Skills, infrastructure and innovation are the essential drivers of the productivity growth on which the UK’s future prosperity depends. So while there are understandable concerns about the currently flat-lining economy, it is even more important to focus on vital long-term investments in these three areas. That requires stable and well-informed policy frameworks anchored in a broad political consensus on a new vision for growth.

These are among the conclusions of the London School of Economics (LSE) Growth Commission, which publishes its final report today. Investing in Prosperity: Skills, Infrastructure and Innovation is based on evidence taken in a series of public sessions from leading researchers, business people, policy-makers and UK citizens.

The LSE Growth Commissioners are Philippe Aghion, Tim Besley, John Browne, Francesco Caselli, Richard Lambert, Rachel Lomax, Chris Pissarides, Nick Stern and John Van Reenen.

The UK has major strengths, which, from 1980 onwards, helped to reverse a century-long relative decline. But the Commissioners note that a failure to invest – notably in skills, infrastructure and innovation – has long been a drag on the UK’s ability to achieve sustainable growth. They propose an integrated set of solutions:

**Education for growth**

*The quality of compulsory schooling in the UK is a fundamental growth issue.* Evidence suggests that increasing UK school standards even moderately – say to the level of Australia or Germany – could put the country on a growth path that would more than double long-run average incomes compared with current trends.

Better buildings, smaller class sizes, higher wages for teachers and greater provision of information technology will all help. But their effects are modest compared with the large potential benefits from **increasing the quality of teachers**.

Achieving this requires **greater flexibility in the UK school system**, with increased autonomy and the ability to grow within a national accountability framework that places a premium on radically raising the standards and aspirations of low achieving groups. Improved education for the disadvantaged has a double dividend as it both improves growth and reduces inequality, an endemic UK problem.

On vocational skills, **apprenticeships are a key way to tackle low basic and intermediate skills**. Employers need to be more involved in training, through a mixture of carrots – such as devolving more of the skills budget to them – and sticks – such as industry-specific training levies.

**Infrastructure for growth**

*The UK’s infrastructure of transport, energy, telecoms and housing are essential facilitators for growth.* Substantial investment is needed in all these areas as well as determined efforts to address the problems that have constrained growth in the past.

Political procrastination and the absence of a strategic framework have created ‘policy risk’, which deters investors from making long-term commitments. Decisions are rarely based on the best evidence and the planning system does not properly share the benefits of development, so that people who are adversely affected by new developments do not receive compensation and have little incentive to support them.

**The UK needs a new institutional architecture** to provide better delivery and funding of major infrastructure projects. This requires the right balance between democratic accountability and long-term strategic decision-making, so as to reduce policy risk and provide investors with the right incentives to support badly needed improvements in the UK’s infrastructure. **A new Infrastructure Bank would facilitate the provision of the stable long-term finance** that the economy needs.

**Innovation for growth**

*Investment in equipment and new ideas are crucial engines of growth.* UK investment as a share of GDP has historically been lower than in France and Germany. This largely accounts for the country’s lower GDP per hour worked. Moreover, the make-up of UK investment is heavily skewed towards property and buildings, rather than equipment, innovation and new technologies.

UK investment performance has been weakened by a series of problems in the functioning of capital markets. These include an inadequate supply of finance to young firms and small and medium enterprises (SMEs); ‘short-termism’ by managers and investors; insufficient competition in the banking system; a bias towards debt rather than equity in company finance; and the lack of a long-term industrial strategy.
The UK would benefit from a stable and coherent policy framework to encourage long-term investment and thereby generate higher productivity and increased prosperity. Two key policies are greater competition in retail banking and a business bank that prioritises lending to SMEs and innovative firms.

How to get to where we want to go

Professor Tim Besley, one of the two co-chairs of the LSE Growth Commission, comments:

‘Despite the current gloom, the UK has many important assets that can be harnessed to create growth, including competitive product markets, flexible labour markets, openness to foreign investors and migrants, independent regulators and a world-class university system.

‘But making the best of them and building institutional structures to support vital investments requires a bold and decisive strategy with an approach driven from the heart of government.’

Professor John Van Reenen, the other co-chair, adds:

‘Economic problems that have built up over many decades will not be resolved in the space of a few years. So it is vital to develop policies that look beyond the next budget cycle, the next spending review and the next parliament.

‘This is a manifesto for growth. We challenge the main political parties to form a consensus for long-run investment to achieve prosperity for our nation.’

ENDS

Further information:

The LSE (London School of Economics and Political Science) Growth Commission report – ‘Investing for Prosperity: Skills, Infrastructure and Innovation’ – was prepared in partnership with the Institute for Government, which provided expertise and advice on issues relating to the machinery of government. The Report will be published on Thursday 31 January 2013 and will be available to download on the LSE Growth Commission website from that date.

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The views expressed in the LSE Growth Commission report are those of the Commissioners. They do not necessarily reflect the views of the LSE, the Institute for Government or any of the other institutions or individuals mentioned above.

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