



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

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**CENTRE for ECONOMIC
PERFORMANCE**

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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



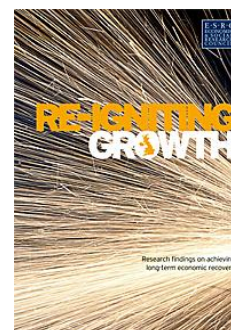
WHY AN LSE GROWTH COMMISSION?

- Focus on long-term structural issues beyond debates about austerity
- Numerous reports on growth
- 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?

NO STONE UNTURNED



GROWTH
The National Institute of Economic Research



British
Chambers of
Commerce

THE CASE FOR A BRITISH
BUSINESS BANK
SEPTEMBER 2012

Comitex
Dr Robert Marshall
Director of Trading and Economic Affairs
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BUSINESS
GOD
OF
BRITAIN

INTRODUCTION & SUMMARY

- **Optimistic story, UK has many assets**
 - Rule of law, flexible labour market, competition, universities, openness
 - Reversal of relative decline in last 3 decades
- **...But 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
 - Low productivity
- **Wanted: A Manifesto for Growth**

MODUS OPERANDI

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

INTRODUCTION & SUMMARY

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

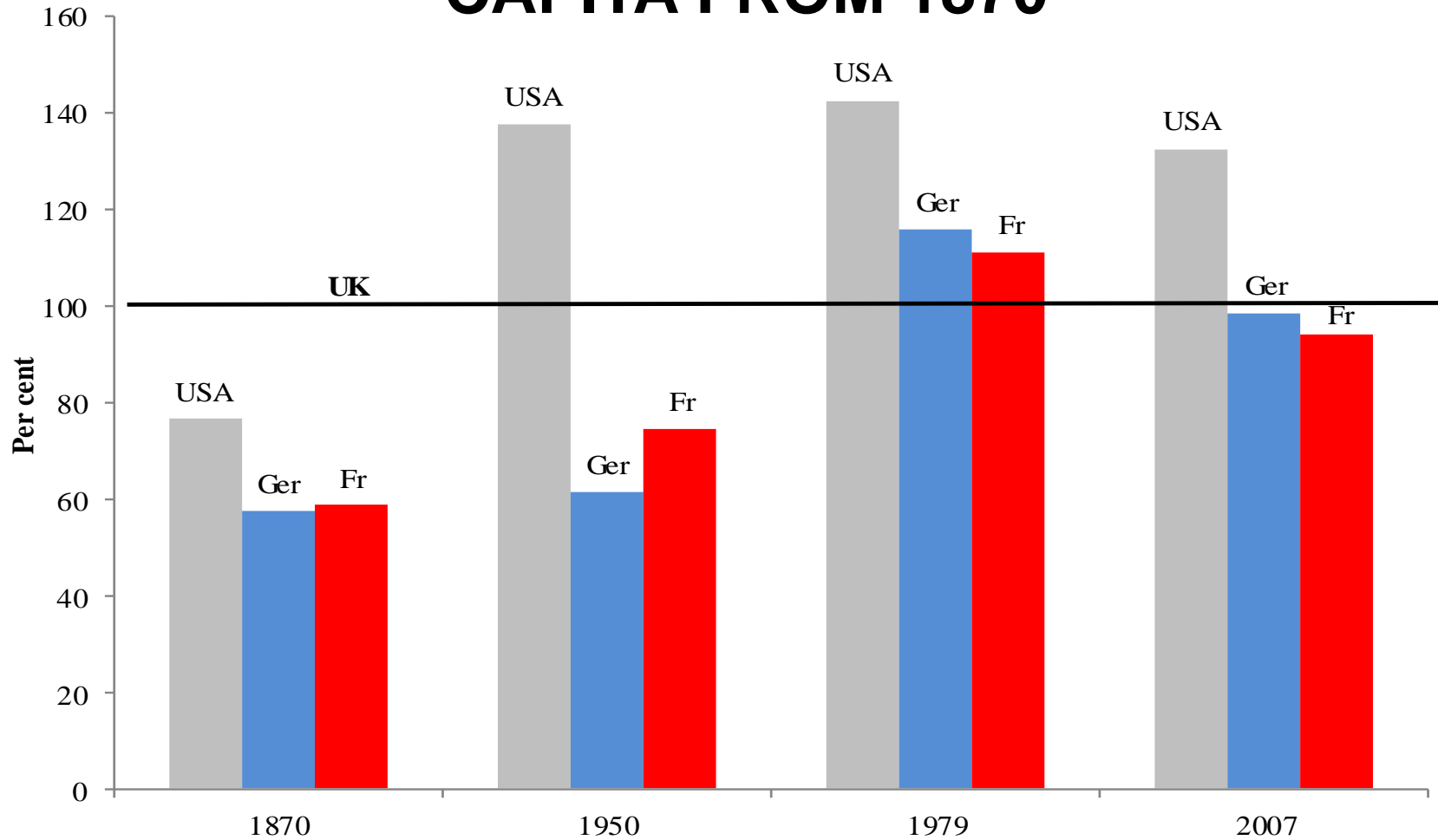
Infrastructure

Innovation & investment

Measuring Progress

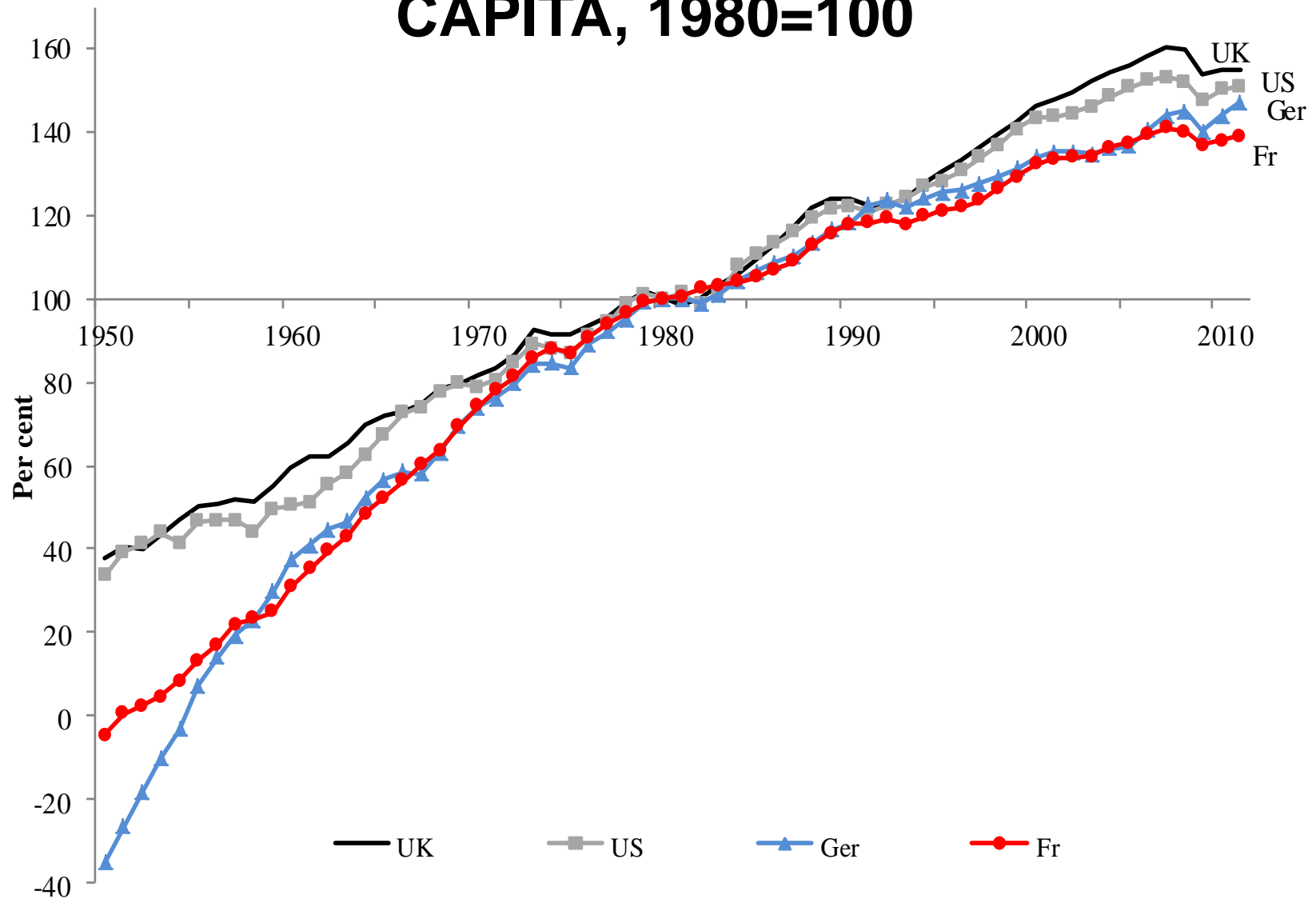
Conclusions

DECLINE AND REBOUND: RELATIVE GDP PER CAPITA FROM 1870



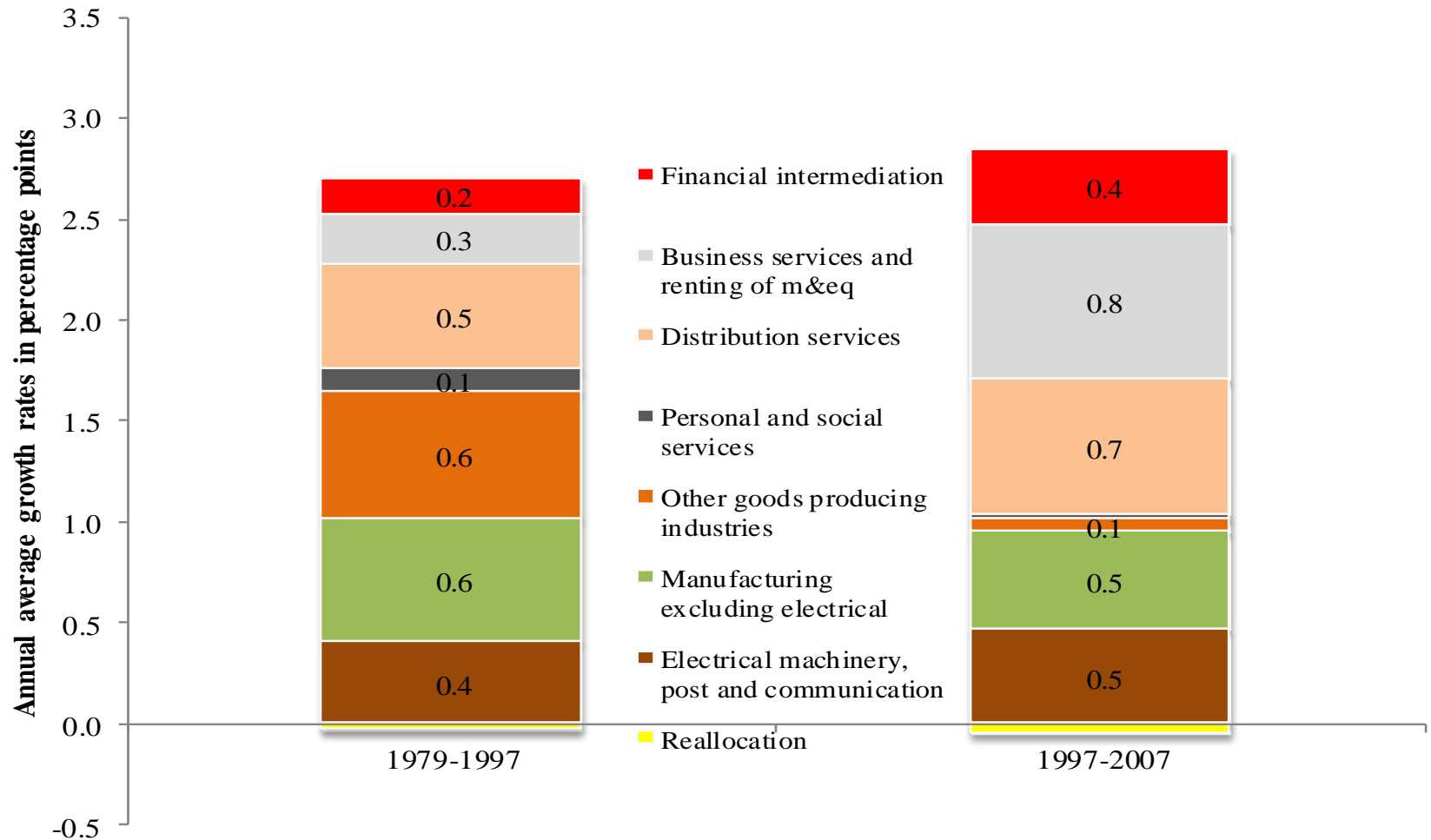
Source: LSE Growth Commission

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

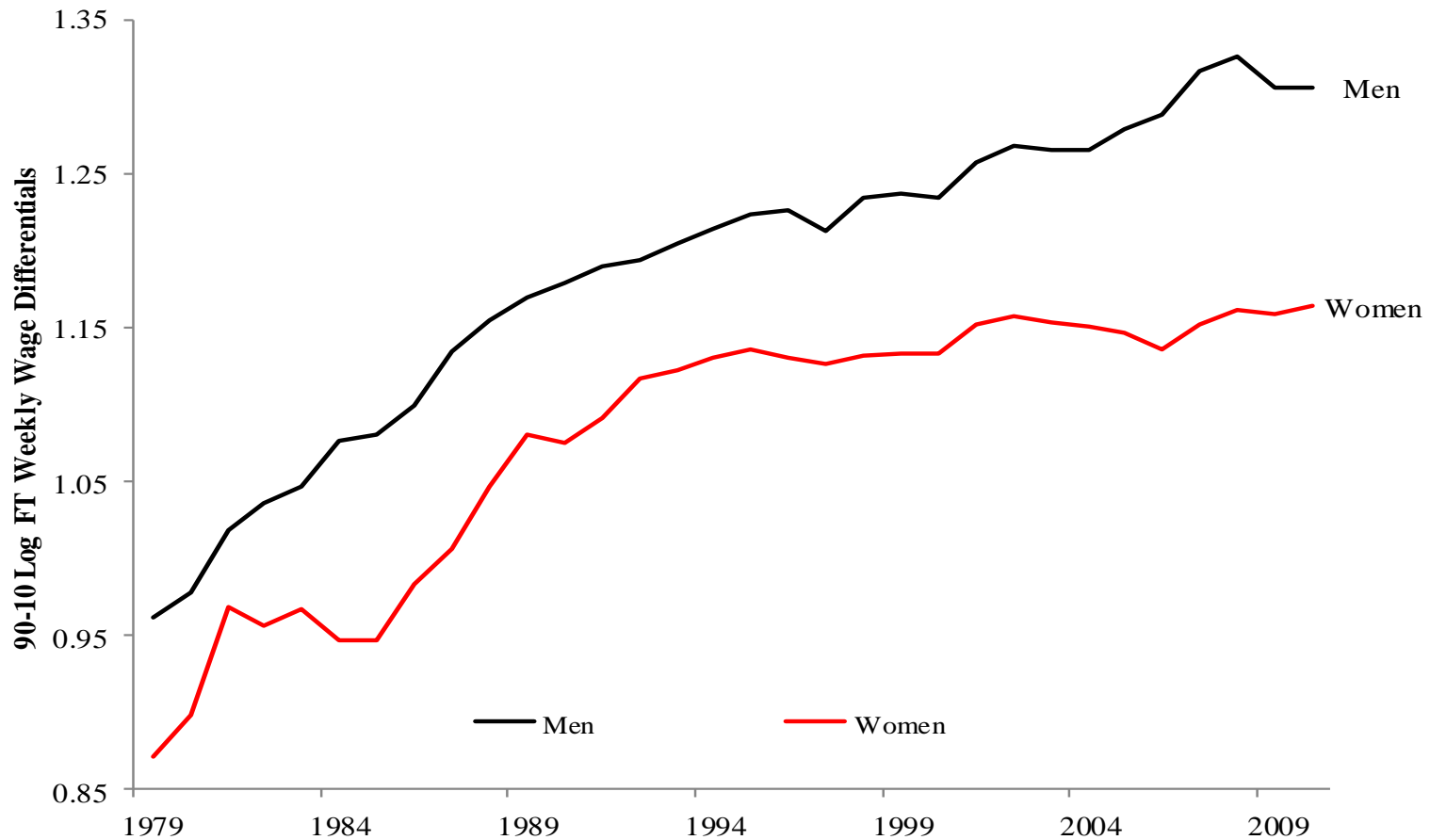
- **Independent bodies – experts & political resilience**

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

WHAT DIDN'T WORK

- Policy failures (procrastination, reversals)
 - Short-term political horizons
 - Adversarial politics causes tinkering, rebranding, reversals
 - Lack of independent expert advice & evaluations
 - Populist pressure
- 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 by JOHN VAN REENEN

Infrastructure

Innovation

Measuring Progress

Conclusions

WHY HUMAN CAPITAL MATTERS

- **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

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)

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

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

Infrastructure by NICK STERN

Innovation

Measuring Progress

Conclusions

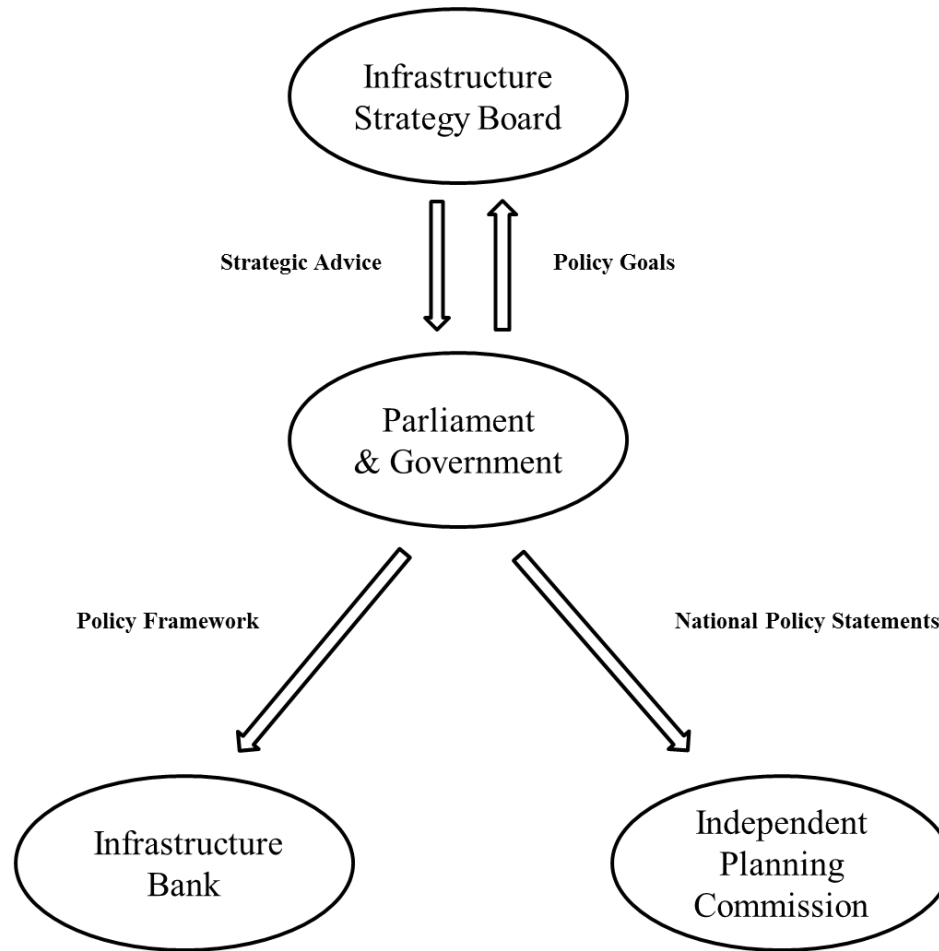
INFRASTRUCTURE

- **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, 28th 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

Human Capital

Infrastructure

Innovation by RICHARD LAMBERT

Measuring Progress

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

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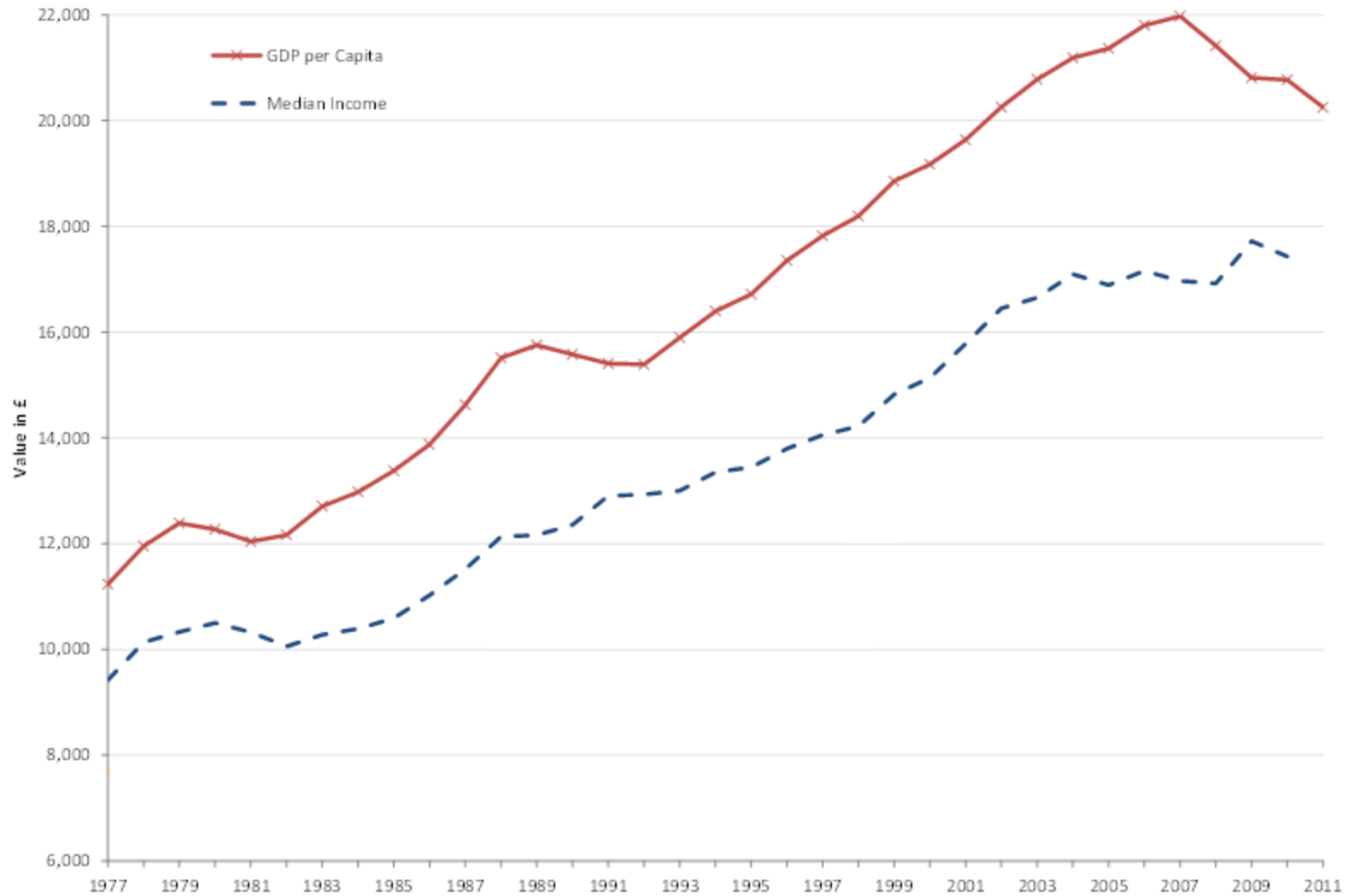
**Measuring Progress by FRANCESCO
CASELLI**

Conclusions

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

The Economic Story of the UK

Human Capital

Infrastructure

Innovation

Measuring Progress

Conclusions by RACHEL LOMAX

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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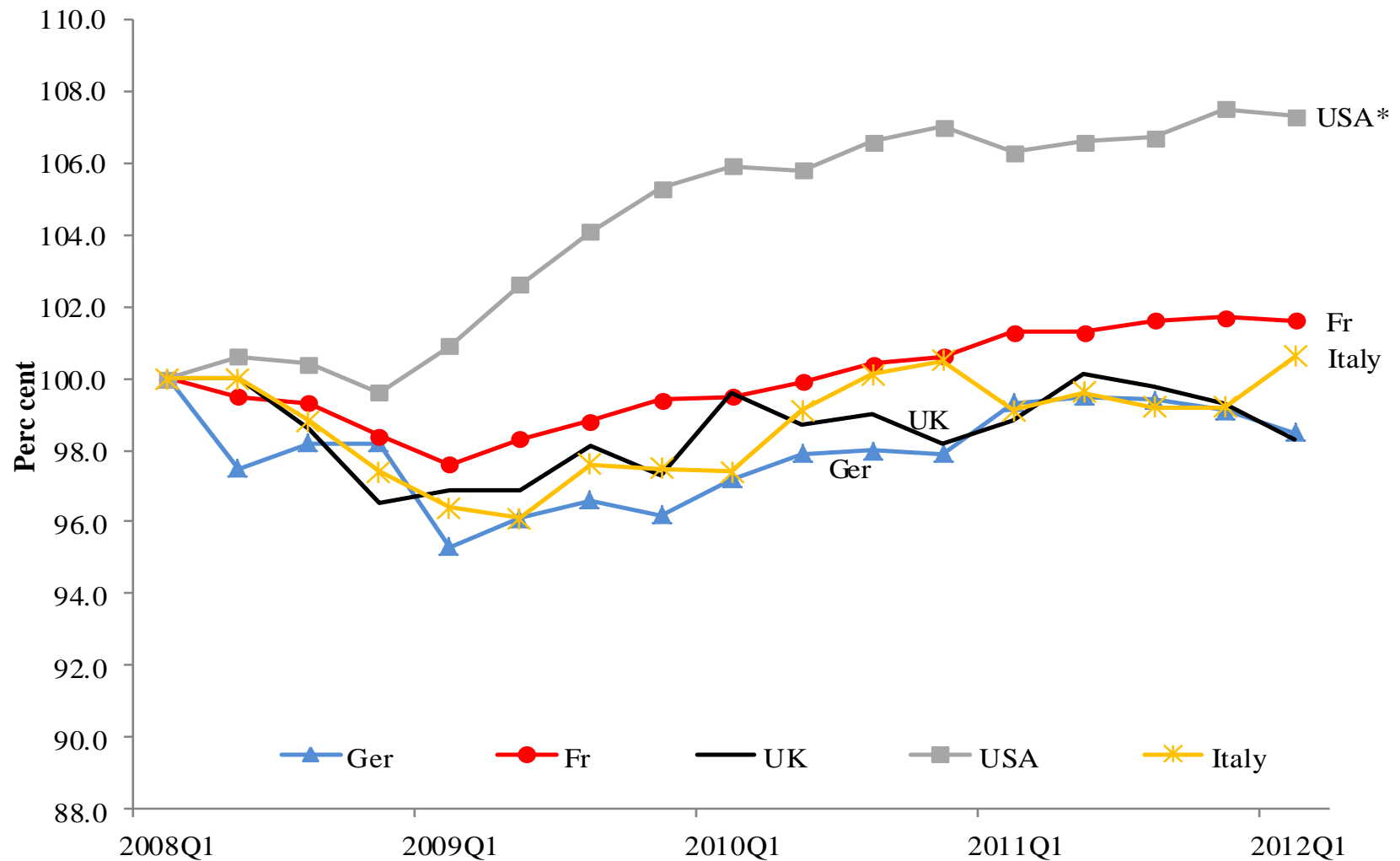
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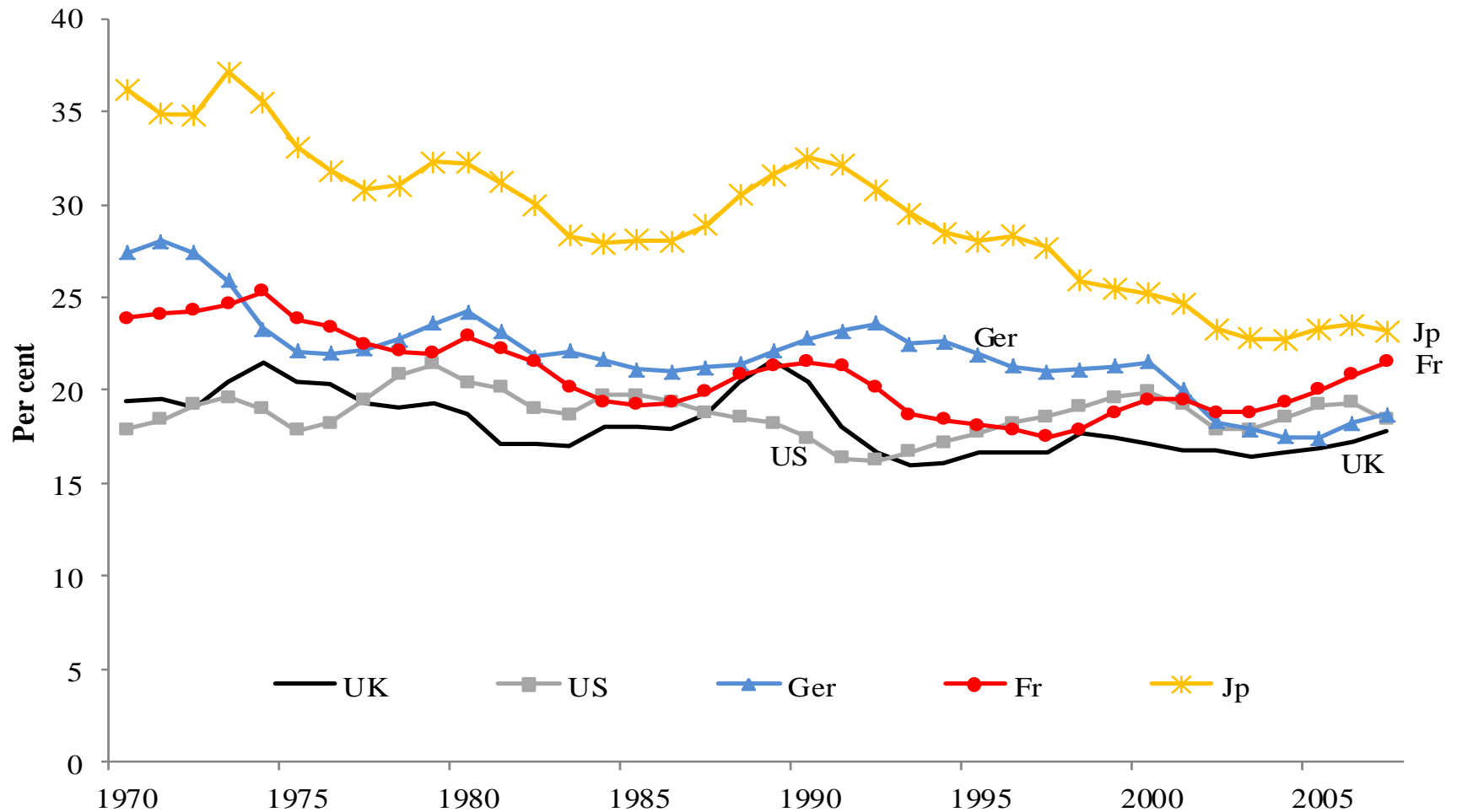
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BACK UP

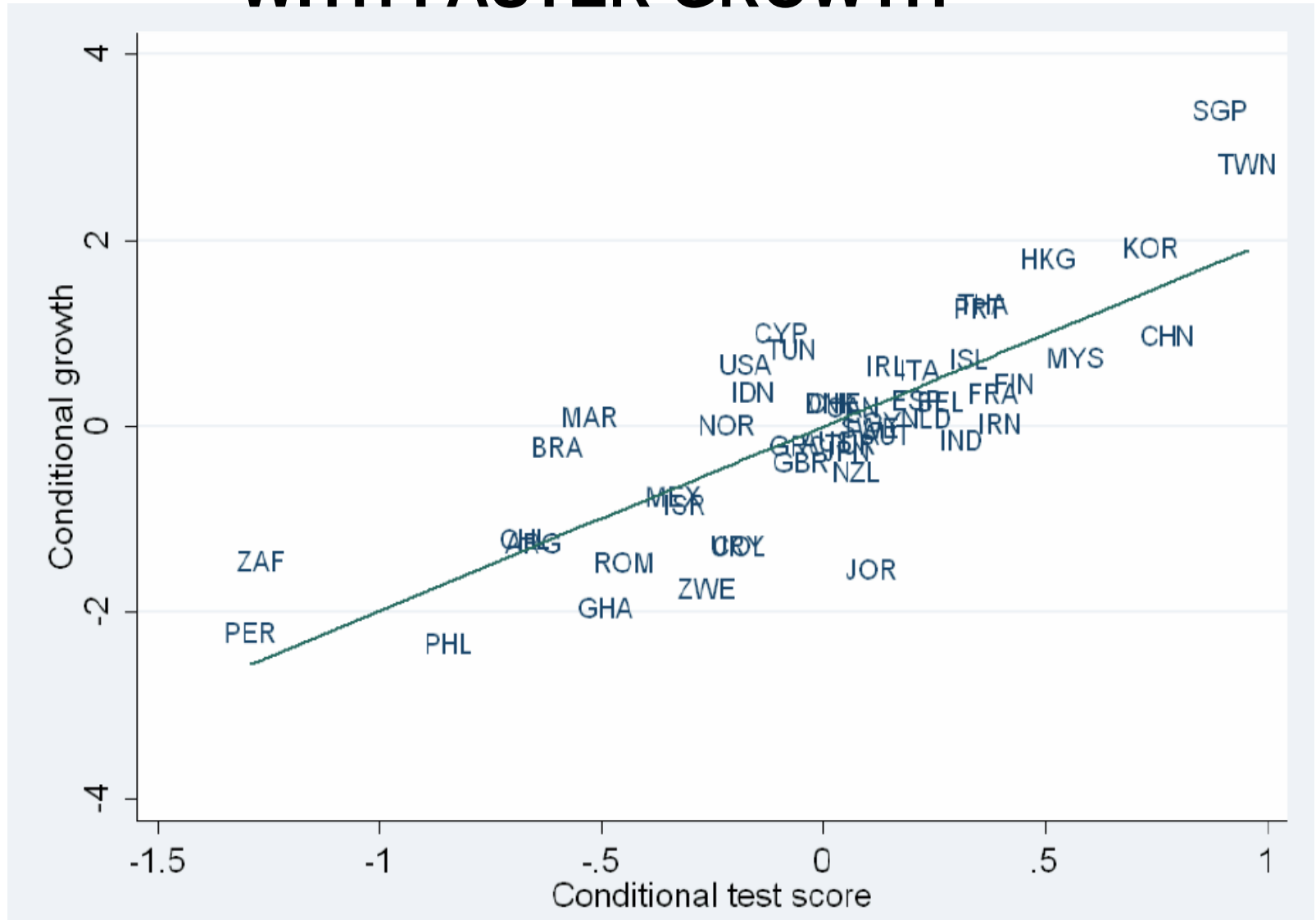
GDP PER HOUR: THE PRODUCTIVITY PUZZLE (IN US)



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

INVESTING FOR PROSPERITY

REPORT OF THE LSE GROWTH COMMISSION



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