

The IPPR Commission on Economic Justice



Time for Change

A New Vision for the British Economy

A Summary of the Interim Report of
the IPPR Commission on Economic Justice



SUMMARY

The British economic model needs fundamental reform. It is no longer generating rising earnings for a majority of the population, and young people today are set to be poorer than their parents. Beneath its headline figures, the economy is suffering from deep and longstanding weaknesses, which make it unfit to face the challenges of the 2020s. Fundamental reform has happened before, in the 1940s and 1980s. The persistent economic problems we have experienced since the 2008 global financial crash demand change of the same magnitude now. This should be guided by a new vision for the economy, where long-term prosperity is joined with justice for all.

This Interim Report of the IPPR Commission on Economic Justice sets out the case for a new approach to economic policy. It argues that the economy we have today is creating neither prosperity nor justice. This is not inevitable, but the consequence of decisions made in recent decades. The economy exists to serve society, not the other way round. So we can choose to change it, if we have the ambition and determination to do so. If we want to change the economy we have, we need to describe the economy we want.

In this report, the Commission proposes some broad directions and areas for reform. Our final report in 2018 will make specific policy recommendations.

In this report we offer a new vision for the economy in 2030 – an economy in which prosperity is joined with justice, which enables everyone to flourish and builds the common good. We want to build a more dynamic economy in which seizing the opportunities of technological innovation achieves higher productivity, creating better jobs with higher wages and shorter working hours. This must be a balanced economy, in which all the nations and regions of the UK thrive, and we succeed in manufacturing as well as service sectors. We seek an inclusive economy which distributes economic rewards fairly and so allows everyone in society to achieve their potential and to have good and fulfilling work, decent housing and an improving quality of life. We need a sustainable economy that constrains its environmental impacts within the earth's limits, taking care of the long term as well as the short. And we desire a partnership economy, in which successful and responsible businesses, a smart and accountable state, strong trade unions and a vibrant civil society work together for the common good.

This is not the economy we have today.

The British economy today is not generating rising prosperity for a majority of the population. Economic growth no longer leads to higher pay: the period from 2008 to 2021 will be the longest period of earnings stagnation for around 150 years. Young people today are poorer than previous generations at the same age. For too many people and parts of the country, the 'economic promise' of rising living standards has been broken.

- **The UK is the most geographically unbalanced economy in Europe.** Almost 40 per cent of UK output is produced in London and the South East, and only those regions have recovered to pre-2008 levels. Median incomes in the North West, South West and West Midlands are now more than 30 per cent lower than in London and the South East; in Wales, 35 per cent; in Scotland 22 per cent. For people in deindustrialised areas and declining communities, there has been little sign of economic recovery.
- **The UK's high employment rate has been accompanied by an increasingly insecure and 'casualised' labour market.** Fifteen per cent of the workforce

are now self-employed, with an increasing proportion in 'enforced self-employment' driven by businesses seeking to avoid employer responsibilities. Six per cent are on short-term contracts, and almost 3 per cent are on zero-hours contracts. More workers are on low pay than 10 years ago. Insecure and low-paid employment is increasing physical and mental ill-health.

- **The UK economy distributes rewards very unequally.** Between 1979 and 2012, only 10 per cent of overall income growth went to the bottom half of the income distribution, with almost 40 per cent going to the richest tenth of households. Although these households' incomes have fallen slightly since the financial crisis, the UK remains among the most unequal of western European countries. Nearly a third of children – four million – live in poverty, and this figure is now rising again.

The British economy suffers from deep structural problems. We have less a 'British economic model' than an 'economic muddle' – a mixture of powerful strengths and profound weaknesses. Many of these problems go back a quarter of a century or more. Many are the product of deliberate policy choices. Together they have generated an economy in which too much power is concentrated in too few hands.

- **We have both world-leading businesses and world-lagging productivity.** UK productivity is 13 per cent below the average for the richest G7 countries, and has stalled since 2008. Our leading firms are as productive as elsewhere, but we have a longer 'tail' of low-productivity businesses, in which weak management and poor use of skills leads to 'bad jobs' and low wages. A third of adult employees are overqualified for their jobs, the highest proportion in the European Union. This has been enabled by a labour market that is one of the most flexible, or deregulated, in the developed world. Too many sectors have effectively fallen into a low-pay, low-productivity equilibrium.
- **We have one of the world's largest financial sectors, yet a lower rate of investment than most of our major competitors.** Public and private investment is around 5 percentage points of Gross Domestic Product (GDP) below the average for developed economies, and has been falling for 30 years. Corporate investment has fallen below the rate of depreciation – meaning that our capital stock is falling – and investment in research and development (R&D) is lower than in our major competitors. Among the causes are a banking system that is not sufficiently focussed on lending for business growth, and the increasing short-termism of our financial and corporate sector. Under pressure from equity markets increasingly focussed on short-term returns, businesses are distributing an increasing proportion of their earnings to their shareholders rather than investing them for the future.
- **We are both succeeding and failing in international trade.** The UK has a trade surplus in services, but an overall current account deficit that – as a percentage of GDP – is the largest of all the G7 countries. This indicates a serious problem of competitiveness, made worse over recent decades by an overvalued currency. The UK's manufacturing sector now makes up just 10 per cent of GDP, lower than in most of our major competitors. The UK's exports are concentrated in a small number of sectors and many of our industrial supply chains are highly dependent on imports.
- **We have experimented with bold monetary policy, but are constrained by pre-Keynesian fiscal orthodoxy.** Since the financial crisis, the UK economy has been supported by extremely low interest rates and a major programme of 'quantitative easing' (unconventional money creation) by the Bank of England. Fiscal austerity – public spending reductions and tax rises – has left the UK's recovery in this period slower than almost all of our major competitors. Growth is now being fuelled again by consumer spending, based on rising debt and falling savings. With monetary policy having little further scope to deal with a slowdown, there is a strong case for increased public investment now to drive demand.

- **The economy depends on public spending, but we have not been sufficiently willing to pay for it.** Public spending cuts are putting increasing pressure on the public services on which our economy and society depend. These pressures are set to increase as the UK's population ages, particularly in health and social care and pensions: as the working-age proportion of the population declines, we will face a growing 'fiscal gap'. Public spending as a percentage of GDP is around 40 per cent, around the developed world average. Yet this exceeds total government receipts at around 37 per cent of GDP, and at around 33 per cent of GDP UK taxation is considerably lower than the average for comparable economies. The complicated nature of the British tax system, and the significant 'tax gap' between taxes owed and those collected, suggest that this is a field open to reform.

These structural problems argue for a new approach to economic policy. The case is made stronger by the challenges and opportunities confronting us as we enter the 2020s. Britain faces a 'decade of disruption', for which we are as yet largely unprepared.

- **Brexit** will be a momentous change to Britain's economic governance and trading relationships. While there remains considerable uncertainty about its impact in both the short and long term, it will clearly require – and may create opportunities for – the British economy to become more resilient and competitive, focussed on higher productivity and export performance.
- **Deeper globalisation** will continue to challenge the UK's role in international trade. As the international economy moves east and south, trade in data and services, in particular, will grow. With emerging economies increasingly able to compete in higher-value products, the UK will need to secure access to global markets in services, and to take advantage of new technological opportunities for advanced and more localised manufacturing.
- **Demographic change** raises serious questions for policymakers, with the population aged over 65 forecast to grow by 33 per cent (from 11.6 million to 15.4 million) by 2030, while the working-age population grows by just 2 per cent. An ageing population will lead to rising demand for spending on health and social care and pensions, and for immigration to bolster the labour force.
- **Technological change** has huge potential to improve living standards, but will need to be managed to ensure that the gains are fairly shared. Automation will change many jobs through advances in artificial intelligence, machine learning and robotics, but higher unemployment can be avoided if the productivity gains are translated into higher earnings and are re-spent in the economy. Society will also need to address the growth of digital companies with near-monopoly power in some markets and in the control of data.
- **Environmental degradation** is reaching critical global and local thresholds across a number of fields, including climate change, air pollution and global habitat loss. 'Green growth' offers significant opportunities for the UK, which is already a leader in some low-carbon and environmental industries. But it will require a much stronger policy framework, including for the almost wholesale decarbonisation of the economy by mid-century.

To respond to these challenges and opportunities of the future, and address the economy's structural weaknesses inherited from the past, the economy will need fundamental reform.

Reform of this kind has happened twice before in the last century, following similar periods of economic crisis. The established economic order broke down first after the Great Depression of the 1930s and then again after the oil shocks and 'stagflation' (simultaneous high unemployment and inflation) of the 1970s. In both cases, economic crisis led to a major shift in economic understanding, policies and institutions. The 2008 global financial crisis has precipitated a

comparable breakdown in the economic settlement of the last three decades. And in the same way that the postwar Keynesian settlement was established in response to the first breakdown, and the ‘free market’ or ‘neoliberal’ settlement by the second, we believe that a new settlement must now be forged today. This must be underpinned by a new understanding of what makes economies successful in the 21st century, drawing on the many powerful insights of modern economics.

This is, therefore, the moment for new, radical policy options to be debated. That means rethinking the institutions, frameworks and rules that govern the economy, and confronting the concentrations of economic power that hold back economic success. In exploring possible policy recommendations for our final report in 2018, the Commission seeks to define a new settlement for the 21st century underpinned by three principles of reform:

First, putting the economy on stronger institutional foundations, enabling long-term prosperity by providing the greater certainty that supports investment. We are considering:

- a new vision, indicators and institutions of economic policymaking, including a stronger partnership between governments, business, trade unions and civil society
- a new approach to macroeconomic policymaking, including fiscal, monetary and exchange rate policy
- a new settlement for the UK’s nations and regions, including new powers and institutions.

Second, making the British economy more competitive, more innovative and better set for long-term success. We are considering:

- a new approach to industrial strategy, aimed at strengthening innovation, raising productivity in the ‘everyday economy’ and using ‘missions’ to address major challenges, including reducing the economy’s impact on climate change and the environment, and responding to an ageing society
- improving entrepreneurialism and market competition, particularly through open data and a new framework for digital monopolies
- reforming the finance sector to support long-term investment, through both banking and equity markets
- reforming corporate governance to promote long-term business success.

Third, wiring the economy for justice. We are considering:

- how to promote better-paying and more secure jobs, including strengthening the role of trade unions, regulating unjust practices in the labour market, promoting better work/life balance and eliminating the gender and ethnic pay gaps
- reform of the tax system, to make it fairer, smarter and simpler
- measures to spread wealth more fairly, including better taxation, new approaches to housing and widening the ownership of firms.

This is an ambitious agenda to rewrite the rules of the British economy. For at this moment of uncertainty and anxiety, there is a profound risk that – in a very British way – we simply attempt to ‘muddle through’. That way will not address the issues we face. We believe the country now needs to chart a new direction. We must face up to the problems honestly, find the courage to confront them boldly, and act with vision and determination to seize the opportunities that lie ahead. By shaping the future through the active choices we make as a society, we can achieve prosperity and justice together.

Over the next year, the Commission will consult widely on our final report, which will be published in autumn 2018. We welcome reactions to the arguments and proposals we have made here and further contributions to our work.

About IPPR

IPPR, the Institute for Public Policy Research, is the UK's leading progressive think tank. We are an independent charitable organisation with our main offices in London. IPPR North, IPPR's dedicated think tank for the North of England, operates out of offices in Manchester and Newcastle, and IPPR Scotland, our dedicated think tank for Scotland, is based in Edinburgh.

Our purpose is to conduct and promote research into, and the education of the public in, the economic, social and political sciences, science and technology, the voluntary sector and social enterprise, public services, and industry and commerce.

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Note

The IPPR Commission on Economic Justice presents this Interim Report in order to stimulate vital public debate. Individual members of the Commission agree with the broad thrust of the arguments made in this report, but they should not be taken to agree with every word. Commissioners serve in an individual capacity, and this report should not be taken as representing the views of the organisations with which they are affiliated.

Thanks

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The IPPR Commission on Economic Justice is a landmark initiative to rethink economic policy for post-Brexit Britain. Launched in November 2016, the Commission brings together leading figures from across society – from business and trade unions, civil society and academia – to examine the challenges facing the UK economy and make practical recommendations for reform.

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