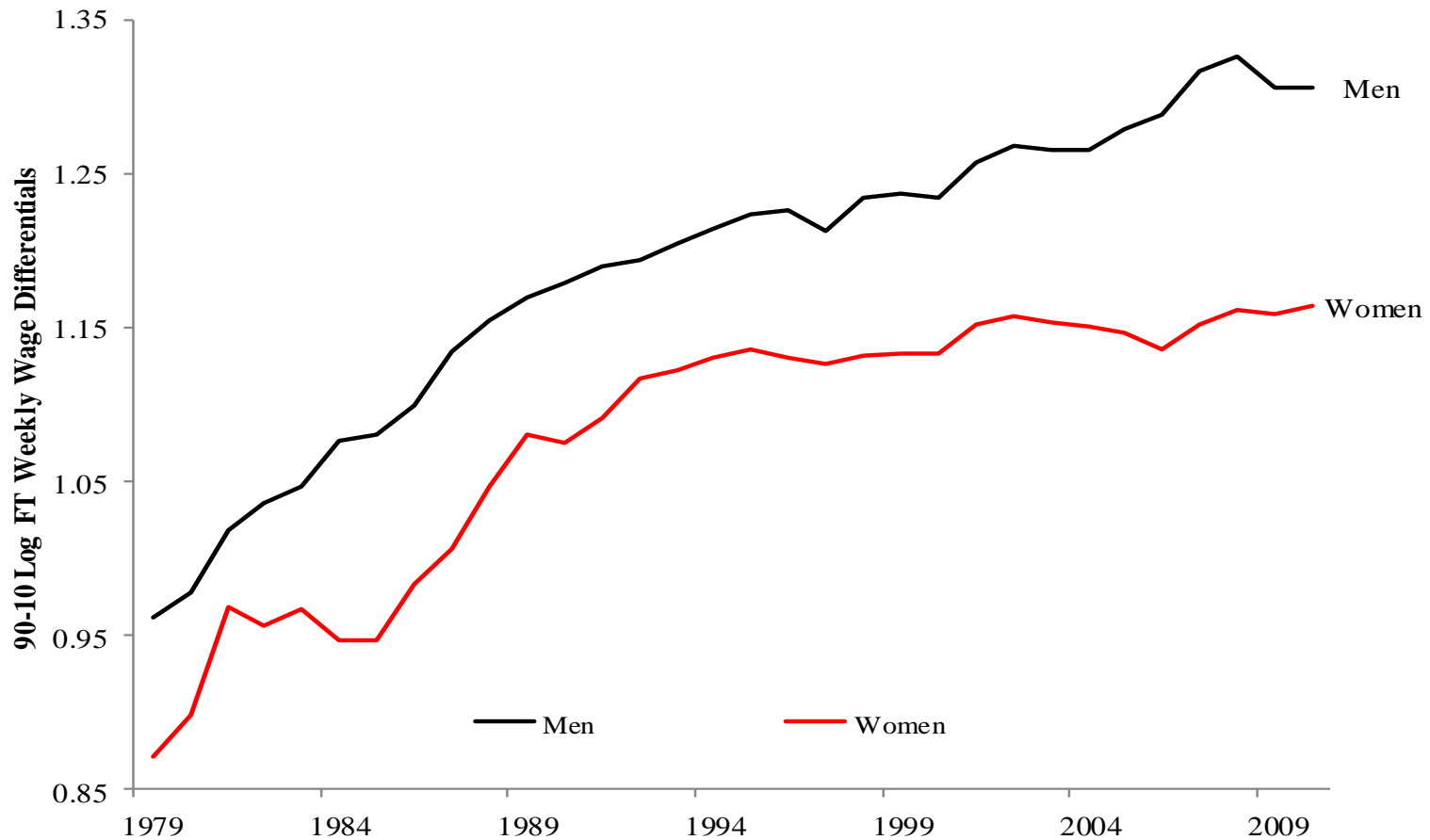
- **Independent bodies – experts & political resilience**

- Competition Commission & OFT
- NICE
- Bank of England MPC
- OBR
- MAC, LPC, NPRB, CCC

# WHAT DIDN'T WORK

- Policy failures over long-term investment
  - Short-termism in economics (e.g. financial system)
  - Short-termism in politics (excess tinkering, rebranding, reversals, procrastination)
  - Independent expert advice & evaluations still limited
  - Populist pressure (e.g. NIMBYism)
- Outcome is high uncertainty & low investment in long-term assets

# THE INEQUALITY CHALLENGE: GROWING WAGE DIFFERENCES



**Source:** LSE Growth Commission

# The Economic Story of the UK

## **Human Capital**

Innovation

Infrastructure

Measuring Progress

Conclusions



# WHY SKILLS MATTER

- **Strong relationship between skills & growth**
  - We focus on schooling age 4-18
  - *Quality* not just *quantity* of schooling matters
  - Teaching most important input
  - “Double Dividend” of increasing human capital of disadvantaged: boosts growth & reduces inequality
- **Some UK problems**
  - Mediocre test scores (e.g. OECD PISA)
  - “Long tail” of underachievement
  - Stronger link between disadvantage and low academic achievement than in other countries

# CORE PROPOSALS ON SKILLS

- **Flexibility**
  - Greater **autonomy, accountability & choice**
  - **Flexibility** for good schools to grow; e.g. *sponsored* academies take over struggling schools
- **Tackling disadvantage:** Current system focuses on average (e.g. floor targets) & not “long tail”
  - *Information, Inspection, Targets*. Performance across distribution (progression of disadvantaged avoids incentives to target marginal kids on threshold)
  - Expansion of academies in disadvantaged areas
- **Improving teaching quality**
  - Expansion of *Teach First, but* Wider intake
  - Rigorous selection at end of extended probation
  - Sharing best practice (e.g. London Challenge)

# SUMMARY ON HUMAN CAPITAL

- People are key resource: we have failed to unlock talent
- More flexible school model helps spread good practice & gives incentives to improve
  - Need to help disadvantaged for growth reasons (not just social justice)
  - Best way is to improve teaching
- Complementary proposals on financial support, post-school & pre-school
- Huge potential gain if reforms can raise quality

# The Economic Story of the UK

Human Capital

**Innovation & investment**

Infrastructure

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# INVESTMENT AND INNOVATION

- **Low investment as a share of GDP**
  - heavily weighted towards property and buildings
- **Weak intangible investment**
  - Low R&D and patent intensity
  - Weak commercialisation
  - Poor management quality
- **Financing gaps affecting start-ups and SMEs**
- **Aggravated by lack of skilled labour and infrastructure investment**

# **PROBLEMS IN UK CAPITAL MARKETS**

- **Short-termism**
- **Lack of competition in retail banking**
- **Lack of economies of scale in SME financing**
- **Excessive reliance on debt**



# PROPOSALS

- **Increase competition in retail/SME banking**
  - Account switching; banking license
  - Referral to Competition & Markets Authority
- **Business Bank to focus on innovative start-ups**
  - Independent board
  - Focus on innovation investments
  - SME securitisation
- **Other Proposals**
  - Voting linked to length of holding shares
  - Implement Vickers in spirit & letter
  - Allowance for Corporate Equity
  - Industrial Strategy
  - Management

The Economic Story of the UK

Human Capital

Innovation

**Infrastructure**

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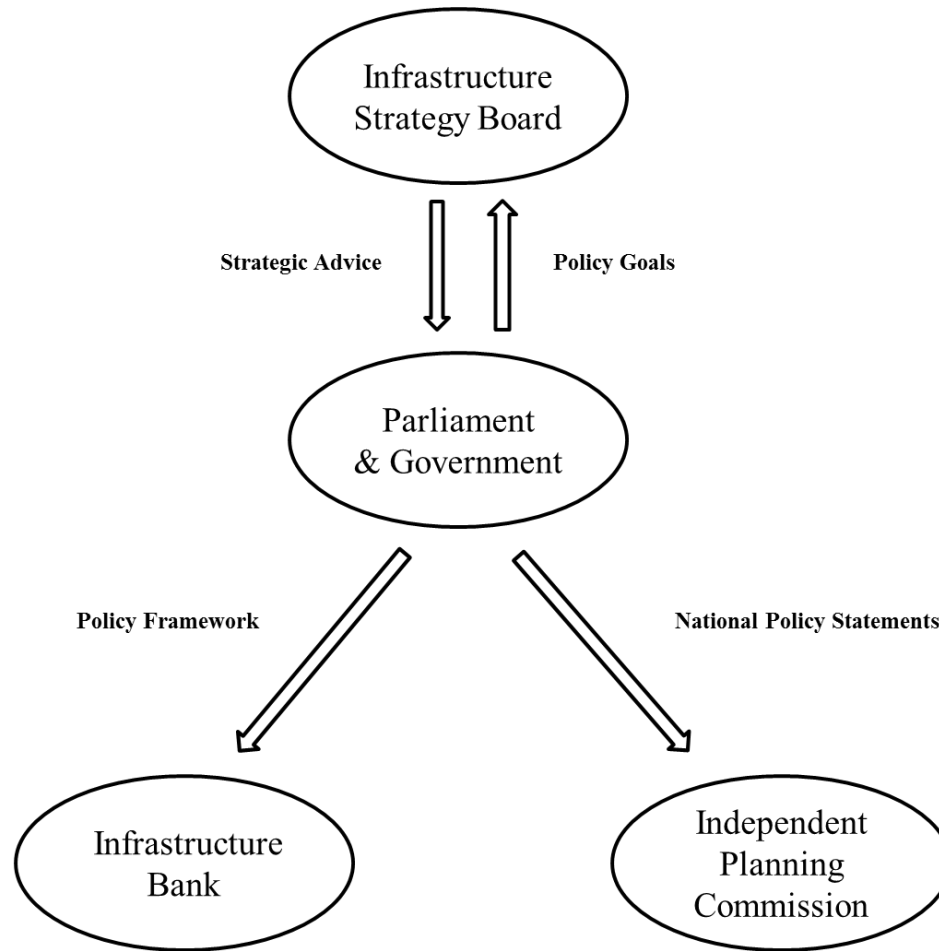
# INFRASTRUCTURE

- **Problem areas**
  - Transport (roads, aviation, rail)
  - Energy
- **Government induced policy risk**
  - Lack of clear sense of strategy – uncertainty
  - Vacillation in and politicisation of policies and projects
- **Rigid planning framework**
  - Rationale with little economic content
  - Limited scope to share benefits
- **Rigid and misleading public accounting conventions**

# NEW INSTITUTIONAL ARCHITECTURE

- **Infrastructure Strategy Board**
  - Independent expert advice
  - Accountable to Parliament
  - Foundation for cross-party consensus
- **Infrastructure Planning Commission**
  - Delivery – planning implications
  - Share benefits of development
  - No ministerial veto
- **Infrastructure Bank**
  - Reduce policy risk to encourage private sector investment
  - Develop sector-specific skills in new areas
  - Catalytic/multiplier effects on private investment

# PROMOTING CONFIDENCE AND TRANSPARENCY



# OTHER PROPOSALS

- **Fiscal targets should recognise assets, not just debt**
- **Road pricing / RAB model for new national roads**
- **Housing**
- **Broadband**

**“HS2 cost rises £2bn in  
12 months”**

Financial Times, 28<sup>th</sup> January 2013

**“Power shortage risks by  
2015, Ofgem warns”**

BBC News Business, 5th October 2012.

**“Third runway at Heathrow?  
Beijing builds an airport with  
seven”**

The Times, 15th January 2013



The Economic Story of the UK

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**Conclusions**

# **POLITICAL ECONOMY OF GROWTH**

- **The problems are well known - why don't we tackle them more effectively?**
- **The fundamental weakness: failure to create a stable policy framework for long term investment**
  - Short term policy horizons
  - Adversarial politics
  - Amplified by 24/7 media
  - Privately owned infrastructure

# OUR APPROACH

## **Build institutions that put politics in the right place**

- Making strategic choices
- Setting high level objectives
- Holding executive bodies to account

## **Supported by**

- More capability at the centre of government
- A bipartisan commitment to evidence based policy

## **Effective action requires sustained cross party commitment:**

- to tackle the key problems holding back long term growth
- to develop the institutions needed to create a stable long term policy framework



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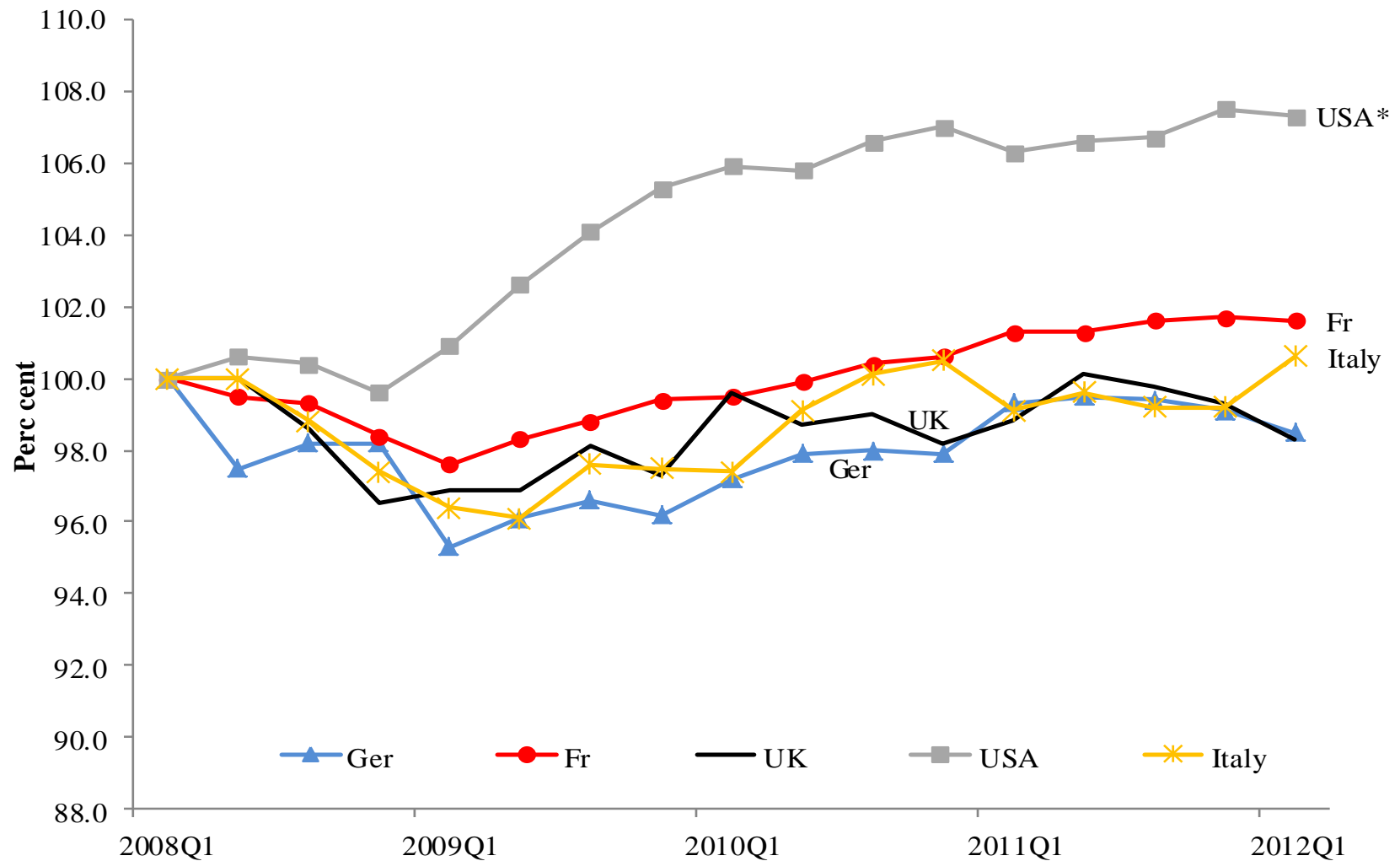
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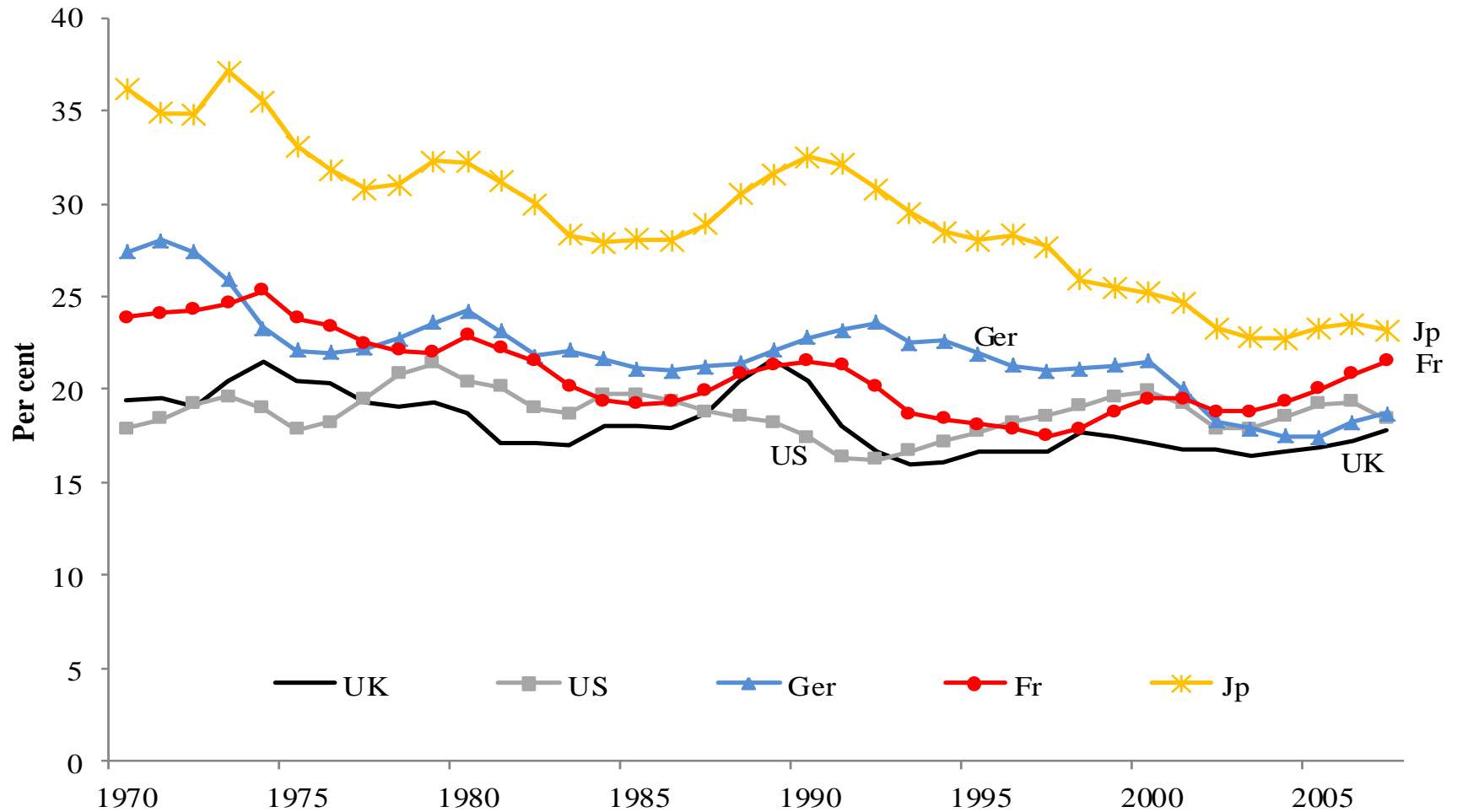
**Twitter  
Hashtag  
#lsegc**

**BACK UP**

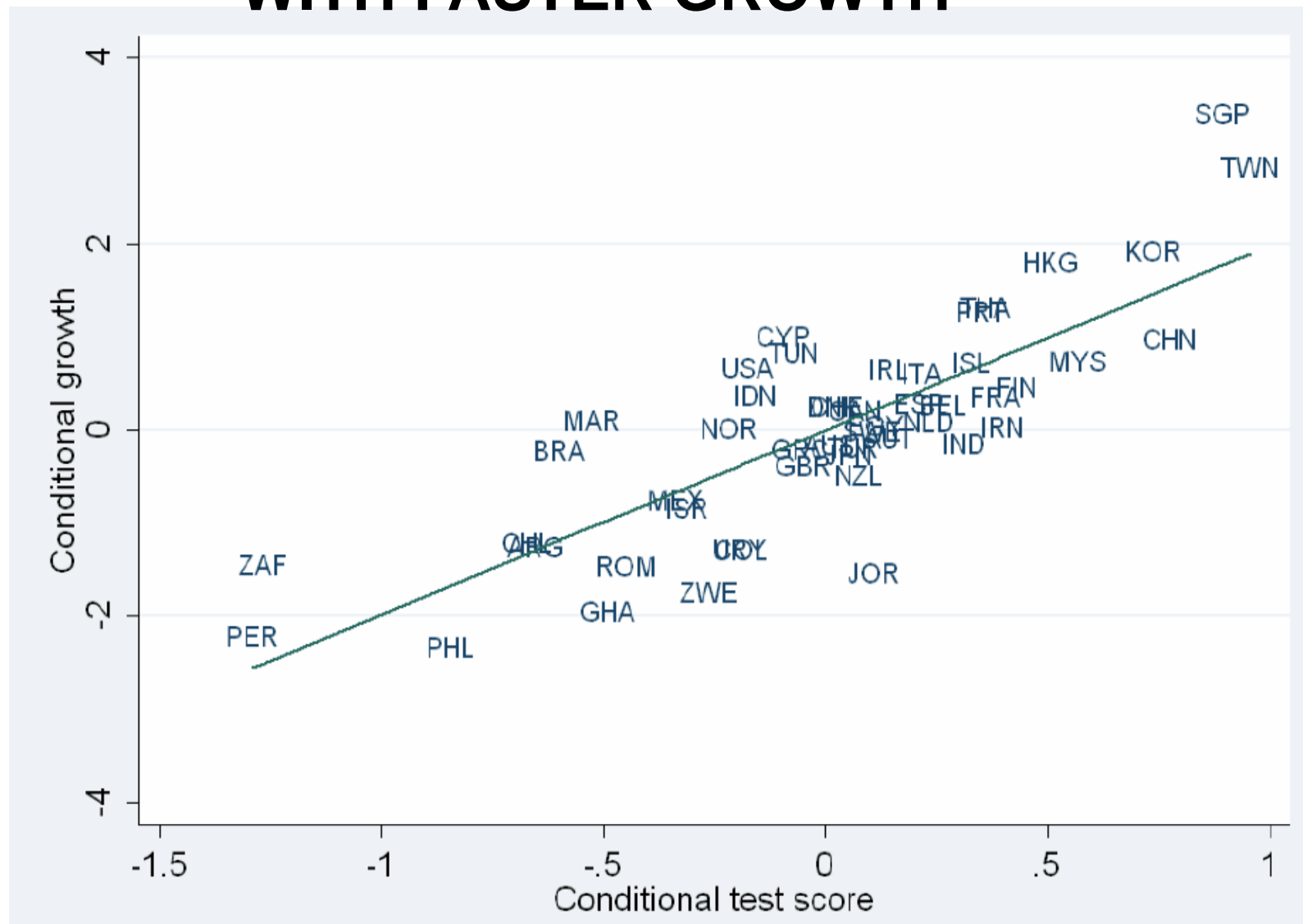
# GDP PER HOUR: THE PRODUCTIVITY PUZZLE (IN US)



# INVESTMENT (GFCF) OVER GDP



# BETTER COGNITIVE SKILLS ASSOCIATED WITH FASTER GROWTH



**Source:** Hanushek & Woessmann (2012)



# WHAT WON'T WORK

- **Right**
  - Ever smaller state
  - Ever more de-regulation
- **Left**
  - More redistribution (less inequality desirable but not generator of growth)
  - More regulation e.g. ever higher minimum/Living Wage
- Short-run policies for austerity or stimulus & leave long-run to look after itself

## 4. SUPPLEMENTARY PROPOSALS

- Financial support for disadvantaged via pupil premium (PP) rising £600 to £900, but targeting issue
  - “PP Plus”: pupils can keep some PP themselves if attendance & performance improvements 14+ (cf. EMA, an evaluation success story)
- **Apprenticeships**
  - Quality too low. Employer control & incentives
- **Pre-School**
  - Children’s Centres; Family-Nurse partnerships

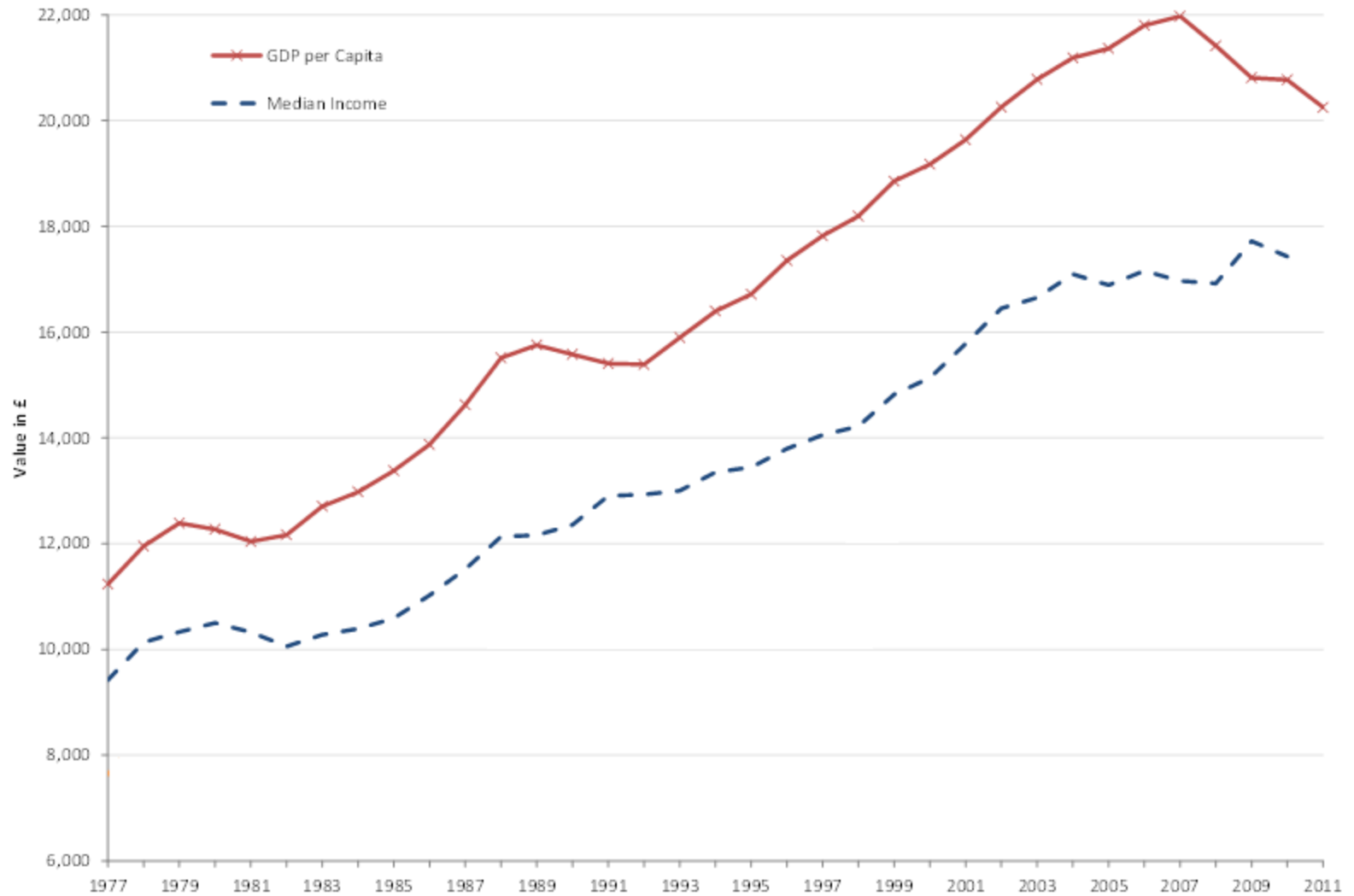
# WHY HAVE PROBLEMS PERSISTED?

- Difficulties/complexity in measuring performance
  - political and media focus on average
- Changes to give perception of policy change & differentiation (reflects adversarial political culture)
- Vested interests

# MEASURING PERFORMANCE

- Important to define criterion for success: growth of what?
- Exclusive focus on GDP not helpful
  - Goes up even if most people are left behind
  - Measures production not income
- Proposed: greater focus on Median Household Income
  - Captures what happens in the core of the population
  - Measures income
  - Focuses on families
- Recommendation: direct statistical agencies to devote more effort and resources to providing timely and accurate measures of MHI

# MEDIAN INCOME AND GDP PER CAPITA



Source: ONS

# MODUS OPERANDI

- Commissioner Meetings
- Evidence sessions
- Written Evidence
- Background documents
- Report
- Follow on ...?

# 1. 'FLEXIBLE ECOLOGY' FOR SCHOOLS

- Make the system work better to spread better teaching practices
  - Greater school **autonomy**
  - Strengthened **accountability** (Ofsted Inspection; information; curriculum)
  - Wider parental **choice**
  - **Flexibility** for good schools to grow
    - School-level expansion
    - *Sponsored* academies. Leadership & governance. Takeover of struggling schools

## 2. TACKLING DISADVANTAGE

- Current system leads to focus on average (e.g. floor targets) & not “long tail” of disadvantage
  - **Information** on performance across the distribution (e.g. League Tables must show progression of disadvantaged kids)
  - Ofsted **Inspection** criteria reflect this information
  - Revise floor **targets** (to avoid incentives to target only “marginal” children around threshold)
  - Expansion of **sponsored** academies in disadvantaged areas

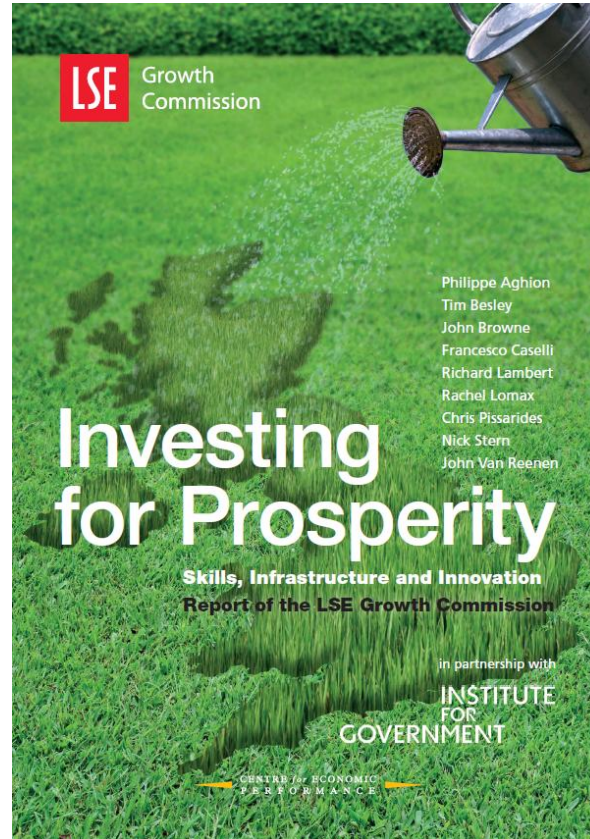


### 3. IMPROVING TEACHER QUALITY

- Key finding: hard to predict which teachers will be good in advance; but can discover after classroom experience
- **Proposals:**
  - Expansion of *Teach First* (top graduates)
  - Wider intake and more rigorous selection at end
  - Probation period extension (e.g. 2 to 4 years)
  - Sharing best practice (e.g. London Challenge)

# INVESTING FOR PROSPERITY

## REPORT OF THE LSE GROWTH COMMISSION



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