After the Age of Abundance

It's the economy

ANDREW TYRIE MP

Centre for Policy Studies

THE AUTHOR

Andrew Tyrie has been the Conservative Member of Parliament for Chichester since 1997. He is Chairman of the House of Commons Treasury Select Committee. This publication reflects his personal views.

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Andrew Tyrie MP
September 2011

PREFACE

"The Government are completely focused on one objective: to help Britain to weather the storm and safeguard our economy," said the Prime Minister in Parliament on 6 November 2011. At a time of global economic uncertainty, rising domestic unemployment and a stagnating economy, he is clearly right. The Coalition must concentrate all its energies on creating the conditions for long-term economic growth. As Andrew Tyrie says here, along with sticking to its plans for deficit reduction, these should be the priorities, the only priorities for government.

This is rapidly becoming received wisdom. The CBI, the IoD and the Federation of Small Businesses have all, in their own way, called for a single-minded determination to reduce business taxes and cut unnecessary regulations. As Tyrie points out, this requires deep-seated supply-side reform and a determination to see all that Government does through the prism of growth. It is a task for the long term; now, with the deficit reduction plan in place, is the time to take this forward.

The Coalition is doing much already. Immediately following the electronic publication of this paper in October, the Chancellor made two key policy announcements: that the UK would cut its carbon emissions no slower but also no faster than our fellow countries in Europe. As he said, “We’re not going to save the planet by putting our country out of business.” And he set out a number of important reforms on employment regulation, not least increasing the qualifying period for unfair dismissal from one year to two years and introducing fees for tribunal claims.

But is it essential that business hears this message clearly, not least because the machinery of government takes time to respond. Just last week for instance, the ONS published its consultation document announcing the questions that will make up the National Well-Being tables.

The Autumn Statement offers an ideal opportunity for the Coalition to set out its plans for improving long-run economic performance. And the Coalition must leave no one in any doubt that they will apply John Cridland’s simple question to all their decisions: “Will this encourage private sector growth?” And if the answer is no, then that policy or regulation must not go ahead.

Finally, it is vital to retain a sense of optimism: things can and will get better, with the right approach. A clear, coherent and consistent explanation that the Government is now determined to move well beyond fire fighting on the deficit, and that it will stick with the long-term reforms needed to get the economy moving again, will provide that essential ingredient for long-term success – confidence. Then investment will come back, the dark clouds will lift again and a better and more stable standard of living can be secured.

Tim Knox
Director
November 2011

FOREWORD

This is a valuable pamphlet which the Government would do well to heed. A philosophy of austerity in public spending is not enough – we need policies that will create growth in the private sector. So Andrew Tyrie has come up with some concise suggestions of ways the state could help achieve that vital goal.

He makes a lucid case for reduced and simpler taxation and regulation. Given time, both actions will have a material impact on investment and business performance, if the Coalition is brave enough to carry out radical reforms in these areas. Tyrie also discusses education and planning, where sound initiatives are already underway, and climate change and transport policy – where Government proposals are far less satisfactory.

For I do believe these are challenging times: therefore half measures will not do. As a nation we need bold steps to improve our competitive position, and encourage entrepreneurs to take the plunge. I am confident we possess the animal spirits; but as a society we must decide if we want a dynamic economy with low unemployment; or do we prefer an entitlement culture, big government, and relentless decline?

This is an era of hard choices. Dreams of this being an Age of Abundance are over. We must attract capital and stimulate talent to locate enterprises here. This is the only way that jobs will be created, and the only way we can reverse falling living standards.

As an entrepreneur and investor, I spend my working life deciding where and when to deploy my cash in the hope of building successful concerns. To me there is nothing more exciting and satisfying than seeing an undertaking add value and expand its workforce. I'm convinced that the right signals and legislation from government can only improve the odds for every capitalist. Let us hope our political leaders read Mr Tyrie's wise words and act on them.

Luke Johnson
November 2011

Luke Johnson is Chairman of Risk Capital Partners and Chairman of the Royal Society of Arts. He is a former Chairman of Channel 4 Television and writes a weekly business column for the Financial Times.

1. INTRODUCTION

"Tackling the deficit is essential," David Cameron and Nick Clegg wrote in their Foreword to the Coalition's *Programme for Government*, "but it is not what we came into politics to achieve."[1] They are right; accountancy is not enough. Britain needs a strategy for sustained higher long-term economic performance.[2] Almost everyone, including government ministers, agrees that the growth strategy is work in progress. Eighteen months on, it still looks it. The Coalition's current piecemeal policies for growth need radical improvement, particularly in view of its inheritance. There is much to do, and it is not just a question of gaps in policy; in places, it is inconsistent, even incoherent.

The central challenge now is nothing less than the revival – for a new generation – of enterprise culture. The politics of reform will be tough. All successful long-term growth strategies – or policies for the supply side – involve challenging vested

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1 David Cameron and Nick Clegg, *The Coalition: our programme for government*, HM Government, May 2010, p.7.

2 See page 11.

interests. The Coalition will need to explain to the electorate why these often difficult and unpopular reforms really are necessary.

Equally important, it will need to convince the public that it is going to stick with the growth strategy with the same determination as the deficit reduction strategy. Only by doing so will the confidence of individuals and businesses return. Investment and sustained growth will follow.

All Governments – if they are to be successful – must be able to justify their purpose, beyond sound finance and remaining in power. The right agenda for safeguarding the economic well-being of the electorate, well explained, is an essential part of it. It was never true, as some senior politicians complacently asserted (as described in Chapter 2), that the big economic issues were settled. The economy is once again the top priority.

The public's overriding concern now is the maintenance of their living standards and prospects for their families. Against a bleak economic backdrop, it is only with a revival of the enterprise culture that the Coalition can satisfy the aspirations of the British people. And it is only by satisfying those aspirations and by releasing the productive energies of millions of individuals and small businesses – the crucial but neglected 'little platoons' of our economy – that sustained prosperity can be restored.

Market economies do not always appropriately reward success and penalise failure, and have not done so recently. They never fully will. The question politicians must address is whether their primary task should be to make markets work better; or to try to substitute for them. The reply from the Coalition should be clear: markets have been outstandingly successful at improving global living standards. Wherever possible, improvement of market efficiency, not substitution for it, is needed.

The acceleration of globalisation — although bringing greater prosperity both to Britain and the world than anyone thought possible a third of a century ago — has exposed crucial weaknesses. These have been evident in the way some corporations are run, as well, of course, as some serious failures in management of risk in financial markets. It is the job of policymakers and regulators to set this right, not by adding further distortions (which have in part made the abuses and excesses possible), but by further careful regulatory reform. That is what the Coalition has sought to achieve by commissioning the Vickers report, and why many are arguing for radical reform to corporate governance.

The modern marketplace is no jungle. Far from it. It is "a complex and sophisticated piece of institutional machinery that has evolved over centuries"[3] and needs our constant attention. All Governments (even when they are talking about other objectives such as quality of life) want and will continue to want to satisfy their citizens' reasonable demands for improvements in their well-being. That means growth.

The test for the Coalition is whether their proposals for achieving this, both current and putative, maximise Britain's opportunities to improve economic performance. The litmus test for the lion's share of proposals is whether they make that market machinery work better, enhance productive capacity and squeeze out rent-seeking; or whether they try to substitute for the market itself. It is with that in mind that this paper examines the Coalition's current measures and makes proposals of its own. It is in no respect comprehensive, but it

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3 Martin Wolf, *Why Globalization Works,* Yale University Press, 2004, p. 48.

argues that, for the Coalition to succeed, it needs to be clear about the tools at its disposal and to have the courage to explain to the electorate how it means to use them.

That clarity will also help create a more optimistic mood. Market conditions for gloomsters have rarely been better than at present, but in a longer perspective we must hold to what we have learned about the roots of prosperity, not just in the last two centuries but in the last 30 years. Britain (and the world) have a massive opportunity, once we have overcome this crisis — as we will — to move into a further period of unparalleled prosperity. Calm heads, common sense, and some knowledge of economic history will be at a premium.

2. TWO FALSE TRAILS AND A CONFUSION

Without the lynchpin of a clear strategy for growth in place, other attempts to provide a more appealing theme than austerity are unlikely to succeed. The Big Society; localism; the Green strategy – whether right or wrong – these and other initiatives have seemed at best irrelevant to the task in hand, if not downright contradictory to it; likewise the huge spending hike on overseas aid and the cost of the Libyan expedition.

The problem is that many of these policies – and particularly the relatively relaxed attitude about their cost – represent a false trail. They reflect the priorities of the middle of the last decade, the point at which David Cameron took over the Conservative Party leadership, and when he and his party expected to inherit buoyant – or at least acceptable – economic conditions from Labour. There appeared to be enough cash to help lubricate public service reform and much else.

We no longer live in an age of abundance

The new leadership's priority was 'detoxification' of the Conservative brand. This was understandable and, in some respects, needed at the time; his predecessors had made fitful attempts to rid Conservatism of its negative associations, but with mixed success. Mr Cameron told his party that it had to 'change to win'.

The politics of abundance as a malady spread across political parties. It is instructive to compare Gordon Brown's notorious boast of "no return to boom and bust" with Oliver Letwin's attempt to define Conservative thinking in May 2007. Politics was no longer "econo-centric" but "socio-centric":[4]

> "Instead of arguing about systems of economic management, we have to discuss how to make better lives out of the prosperity generated by the free market. Growth in well-being hasn't kept pace with growth in domestic product."

Such a consensus to downplay the significance of growth is not new. In *The Future of Socialism*, Anthony Crosland famously took growth as a given —Britain was "on the threshold of mass abundance" — and therefore focused his attention on distribution, a view that he revised in the more sombre circumstances of the 1970s. However, the revival of such cross-party thinking in the last decade meant that the Conservatives were only a little better prepared for a change in economic conditions than were Labour.

It came in 2008. The financial crash exposed the scale of the structural budget deficit. Instead of an inheritance that allowed it to address the questions and priorities of a time of affluence, a new Government found itself confronting the challenges of the deficit and declining economic performance: an 'East of Suez'[5] moment in domestic policy.

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4 Oliver Letwin, speech at Policy Exchange, 8 May 2007.

5 The phrase is that of Professor Tony Travers. Arguably, the East of Suez moment should not only have applied to domestic policy. The Libyan intervention, however, suggests that these conclusions have not been consistently drawn.

David Cameron and George Osborne adopted the rhetoric of austerity, albeit cautiously and inconsistently in the face of a wary public opinion. In office, both parties of the Coalition have courageously translated that rhetoric into a credible path for reducing the deficit. What it has not yet done – and must do now – is to provide a wider sense of economic purpose which can command public acceptance and respect. When Conservatives tell the electorate that Britain needs to double the aid budget or needs higher electricity bills to help save the planet, this sounds more like a moral crusade than a coherent policy, or one that is relevant to the immediate concerns of millions of voters.

Today, the still fashionable focus on quality of life and the 'happiness agenda', much of it relying on survey data to find out what people want, is incongruous. This too reflects the politics of abundance, a time when rising living standards seemed so assured that they could be played down as of secondary importance. There was also a good political rationale: to dispel the image of the nasty Tories, a set of desiccated accountants "who knew the price of everything and the value of nothing".

There is room to doubt the validity of an approach based on survey data, with its scope for biases on the part of the questioner, rather than revealed preferences – the things on which people are prepared to spend real money or devote time. While it makes sense to try to understand the sources of happiness better, it is folly to think that we know much about how to manipulate them, still less that central government can play the role of manipulator. Whereas with respect to economic growth, notwithstanding all its deficiencies as an indicator, we have some knowledge as to which policies work and which do not; with respect to happiness we are still in the dark. This is essentially a paternalist approach. It blurs the Coalition's political message. Worse, it could create the impression either that the Coalition is itself distracted, or that it wants to distract voters from their key priorities: concern about their own standards of living and opportunities for their children.

Radical public sector reform: tough in an age of thrift

If themes from an age of abundance represent one false trail, a second and perilous trail is radical public sector reform. I recall listening to a discussion some years ago – not long after the financial crisis broke – between some senior Conservative backbenchers and a number of advisers close to the party leadership. The advisers took the line adopted at around the same time by Rahm Emanuel, then President Obama's Chief of Staff that: "You never want a serious crisis to go to waste." In other words, this was a great opportunity to push through systemic changes to the public sector. The backbenchers, some of whose grey hairs might be attributed to real experience of reform efforts in the past, thought just the opposite: there was every risk that the end result could be to discredit these ideas, including the good ones.

The backbenchers are likely to have the better of the argument. There is a long-standing argument that raising public sector productivity, quite apart from improving services, is an important component in a stronger economy. Yet large-scale reforms of public services are high-risk ventures in a time of austerity. This has certainly turned out to be true of health, and may well be so in the case of benefit reform; among several others. The U-turns have begun.

Public service reform requires challenging the most vociferous vested interest groups in the country. It is difficult enough in good times. In its early years, Mrs Thatcher's Government attempted relatively little in this area; ministers waited until the recovery was entrenched. The Blair administration tried but largely failed, throwing heaps of money at problems but not securing enough reform, and scarcely any improvements in productivity.

The problem is that public sector reforms are complex, large-scale undertakings, and the benefits generated are sufficiently intangible that there will be little political pay-off, especially in the short term. Purely economic reforms may also stir opposition, but are more likely to be able to demonstrate tangible benefits. Meanwhile, voters are most likely to take their cue as to the state of the services from disgruntled public sector providers. Worse, the reforms are likely to take the blame for the effects of constrained budgets; this has already been seen in health, where critics have conflated the impact of Andrew Lansley's proposals with the £20 billion pressure (the "Nicholson challenge") generated by turning off the spending tap.

It is not surprising that past efforts at reform have been accompanied by extra spending. This was the case when the internal market was introduced into the NHS at the start of the nineties. The political pressures of recent months, the controversy about health reform and the concessions needed to accommodate these pressures, are a powerful illustration of the difficulty of combining reform with austerity. We will see more of the same over the next year or two.

Responding to the changed public mood

In any case, neither themes from an age of abundance nor public service reform are sufficient to answer the electorate's demands now. The country has some way to go before it reverts to the dour pessimism of the seventies. But we have lost the self-confidence that took root in at least some sections of society in the eighties, developed – after the setback of the early nineties recession – in the decade that followed, and was at full throttle in the early years of the new century. Throughout this period, there was a widespread sense that individuals could see their circumstances, and those of their families, improve in step with the advance of the country.

That mood has gone into reverse. In part, this reflects the sense of diminishing public choices in an era of austerity. To this must be added an element not present in the eighties, when falling inflation and interest rates contributed to rising living standards for those in work. Relatively buoyant wages and, in the early years of adjustment, a preponderance of job losses in sectors and regions that faced huge structural changes, meant that the social and political pain was concentrated rather than spread. Three decades on, the labour market is in many ways working better, with wages and working hours taking more of the strain; 'insiders' appear to be benefiting less at the expense of jobless 'outsiders'. However, when coupled with somewhat higher inflation, the result may well turn out to be a squeeze on general living standards not seen for more than a generation.

The Coalition needs to revive the sense that it is doing all it can to raise living standards, both personal and national, by releasing the energies of ordinary people, not least through greater choice and competition. This has been caricatured as a bourgeois philosophy, but is none the worse for that; it can and should embrace large parts of what is now a largely middle-class society. This approach has underwritten successful Conservative administrations in the past, from Macmillan in the fifties to Thatcher in the eighties. It is consistent with much that the Liberal Democrats have espoused in recent years.[6] The Coalition needs it now.

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6 See, for example, David Laws and Paul Marshall (eds), *The Orange Book: Reclaiming Liberalism*, Profile Books, 2004.

A confusion between deficit reduction and raising the long-term growth rate

The task of policy-making, and particularly explanation to a sceptical public, has been further complicated by a ready confusion, among some, of policies for crisis management with policies for improving long-term economic growth. For ultimately the target of many who criticise the Coalition's growth strategy is the deficit plan, not the supply side.

Plan B supporters congregate around those arguments. It is fuelled partly by unreconstructed Keynesian demands for further stimulus and partly by those who see advantage in opposing spending cuts with all their attendant political and economic pain.

Nor is the Coalition immune from exacerbating this confusion. It slips a little too easily from talk about tackling the deficit to a language of rebalancing the UK economy. However, the discussion about rebalancing is too often vague and confused. At various times, it emphasises a move away from financial services and towards manufacturing; at other times it stresses the regional dimension and shifting economic activity from London and the South East to the North; on yet other occasions it focuses on the shift away from government spending and consumption to exports and investment and from personal spending to saving.[7]

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[7] See the Prime Minister's exchanges on this with the author at the House of Commons Liaison Committee on 17 May 2011: House of Commons Liaison Committee, *The Prime Minister (Rt Hon David Cameron MP) Oral Evidence,* July 2011, Q.172-181.

Some of these are responsive to policy, and early action is needed. Others less so. Some, insofar as rhetoric means a great deal, can be taken as indicators of improving the public finances, others as implying measures to improve long-term growth. Much more care is needed in the use of the rebalancing rhetoric, if the public are to be persuaded of the need for tough measures.

3. IMPROVING LONG RUN ECONOMIC PERFORMANCE: A FEW SUGGESTIONS

What follows does not address the merits of a Plan B for the economy. It does argue for the need for a Plan A for the supply side. It also argues that unravelling the confusion of rhetoric around economic policy is essential if the country is to be won over to something more than acquiescence in crisis management. And it tries, as many others have already done, to outline an agenda for those reforms whose success will be as important for the long-term success of the British economy as they will be for the long-term political health of the Government.

There is much work to be done. The Coalition's approach so far is encapsulated in its *Plan for Growth.*[8] Launched alongside the 2011 Budget, it is an uneasy amalgam of sensible long-term reforms (such as reductions in corporate tax and a "direction of travel" towards tax simplification), Enterprise Zones that may prove an expensive way of shifting jobs from one place to another and generic strategies in favour of the usual suspects of favoured

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8 HM Treasury and Department of Business, Innovation and Skills, *The Plan for Growth*, March 2011.

sectors (low carbon energy, the creative industries and the like). Worse, hangovers from the era of abundance dilute the Plan's coherence. It is time for a more consistent approach.

It must immediately be acknowledged that coherent supply-side reforms are easy to list and difficult to deliver. Reform will be a remorseless process, assailed by vested interests. What follows provides no more than a few suggestions and flags up some of the contradictions in existing policies.

Labour market regulation

Many aspects of labour market regulation need to be examined. In no particular order, this could include: the tribunal system; parental leave; the retirement age; the effect of the Equality Act on the labour market; and the scope for an exemption for small businesses from some of the rules, or at least the piloting of such an exemption. While the Coalition's room for action in this field is circumscribed by EU regulation (which is outside the scope of this paper), it should make use of all the flexibility that it can.

Financial regulation

Much of the regulation of the financial sector appears to have developed the wrong culture, with high cost regulation failing to protect customers from mis-selling and other abuses. The accountability of the successor bodies to the FSA – the FCA, the FPC and the PRA – need careful review; certainly the arrangements in place for the FSA did not prove adequate. These are areas that the Treasury Select Committee is currently investigating.

There must also be much greater clarity about the purposes of regulation. These should primarily be to sustain competition and choice for the consumer; to keep pricing honest, minimising implicit or explicit subsidies; and to tackle crime, fraud and economic rent-seeking. Like taxation, this is an area that is best kept to the achievement of relatively simple objectives but has, in practice, been used as an instrument of social engineering.

Competition policy

Competition and hence competition policy, needs further enhancement. In this area, the last Labour Government did a good job with the Enterprise Act of 2002, by removing much scope for political meddling in competition policy. However, Gordon Brown's administration tarnished this record with its intervention in the HBOS/Lloyds merger. A thorough review of the criteria on which political considerations can intrude into competition policy is required. Policy also needs a new impetus to secure improvements in the regulation of several of the utilities. Again, greater competition and choice for the consumer should be paramount.

Education and training

The country's education and training system needs to be examined by reference to a common sense principle: it is government's job to do what it can to ensure that young people entering the labour market have the necessary maths, science and literacy skills for today's workplace. It is the primary responsibility of employers to train them, often through learning on the job. Reliefs and subsidies, however logical they may appear, can be gamed by employers, adding costly distortions to the labour market.

Tax reform

Tax reform will be central to supply-side improvement. This needs to be based on a few clear principles and implemented with remorseless consistency. In March 2011 the Treasury Select Committee published a short report setting out what those principles should be. In a nutshell these are certainty (including simplicity), stability, practicability (including ease of calculation) and coherence. The system should support growth and encourage competition. In addition, it must pass a fairness test; any system which fails it will be unstable.[9] These criteria are consistent with the conclusions of the Mirrlees review. Cleaning up the tax system is a massive undertaking in good times but a Herculean struggle in the absence of cash to compensate losers from reform. A successful growth strategy would embrace a strong drive towards tax simplification. On both rates and simplification, Britain has lost significant ground to its competitors in the last decade.

The Coalition has taken some important steps in the right direction. It has set a trajectory for reducing the corporation tax rate from 28 per cent to 23 per cent by 2014. The establishment of the Office of Tax Simplification (OTS) is welcome, and there is widespread agreement that the Coalition has a "direction of travel" towards a simpler system. Building on the work of the OTS, the Chancellor scrapped seven tax reliefs in the 2011 Budget and announced a timetable for the removal of a further 36. However, overall progress has been patchy. As John Whiting, Tax Director of the OTS, put it to the Treasury Select Committee, "We are abolishing some legislation, but it is clear that there is a heck of a lot more legislation coming in. I think the trend is towards simplification, but it is not exactly a simple one-way street. It's quite a hard struggle."[10]

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9 House of Commons Treasury Select Committee, *Principles of Tax Policy* March 2011, Volume 1, p. 28.

10 House of Commons Treasury Select Committee, *Budget 2011*, April 2011, p. 54.

The Coalition will have to work harder to cut back on tax reliefs, many of them public expenditure by another name. It should also redouble its efforts for a lower burden of corporate tax, setting a long-term target to achieve a still lower rate than the 23 per cent projected for the end of this Parliament.[11] Where existing policy is self-contradictory or undermines growth potential, it should be re-examined.

There are countless examples keeping accountants busy. Candidates for scrutiny include the tax treatment of leasing. The tax law here is complex and it appears to be based on the assumption that asset leasing is essentially a tax avoidance scheme. Another area of unintended policy consequence that is ripe for review is the series of measures – including the provisions around Entrepreneurs Relief – that act as a disincentive for growing businesses to bring in extra funds for expansion, since the original investors now get less favourable treatment.[12]

Another crucial project, and one intimately bound up with the design of the tax system, is the revival of a personal savings culture. Policy needs to start from the premise that it is people who need to be allowed to plan for their futures, not government. The principle that people should only be taxed once on their savings has both public appeal and merit as a tax policy. Both double taxation and exemption of savings, including

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11 The Institute of Directors, in its *IoD Freebie Growth Plan*, argues for a 20 per cent target by 2020. This seems a sensible target. See: http://www.iod.com/mainwebsite/resources/document/policy__publications__freebies__1102.pdf

12 I am grateful to the Chartered Institute of Taxation for highlighting a number of contradictions within existing tax policies.

for retirement, need review. Simplicity, certainty and stability in the tax treatment of saving is as essential as a consistent language to explain the policy.

A simple and stable tax code is also vital for business. Here the 2011 Budget was less favourable; to pay for cuts in fuel duty and a partial suspension in the fuel duty escalator, the Chancellor introduced the Oil and Gas Supplementary Levy, undercutting his previous commitment to a predictable environment for an important sector. This decision was taken without warning or consultation. Such sharp reversals of intention should be avoided if at all possible. Efforts to reduce the degree to which relief increases up the income scale have generated enormous complexity. Business needs much greater certainty about the direction of long-term reform.

Planning

The Coalition has been right to attempt to reform the planning system. Inevitably, such reforms are controversial and there may need to be further modifications, but something is needed. This is not only about house-building, but about retail and industrial space too. To maximise its effectiveness a review, in some cases radical, of building and listing regulations, environmental and health and safety rules may also be needed.

Climate change policy

There are many areas in which the politics of abundance are still in evidence, clashing with policies for improving economic performance, and in which changes of direction are needed. One such policy area is climate change, developed by the last administration but broadly supported by Conservatives and Liberal Democrats, competing to burnish their green credentials, in opposition.

This policy now threatens to reduce competitiveness by forcing up business costs. The impact of the EU's Emissions Trading Scheme has so far been vitiated by a generous issue of allowances and the impact of recession. From 2013, however, the screw will be tightened with a gradual reduction in allowances, just as economic recovery may be increasing demand, and a move to auctioning them rather than giving them away. The Coalition also acted unilaterally in the 2011 budget to set a floor price for carbon. I agree with the Energy and Climate Change Select Committee which noted that this measure, "introduces political risk with little evidence of the supposed benefits." The Committee also noted its potential risks to energy security (by increasing reliance on cheaper energy imports) and impact on some intensive users of electricity.[13]

Policy is also tilted sharply in favour of renewables, especially wind; this is, in the Select Committee's words, "an expensive way of achieving decarbonisation of the electricity sector." The mechanisms intended to achieve this, such as feed-in tariffs, are likely to provide the strongest financial support to the most expensive forms of renewable energy, locking the UK into high-cost energy for years to come.[14]

None of this looks easy to justify on supply-side grounds. The Department of Energy and Climate Change has estimated that non-domestic energy bills will be 26 per cent higher by 2020 than

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13 House of Commons Energy and Climate Change Select Committee, *Electricity Market Reform*, Volume 1, May 2011, pp. 4, 44-6.

14 *Electricity Market Reform*, pp. 14-5; Matthew Sinclair, *Let Them Eat Carbon: The Price of Failing Climate Change Policies, and How Governments and Big Business Profit from Them,* Biteback, 2011, p. 105.

would otherwise be the case because of climate change and energy policies.[15] The huge investment required to achieve environmental targets (estimated at over £200 billion, significantly higher than that of other major European economies) will require a major transfer of funds to the energy sector.[16]

The impact on energy intensive industries such as steel, aluminium, chemicals and fertilisers could be particularly significant. It comes with the risk of “carbon leakage” – that is, jobs and economic activity (as well as the associated carbon emissions) leave Britain for elsewhere, damaging our economy while doing nothing to reduce global emission levels. Nor is concern limited to traditional industries; Britain’s competitiveness in parts of the service sector with high energy demand such as data centres may also be affected.[17] And the higher bills faced

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15 Department of Energy and Climate Change, *Estimated impacts of energy and climate change policies on energy prices and bills,* July 2010, p. 3. Some of the assumptions in that study will no longer hold – notably the funding of the Renewable Heat Obligation has been changed from the plans set out under the previous administration – but the general point is still valid. The Department assumes significant energy saving by consumers, so the projected increase in prices will be still higher than the increase in bills.

16 Sinclair, p. 110. See also Peter Atherton, Citigroup Global Markets, presentation at University of Exeter Energy Week, 20 May 2011: www.exeter.ac.uk/few/documents/presentations/Peter__Atherton__Keynote.pdf

17 Waters Wye Associates, *The Cumulative Impact of Climate Change Policies on UK Energy Intensive Industries – Update Against New Government Policy: a Summary Report for The Energy Intensive Users Group,* March 2011. See: http://www.waterswye.co.uk/EIUG%20Carbon%20Tax%20Update%20201103.pdf; and *The Cumulative Impact of Climate Change Policies on UK Energy Intensive Industries – Are Policies Effectively Focussed? A Summary Report for The Energy Intensive Users Group and the Trades Union Congress,* July 2010. See: http://www.waterswye.co.uk/WWA%20Impact%20of%20Climate%20Change%20Policies%20EIUG%20TUC%202010723.pdf ; Sinclair, pp. 173-80.

by small businesses and traders could turn out to be the most damaging if least noticed of all.

The growth strategy must challenge these economic contradictions. Lower relative costs for business are essential. As Lord Turnbull, the former Cabinet Secretary and Permanent Secretary to the Treasury has recently and trenchantly observed, we need our political leaders to abandon "dogged unilateralism" and "pay more attention to the national interest and less to being global evangelists."[18] The Coalition should re-examine measures, such as the carbon floor price, that are more rigorous than those undertaken by other EU countries. It should also reopen with international partners, particularly in the EU, a debate over the economic consequences of its proposed route to decarbonisation and reconsider its speed of trajectory, too. The Coalition should also jettison the absurd notion that renewables policy should be judged on the number of jobs allegedly created.[19]

Transport

Transport policy is also sending mixed messages. Aspects of air transport policy seem calculated to export a sizeable chunk of the UK's civil aviation industry and need reappraisal. Taking a stand against the third Heathrow runway, as both Coalition parties did in opposition, combined fuzzy greenery about carbon emissions from flying with local interests of constituencies in the flight paths. It is widely accepted that the

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18 Andrew Turnbull, *The Really Inconvenient Truth Or "It Ain't Necessarily So"*, The Global Warming Policy Foundation, July 2011, p. 15.

19 Gordon Hughes, *The Myth of Green Jobs*, The Global Warming Policy Foundation, August 2011.

decision to cancel the third runway will undermine Heathrow's role as a European hub airport. Recognising the impact of the decision on competitiveness, business lobbied strongly against it, but without success. Whether Boris Johnson's 'island airport' idea has merit, among other ideas recently touted, is still unclear.[20] But reliance on congestion to ration air travel is certainly not a policy. It is the negation of one. Some careful reconsideration of this decision is needed.

Contradictions abound in transport policy. High levels of Air Passenger Duty (inherited from the previous administration) undermine the UK's competitive position in tourism, touted as one of the industries that the Coalition is keen to promote. Inclusion of aviation in the Emissions Trading Scheme would presumably exacerbate the problem. In general, efforts to boost particular sectors or regions will need careful handling, since they can all too often turn into wish lists of fashionable projects.

Thinking from the age of abundance also lies behind the commitment to the HS2 rail project. Considerable uncertainty remains about the costs and benefits of this project. At a cost of £32 billion (£17 billion for the initial London-Birmingham connection), albeit over many years and little clarity over the exact financing mechanisms to be used, it would represent a major drain on a DfT capital budget, currently running at between £7.5 billion and £8 billion per year, with around £4.5 billion of this going to railways. The 2006 Eddington Transport Study argued against such schemes, demonstrating that existing connections between major British conurbations compared favourably with those of our international

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20 "Boris Johnson airs plan for Heathrow-on-Sea", *Sunday Times*, 10 February 2008.

counterparts. Even taking HS2's own arguments at face value demonstrates a benefit to cost ratio of 2.7, well below the cut-off point for road schemes. Policy should concentrate on what the public are demanding: more capacity, comfort (people want a seat) and reliability, ahead of speed. Even if there is a case for new lines to increase reliability, these do not necessarily have to reach the highest speeds.

The Transport Select Committee has noted that (unsurprisingly) "the list of transport needs and potentially worthwhile schemes presented to us would add up to a great deal more than current funding limits." The Association of Train Operating Companies told the Committee that its main priority was the existing network and that, while it was sympathetic to high-speed rail but was "concerned that a large network might not be affordable."[21]

There are many alternative demands on the funds, from road expenditures to upgrades of existing rail capacity that may well turn out to offer better value for money, yet HS2 remains at the top of the DfT's list of priorities in its Business Plan. The abandonment of the commitment to the project would certainly not be easy (although it would cost only a few million pounds to do so now). Yet there could be politically attractive compensation from the scope created for refocusing spending on addressing visible infrastructure blockages to enterprise and growth, not least in those regions that HS2 is supposed to help.

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21 House of Commons Select Committee on Transport, *Transport and the Economy,* March 2011, pp. 19, 25.

4. TAKING THE PUBLIC WITH US

These are the some of the measures which need to be taken; and some of the policies which may benefit from reappraisal. Some institutional change at the heart of government is also needed to support this effort. A dedicated team in the Treasury is required to push them through, combined with task forces of independent experts, working to short reporting timetables, to advise on some of the most knotty problems. A fundamental change of culture is needed in Whitehall after a decade of chequebook solutions.

With a fully worked-up strategy could come a new language and more of the straight talking that we have seen on public spending. This will boost public understanding and confidence about the direction of policy: it is this confidence that is needed to underpin investment and growth in the private sector.

There are still hangovers from the Blairite style of politics, with its attempt to conflate public spending with economic growth through the term "investment". Spending is needed to sustain decent public services, but to call it investment is a corruption of language, especially when much of the funding went into higher salaries. Another misused concept was that of "stability".

It is hubris – as Gordon Brown's experience demonstrated – to believe that, in a dynamic and open economy, policy-makers can achieve perfect stability of macroeconomic indicators such as growth and inflation. This is not, nor was it ever, within government's gift; the business cycle will always be with us. What the Coalition can do – and can do much better than it has in recent years – is to provide much greater stability and predictability for those parts of the business environment, such as taxation and regulation that are within its ambit.

The Coalition must also avoid the mistaken belief – again, a hangover from the days of opposition rebranding – that the approach to politics that made Tony Blair so electorally successful will work for this administration. Much of that style has been devalued or discredited. In any case, these are very different circumstances. We need a new approach that extends the directness of explanation to the electorate on wider issues of economic growth that has been successfully brought to bear on hard accountancy issues.

The Conservative leadership is and has for some time been nervous about being associated with the policies of the 1980s, with their mixed standing in folk memory. However, it should be able to see the policy mix that is needed now in a longer historical perspective. The Conservative Party has, with varying degrees of confidence and commitment, taken a consistent stance ever since the consolidation of the post-war welfare state gave way to the huge burst of spending and economic intervention of the 1960s.

An agenda for economic freedom, less government and attention to the vital role that a small business sector can play has been in the party's bloodstream for a long time. It has stood for spending restraint and opposition to the complex webs of taxation, subsidies (often targeted at big business interests) and regulation that grew up in that earlier era and have now, in somewhat different form, crept up on us again in the last decade and a half. It is a message with which, particularly in recent years, our Liberal Democrat partners have also felt more at ease. That message can and should be part of the Coalition's reform programme.

So much of what is required is little more than common sense. If government gets out of the way, people can do more. Yet the explanations required to win first acceptance and then support for such a programme of economic reform are not easily packaged in soundbites nor, for the most part, susceptible to short-term initiatives aimed at satisfying the demands of a 24/7 media. The case for these reforms can be made, and arguments won, but only by relentlessly explaining their benefits in a consistent way. This is long-term politics for long-term economic gain; again, a very different style of dialogue from much of the last 15 years.

The Coalition's greatest achievement, so far, has been not just the deficit reduction strategy but its success in persuading the public of its necessity. Some momentum has been created and some trust restored. It is now essential to deploy that political momentum to argue for much-needed wider economic reforms. It is equally essential that this clear message is not confused or diluted by contradictory messages and measures. For the public are not foolish – their understandable priority is economic well-being and security for themselves, their families and those close to them. They will sense and reject attempts to persist with parts of an economic agenda – much of it derived from an era of abundance – which does not accord with those priorities.

The uncomfortable reality is that many supply-side measures take a number of years to take full effect; the Coalition will see only a modest payback by the time of the next election. Before those benefits are realised, a reform programme will face strong attack from the vested interests that it threatens. What is needed, therefore, is a clear and consistent message that gives a sense of momentum; that explains that the Coalition is on the side of aspiration; and that offers something more than austerity and accountancy, necessary as both are to achieving financial stability.

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