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The UK's relative decline has gone on long enough, it's time for a new economic strategy

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The British economy is stagnating, but this doesn't have to be terminal argue **Torsten Bell** and **Stephen Machin**, who set out The Economy 2030 Inquiry's roadmap to a new prosperity.

The British economy has many great strengths, but it is in relative decline. It hasn't always been like this. Real wages grew by an average of 33 per cent a decade from 1970 to 2007, before falling to below zero in the 2010s. Countries can survive a year (or two) of poor productivity growth and flatlining wages. But 15 long years of stagnation have left their mark on our economy and our living standards. If wages had continued growing on the same trajectory they were following before the financial crisis, British workers would be earning an additional £10,700 a year, on average. And because the UK is the most unequal major economy in Europe, its middle-income and poorer households are worst hit by our stagnation. It's time for a change of course.

After nearly three years of research, The Economy 2030 Inquiry – a collaboration between the Resolution Foundation and the Centre for Economic Performance at LSE, funded by the Nuffield Foundation – has delivered its Final Report, and along with it, a roadmap out of stagnation for Britain. The bottom line is that it's time to get serious about the toxic combination of low growth and high inequality, with an ambitious but pragmatic path to prosperity, built on hard-headed analysis not wishful thinking.

> "Britain… needs to start investing in its future, rather than living off its past."

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How do we get Britain growing again?

We should start by acknowledging where our strengths lie. While we might not celebrate it much, Britain is the second biggest services exporter in the world. Only the US sells more. We have the advantage of an accessible time zone, a widely spoken language and a robust legal framework. Our services strengths are not limited to financial services, whose role in our economy is if anything shrinking. Our universities, architects, cultural services, technology companies and many others are world-leading.

We've got form to build on, and the size of the pie is set to grow. Global trade in the services we enjoy a comparative advantage in – for example, business services – is growing twice as fast as goods trade. New services-centred trade agreements with the likes of Singapore, Australia, Canada, Switzerland and Japan would set us in good stead for further expanding our often high-skilled, high-paying service sector firms. This offensive trade strategy should be complemented by a defensive one on goods, protecting our high-value manufacturing firms' places in European supply chains.

Britain also needs to start investing in its future, rather than living off its past. Over the past four decades we've been the weakest investor in the G7. Those British firms that do invest see, if anything, a higher return on their investment than those elsewhere – the problem is management rarely invests for the long term. Changing that will require more pressure on management from above (with a smaller number of far larger pension funds behaving as active owners) and below (with workers on boards of companies – something that has raised investment levels in several European countries).

Public investment has also consistently been too low – and we're cutting it again today. We can see the results everywhere – from struggling hospitals, to shaky public transport, and too little housing. Not only is our public sector investment low, it's also highly volatile, with long-term planning decisions stunted by the short-term nature of twice-yearly fiscal events, and the need to meeting rolling fiscal rules. We need to take a new approach – raising public investment to three per cent of GDP, and keeping it there.

The fruits of thriving service sector firms and fresh investment should be seen in our great cities, such as Birmingham and Manchester. These are prime sites for investment to increase productivity and raise living standards locally and nationally, but they are economic underperformers – especially compared to other major cities across Europe.

Turning around these cities and regions, which lag significantly behind the national average for productivity, will boost national income and shrink regional gaps. But it will need change on a scale not yet contemplated. Closing the productivity gaps of Birmingham and Manchester with London to those that Lyon and Toulouse have with Paris would require increasing each city's business capital stock by 15 to 20 per cent; over 160,000 additional high-skilled workers in each city; city centres expanding up (in the case of low-storey Birmingham) or out (in the case of

Manchester, in which too much prime land is used for warehousing); and billions of central government investment to expand transport networks.

> Truly shared prosperity must include the 11 million working-age households who get less than half of their income from the labour market.

How can we make sure the benefits are shared equitably?

The measures already outlined would increase prosperity, but it may not reach everyone. In fact, growth alone could well increase inequality. The goal is not to become the US.

So we need to focus on "predistribution" – ensuring that higher pay and employment benefit those on low and middle incomes. We must continue to raise the minimum wage but also raise wider standards at work – so that workers have access to good work in every town. It cannot be right that half of shift workers in Britain get less than a week's notice of their hours – we should create the right to a contract enshrining minimum hours and two weeks' advance notice of shifts. Statutory Sick Pay leaves many to live on just £44 if they are sick for a week, and should be reformed to pay 65 per cent of normal earnings.

Good work must be more than just minimum national standards though. The decline of trade unions over the past four decades has left many workers in weak bargaining positions. Meanwhile, many of the biggest problems are concentrated in specific parts of the economy – such as illegal underpayment in the social care sector. To address this, we propose pioneering new Good Work Agreements – bringing together unions, businesses and independent experts in the same vein as the Low Pay Commission – to agree higher sectoral standards. The perfect place to start is social care – with its 1.7 million-strong workforce.

Truly shared prosperity must include the 11 million working-age households who get less than half of their income from the labour market. These families have been hit hard over the past decade – since 2010 benefit cuts have left the poorest households £2,700 a year worse off. The consequences are everywhere to see, as food banks expand and homelessness hits record highs.

In order to ensure that our safety net strengthens as our economy grows, benefit levels for both working-age and pensioner households should keep pace with wages.

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Of course, many of these policies will carry a cost, and the tax take is already on course to hit an 80-year high this decade. The need to raise investment, rescue public services and repair public finances means it is likely to stay elevated, whichever government commands the coffers after the next election.

We need to ensure that those taxes are better, not just higher. The burden cannot continue to fall disproportionately on employees, which means taxing income consistently whatever its source so that landlords pay the same taxes as their tenants. Household wealth has risen from three to over seven times national income since the 1980s, while poorly designed wealth taxes have not risen at all as a share of GDP.

How can we steer such significant economic change?

Renewing the UK's economic strategy will be far from easy, requiring real trade-offs. A higher-investing Britain will need to start saving more. Good work for those on lower salaries will mean higher prices in restaurants for those on higher incomes. And some will question how realistic it is for the UK, a relatively small and mature economy, to turn its stagnation around.

But fatalism is misplaced. Today six in 10 Britons think the country is heading in the wrong direction, with just 16 per cent thinking it is on the right track. This parliament looks set to be the first one since records began to oversee a tangible fall in living standards over its tenure. People are ready for change. And having fallen so far behind, we now have one huge advantage: catch-up potential. We don't need to become as rich as the US or as equal as Scandinavia. Closing our productivity and inequality gap with countries we've long considered ourselves similar to – Australia, Canada, France, Germany and the Netherlands – would mean typical British households being more than £8,000 better off. That is a huge prize, worth embracing a new economic strategy for.

All reports from the **Economy 2030 Inquiry** are available online.

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