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
INSTITUTE FOR GOVERNMENT
CENTRE FOR ECONOMIC PERFORMANCE
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ESRC Economic & Social Research Council

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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:
  o Philippe Aghion
  o Lord John Browne
  o Francesco Caselli
  o Sir Richard Lambert
  o Rachel Lomax
  o Lord Nick Stern
  o Nobel Laureate Chris Pissarides
WHY AN LSE GROWTH COMMISSION?

• Focus on long-term structural issues beyond debates about austerity
• Numerous reports on growth. What’s different?
  – 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?
INTRODUCTION

• Optimistic story, UK has many assets
  – Rule of law, flexible labour market, competition, universities, openness
  – Reversal of relative decline in last 3 decades

• …But also 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
    • Outcome is low productivity

• Wanted: A Manifesto for Growth
SUMMARY

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

• 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

Innovation & investment,

Infrastructure

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 over long-term investment
  – Short-termism in economics (e.g. financial system)
  – Short-termism in politics (excess tinkering, rebranding, reversals, procrastination)
  – Independent expert advice & evaluations still limited
  – Populist pressure (e.g. NIMBYYism)

• Outcome is high uncertainty & low investment in long-term assets
THE INEQUALITY CHALLENGE: GROWING WAGE DIFFERENCES

Source: LSE Growth Commission
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WHY SKILLS MATTER

• 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
CORE PROPOSALS ON SKILLS

• Flexibility
  – Greater **autonomy, accountability & choice**
  – **Flexibility** for good schools to grow; e.g. **sponsored**
    academies take over struggling schools

• **Tackling disadvantage:** Current system focuses on
  average (e.g. floor targets) & not “long tail”
  – **Information, Inspection, Targets.** Performance across
    distribution (progression of disadvantaged avoids
    incentives to target marginal kids on threshold)
  – Expansion of academies in **disadvantaged** areas

• **Improving teaching quality**
  – Expansion of **Teach First, but** Wider intake
  – Rigorous selection at end of extended probation
  – Sharing best practice (e.g. London Challenge)
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

**Innovation & investment**

Infrastructure

Measuring Progress

Conclusions
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
The Economic Story of the UK

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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

Infrastructure Strategy Board

Strategic Advice

Policy Goals

Parliament & Government

Policy Framework

National Policy Statements

Infrastructure Bank

Independent Planning Commission
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”

“Third runway at Heathrow? Beijing builds an airport with seven”
The Times, 15th January 2013
The Economic Story of the UK

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Conclusions
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
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
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
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
MODUS OPERANDI

• Commissioner Meetings

• Evidence sessions

• Written Evidence

• Background documents

• Report

• Follow on …?
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)