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We Need A Queen's Speech For Growth

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Neither the pomp and ceremony of the Queen's Speech nor its accompanying bills can hide the fact the UK requires urgent action to restart economic growth.

So too does Europe as a whole. A European recovery would help the UK greatly. But Europe will take time to agree a strategy: the UK can and must get on with it. There is a clear way forward – kick-start investment now through strong, clear and credible measures that reduce so-called 'policy risk' and mobilise private savings and liquidity.

Tax cuts to generate consumption-led growth will not be fiscally credible. Structural reform of the UK economy to increase productivity is essential, but takes time. The recovery must be investment-led and place only modest demands on the public finances. But without the recovery any attempt to achieve fiscal balance, however defined, any time soon will be unacceptably destructive, both economically and politically, a lesson which the last few weeks and days in the UK and Europe have surely demonstrated dramatically.

Investment has slumped mainly because households, businesses and banks are nervous about future demand, and have responded by forgoing more risky investment in physical capital. Instead, companies and households are squirrelling away private saving into 'risk-free' assets such as solvent sovereign bonds. As a result, annual private sector surpluses over the past few years have been at record levels, and amounted to £99bn last year, equivalent to 6 per cent of UK gross domestic product. When everyone cuts spending simultaneously, fear of recession becomes self-fulfilling.

Desired saving has exceeded desired investment in many advanced economies to such a degree that real 'risk-free' interest rates for the next 20 years have been pushed to zero and below. Savings are losing value by the day as pension funds and financial institutions pay real interest to (rather than receive interest from) governments; a truly perverse state of affairs given the need for productive investment. These low rates do not reflect a collapse in the underlying returns to capital, but instead reflect desperately depleted confidence.

With short-term interest rates close to zero, the effectiveness of monetary policy to stimulate growth is reaching its limits. Fiscal policy is tightly constrained. What is needed to restore confidence is a strategic vision, the rationale for which businesses clearly understand, with supporting policies to guide investors.

In the past, we have seen Roosevelt's New Deal or rearmament. In this case, recognising the inevitable transition to a low-carbon economy, and helping drive forward investment in resource-efficient, innovative sectors, could restore growth and leave a lasting legacy. As well as bringing energy security, tackling climate change, and saving consumers and businesses costs in the long run, these sectors offer long-term returns for investors.

Standard macroeconomics tells us that the best time to promote investment is during a protracted economic slowdown. Resource costs are low and the potential to crowd out alternative investment and employment is small. In addition, while public budgets are stretched, there is no shortage either of private capital available for investment, or of investment opportunities with potential profitable returns. There is, however, a shortage of perceived opportunities. The longer that recovery is delayed, the more skills will be lost and potentially valuable capital is scrapped.

This is about more than correcting market failures, such as those associated with greenhouse gas emissions; it is about restoring confidence through creating new markets which spur innovation. Policies to encourage low-carbon investment would provide new business opportunities, would generate income for investors, and would have credibility in the long term both because they address growing global resource challenges, while tapping into a fast-growing global market for resource-efficient activities, and there is a recognition that actions cannot be delayed indefinitely.

The most recent figures published by the Department for Business, Innovation and Skills show that the UK low-carbon and environmental goods and services sector had sales of £116.8bn in 2009-10, growing 4.3 per cent from the previous year and placing us sixth in the global league table for such sales.

But the private sector is not investing as heavily as it could in green innovation and infrastructure because of a lack of confidence in future returns in this policy-driven sector. Only the government can reduce this policy risk. Thus, by backing its own low-carbon policies, the Government can stimulate additional net private sector investment, and make a significant contribution to economic growth and employment.

The government can do this, for instance, by introducing in the next Parliamentary session a bill to reform the electricity market, and by allowing the Green Investment Bank to operate as a lending institution, offering loans to private companies so that it shares some of the risk of private investments in green infrastructure. The UK should also work with other member countries to increase the European Union's target for emissions reductions for 2020 to 30 per cent from 20 per cent, providing a boost for the carbon price within the Emissions Trading System. And it should support additional investment from the European Investment Bank, and encourage the development of a European supergrid.

But the prime minister and his cabinet colleagues also need to be strong advocates for the green economy. If they convey the false impression that we have to make a choice between environmental responsibility and economic growth, they will undermine the confidence of private sector investors in the direction and consistency of future policy.

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