

Economic policy in the turbulent 2020s after the sluggish 2010s

Transitioning from crisis management to structural reform

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**This essay represents the views of the author and not necessarily those of the Bank of England.*



Navigating Economic Change
Lessons from abroad and history

Navigating Economic Change

As the UK is buffeted by the economic shocks and challenges of the 2020s, The Economy 2030 Inquiry, a collaboration between the Resolution Foundation and the Centre for Economic Performance at the London School of Economics (LSE), funded by the Nuffield Foundation, is publishing a series of essays examining how policy makers from a range of advanced economies, including the UK in the recent past, have managed periods of disruptive economic change. As we seek to reformulate the UK's economic strategy for new times it is vital that we learn the lessons of these comparative and historic perspectives.

Some consider the trajectory of a national economy following a major shock – for instance, Germany after unification, New Zealand after the UK joined the European Community, Estonia post-USSR and the UK during the tumultuous 1980s. Others examine the experience of particular cities – for instance a group of post-industrial ‘turn-around cities’ - or the adjustment of key features of a national economic system, such as Danish ‘flexicurity’. Together they offer a powerful and timely set of insights on the successes and failures of economic policy makers in the face of economic shocks and structural change.

The essays are written by a range of leading economists and national experts and reflect the views of the authors rather than those of the Resolution Foundation, the LSE or The Economy 2030 Inquiry.

They have been commissioned and edited by Gavin Kelly (Chair of the Resolution Foundation and member of the Economy 2030 steering group) and Richard Davies (Professor at University of Bristol and fellow at the LSE's Centre for Economic Performance).

The Economy 2030 Inquiry

The Economy 2030 Inquiry is a collaboration between the Resolution Foundation and the Centre for Economic Performance at the London School of Economics, funded by the Nuffield Foundation. The Inquiry's subject matter is the nature, scale, and context for the economic change facing the UK during the 2020s. Its goal is not just to describe the change that Covid-19, Brexit, the Net Zero transition and technology will bring, but to help the country and its policy makers better understand and navigate it against a backdrop of low productivity and high inequality. To achieve these aims the Inquiry is leading a two-year national conversation on the future of the UK economy, bridging rigorous research, public involvement and concrete proposals. The work of the Inquiry will be brought together in a final report in 2023 that will set out a renewed economic strategy for the UK to enable the country to successfully navigate the decade ahead, with proposals to drive strong, sustainable and equitable growth, and significant improvements to people's living standards and well-being.

The last few years have been tumultuous with a pandemic and war upending people, businesses, and economies. Sweeping emergency policies have been implemented in response to these shocks. Even as we start to emerge out of this current phase these measures and their impacts continue to influence economic outcomes which, in turn, feedback into policymakers' decisions.

It is too early to judge which of the different emergency policy packages were 'best', since the shockwaves and policy spillbacks continue to roil economies. Moreover, these shocks did not take place against a backdrop of robust and inclusive economic growth. Many countries were already facing economic headwinds – sluggish productivity growth, challenging inequalities, rising exposures to climate change – that sapped economic performance and undermined societal wellbeing.

A huge amount has been written about the 2020s shocks, their repercussions, and the policies put in place to confront them: for example, on the health and sectoral effects of Covid-19, supply chain disruptions and bottlenecks, and skyrocketing prices for energy and food due to Russia's invasion of Ukraine. Similarly, much has been written about the 2010s and aftermath of the Global Financial Crisis: particularly, sluggish productivity growth, the fraying social and political cohesion on account of inequalities within and across generations and regions, the rising costs of climate change alongside the promise and pitfalls of technological innovation and adoption.

The aim of this essay is to step back from detailed assessments of these different crises and focus on the key challenge facing policymakers: how to transition from a crisis-policy phase to a longer-term agenda that tackles underlying economic, social, and environmental challenges. What are the realistic prospects for a coherent transition to a new phase for policy? And, more specifically, to what extent do the emergency policies provide a useful jumping-off point, or do they delay and distract us from making the necessary shift to a more future-focused agenda?

Policies for recent turmoil versus policies for long-term headwinds

Three themes structure this assessment of the prospects for a transition from 'emergency mode' to a long-term approach that tackles underlying trends: to enhance sustainability, reduce scarring, and enable transformation.

Sustainability can refer to many things, but here it is used broadly to capture fiscal, climate, and societal sustainability and the interactions among them. To what extent are there tensions between the approach taken in the emergency response to recent shocks and those needed to tackle the systemic challenges of low productivity growth, high inequality, and rising costs of climate change?

For instance, the increase in government spending and borrowing arising from the pandemic response measures and energy shocks could constrain the fiscal space required to raise productivity growth and achieve net zero.

On the other hand, climate policy using market-based mechanisms – such as a carbon tax or emission trading scheme (ETS) – can raise revenues that could be used to ameliorate the differential impact of the costs of the energy transition. These market-based policy mechanisms would not only incentivise energy efficiency but could also catalyse the private innovation, finance, and capital expenditure needed to shift energy systems toward greener production and processes.

The second theme we explore is scarring. Scarring refers to the negative, potentially permanent, impacts of a shock and how they can impact on particular groups (for example young or older workers), types of firms or regions of the country. Following the pandemic there appears to be various types of scarring affecting different age groups (for example, those that lost valuable early years of education).¹ The business community also bears scars – whether in terms of bankruptcies, reduced investment, supply chain bottlenecks or a fall in business formation. We need to understand whether recent emergency policies have helped or hindered pre-existing inequalities and sluggish productivity growth.

The third theme we explore is transformation. Transformation involves changes in the behaviour of firms and workers, often resulting from a shift in incentives or norms, that increases their productive capacity. Transformation often occurs via sectoral and geographic reallocations of labour and capital in response to changes in policies, production systems or patterns of demand. From an economic perspective, terms used to describe what is referred to here as transformation include ‘growth in potential supply’ and ‘total factor productivity growth’. This theme is perhaps the most central of all and has a strong relationship to both sustainability and scarring.

There are powerful interactions and trade-offs among all three themes. Climate, fiscal and ultimately social sustainability all depend on the performance of the supply side of the economy, above all productivity growth. However, the transformation of products, processes, and workplace practices that underpins stronger productivity growth, and that is needed to achieve net zero, almost inevitably comes with some degree of scarring and impact on inequality. Transformation generally, and the transition to net zero specifically, requires dynamic change – and the capacity to successfully undertake this change differs greatly across people, firms, and regions.

What are the prospects for a successful transition from an emergency mode of policy to one focused on putting in place incentives that help manage the apparent trade-off between creating the necessary transformations, not least for net zero, and minimising and managing the potential scarring and inequalities that may result?

A look at recent evidence can shed some insight here. In some areas of policy – particularly with respect to energy policy – there appear to be clear tensions. Whereas in other areas – such as labour market policies – there are signs of complementarity and coherence.

Aligning emergency policies with headwind challenges – the labour market

Pandemic-era labour market policies varied between those oriented toward maintaining firm-worker relationships and those offering untied and generalised financial support. There also were differences in the degree to which business support was integrated with labour support or was treated separately. And there were also significant variations in the costs of emergency packages.

Focusing on labour market outcomes, what can we say about how these programs affected the behaviour of firms and workers? And can we discern the extent to which pandemic measures helped address underlying trends: did they ameliorate scarring and enhance fiscal and social sustainability?

¹ N Schady et al., [Collapse and Recovery: How the COVID-19 Pandemic Eroded Human Capital and What to Do about it](#), World Bank Group, February 2023.

It is not possible to look at all countries, or to make sweeping generalisations, given the on-going nature of shocks and policy responses. However, the fiscal costs of pandemic policies were higher in the UK than for the Euro Area (EA) – but the all-in-cost of the US support packages was ultimately higher than either since it included a third round of untied financial support in January 2021.

As countries emerge from the immediate aftermath of the pandemic what can we say about how these various strategies have affected labour market scarring, social sustainability, and overall inequalities? At first glance they look successful. Unemployment rates are *lower* than pre-pandemic for all three economies, albeit the EA still posts a higher unemployment rate than the other two comparators, as has been the case for most of the last decade.

But the unemployment rate masks important differences in labour market performance across these economies, which could be related to pandemic era policy choices. For example, labour market participation rates in the US and the UK are lower than they were pre-pandemic, whereas they are higher in the EA.

Another lens for thinking about comparative labour market performance is job reallocation. All countries faced sectoral demand destruction and rebound: for example, in consumer-facing services, in goods production, and in IT business services as firms reacted and retooled in response to shifting demand. In labour markets where workers tend to have more firm-specific skills (such as manufacturing), maintaining worker-firm matches would both reduce scarring and aid the recovery of production. In contrast, in sectors characterised by substantial job churn even before the pandemic (such as some consumer-facing services) maintaining worker-firm matches may have yielded less of a dividend. To the extent that demand rebounded robustly in these sectors, a more loosely tied labour market would tend to generate more competition for workers and higher wage growth, which is what has been observed (particularly in the US and the UK). This new dynamic in the labour market has resulted in some wage compression and closed at least some of the wage-inequality that has grown over recent decades.

Low rates of labour market participation could exacerbate the 2010s trends of rising (particularly intergenerational) inequalities and sluggish productivity growth. When looking at how labour participation has evolved, for example, two age groups stand out – the young, and older but still prime-age workers (here defined as aged 55 to 64). It is well known that, on average, older cohorts have had a more favourable trajectory for their life-time earnings than that of younger cohorts.² This concern is sharpened in this crisis era by other evidence showing that young people who start their careers during a period of sluggish growth have relatively worse life-time economic outcomes. Policymakers must carefully track whether today's young workers are further set back in the post-pandemic era, exacerbating already rising intergenerational inequalities.

Another feature of the pandemic aftermath has been an increase in older prime-age workers leaving the jobs market due to both early retirement and sickness. This has been apparent in the US and the UK, but not in the EA where it is possible that the nature of their worker-firm schemes may have succeeded in keeping older workers attached to the labour market and their jobs.

Scarring among young and older workers has implications for fiscal and social sustainability as well as for the supply potential of the economy. This is clear when we consider older workers who have

² OECD, Preventing Aging Unequally, October 2017.

decided to retire early – some of whom are likely to find they have insufficient funds to support themselves later in life. Decisions to retire can be hard to reverse; it is increasingly difficult to re-enter the labour market as an older worker, even more so if skills atrophy. For those who have left due to sickness, there will presumably be increased pressure on health expenditure. Who will bear the societal burdens of older workers who do not return to the labour market? If it is presumed that younger workers will pay through higher taxes, then intergenerational tensions could worsen. Policymakers should be concerned about the combined effect of long-term income scars facing younger workers and the rising post-retirement demands of older workers.

The fall in labour force participation will have wider consequences. If it persists it will result either in firms investing in labour-saving technology, or we will see the continuation of the sluggish productivity growth of the 2010s. To date there is little evidence that firms are undertaking this investment – in part because lower employment also reduces demand, and demand for products is the most important signal for firms to invest.

In terms of the likely success in making a smooth transition from crisis to long-term policies in relation to the labour market, three policy areas merit particular attention. First, education and training. Research suggests that certain types of firms are likely to offer training, or not. The smaller the firm, the less likely they are to train workers, which could be because of limited resources and limited vision, or because a trained employee is more likely to be poached by a competitor. Therefore, the size-distribution of firms within an economy can be important: a large share of small firms – as exists in the UK – could result in a collective labour-market outcome that is sub-optimal in terms of training and skills that policy needs to rectify.

Second, there is a clear role for active labour market policies (ALMP) to help deal with the tendency to under-train due to the risk of poaching. Countries differ substantially in the provision of ALMP, as measured by spending as a percent of GDP, and the UK is near the bottom of the league table. Combined with the factors that might hinder employer provision of training, this may help to explain why the UK has one of the highest shares of under-qualified workers among OECD countries. Worker motivation to take-up training is also a factor. The older the worker, the less likely they are to take up available training. Increased disengagement of older prime-age workers points to a need to redouble efforts to engage and upskill these members of the workforce. It's also the case that increased business dynamism and new firm creation tend to increase the effectiveness of efforts like ALMP to support workers, as new jobs are being created. Both are important ingredients in efforts to tackle long-term sluggish productivity and supply-side growth.³

The final areas of labour market policy that could bridge crisis-era policies and structural concerns is childcare support and the reduction of the income-tax wedge (i.e. the difference between what an employee costs a firm and what the employee takes home). Research suggests that these can be effective routes to supporting both household disposable income in the shorter term (via reductions in the immediate cost of childcare) *and* future labour supply in the longer term (lower tax rates might incentivise people to work longer, and more childcare may alter career paths). Given the scale of the current hit to disposable incomes, the dip in labour force participation (at least in some economies), the fact that the UK has particularly expensive childcare, and is only slightly below the OECD average for the tax wedge, both of these policy areas are ripe for consideration.⁴

³ OECD, [Structural policies for stronger, more resilient, equitable and sustainable COVID-19 recovery](#) in Economic Policy Reforms 2021 – Going for Growth: Shaping a Vibrant Recovery, April 2021.

⁴ Consistent with this argument the UK Chancellor acted on childcare in the March 2023 Budget.

Aligning emergency policies with underlying challenges – climate change

Turning to the second major shock of the 2020s: surging energy prices and a cost of living crisis. Emergency policies have been deployed to cushion the impact on both households and firms, with the costs of these packages ranging from 7.4 per cent of GDP in Germany to 3.7 per cent in the UK and 0.5 per cent in Denmark.⁵ This shock has not been felt equally by all economies; indeed, energy net exporters have done better than pre-crisis. However, even those countries not directly in the eye of the storm have responded with emergency policies. Unlike the pandemic policies – which were focused on the consequences of lockdowns for specific sectors, or ‘risk pooling’ between firms, workers, and the state (namely, furlough schemes and loan guarantees instead of subsidies) – energy policies have required direct intervention by the state in prices (i.e. via price caps and subsidies).

Urgent policy measures were required to deal with surging prices and the effects that volatile prices have on firms’ and consumers’ ability to make decisions. But the emergency policies were to some degree inconsistent with the long-term objective of reducing emissions. So, too, was a decision by some countries to return to high-carbon-intensive energy production (e.g. coal). Such direct interventions will leave a legacy.

It shouldn’t be controversial to state that fossil-fuel prices need to rise from their 2010s average to address climate change (gas was, for example, relatively cheap until the current crisis). In general, price signals will help to incentivise conservation by households and firms, and redirect investment toward greener energy production; at least the first of these (price responsiveness) has already been observed even in the face of the emergency policies. The goal should be to use this moment – which will leave a legacy of permanently higher energy prices – to transition from emergency policies to those aligned with sustainability and transformation.

To put emissions on a path consistent with the Paris Agreement (global emissions need to be reduced by 45 per cent by 2030 and net zero reached by 2050), the key question is how high does the price of carbon need to be to disincentivise its use? None of the current approaches to carbon pricing are on track to achieve the Paris commitments, nor will the recently elevated price of energy be enough to achieve this objective on its own.⁶

One way forward would be to place greater emphasis on environmental standards, but we should be mindful that there are some (albeit necessary) trade-offs.⁷ Tightening environmental standards can help increase firm-level productivity – particularly for firms that are highly productive and pollution intensive. By contrast, firms that are both pollution intensive and low productivity tend to find it harder to make the necessary adjustments and are likely to exit the market. Higher regulatory standards could both support longer-term supply-side growth *and* create some unemployment as low productivity firms exit the market.

More broadly, countries are making different choices in how they transition from emergency measures to a longer-term perspective on climate change. These policy choices have different implications for the wider objectives of fiscal, social, and climate sustainability. Three prominent examples are carbon

⁵ G Sgaravatti et al., [National fiscal policy responses to the energy crisis](#), Bruegel Datasets, first published 4 November 2021 updated 24 March 2023.

⁶ IMF & OECD, [Tax policy and climate change: IMF/ OECD report for the G20 finance ministers and central bank governors](#), September 2021.

⁷ OECD, [Assessing the economic impacts of environmental policies: Evidence from a decade of OECD research](#), May 2021.

taxes, an emission trading system (ETS), and fiscal expenditures or subsidies – all of which are being explored or deployed by leading economies.

First, we consider direct fiscal action, such as the Inflation Reduction Act in the US, or Next GenEU in the European Union. Research suggests that the ‘fiscal multiplier’ (the change in national output associated with a change in government spending) for the type of investment these measures support is greater than one, about twice that of government investment in fossil fuel. The higher multiplier arises in part because the green investments require a range of complementary activities and infrastructures (such as construction, transmission and distribution networks, and consumer metering). This combination of products and processes generate a higher marginal product than investment in fossil fuels.⁸ On the other hand, direct fiscal expenditures can create tensions between fiscal and climate sustainability. And the precise detail of such fiscal policies (subsidies versus tax credits, for example) also matter.

By contrast, the alternative approaches of a carbon tax or ETS raise revenues that mitigate fiscal costs, but potentially create a tension with the goal of social sustainability. The revenue gain from these market-based approaches to energy pricing are quite significant.⁹ But it is equally clear that, since the energy share in consumption varies by household income, just as it does in production by region, significant inequalities are likely to arise that need to be mitigated by some form of redistribution. In this regard, fiscal revenues raised through energy policy schemes tend to be ‘spoken for’ rather than representing a significant new source of net revenue.

As wholesale energy prices level off, now is the time to put in place a longer-term strategy for both greater use of market-mechanisms and revenue redistribution. How best to go about redistribution depends on a country’s social institutions. One example from Germany shows that the redistribution of lump sum rebates from the EU Emissions Trading System overcompensates low-income households, whereas reductions in social security contributions overcompensate higher income households.¹⁰ Evidence from the UK shows that there are many options for redistribution (including across regions) to ameliorate higher energy prices.¹¹ This research should also reassure us that redistribution does not ‘unwind’ the reduction in emissions: the change in the relative price of energy induces energy conservation, whereas the extra spending that the redistribution facilitates is spread evenly over a household’s consumption basket.

Aligning policies with headwind challenges – a focus on the supply side

Above all else, policy should support ‘transformation’. It is this goal – otherwise known as total factor productivity growth – that determines living standards in the longer term. What impact have the various emergency responses to the recent crises had on an economic transformation agenda and what are some of the trade-offs and synergies that policymakers must consider?

Some early indicators should shape how we think about this policy transition. For example, worker retention schemes, intended to mitigate scarring and ensure businesses bounced back post-crisis, might unintendedly limit the reallocation of labour and capital. While it is too early to tell, particularly

⁸ N Batini et al., [Building back better: How big are green spending multipliers?](#), IMF Working Paper 2021(87), March 2021.

⁹ OECD, [Carbon pricing in times of COVID-19: What has changed in G20 economies?](#), October 2021.

¹⁰ G Zachmann, G Fredriksson & G Claeys, [The distributional effects of climate policies](#), Bruegel blueprint series 28, November 2018.

¹¹ J Pareliussen et al., [Policies to reach net zero emissions in the United Kingdom](#), OECD Economics Department Working Papers 1742, December 2022.

considering the on-going energy shock, the trend in labour productivity appears to vary little between economies adopting different approaches. This might be because sectoral reallocation is simply a slow process – whether in response to shocks or policies.

But it is also possible that successful worker retention schemes could encourage more in-house training and life-long learning, which would improve both worker and firm performance in the longer term. Untangling this effect in the UK is particularly challenging given that both the Global Financial Crisis (GFC) and Brexit shocks have seemingly reduced worker training, especially among large companies, as uncertainties about the future business environment weighed heavily.¹²

Understanding the causes of the post-GFC productivity slowdown is a prerequisite for smart policy design as we transition out of the emergency era. Whereas average productivity across the economy is often used as a key metric of overall performance when it comes to policy design, a more granular firm-level perspective is needed. Evidence suggests that even the ‘best’ firms in each sector appear to have experienced a slowdown in productivity growth over the last decade. Moreover, most firms significantly lag this productivity frontier, and therefore drag down the average rate of productivity growth. Both the productivity behaviour of ‘the best’ *and* the gap with ‘the rest’ are important areas for policy if we are to improve on the disappointing trends of the 2010s. This challenge is particularly acute in the UK given the wide gap between ‘the best’ and ‘the rest’, and the particularly low rate of productivity growth in the 2010s.¹³

Policymakers might wonder whether to focus policies on pushing out the productivity frontier or raising productivity among ‘the rest’. Either approach could help raise the average, but the policy choices are different, as will be the implications for different workers and regions. The stance taken also needs to take account of other objectives such as enhancing sustainability and reducing scarring.

R&D policy —perhaps focused on climate-related R&D – might further boost the productivity of firms at the frontier. But ultimately it is scale, domestic market size, financial backing, and global reach that appear to be most important in making ‘the best’ even better. Achieving scale is not just about domestic geography, but also about consistent policies across national entities, such as regulatory coherence, as well as accessing larger markets through trade agreements. The struggle to ‘complete the single market’ in Europe, and the UK’s decision to leave the EU, are very real examples of where scale has been placed behind other political objectives.

When it comes to the ‘long tail’ of less productive firms, policy will need a different emphasis. The exit of the least productive firms improves average productivity (as well as reducing the gap between firms), not just ‘arithmetically’ but also in the very real sense of allowing the resources (capital, labour, and credit) embedded in the least-productive firms to move to more productive ones.¹⁴ In the emergency response to the pandemic, some of this reallocative dynamic was held back by state-based lending, guarantees, and bankruptcy forbearance (rightfully so, since both viable and likely non-viable firms were hit by the exceptional shocks of lockdown and the energy price surge).

¹² J De Lyon & S Dhingra, [To recover from COVID and Brexit, the UK must upskill its workforce](#), LSE, February 2021.

¹³ OECD, [OECD Economic Surveys: United Kingdom 2020](#), September 2020.

¹⁴ M Adalet McGown et al., [Insolvency regimes, zombie firms, and capital reallocation](#), Economics Department Working Papers 1399, OECD; K Shah & G Thwaites, [Minding the \(productivity and income\) gaps: Decomposing and understanding differences in productivity and income across countries](#), February 2023.

On the other hand, the forces driving reallocation are strong. Even during the Covid-19 lockdowns, characterised by forbearance and furlough, reallocation was still taking place. Even at the peak of the pandemic, lower productivity firms contracted and higher productivity firms, that had more investment in digital technology, expanded their workforces.¹⁵ But there is evidence that there was a delay in the exit of what were – or certainly will be upon the winding up of all emergency policies – non-viable firms.¹⁶

When it comes to the energy crisis, there will be a temptation to continue forbearance and price controls even as the impact of the shock fades. But since climate sustainability will require that fossil fuel prices rise, it is important that price and demand signals identify (un)viable firms. There is a clear complementarity between longer-term energy price strategies and transformational policies.

Digital infrastructure – be that faster broadband or upgrading skills – seems to play a particularly important role in determining which firms prosper. While initial costs can affect take-up by smaller firms, complementary human capital is often the major bottleneck.¹⁷ The UK appears average (compared to other advanced economies) in its investment in intangible assets, but its investment in IT infrastructure and complementary workforce skills lags behind its peers. Policies to support education and training, noted earlier in the context of scarring, are equally important when it comes to productivity.

Policy coherence: transitioning emergency policies to address the long-term challenges

How should economic policymakers think about the transition from crisis-management to a more strategic policy outlook focused on tackling underlying trends? When it comes to labour market policies this transition is less challenging. Some of the measures that succeeded in maintaining firm-worker relationships during the pandemic have brought gains (like keeping a lid on unemployment) during the subsequent recovery phase. This next phase of policy should promote the reallocation of firms and workers to support productivity growth.

The pandemic also led to a fall in labour force participation in some countries. Encouraging older prime-age workers to stay in or return to work would improve fiscal sustainability, which in turn would help avoid exacerbating intergenerational inequalities. Likewise, stepping up workforce training for younger workers would mitigate some of the penalties facing those starting careers during a global economic slowdown which may otherwise reinforce intergenerational inequalities.

High energy costs and rising food costs mean the cost of living crisis is far from over. Likewise, the pandemic legacy of low labour force participation continues. Focusing on household-focused policies rather than firm-focused policies would, therefore, have important near-term growth benefits. Ensuring affordable childcare, for example, allows care-givers to return to the work force. Increased participation and earnings support fiscal sustainability as well as ameliorating the long-term headwind of supply side growth.

When it comes to the fit between recent emergency measures and net zero, energy crisis policies need to be reassessed for their indiscriminate treatment and generosity. To meet our net zero

¹⁵ D Andrews, A Charlton & A Moore, [COVID-19, productivity and reallocation: Timely evidence from three OECD countries](#), OECD Economics Department Working Papers 1676, July 2021.

¹⁶ OECD, [Business dynamism during the COVID-19 pandemic: Which policies for an inclusive recovery?](#) February 2021.

¹⁷ OECD, [Digital dividend: Policies to harness the productivity potential of digital technologies](#), OECD Economic policy paper 26, February 2019.

commitment the price signal mechanism needs to incentivise efficiency in consumption and a shift to greener investment. More reliance on market-based climate policies, twinned with effective redistribution, would promote the private-sector innovation and investment needed to achieve climate sustainability, while avoiding a worsening of inequalities. At the same time, global consistency in climate policy is needed to reduce regulatory arbitrage, level the playing field across countries, and avoid harm to trade competitiveness.

Is there one critical strategic goal for policymakers that can align the objectives of reviving productivity growth, moderating inequalities, and addressing our exposure to climate change? Yes, net zero is that goal. Policies that support the climate transition will generate innovation, business investment, and job opportunities – therefore raising supply-side potential.¹⁸ But support to help workers adjust – including through skills and geographic mobility – is critical if we are to ensure progress towards net zero. Therefore, effective labour market policies are central. So too are market-based energy prices, such as a carbon tax, that generate revenues that can be deployed to support firms, households, and regions as they make the transition.

Shocks in the form of Brexit, the pandemic, and the Russian invasion of Ukraine came in quick succession. Even when these crises subside, others will emerge. A clear focus on the net zero policy goal will help keep strategies aligned for the longer-term even as the economy is buffeted. Getting onto that path – and staying on it – is the urgent task facing today's decision makers.

¹⁸ C André et al., [Rising energy prices and productivity: short-run pain, long-term gain?](#) OECD Economic Department, May 2023.

Navigating economic change: lessons from abroad and history

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