Chapter Four

Rebooting Britain

Chapter summary

- The UK is the second-largest services exporter in the world and a broad-based services economy, built on successful musicians and architects as well as bankers. This is not the cause of our slow growth: services-led economies are on average higher-income than goods specialists.
- This will not change anytime soon: of the top 10 products the UK was most specialised in back in 1989, seven were in our top 10 in 2019.
- The task for Britain is to make a success of our services economy, including by wrestling with the upward pressure it places on inequality: jobs in tradable services are 80 per cent more likely than average to pay in the top 5 per cent while services exports are concentrated in the highest wage areas.
- While our current economic specialisation is consistent with future prosperity, our regional divides are not. The UK's most plausible route to raising national income and closing regional gaps is our big cities outside London succeeding: all of England's biggest cities outside London currently have productivity levels below the national average.
- But achieving this requires change on a scale not currently contemplated: halving Manchester's productivity gap to London, so that it becomes as productive as Edinburgh, would require tens of billions of pounds of investment and an increase in size of over 500,000 workers.
- The 2020s has to be a high-investment decade not just because of net zero, but because the UK has been a low-investment economy for too long. In the 40 years to 2019, total fixed investment in the UK averaged 19 per cent of GDP, the lowest in the G7.
- We need an economy better able to manage change. In the UK, 40 per cent of employed people experience a large loss of income when becoming non-employed, compared to 30 per cent of employed people in Germany and 26 per cent of employed people in France. This lack of income insurance not only provides too little support to those losing a job, but prevents risk taking.

- Good jobs must be an explicit objective of an economic strategy. We should celebrate the benefits of our flexible labour market, including low unemployment, but not be scared of tackling its flaws. Half of shift workers in Britain receive less than a week's notice of their working hours or schedules, and under 10 per cent of low-paid private sector workers are unionised.

- We should combine realism about the different roles of different places in our economy with an ambition to reject wide gaps in status and quality of life across the country. Delivering on that ambition is hard when council revenues per person fell by 30 per cent between 2009 and 2019 in the most-deprived places, compared to 15 per cent in the least-deprived places. The proportion of people thinking their local area has deteriorated in the preceding two years has risen steadily from 20 per cent in 2013-14 to 26 per cent in 2019-20.

- The British state has grown which, combined with slow growth, has seen taxes raised to their highest levels since the 1940s. But these higher taxes will need to be fair and efficient. Both main parties' focus on raising National Insurance has asked more of younger workers at a time of flatlining wages, but nothing of landlords or most pensioners. A strategy for the 2020s will need to consider new approaches, recognising that wealth has risen from three to almost eight times national income since the 1980s, while wealth taxes have not risen at all as a share of GDP.

Renewing our economic strategy

We have argued that the task facing Britain in the 2020s is to renew our economic strategy to tackle the twin challenges of low growth and high inequality, and to do so in a period of more significant change than we have been used to. It is far from certain that our politics will rise to this task: it is not an easy undertaking, and it remains unclear whether we are serious as a nation about confronting it.

This chapter turns to what the key building blocks of a more serious attempt might look like: one that is grounded in the evidence about the kind of economy the UK is and could plausibly be. It aims to be serious not just about the constraints and trade offs involved but also the scale of ambition required to make a substantial difference. Its argument is that there is a plausible landing zone for the kind of strategy that is needed, which offers the prospect not just of overcoming our problems but of building on our strengths to set the UK on a path to being a fairer, more prosperous, and greener country.

Intentionally our focus is on the most material elements of a renewed UK-wide strategy, rather than a comprehensive list of every policy area. The second phase of The Economy 2030 Inquiry over the coming year will develop specific policy interventions that would be required to make the implementation of such a strategy a success.

Getting serious about the nature of the UK economy: a broad-based services superpower

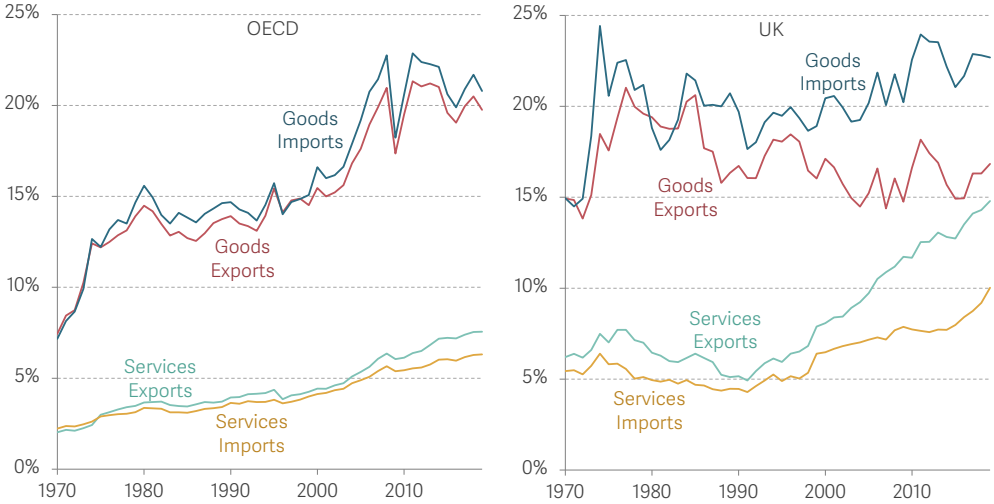
A foundational aspect of an economic strategy is clarity about what kind of economy it relates to, given that this underpins everything from the big picture of how growth is achieved and shared, to the specific policy choices a strategy might imply (for example, what should be prioritised in post-Brexit trade agreements).

It doesn't take a long time studying economic data to see that for the UK this starting point is our strength as a broad-based services economy. The view that our economy is narrowly built on banking is as misplaced as the claim that there is an easy route to turning ourselves into a German-style manufacturing powerhouse.

Services account for almost half of UK exports (45 per cent, or $418 billion),[1] which is roughly twice the OECD average share (Figure 26) and the clear majority of our trade in terms of value added.[2] Although it is rarely celebrated, the UK is in fact the second largest exporter of services in the world, behind only the US.

Figure 26: Services account for almost half of UK exports, roughly twice the OECD average

Goods and services exports and imports as a proportion of GDP: OECD & UK



Notes: The set of countries included in the OECD excludes those with missing data over the period.
Source: World Bank, Trade and Services Exports and Imports as a Proportion of GDP.

The UK's comparative advantages stretch across a broad range of high-value tradable services – not only banking and finance, whose proportion of total exports in fact fell from 12 per cent in 2009 to 9 per cent in 2019, but information and communications, cultural, and intellectual property services too.[3] When combined with important, but more concentrated, strengths in certain goods sectors, such as beverages and aerospace (see Box 8), our overall degree of export specialisation is typical for a country of our size and level of development. The UK is far from a one-trick pony.

1 J De Lyon et al., Enduring strengths: Analysing the UK's current and potential economic strengths, and what they mean for its economic strategy, at the start of the decisive decade, Resolution Foundation, April 2022.

2 Services excluding construction contribute 63 per cent of value added as a proportion of total value added, see: OECD, Trade in Value Added (TiVA), Principal Indicators, 2021.

3 Analysis of ONS, UK Trade in Services; UK Trade in Goods.

Box 8: The role of manufacturing

Recognising that the UK's economy is, and will remain, a services-led economy should not mean giving up on manufacturing: it is not an either/or situation with the UK having significant, albeit concentrated, manufacturing strengths to build on and these often being highly complementary with related services.

The UK currently specialises in pharmaceuticals (as part of the wider life sciences sector), as well as beverages and aerospace.[4] Understanding what we are already good at as a nation is important to supporting future areas of strength that are likely to be closely aligned to existing capabilities. Our analysis indicates that potential manufacturing opportunities for the UK are clustered in the chemicals and machinery categories – including the production of medical equipment. The UK's specialisms in 'clean' technologies could also be built upon, with the UK within the top 10 exporters of 'green products'.[5]

Supporting our existing manufacturing strengths, and building new ones, will be central tasks for a renewed economic strategy. But more weight cannot be placed on manufacturing within the strategy than it can plausibly bear. For example, claims that it can be a main driver of high-quality, high-paying jobs growth are overdone. The entirety of manufacturing now accounts for just 8 per cent of employment in the UK and the parts of manufacturing likely to grow after Brexit are lower paying (e.g. food manufacturing).

A plausible economic strategy should be grounded in the UK economy remaining services-dominated

If the UK is to thrive during the 2020s it will be by making a success of these existing industrial strengths – embracing as well as adding to them – and ensuring more people and places enjoy the benefits from such an approach. The alternative – of basing a renewed strategy on attempting a significant industrial transformation (as some leading politicians, at least rhetorically, are

4 J De Lyon et al., Enduring strengths: Analysing the UK's current and potential economic strengths, and what they mean for is economic strategy at the start of the decisive decade, Resolution Foundation, April 2022.

5 B Curran et al., Growing clean: Identifying and investing in sustainable growth opportunities across the UK, Resolution Foundation, May 2022.

keen to do) – is highly unlikely to be successful, in large part because it is very unlikely to happen.[6] If we are to succeed, it will be as a better version of Britain, not a British version of Germany.

Countries' industrial specialisations are highly persistent: the UK has been a services superpower for over four decades, and of the top 10 products in which the UK was most specialised in 1989, seven were also in our top 10 in 2019. Even a huge change like Brexit will not fundamentally change this, as discussed in Chapter Two. Attempting to transform the UK into a manufacturing-heavy economy would require huge investments (reflecting countries such as Germany and South Korea having materially larger stocks of physical and human capital) and lower consumption for years, with far from guaranteed success. Internationally, major swings between goods and services specialisation by advanced economies are extremely rare, reflecting the strong role of accumulated knowledge, capital, institutions, and experienced labour in being able to compete globally in high-value-added sectors that are central to maintaining our living standards.

Moreover, there are good reasons for the UK to build on what we already do well. Our industrial structure does not lie behind our weak economic performance: on average, services specialists like the UK are richer than manufacturing specialists. And our product mix is perfectly consistent with rapid export growth: global demand actually grew faster in our key export industries than in China's in the decade to 2019, but China's exports grew twice as fast.[7] India's demand for business services and telecommunication and computer services, two competitive UK export sectors, is expected to more than triple in real terms between 2019 and 2030.[8]

Our non-tradable sectors are central to an economic strategy, but are unlikely to be the main drivers of growth

Most goods and many services can be traded fairly cheaply over long distances within or between countries – think of sunflower oil, mobile phones, and song rights. For the rest, trade is too expensive or impractical, or is limited by the

6 George Osborne promised a "march of the makers" in 2011, HM Treasury, 2011 Budget: Britain open for business, March 2011; J Elgot, Labour vows to reverse decline in UK manufacturing, The Guardian, February 2022.

7 J De Lyon et al., Enduring strengths: Analysing the UK's current and potential economic strengths, and what they mean for is economic strategy at the start of the decisive decade, Resolution Foundation, April 2022.

8 S Hale, A presage to India: Assessing the UK's new Indo-Pacific trade focus, Resolution Foundation, January 2022.

need for production and consumption to take place in the same location – think of fresh croissants or a haircut. Some have suggested that an economic strategy should approach growth by focusing on the latter (non-tradable) sectors rather than the former (tradable) sectors.[9] But such an approach would be misguided.

An economic strategy needs to focus on creating a bedrock of decent jobs in every place, as we turn to below. And good jobs in non-tradable sectors are foundational to such an approach – they account for 60 per cent of hours worked in the UK, and provide vital goods and services.[10] But these sectors should not be the central focus when it comes to raising growth and productivity.

In fact, aiming to increase the proportion of jobs in non-tradable sectors would reduce productivity in the economy overall: tradable industries are around 14 per cent more productive than non-tradable industries[11] which have a higher share of lower-paid jobs.[12] There are desirable ways to raise productivity in non-tradable sectors, but focusing efforts to raise productivity there may also be risky. Not only can such gains be hard, or undesirable, to realise (for example by reducing the delivery of face-to-face social care), but the main effects may be lower prices for higher-earning consumers while intensifying work for lower earners. We should pause before taking that approach to raising productivity, given that the proportion of workers who say their job requires that they work "very hard" is already high, having increased from 30 per cent in the early 1990s to 46 per cent pre-pandemic.[13]

Our goals instead should be to increase the employment proportion and productivity of tradable sectors while improving pay and conditions in non-tradable sectors, as Box 9 explores. This may involve higher prices (a subject we return to below).

9 R Reeves, The everyday economy, March 2018.

10 B Broadbent et al., The Brexit vote, productivity growth and macroeconomic adjustments in the United Kingdom, Bank of England, August 2019.

11 These two categories inevitably hide a huge amount of productivity variation within sectors and there are some kinds of non-tradables – such as health and education – that help to make the whole economy more productive, as well as being valuable in their own right. The figures on employment and productivity in the tradable and non-tradable sectors are taken from B Broadbent et al., The Brexit vote, productivity growth and macroeconomic adjustments in the United Kingdom, Bank of England, November 2020.

12 J De Lyon et al., Enduring strengths: Analysing the UK's current and potential economic strengths, and what they mean for its economic strategy, at the start of the decisive decade, Resolution Foundation, April 2022.

13 K Shah & D Tomlinson, Work experiences: Changes in the subjective experience of work, Resolution Foundation, September 2021.

Box 9: The implications of growing the tradable sectors

Shifting more workers into tradable sectors generally will tend to raise GDP somewhat on the basis of its higher productivity levels: boosting the proportion of hours in tradables by 5 percentage points – equal to the fall in the share between 1994 and 2018 – would increase aggregate productivity by 0.7 per cent. More significant gains would come from policy makers focusing on growing the size of higher productivity parts of the tradable sector and productivity levels across the sector.

Boosting employment in the tradables sector can help the economy more widely. For example, suppose that the economy consists only of car factories (tradable) and restaurants (non-tradable). If people move jobs from restaurants to (higher-paying) car factories, they will seek to spend more money going out for dinner. There are two possibilities at this point. Either the restaurants find a way to become more productive and serve more customers with fewer staff, boosting GDP and restaurant wages, or they don't, and the restaurants compete for waiting staff and raise their wages and prices to choke off the extra demand.

Recognising the nature of the UK economy is also important in tackling the challenges it brings

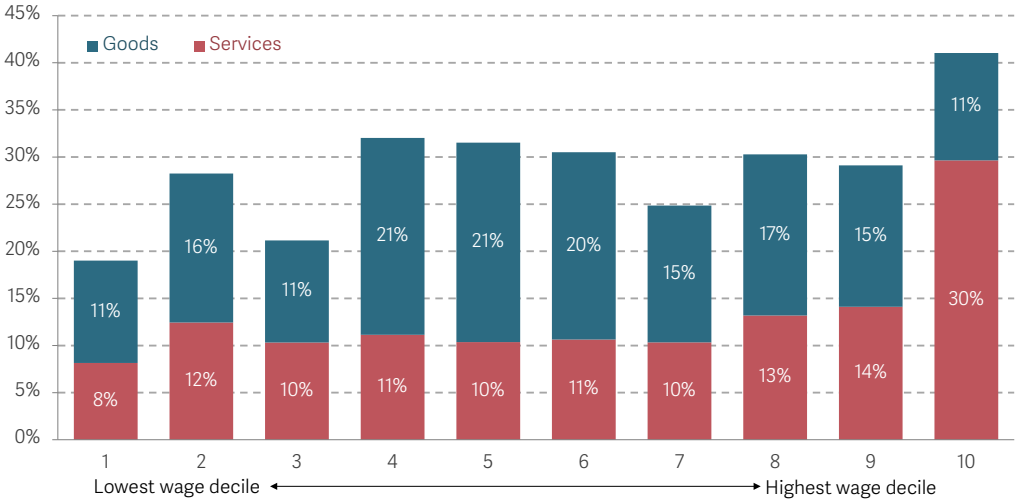
We need to understand the nature of our economy, not only to make a success of formulating and implementing an economic strategy, but also to address the downsides it brings. The key aspect to highlight is that tradable services, all else being equal, push up on inequality between people and places. In 2016-17, over half of the around 50,000 people in the top 0.1 per cent of the UK taxable income distribution worked in 'finance, insurance, and real estate' or were providing 'professional, scientific, and technical services'.[14] Moreover, as Figure 27 shows, while goods exports are fairly evenly spread across areas irrespective of local wage levels, services exports are much more concentrated in highly-productive areas accounting for 30 per cent of gross value added

14 M Brewer & C Samano Robles, Top incomes in the UK: analysis of the 2015-16 Survey of Personal Incomes, Institute for Social and Economic Research, 2019

(GVA) in the highest wage areas, compared to less than 15 per cent across the rest of the country.[15] And jobs in tradable services are 80 per cent more likely than average to pay in the top 5 per cent.[16]

Figure 27: Tradable services are concentrated in the highest-income regions of the UK

Goods and services exports as a proportion of gross value added (GVA) across regions grouped by real wage decile: UK, 2018



Notes: Each NUTS region is assigned to a real income decile based on regional average real wages in 2018. The share of services and trade is calculated as a share of GVA for that group of regions. Services excludes regions with no services trade data and Northern Irish regions for which no data available.
Source: Analysis of ONS, International Trade in Services by Subnational Areas of the UK; ONS, UK Regional Trade in Goods Statistics Disaggregated by Smaller Geographical Areas.

So action will be required to ensure that the benefits of the UK's trade specialisation are widely shared. This is clearly possible. France and the US specialise in services exports and are very productive, but the former has lower household inequality and the latter a better spread of productive places than the UK. Recognising the nature of our economy is not the same thing as welcoming all aspects of it, but an economic strategy that fails to understand it is no strategy at all.

15 J De Lyon et al., Trading places: Brexit and the path to longer-term improvements in living standards, Resolution Foundation, October 2021.

16 J De Lyon et al., Enduring strengths: Analysing the UK's current and potential economic strengths, and what they mean for its economic strategy, at the start of the decisive decade, Resolution Foundation, April 2022.

Getting serious about the constraints holding the economy back

A renewed economic strategy doesn't just need to be clear-eyed about our strengths, it also needs to put up in lights the big barriers that hold us back from making a success of the kind of economy we want to become.

This inevitably involves judgements about the extent to which these barriers are amenable to policy change. Unlike our biggest strength, our persistent and deep services specialisation, some major constraints can and should be shifted. Here we take the most salient barriers to widely shared economic prosperity in our services-led economy in turn: the UK's unbalanced economic geography, prolonged underinvestment in capital in all its forms, and the extent to which welfare policy and high housing costs prevent our economy from being as dynamic as it could be.

Ending the underperformance of major cities outside London is a national priority but requires change far beyond anything currently contemplated

UK economic spatial disparities are large. In 2019, London produced £76,000 of value added per job, more than twice that produced in Powys and Torbay.[17] And they are persistent: 60 per cent of the pre-pandemic variation in productivity across areas can be explained by the pattern in 2002, while 80 per cent of the variation in incomes across local authorities can be predicted by the pattern in 1997.

But while the starting point for an economic strategy should be to accept path dependency on our industrial structure, it must confront elements of it on economic geography. While our current economic specialisation is consistent with future prosperity, our regional gaps are not – as Michael Gove has noted, the UK is like a jumbo jet running mostly on one (London and the South East-shaped) engine.[18]

The services-led nature of our economy tells us what a plausible route to overcoming this problem will be. High value services industries thrive when similar firms co-locate in large places with highly educated populations: cities.

17 P Brandily et al., Bridging the gap: What would it take to narrow the UK's productivity disparities?, Resolution Foundation, June 2022.

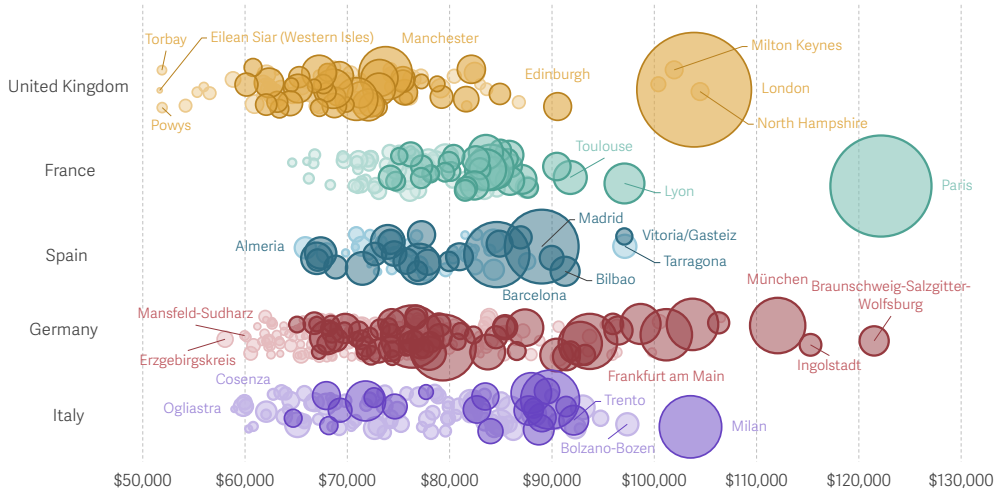
18 M Gove, Britain's a jet plane that needs to be firing on all its engines...not just the one in the South East and London, The Mail on Sunday, January 2022.

Indeed, during the 21st century this pattern has been reinforced, along with the importance of an area's workforce size, skill levels, and stocks of capital (including intangibles) in determining its productivity growing.

Our large regional productivity gaps fundamentally reflect our failure to ensure that enough of our big cities, all deeply scarred by deindustrialisation, have successfully made the transition to contribute to our national success in tradable services. London alone accounts for 63 per cent of the UK's surplus in services trade, and aside from Edinburgh, the UK does not have any highly-productive mid-sized metro areas (see Figure 28).[19] The popular focus on lower productivity gaps between places in Germany offers little guide for the UK in the 2020s, with its more even spread of output reflecting a goods-dominated economy. But France, also a services-led economy, has more-productive second cities, like Lyon, which stand out relative to the likes of Birmingham and Manchester: Paris is only 26 per cent more productive than Lyon, whereas London is 41 per cent more productive than Manchester.

Figure 28: The UK's large cities are further behind the capital than in France

Gross value added (GVA) per worker by country and area: 2018



Notes: PPP adjusted. Spatial units are a combination of OECD metro regions and NUTS3 for non-metro regions. Metro areas are shown in darker bubbles in the figure. Bubbles are proportional to the number of workers in each region. Gross value added (GVA) is the value of a unit's outputs less the value of inputs used in the production process to produce the outputs.
Source: Analysis of OECD, Regional Economy Database.

19 ONS, International trade in services by subnational areas of the UK: 2018, September 2020.

Turning this around is certainly possible, with a welcome consensus emerging about the need to 'level up' our country and some major policy shifts (including a commitment to increase public R&D spending – an important enabler of economic growth – outside the Greater South East by 40 per cent between 2021-22 and 2030).[20] And there are signs of success to build on: between 1997 and 2015, the share of total GVA from business services in Leeds rose from 8.7 per cent to 15.8 per cent – an increase which took it from below the economy-wide share (9 per cent in 1997) to well above it (12.4 per cent by 2015).[21]

This focus on cities is not a strategy for the few: 69 per cent of the UK population live in cities or their hinterlands, compared to 56 per cent in France and just 40 per cent in Italy.[22] And generating productivity growth in our core cities does not simply support incomes in nearby areas – Buckinghamshire has the same average income as London despite productivity being £20,000 per job lower – it also has the potential to drive further productivity gains in these nearby areas: proximity to large economically productive areas is key in explaining the high levels of productivity in North Hampshire.[23]

But this change will be far from easy or swift. Coming close to halving the productivity gap between London and Manchester (to that seen between Edinburgh and London or Lyon and Paris ie 15 to 20 per cent) requires change equivalent to increasing Manchester's size, graduate share, and capital stocks by 20 per cent. This amounts to many tens of billions of pounds of investment and an increase in Greater Manchester's size by just over 500,000 workers. Change on that scale should be our objective, but it is not consistent with national politicians refusing to concentrate their efforts or local politicians being unable to embrace the disruption involved because they lack the powers to shape it. On both the scale of investment and the crucial role for devolved governance arrangements enabling meaningful economic leadership, there are international lessons to learn from successful 'turn-around' cities.[24]

20 Department for Levelling Up, Housing and Communities, Levelling up the United Kingdom, February 2022.

21 ONS, Regional Gross Value Added (Income Approach) by Local Authority in the UK.

22 Analysis of OECD, Metropolitan Areas Dataset.

23 P Brandily et al., Bridging the gap: What would it take to narrow the UK's productivity disparities, Resolution Foundation, June 2022.

24 P Collier et al., Chapter in Economy 2030 Inquiry international case studies book, Resolution Foundation, forthcoming.

Once again, it is important to consider what this strategy will, and will not, achieve. Successfully closing productivity gaps between cities does not mean every city becoming like London: they will, and would, specialise in different sectors and remain very different in size, culture, and housing costs. But ensuring that more places are part of the cutting edge of the UK economy holds out the possibility of raising national growth and shrinking regional productivity gaps. Although it should raise incomes in poorer regions and reduce national inequality, within-region inequality in productivity and incomes would be likely to widen. Policy makers will need to proactively seek to connect those from more deprived areas to the opportunities created. And without an active housing policy, higher productivity and earnings will lead to higher housing costs, with much of the benefits of economic success flowing to the owners of land rather than workers.[25]

British firms investing more is central to their own, and the country's, future

Many of the challenges the UK is wrestling with have parallels elsewhere: low productivity growth in Italy, high inequality in the US, or an economy dominated by its capital city (France). But when it comes to low business investment, the UK is in a league of its own. This low level of investment may have made sense when the UK was the most advanced economy in the world with a huge capital stock advantage over its competitors, but that was a century ago: the current state of affairs is a recipe for relative decline. In the 40 years to 2019, total fixed investment in the UK averaged 19 per cent of GDP, the lowest in the G7 and some 4 percentage points below G7 average of 23 per cent.[26] Persistent low investment means that virtually all of the productivity gap with France is explained by French workers having more capital to work with.[27] It should be obvious that UK policy debates should focus on the danger of too little automation rather than too much.[28]

25 E Moretti, Local Labor Markets, in O Ashenfelter & D Card (eds.), Handbook of Labor Economics, North Holland, 2011.

26 Analysis of OECD data. This is calculated as simple averages of the ratio of total gross fixed capital formation (GFCF) to GDP, in current prices.

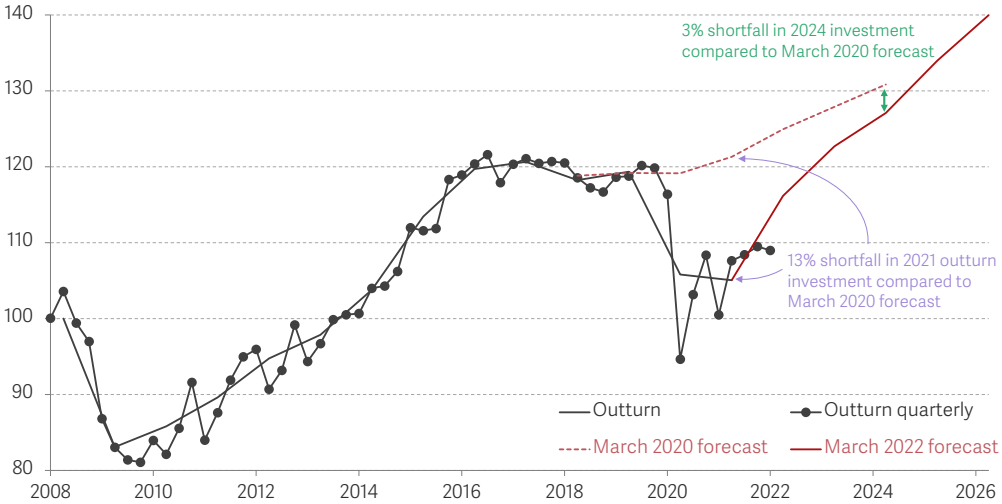
27 The productivity gap with the US can be partly explained by poor management practices; just 11 per cent of UK firms are as well-managed as the best quarter of US firms. This is covered in detail in: J Oliveira-Cunha et al., Business time: How ready are UK firms for the decisive decade?, Resolution Foundation, November 2021.

28 S Farrell, UK economy has "too few robots", warn MPs, The Guardian, September 2019.

Low investment is not driven by our industrial structure, and nor is the problem in the 2020s with the public sector: after decades of underinvestment the Government has now increased public sector net investment to its highest sustained levels since the 1970s.[29] It is the private sector where our lack of investment is acute and where a renewed economic strategy should focus (Figure 29).[30]

Figure 29: Business investment has underperformed and is not recovering strongly from the pandemic

Index of real business investment, outturn, and select forecasts (2008 = 100): UK



Source: Analysis of OBR, Economic and Fiscal Outlook (various).

A clear economic strategy would in itself help to reduce the economic and policy uncertainty underpinning weak investment growth over the past half-decade. Tax does matter, and the Chancellor has already made a persuasive case for his plans to look again at whether our corporate tax system can do more to encourage capital investment and R&D.[31] But there are limits to the role of traditional tax incentives, which struggle to cover most intangible investment, in an economy like the UK's. Wider questions of business culture, management quality, and financing should be considered, alongside how more firms can benefit from the UK's world-class research.

29 OBR, Public Finance Databank, April 2022.

30 J Leslie, Bouncebackability: The UK corporate sector's recovery from Covid-19, Resolution Foundation, June 2022.

31 R Sunak, Chancellor Rishi Sunak's Mais Lecture 2022, HM Treasury, February 2022.

And once again, the trade offs of a strategy that boosts private sector investment must be recognised. When all potential workers are employed, the amount that the economy can produce is more or less fixed in the short run. Using more workers to make investment goods – such as building materials and machine tools – means having fewer workers available to wait tables. In other words, there is a trade off in the short run between investment and consumption. Alternatively, the investment goods could be imported, rather than made at home with domestic labour, but the extra imports will need to be financed by foreign debt. So, even though higher investment is crucial, we need to recognise that it is not cost free in the short run.

Human capital progress must be sped up and shared out

The immediate post-pandemic period appears to be one where the rising labour force participation we were used to in the 2010s has come to a sharp halt, and as such the quality of labour supply is all the more important.[32] But, as noted in Chapter One, our rate of human capital progress has slowed and the stock is markedly unequal. While popular debates focus on whether we have too much education, the reality is one of growing gaps in education and skills between places, something that the Covid-19 pandemic may have reinforced.[33] Schools in the most deprived areas of England experienced larger real-term spending cuts between 2009-10 and 2019-20 (a 14 per cent reduction) than those in the least deprived areas (a 9 per cent reduction).[34] And debates about whether university expansion has gone too far sit alongside the reality that Higher Education (HE) 'black spots' still exist in the more deprived areas of the UK.[35] Over half of state school-educated young people in London entered HE by age 19, compared to 37 per cent in the South West.[36] Rather than a so-called brain drain from poorer areas, young people from the most-deprived areas

32 M Broome, Big welcomes and long goodbyes: The impact of demographic change in the 2020s, Resolution Foundation, June 2022.

33 L Elliot Major, A Eyles, & S Machin, Pupils lost a third of their expected learning during COVID, with Wales and Scotland even further behind, London School of Economics, July 2021.

34 L Sibieta, 2020 annual report on education spending in England: schools, Institute for Fiscal Studies, September 2020.

35 This inequality is all the more concerning because there is so little education provision between Level 3 (e.g. A-levels) and Level 6 (e.g. degrees). In England, only 4 per cent of 25-year-olds hold a Level 4 or Level 5 qualification as their highest Level. By contrast, in Germany, Levels 4 and 5 make up 20 per cent of all HE enrolments. For more discussion of this see: Department for Education, Independent panel report to the Review of Post-18 Education and Funding, May 2019.

36 Office for Students, Place matters: Inequality, employment and the role of higher education, November 2021.

are 2.5 times less likely to leave their home area upon reaching adulthood than their peers in the least deprived quintile (17 per cent compared to 42 per cent).[37]

Too often, discussions of how to restart this progress get bogged down in a row between the merits of HE and, chronically underfunded, further education (FE) when the evidence shows that they are complementary. HE is key to providing lots of vocational training, such as for nursing, just as FE is both a route into HE and an independent route to many qualifications that are in short supply – from lorry driving to plumbing. The sheer scale of the decline of workplace training in the UK (see Chapter One) needs more attention than employers' complaints about skills shortages.

Significant policy change is already underway in this area. With the Apprenticeship Levy, whatever its wider challenges, the Government is rightly recognising that levies will have to play a central role in turning around the collapse in workplace training. But a purposeful human capital strategy must go much further, recognising the urgency of ensuring we are prepared for the specific challenge of the net zero transition and the general challenge of boosting the UK's competitiveness against the backdrop of stagnant productivity growth.

Barriers to workers' resilience and a more dynamic economy must be addressed

Chapter Two described how the decade ahead will see an acceleration of labour market change, even if not to the highs of previous decades. We must do a better job than we have in the past to help workers losing their jobs navigate this involuntary change. But an economic strategy for the 2020s also needs to go further and confront the worrying lack of 'good change' seen in the UK in recent years.

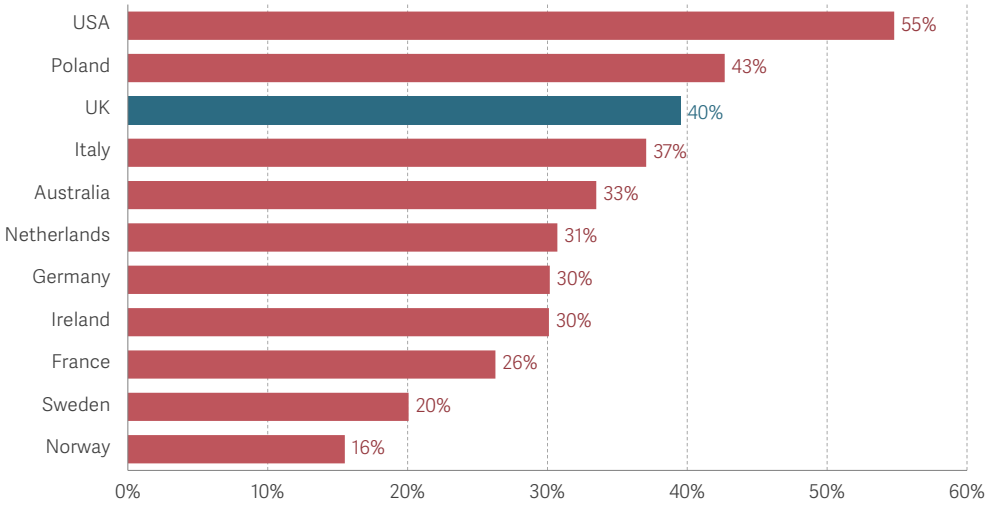
On both fronts, the UK's lack of income insurance is a concern, limiting risk taking in the labour market, and causing people to suffer unnecessarily when they experience the pain of redundancy (see Figure 30). Our social security system is highly unusual in providing some groups with very little support if they lose their jobs. In the UK, 40 per cent of employed people experience a large loss of income when becoming non-employed, compared to 30 per cent

37 L Judge & D Tomlinson, All over the place: Perspectives on local economic prosperity, The Resolution Foundation, June 2022.

of employed people in Germany and 26 per cent of employed people in France (Figure 30). Such large income shocks make the risk of job loss very high unless wider support is available from family, friends, or savings. It was for good reason that a furlough scheme providing furloughed workers with 80 per cent of their previous earnings was introduced at the start of the pandemic.

Figure 30: The UK has a high proportion of people likely to face a large income loss when becoming unemployed but a low risk of unemployment

Proportion of employed people experiencing a large income loss when becoming non-employed: selected OECD countries, early 2010s or latest



Notes: Large income losses are defined as 20 per cent or more income losses from one year to the next. Data for the United States refer to bi-annual transitions. Data is for the working-age population (18-65).
Source: OECD, A Broken Social Elevator? How to Promote Social Mobility.

Income falls at job loss are larger for middle and higher earners and our qualitative research found that this lack of insurance weighed on their minds when it came to considering taking labour market risks.

> *"I'm the main earner of the house. ... If I really wasn't happy, OK, I might look for other jobs, but I wouldn't just quit mine and walk. If my wife really wasn't happy in her job, we could probably get by without her working while she was looking for something else. But as [the] main breadwinner, no, I see it as my job to keep my salary coming in."*
>
> (Focus group participant, Chippenham)

High, and highly variable, housing costs present another barrier to workers taking up new opportunities. The propensity of young private renters to move home and job fell by two-thirds between 1997 and 2018.[38] In part, this is a result of improved labour markets in previously low-employment areas. But it also reflects private rents rising faster in higher-paying areas, materially reducing or removing the financial incentive to move to more productive places. Even among home owners, large gaps in house prices present a huge barrier to moving into a more expensive area. It is unsurprising, then, that this century a larger proportion of those changing address are relocating to lower-housing-cost areas.[39]

Addressing these barriers to voluntary job moves would benefit individuals, with job switches a key route to higher pay and better job matching.[40] More workers changing jobs and moving into higher-productivity firms would also help with our national productivity challenge, and would be much more useful than boosting the 'long tail' of low-productivity firms that has been a focus for policy makers.[41] Firms in the 'long tail' are so unproductive that they cannot play a major role in raising aggregate output: raising the productivity of the least productive firms employing 40 per cent of workers by 10 per cent would raise productivity by only 1.2 per cent. In contrast, transferring one-tenth of those workers into high-productivity firms (assuming, for illustrative purposes, that could be done without affecting the productivity of those firms) would boost productivity by some 6 per cent.[42]

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38 L Judge, Moving matters: Housing costs and labour market mobility, Resolution Foundation, June 2019.

39 L Judge, Moving Matters: Housing costs and labour market mobility, Resolution Foundation, June 2019.

40 N Cominetti et al, Changing jobs?: Change in the UK labour market and the role of worker mobility, Resolution Foundation, January 2022.

41 Department for Business, Energy and Industrial Strategy, Business productivity review: call for evidence, May 2018.

42 J Oliveira-Cunha et al., Business time: How ready are UK firms for the decisive decade?, Resolution Foundation, November 2021.

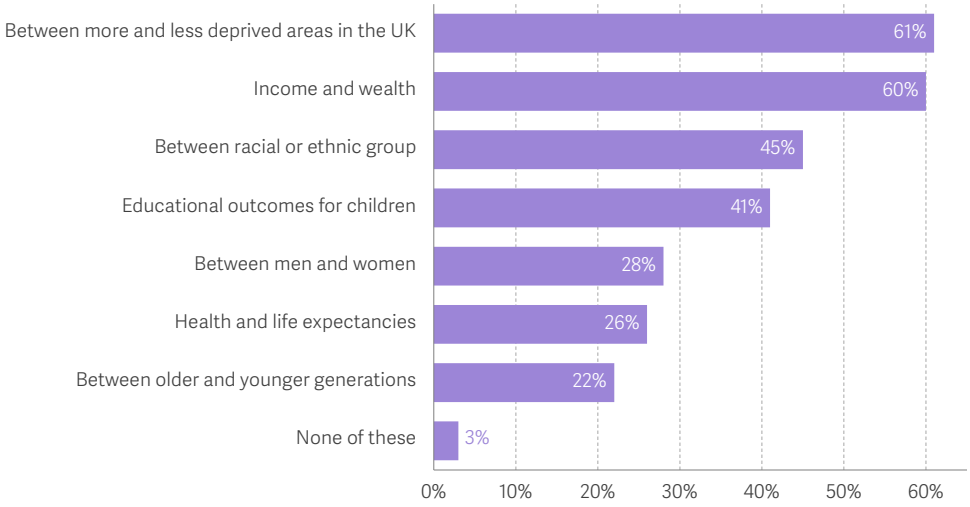
A serious economic strategy will be as hard-headed about lower inequality as it is about higher growth

A renewed economic strategy needs to be as hard-headed about what it will take to ensure a fairer country as what is needed to end its relative economic decline. The goal for the 2020s is not to become like the US, which is far richer than the UK but also far more unequal.

Large gaps between people and places undermine parity of dignity and respect, which are central components of a shared citizenship of a country. As a result, in the long run an unbalanced and unequal economy risks being democratically – and therefore in time economically – unsustainable. Indeed, the last decade across advanced economies has put the nature of the feedback loop from economic dissatisfaction to political upheaval back to deteriorating economic outcomes up in lights.

Figure 31: Place, income, and wealth inequalities are viewed as the most serious divides by Britons

Responses to the question: which three or four of the following types of inequality, if any, do you are most serious in Britain: Great Britain, 2020



Source: B Duffy et al., Unequal Britain: Attitudes to inequalities after Covid-19, The Policy Institute, King's College London, February 2021.

Democratic legitimacy depends on governments making headway with the challenges that the public pose, and it is clear that people think that inequality between places, and the income and wealth gaps between households, are of concern. As Figure 31 shows, these are raised as the "most serious" inequalities in the country by six in ten Britons.

The gaps between people are not just unsustainable in theory but also in practice. A country where four-tenths of the lowest-income households could not manage for one month on savings pre-pandemic is not resilient.[43] And it is not a sustainable state of affairs that the number of families experiencing destitution at some point in 2019 reached more than 1 million in the UK, an increase of a third compared to 2017.[44]

Too much of our public debate is superficial about what it takes to reduce entrenched inequalities between people and places. Huge productivity gaps between places are supposed to be solved by asking councils to bid for small pots of cash, while political competition on the level of the minimum wage has not be matched by any wider progress on the quality of work for low earners. Firms think that embracing Environmental, Social and Governance (ESG) metrics counts as sufficient progress, while others suggest that a bit more tax and spend might just do the job. A more serious approach would start from the fact that while jobs delivering services exports will be concentrated in certain areas, good jobs and places to live should not be.

Good jobs should be an explicit goal of economic policy

Good jobs, with decent pay and conditions, are the bedrock of widely-shared prosperity and should be the norm everywhere. This not a by-product of a successful economic strategy but a central objective for it. Work is an important source of meaning and contribution for people, as well as a source of income.[45]

43 Analysis of Wealth and Assets Survey.

44 S Fitzpatrick et al., Destitution in the UK 2020, Joseph Rowntree Foundation, December 2020.

45 K Handscomb, L Judge & H Slaughter, Listen up: Individual experiences of work, consumption and society, Resolution Foundation, May 2022.

Britain's flexible labour market is highly effective at generating a good quantity of work. The importance of this for low-income families is often unrecognised: the poorest half of households experienced two-thirds of the jobs growth in the decade after the financial crisis.[46]

However, recognition of the strengths of our flexible labour market – including the way in which the UK has avoided an entrenched insider–outsider problem that can hold back younger or more disadvantaged workers – has too often translated into a reticence to address its weaknesses.[47] The alternative to the status quo is often seen to be a return to the strife of the 1970s.

This false dichotomy has left us relying on a tight labour market, where unemployment is low and vacancies are high, to give workers power to demand better terms and conditions. While attention right now is on workers attempting to exercise such power in the face of high inflation, the lesson from recent decades as a whole is that waiting for a booming labour market to drive up standards is risky. Not only is it far from the norm, but this approach has left us with a labour market with high weekly wage inequality, where individuals do not feel empowered to ask for pay rises,[48] while low-paid workers feel less involved in workplace decisions[49] and face much higher insecurity than the rest of the workforce (see Figure 32).[50] Trade union membership has fallen from over 50 per cent to under 25 per cent during the past four decades,[51] and it is under 10 per cent among the lowest earners in the private sector, with this decline explaining one-sixth of wage inequality among men between 1983 and 2019.[52]

46 S Clarke & N Cominetti, Setting the record straight: How record employment has changed the UK, Resolution Foundation, January 2019.

47 T Biergert, Labor market institutions, the insider/outsider divide and social inequalities in employment in affluent countries, Socio-Economic Review, November 2017.

48 Ipsos, Global perceptions of inflation 2022, May 2022.

49 K Shah & D Tomlinson, Work experiences: Changes in the subjective experience of work, Resolution Foundation, September 2021.

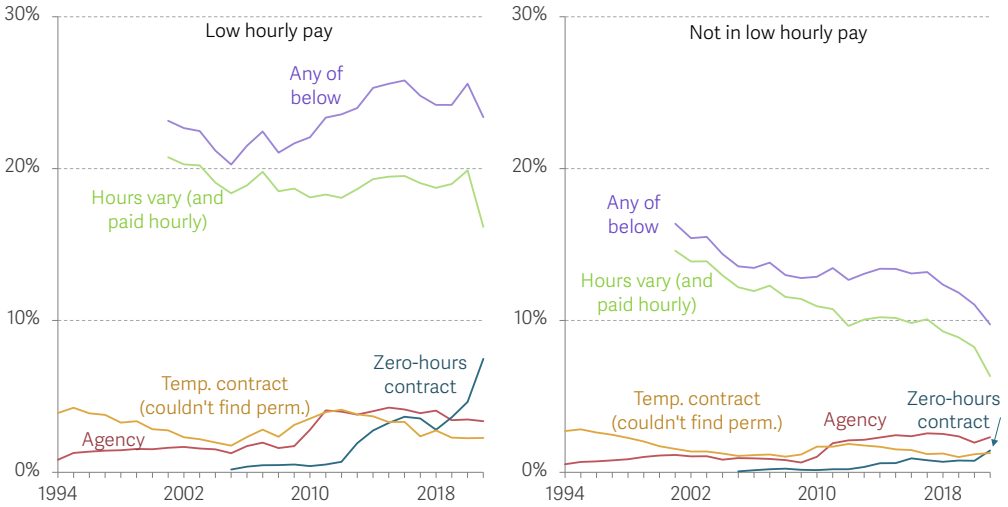
50 N Cominetti et al., Low Pay Britain 2022: Low pay and insecurity in the UK labour market, Resolution Foundation, May 2022.

51 U Altunbuken et al., Power plays: The balance of employer and worker power in the UK labour market, Resolution Foundation, July 2022.

52 Analysis of ONS, Labour Force Survey.

Figure 32: Low-paid workers are around three times more likely than higher-paid workers to experience contract insecurity or volatile hours and pay – and the gap has been growing

Proportion of employees experiencing different forms of contract insecurity or volatile hours and pay, by whether in low hourly pay: UK



Notes: Low pay is defined as hourly pay below two-thirds of the median. Includes employees only.
Source: Analysis of ONS, LFS.

Two lessons from history should make us consider a more active approach. First, raising the minimum wage from 46 per cent of median pay for those aged 25+ in 1999 towards a goal of two-thirds by 2024, without costing jobs, has provided us with important evidence that power imbalances in the UK labour market exist and that policy can address them.[53] Indeed, the latest evidence suggests that wages could be between 15 and 25 per cent lower than they would otherwise be because of employer power over workers.[54] These

53 Low Pay Commission, The National Living Wage Review (2015-2020), May 2022.

54 Some indirect estimates based upon how quickly workers leave firms with low wages in the US – a labour market with a lower (and falling) labour share, a lower minimum wage, and less collective bargaining than the UK – suggest that wages could be between 15 and 20 per cent lower than they would be otherwise because of employer power over workers. See: M Langella & A Manning, Marshall Lecture 2020: The Measure of Monopsony, Journal of the European Economic Association 19(6), December 2021. Recent evidence from the UK suggests an even higher wage markdown, of between 20 and 25 per cent. See: N Datta, Local Monopsony Power, January 2022.

estimates are extremely imprecise – but a wage markdown of 15 per cent, at the conservative end of these estimates, would mean the average worker today is losing out on almost £100 a week.[55]

Second, low levels of worker power are not an essential feature of our labour market. While other aspects of our economic model have remained largely consistent over decades, our labour market institutions changed markedly during the 1980s.[56]

A new approach might see national labour market regulations used to tackle well-established problems such as low weekly earnings, uncertainties around hours and shifts, and the rise in low-paid self-employment.[57] For example, half of shift workers in Britain receive less than a week's notice of their working hours or schedules.[58] Existing rights also require stronger enforcement, while the UK could also learn from the experiments and institutional reforms taking place in other countries with flexible labour markets to improve labour market outcomes.[59] For example, new sectoral wage boards in New Zealand will set minimum standards across particular sectors of the economy.[60] We should also be thinking about how we might improve the quality of specific occupations that are likely to grow and have the potential to provide large numbers of geographically distributed jobs. There are several over which government has significant influence. Primary examples include health and care work, and the jobs required to install insulation and low-carbon heating in homes across the country.

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55 U Altunbuken et al., Power plays: The balance of employer and worker power in the UK labour market, Resolution Foundation, July 2022. Average weekly pay (excluding bonuses and arrears) was £562 in April 2022. If employers are marking down pay by 15 per cent, average weekly earnings would be £661 in the absence of employer power over workers – that is, average wages would be £99 a week higher. Source: Office for National Statistics, AWE: Whole Economy Level (£): Seasonally Adjusted Regular Pay Excluding Arrears, June 2022.

56 U Altunbuken et al., Power plays: The balance of employer and worker power in the UK labour market, Resolution Foundation, July 2022.

57 A quarter of employees are in low weekly pay, and 20 per cent of this group (1.4 million people) express a desire to work more hours. For more detail on the range of issues facing low-paid workers in Britain's labour market, see: N Cominetti et al., Low Pay Britain 2022: Low pay and insecurity in the UK labour market, Resolution Foundation, May 2022, Resolution Foundation, May 2022.

58 J Richardson, The insecurity complex: Low paid workers and the growth of insecure work, Living Wage Foundation, July 2021.

59 Issues with the UK's labour market enforcement regime were explored by the Government-commissioned Taylor Review. Department for Business, Energy and Industrial Strategy, Good work: The Taylor Review of modern working practices, July 2017; for discussion of low-paid self-employment, see: C D'Arcy, The minimum required? Minimum wages and the self-employed, Resolution Foundation, July 2017.

60 D Tomlinson, More than we bargain for: Learning from new debates on how institutions can improve worker pay and security in Anglo-Saxon economies, Resolution Foundation, November 2019.

There are real trade offs of raising wages, particularly in non-tradable jobs such as hospitality, retail, and care. Higher prices are a likely result. But cross-country evidence indicates that, for a given level of productivity, higher wages in non-tradable industries, paid for by higher prices, can make an economy more equal.[61] This reflects workers in non-tradable industries tending to be lower paid. This approach is also consistent with a growth strategy that seeks to raise productivity via workers exiting lower-productivity firms, which is – for example – what was seen after the introduction of the German minimum wage.[62]

Our qualitative research indicates that people understand there is no route to politicians delivering on their promises that all jobs will be available everywhere. Indeed, many feel it would be undesirable in failing to reflect local differences, and are more positive about young people who want to leave their local area for work and study than is commonly portrayed.[63] But realism about what economic activity will take place locally – be that roles in warehouses in Barnsley or tourism in Scarborough – was combined with a clear wish for those jobs to be better. Meeting that wish should be a priority during the 2020s.

> *"[Participant 1] You know, we are not a big city. We're a small coastal town...So, you know, we've got to make the best of what we've got.*
>
> *[Participant 2] If we had a massive water sports centre here too – surfing, windsurfing, powerboating, training for the fishermen as well – that would be a massive help...we're near the coast, it's such a great opportunity that not all have."*
>
> (Focus group participants, Scarborough)

61 We obtain this result by quantifying the relationship across countries and over time between how expensive the cost of a given basket of goods is (i.e. how high the real exchange rate is) and how big the difference is between wages at the 10th and 50th percentiles of the wage distribution, using a linear regression. If the price of tradable goods is similar across countries (because they are tradable) then the real exchange rate will be driven by differences in the price of non-tradable goods. We establish this relationship using a panel linear regression. We control for productivity (TFP) to strip out any effect from richer countries tending to be more or less equal, and because more productive countries tend to be more expensive (the Balassa-Samuelson effect). A 10 per cent increase in the real exchange rate reduces inequality by about 1/6th of a standard deviation. The effect is qualitatively similar for the ratio of the 90th percentile of workers' earnings to the 50th percentile.

62 C Dustmann et al., Reallocation effects of the minimum wage, CReAM discussion paper, February 2020.

63 L Judge & D Tomlinson, All over the place: Perspectives on local economic prosperity, Resolution Foundation, June 2022.

> *"I think it's changed a lot, Barnsley. Every family and generations going back were mining, and that's now shut down. Barnsley is now trying to create industrial estates, putting small technology firms, small businesses, that's cropping up all the way and we've got big warehouses because we're near the M1 motorway. Barnsley is diversifying."*
>
> (Focus group participant, Barnsley)

The public are serious about good places to live

As well as their work, people care deeply about their locality: two-thirds of people in England report that they feel they belong either "very" or "fairly" strongly to their local neighbourhood.[64] Although they are generally very positive about the place they choose to call home, people are also clear about what needs to be done to improve things locally. Issues that are raised almost everywhere should be centre stage in an economic strategy, such as the state of high streets and town centres, the quality and availability of public services, the capacity of local government to deliver the basics, and the challenge of connectivity within and between places.[65]

> *"There isn't really anything...Nothing vintage or nothing cool that's going to make you want to hang out in the town. When I walk through the town I just want to get through it as quickly as possible."*
>
> (Focus group participant, Scarborough)

The Government has received criticism for their 'Levelling Up' agenda focusing on liveability rather than just productivity, but such an approach has merit given the public's reasonable aspirations for their areas that will require economic policy support to realise.[66] But while the direction of travel is positive, the policy approach taken to date – allocating small pots of cash for improving local areas via competitive bidding regimes – is deeply flawed. A striking 18 per cent of all revenue grants and 30 per cent of all capital grants for

64 Department for Digital, Culture, Media & Sport, Community Life Survey 2020/21, July 2021.

65 L Judge & D Tomlinson, All over the place: Perspectives on local economic prosperity, Resolution Foundation, June 2022.

66 Department for Levelling Up, Housing and Communities, Levelling up the United Kingdom, February 2022.

local authorities are wound up every year, making long-term planning difficult.[67] And providing grants for specific improvements misses the importance of the 'basics' that are too often lacking, unsurprisingly with council revenues per person falling by 30 per cent between 2009 and 2019 in the most-deprived places, compared to 15 per cent in the least-deprived places.[68] From long waits at A&E, to teacher shortages and the decaying of our public spaces and high streets – the sense that public services and the public realm are lacking the investment they need is real and acute in poorer areas. This directly feeds through into a sense of local decline in many places, with the proportion of people thinking their local area has deteriorated in the preceding two years rising steadily from 20 per cent in 2013-14 to 26 per cent in 2019-20.[69]

There will be tensions between the push towards fiscal devolution to underpin more local economic leadership discussed above with the need set out here to ensure poorer areas have the funding required for a decent public realm. But it is a tension many other less centralised countries navigate successfully and so should the UK.

Realism about the different roles of different places in our economy should be combined with an ambition to reject the wide gaps in status and quality of life that are too often associated with that. Good jobs and places to live everywhere should be the universalist promise of a renewed economic strategy.

The state will grow, but it must be funded fairly and efficiently

Despite, or perhaps because of, its centrality to politics and policy debates, there is more wishful thinking about the state than any other component of economic strategy. Politicians declare their low-tax 'instincts' while raising taxes to their highest levels since the 1940s, or call for a smaller state and a bigger army.

Forecasts of changes in public spending into the medium-term are heavily dependent on demographic projections, which are revised regularly and often substantially. There are some clear pressures on the size of the state

67 A Breach & S Bridgett, Centralisation Nation: How a broken system of local government harms the British economy, Resolution Foundation & Centre for Cities, forthcoming.

68 T Harris, L Hodge & D Phillips, English local government funding: Trends and challenges in 2019 and beyond, Institute for Fiscal Studies, November 2019.

69 Department for Digital, Culture, Media & Sport, Community Life Survey 2020/21, July 2021.

in the years ahead: spending on the State Pension will rise as the number of people aged 65 and above increases by 20 per cent between 2020 and 2030; [70] healthcare spending has been growing faster than other spending throughout the 2010s and this is likely to continue;[71] and net zero will require the state to do more. In addition, pressures to address new geopolitical realities (with new commitments to raise defence spending to 2.5 per cent of GDP) and to reverse the deterioration in the quality of public services will persist.[72] On the other side of the ledger, the latest population forecasts imply a large (9 per cent) fall in the number of under-15s over the course of the 2020s, reducing pressures on education spending; [73] and recent revisions to population projections assume a lower life expectancy than the previous vintage and a lower 'old age dependency ratio'.[74]

So a serious economic strategy needs to wrestle with how to manage fiscal pressures, in whatever shape and size they materialise, at a time when many of the strategies used to respond to previous spending pressures are either not available or desirable. Health, education, and social security spending nearly doubled as a proportion of GDP between 1955-56 and 2019-20, in large part funded by shrinking defence spending (from 8 per cent of GDP in 1955-6 to 2 per cent – the level committed to as part of NATO membership – in 2022) or cutting public sector investment (a damaging trend that the Government has rightly reversed).

With other margins of adjustment exhausted, taxes are rising: the latest forecasts are for them to hit levels not seen since the Second World War (or the 1980s, depending on the measure focused on). The question of who pays these taxes (across the income distribution and the generations) and on what basis (be it income, expenditure or wealth) will be central. And new answers will be needed. Over recent decades, both main parties have turned to increases in National Insurance (NI) to fund spending increases. Most recently, in September 2021, the Government announced additional spending on health and social care, funded by increases in NI worth around £17 billion per year.[75]

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70 M Broome, Big welcomes and long goodbyes: The impact of demographic change in the 2020s, Resolution Foundation, June 2022.

71 K Shah, J Smith & D Tomlinson, Under pressure: Managing fiscal pressures in the 2020s, Resolution Foundation, February 2022.

72 J Lee, UK defence spending to rise as dangers increase - PM , BBC, June 2022.

73 C Giles & S Joiner, Population changes provide UK with unexpected boost to public finances, Financial Times, February 2022.

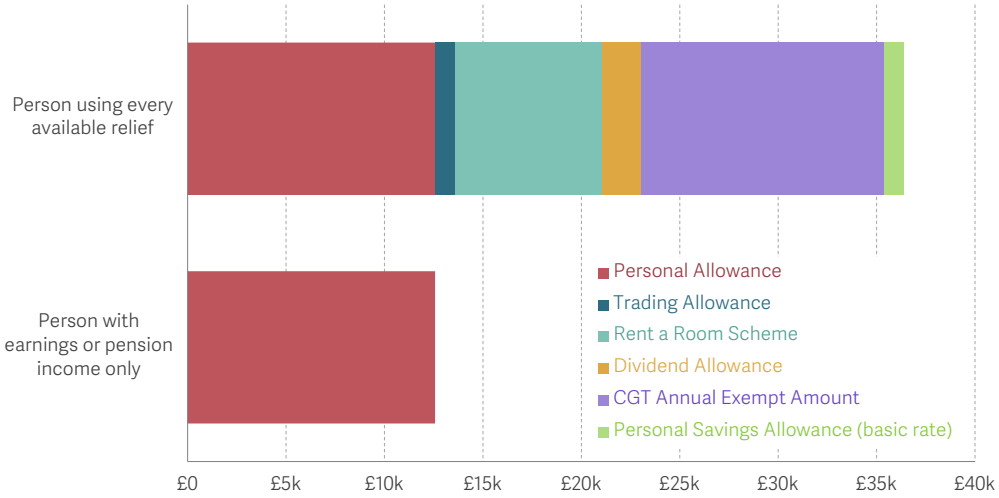
74 ONS, National population projections: 2020-based interim, January 2022.

75 OBR, Economic and Fiscal Outlook, March 2022.

These tax rises are progressive, but fall disproportionately on the working-age population: a typical 25-year-old today will pay an extra £12,600 over their working lives from the employee part of the tax rise alone, compared to nothing for landlords and most pensioners.[76] Landlords are not asked to contribute, while their working tenants very much are. This is not what a good strategic response to the dilemma of needing to fund higher spending in an era of weak earnings growth looks like.

Figure 33: Income from diverse sources is liable for less tax

Total amount of tax-free income available to a person with earnings and/or pension income only, and a person using every available relief: UK, July 2022 to March 2023



Notes: Person using every available relief includes: income from employment, self-employment, room-rental, dividends, capital gains & savings. A person could also use the tax free ISA allowance on top of this, however all ISA income is tax-free so this has not been included here.
Source: Analysis of HMRC.

Fairer, and more efficient, approaches will need to be explored in the years ahead. Our tax system currently hugely benefits those (largely richer and older) who do not rely solely on wages for their income and who often have choices over which form to take it in. Not only do many of them incur a lower tax rate than is charged on earnings (for example, capital gains are

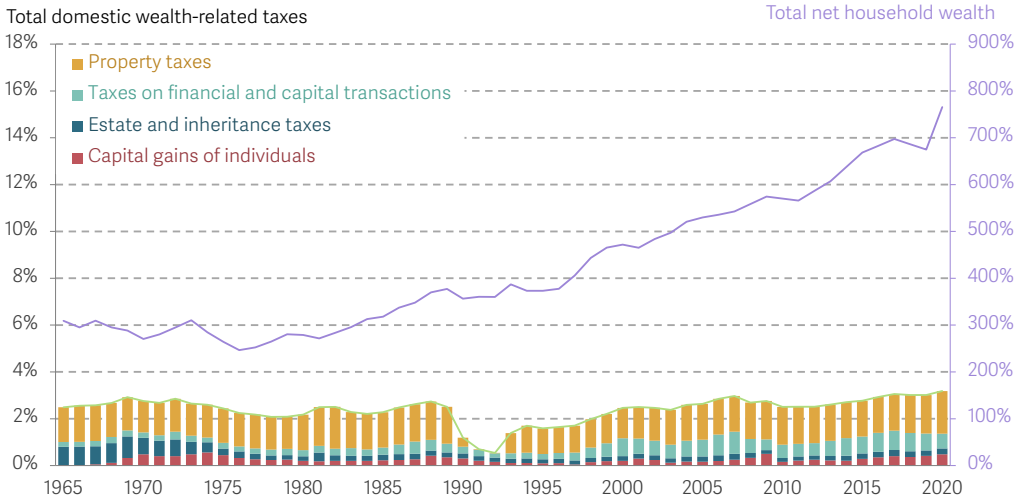
76 T Bell et al, Nationally Insured?: New taxes and new spending to address key Department for Health and Social Care priorities, Resolution Foundation September 2021.

taxed at lower rates than other income), but – as demonstrated in Figure 33 – those with multiple sources of income (from the likes of dividends, capital gains, rent, or savings) can exploit separate tax allowances to pay far lower tax than an employee with the same income. [77]

Policy makers will also need to wrestle with the related challenge of the very different trajectories for income and wealth discussed in Chapter One. Although the amount of wealth held by private households has risen from three times GDP to nearly eight times GDP since the 1980s, there has been no increase in the related tax take as a proportion of GDP, as Figure 34 shows. [78]

Figure 34: Wealth tax revenues have not risen in line with wealth

Total wealth and wealth taxes as a proportion of GDP: GB, 1965-2020



Notes: Estimated 2020 value calculated by multiplying the value of wealth as a proportion of GDP from the Wealth and Asset Survey by the growth rate in this value found between 2019 and 2020 in the National Accounts.
Source: Analysis of D Blake & J Orszag, 'Annual estimates of personal wealth holdings in the United Kingdom since 1948', Applied Financial Economics 9, 1999; ONS, UK National Accounts, ONS, Total Wealth, Wealth in Great Britain, ONS Gross Domestic Product at market prices; Current price: Seasonally adjusted £m; OECD, Details of Tax Revenue.

77 G Bangham et al., Unhealthy finances: How to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2021.

78 K Shah, Wealth on the eve of a crisis: Exploring the UK's pre-pandemic wealth distribution, Resolution Foundation, January 2022.

Those on lower incomes must be protected from the costs of net zero and a benefits system that leaves many exposed to hardship

While fair taxes are often at the centre of political debates, the fair financing of the net zero transition will be a relatively new addition during the 2020s. But it will be a crucial one if the high levels of public support for net zero, and progress on the transition itself, are to be maintained. The state's top priority should be to protect low-income households from the upfront costs, in particular when it comes to the home heating transition, where the most immediate challenge is improving the energy efficiency of our housing stock. After years of policy failures, efficiency installations in Britain's homes are running at around 10 per cent of the levels seen in the early 2010s.[79] To keep us on track for net zero this needs to change fast, with low-income property owners highly exposed: 72 per cent of them live in homes rated EPC band D (the average energy efficiency rating for UK homes) or below.[80] The average cost for bringing such homes up to band C standard is estimated at over £8,000 per household, which means it simply will not happen without government intervention given that the average income of poorer homeowners after housing costs is around £9,100.

The challenge to some lower-income households posed by the transition to net zero sits alongside a longer-term trend: the incomes of the poorest in society are low and have failed to keep pace with the rest of society in recent years. Living standards have barely improved for lower-income households for much of this century: the typical incomes of the poorest fifth of the population were no higher on the eve of the pandemic than they were back in 2004-05, despite GDP per person growing by 12 per cent over this period. This partly reflects decisions around benefit levels, as we show in Figure 35: the basic level of unemployment benefit has been completely decoupled from income levels of the rest of society and now stands at its lowest rate on record (£77 per week, which is equivalent to just 13 per cent of average pay).[81]

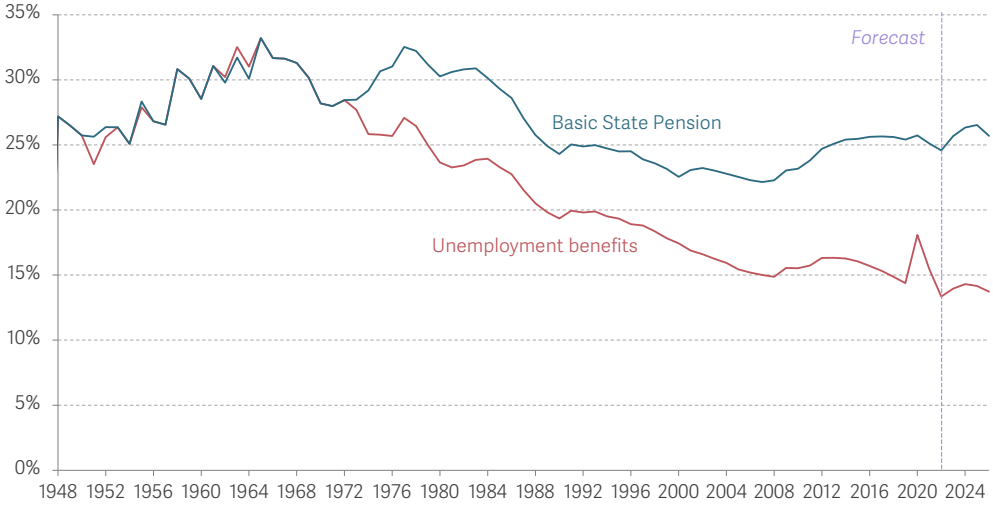
79 A Corlett & J Marshall, Shrinking footprints: The impacts of the net zero transition on households and consumption, Resolution Foundation, May 2022.

80 Properties are rated on how efficient a property is, with bands from A to G. The most efficient homes are in band A, and the least efficient are in band G. The Government has set a target of all homes reaching a C rating on the EPC scale by 2035.

81 A Corlett, F Odamtten & L Try, The Living Standards Audit 2022, Resolution Foundation, July 2022.

Figure 35: The basic level of unemployment benefit is now just 13 per cent of average pay, its lowest level on record

Value of selected benefits as a share of Average Weekly Earnings: UK



Source: Analysis of DWP, Abstract of Benefit Statistics; ONS, CPI; OBR, Economic and Fiscal Outlook March 2022; Bank of England, Monetary Policy Report May 2022.

Developments for disabled people and larger families are particularly concerning. While the overall spend on disability and ill-health related benefits has increased because of a rising caseload, the generosity of those benefits has not. In fact, disabled people are at increased risk of poverty, with almost a third (31 per cent) of households with a disabled adult being in poverty in 2019-20, compared to 19 per cent of families in which no one is disabled.[82] Similarly, the result of successive social security policy changes, such as the introduction of the benefit cap and two-child limit, is that by 2019-20, almost half (47 per cent) of families with three or more children were in poverty, up from 33 per cent in 2012-13.[83] An renewed economic strategy that is even remotely serious about reducing inequality will need to put these trends into reverse.

82 Joseph Rowntree Foundation, UK Poverty 2022: The essential guide to understanding poverty in the UK, January 2022.

83 M Brewer et al., Social insecurity: Assessing trends in social security to prepare for the decade of change ahead, The Resolution Foundation, January 2022.

Our macroeconomic policy framework needs rebooting

Spending pressures will be easier to meet if we can sustain GDP growth, while avoiding major downturns is particularly important for those on lower incomes. For example, after the 1980s recession those towards the bottom of the income distribution were six times more likely to be unemployed than those towards the top.[84] These are among the reasons why a strong macroeconomic policy framework, where policy makers have the tools to stabilise the economy, is crucial.

Today's macroeconomic policy framework – centred around an inflation-targeting Bank of England that has the primary responsibility for stabilising the economy – faces significant challenges. The focus today is on high inflation, but the Bank clearly has the tools to avoid that becoming entrenched and is using them, with interest rates increasing by 1.15 percentage points between December 2021 and June 2022 to reach the highest level in 13 years.[85] But the Bank has less room for manoeuvre when it comes to the opposite problem, a downturn. With interest rates trending down now for several decades, the central bank has far less scope to cut them to support the economy during a recession because of the zero effective lower bound (ELB) on interest rates (which means they cannot fall materially below zero).

Just because this is not today's problem does not mean it is one we should continue to ignore. Macroeconomic policy makers have had to improvise in the last two recessions. When the financial crisis hit, they partially relaxed the ELB with quantitative easing (pushing down longer-term interest rates) and a discretionary fiscal stimulus. The same thing happened again in the Covid-19 recession, albeit with fiscal policy doing the lion's share of the work.

But after 14 years and two 'once in a generation' recessions with Bank rate at or near the ELB, there is a strong case for more sustainably reforming the macroeconomic policy framework for the new era we find ourselves in. The scale of constraint in the current system is illustrated by the fact that interest rates were cut by just 0.65 per cent in the pandemic compared to a norm of around 5 percentage points in a downturn before the financial crisis.[86] If policy does not have enough room to react in the next recession, living standards,

84 J Smith et al., Recession ready? Assessing the UK's macroeconomic framework, Resolution Foundation, September 2019.

85 Bank of England, Bank Rate increased to 1.25% – June 2022: Monetary Policy Summary and minutes of the Monetary Policy Committee meeting, June 2022.

86 J Smith et al., Recession ready? Assessing the UK's macroeconomic framework, Resolution Foundation, September 2019.

especially of low-to-middle income households, will suffer. The dangers of repeated improvisation include a lack of certainty about how policy makers will respond as well as institutional risks from confusion about the respective roles of monetary and fiscal policy (this is well illustrated by recent proposals to tax the banking system, either implicitly[87] or explicitly,[88] in order to mitigate the costs to the taxpayer or rising interest rates).

There are a number of avenues that should be explored to reduce the constraint on monetary policy, including a higher inflation target or moves to make negative interest rates practical in the UK. The way in which fiscal policy is able to help support the economy in a recession could also be strengthened, while recognising that the recent pattern of very large fiscal stimulus during a downturn will require lower borrowing in normal times than would otherwise be the case.

Towards a renewed economic strategy

Despite its huge strengths and privileges, Britain has become a stagnation nation of low growth and high inequality. The task of the 2020s is to turn that around. This will require us to be honest about where growth may come from, and the scale of change required to meaningfully address inequalities between people and places. But this chapter has also demonstrated that policy makers should reject fatalism, given the significant strengths of the UK economy and the existence of plausible routes to rebuilding our economic strategy during the 2020s. This initial outline of a plausibly successful economic strategy for the UK will give direction to our work in the second half of The Economy 2030 Inquiry. From this jumping off point – not bound by the economic or policy status quo, but being realistic about where we start from as a country and some of the legacies that need to be grappled with – we will build a series of proposals that when combined could turn a strategy into a reality.

Implementing it wouldn't be easy, with difficult economic and political trade offs. The scale of those challenges means some will ask whether it is worth it, especially if they see slow growth and our high inequality as inevitable (perhaps because of lower technological progress and increased returns to skills). The next, and final, chapter discusses how we should wrestle with these questions.

87 National Institute of Economic and Social Research, Quantitative tightening: Protecting monetary policy from fiscal encroachment – one year on, June 2022.

88 F Van Lerven & D Caddick, Between a rock and a hard place: The case for a tiered reserve monetary policy framework, New Economics Foundation, June 2022.