HM Treasury

Fixing the foundations:

Creating a more prosperous nation

Cm 9098

July 2015

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Creating a more prosperous nation

Presented to Parliament by
the Chancellor of the Exchequer
by Command of Her Majesty

July 2015

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Foreword

Productivity is the challenge of our time. It is what makes nations stronger, and families richer. Growth comes either from more employment, or higher productivity. We have been exceptionally successful in recent times in growing employment. We are proud of that. But now in the work we do across government we need to focus on world-beating productivity, to drive the next phase of our growth and raise living standards.

The drivers of productivity are well understood: a dynamic, open enterprising economy supported by long-term public and private investment in infrastructure, skills and science. A nation flourishes when it uses the full skills of all its people in all parts of that nation.

The UK has a long-term productivity problem, which has been made worse by the financial crisis. Like many western democracies the challenge has not been to understand what to do; the challenge has been to be bold enough as a country to take the difficult decisions required to deliver this whole-heartedly. That must now end.

We are determined that Britain does take these decisions. That is the only way to ensure rising living standards and a better quality of life for our citizens. Indeed, our ambition is that Britain becomes the richest of all the major economies by 2030. This document sets out the Conservative government's vision to deliver that.

Every part of government will contribute to this ambition and we and our colleagues will ensure the reforms set out here are delivered with urgency and pace.

Productivity will not be transformed overnight, but the reforms set out here will deliver a step change that can realise both the aspirations of working people, and the ambition that our children's lives will be better than our own. It lays the foundations for a better future.

George Osborne
Chancellor of the Exchequer

July 2015

Sajid Javid
Secretary of State for Business, Innovation and Skills

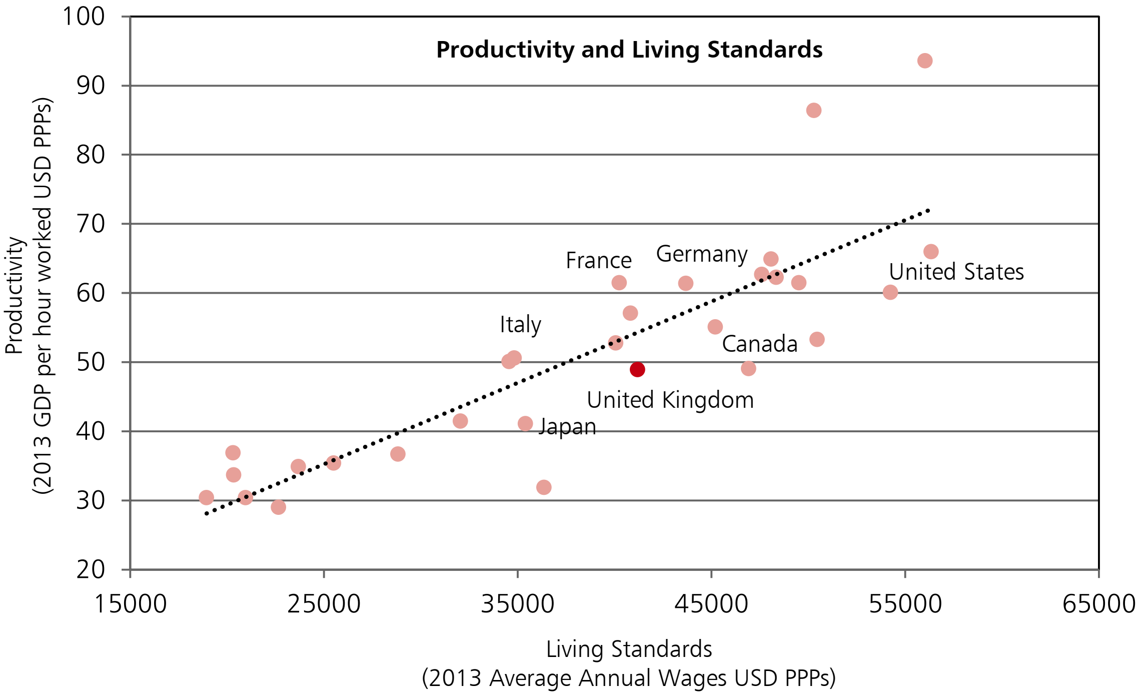
July 2015

Executive summary

The importance of productivity

Higher productivity increases household incomes. Productivity is the single most important determinant of average living standards and is tightly linked to the differences in wages across countries. In every member country of the Organisation for Economic Co-operation and Development (OECD) where average wages are above UK levels, productivity is also higher (Chart i).

Chart i: Productivity and living standards



Source: OECD Dataset: Averages annual wages; OECD Dataset: Level of GDP per capita and productivity.

The global economy continues to recover from the most damaging financial crisis in generations. To secure stability and lay the foundations for growth, the government will continue its long term economic plan and eliminate the fiscal deficit.

The UK is set to be the fastest growing G7 economy in both 2014 and 2015, with Gross Domestic Product (GDP) now 4.5% above its pre-crisis peak.[1] Employment is around record levels and has risen by 2 million since the start of the last Parliament, while unemployment is continuing to fall.[2]

Rising employment has been a major source of growth, but over the longer term, productivity is the more essential ingredient. UK productivity has persistently lagged behind other major

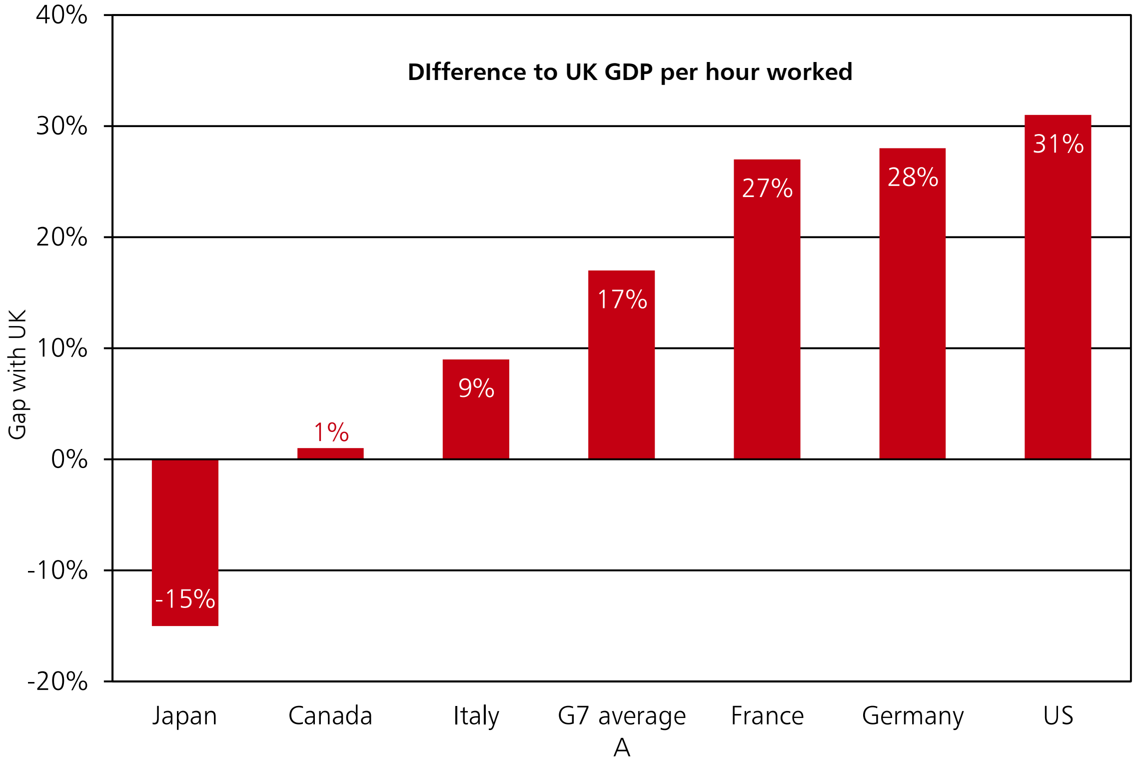
[1] *Quarterly National Accounts*, ONS, June 2015; *Economic Outlook No.97*, OECD, June 2015

[2] *Labour Market Statistics*, ONS, June 2015

economies and although it grew in the decades before the financial crisis, it has stalled sharply in the wake of the crisis.

Raising productivity is an international challenge with an important European dimension. Nevertheless, a large productivity gap exists between the UK and leading advanced economies (Chart ii). The government believes this gap is too large and that narrowing it is a prize worth striving for. Matching the productivity of the US would raise GDP by 31%, equating to around £21,000 per annum for every household in the UK.[3]

Chart ii: The productivity gap: comparisons between the UK and G7



Source: ONS International Comparisons of Productivity – Final Estimates, 2013
A: G7 average excluding the UK

This plan responds to the recent slowdown of productivity growth in the UK and, perhaps more importantly, to the long-standing gap compared to other countries. This is not a quick or easy task, but it is fundamental to securing a sustainable recovery and raising living standards over the long term. Small improvements can have transformative impacts if sustained over long periods. Raising annual trend growth by just 0.1% would mean the UK economy would be £35 billion larger in 2030 – the equivalent of approximately £1,100 extra for every household.[4]

Higher productivity will improve the public finances. The Office for Budget Responsibility (OBR) estimated in 2014 that in a high productivity scenario public sector net debt would fall to 56.7% by 2019-20, while under a low productivity scenario debt would rise to 86.6%.[5] Raising

[3] Note: GDP per household is not a household income metric as GDP also includes Gross Operating Surplus of corporations and other measures of domestic income/production. HMT calculation: 2014 nominal GDP (YBHA) divided by 2014 ONS household estimates; *Quarterly National Accounts*, ONS, June 2015 and *Families and Households*, ONS, January 2015.

[4] HMT calculation: Increasing annual real GDP growth by a theoretical 0.1 percentage point for the next 15 years, relative to a counterfactual where it grows in line with its average since 2000. Forecast for number of households in 2030 taken from DCLG household projections. 2011 prices.

[5] *Economic and Fiscal Outlook*, Office for Budget Responsibility (OBR), December 2014

productivity can also improve the UK's trade position by better enabling UK firms to compete with foreign firms in the global marketplace.

The measures in this plan are based on an assessment of the UK's productivity performance, which is set out in more detail in Annex A. One of the clear challenges that arises in assessing productivity is the difficulty of measuring it accurately in a modern and increasingly technological economy. This is an ongoing challenge and statistical offices globally must rise to it. Professor Sir Charles Bean has therefore agreed to lead an independent review of the quality, delivery and governance of UK economic statistics. The review will build on the established principle of independently produced statistics and make interim recommendations in the autumn with a final report to be published by Budget 2016.

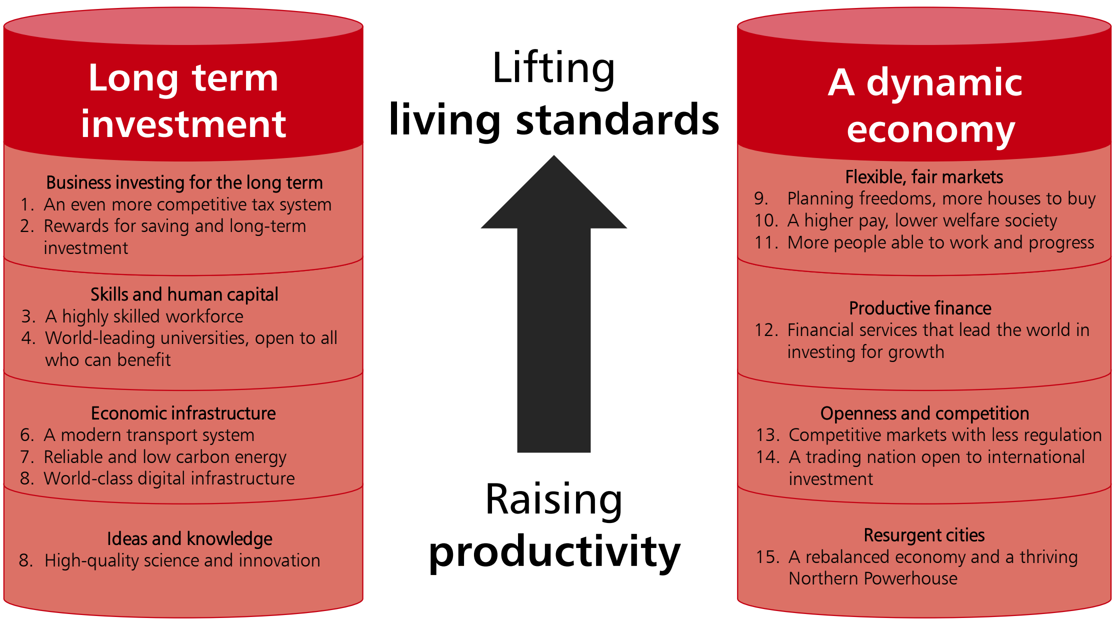
The government's approach to raising productivity

The government's framework for raising productivity is built around two pillars:

- encouraging long-term investment in economic capital, including infrastructure, skills and knowledge
- promoting a dynamic economy that encourages innovation and helps resources flow to their most productive use

These high-level drivers of productivity are based on widely agreed and relatively well-understood academic analysis. The government is now rising to the challenge, and this document sets out a fifteen-point plan for productivity that takes on the hard choices needed for lasting change.

Chart iii: A framework for raising productivity



Source: HM Treasury

Long term investment

1: An even more competitive tax system, bringing business and investment to Britain

High rates of corporation tax distort incentives and stifle business investment. During the last Parliament the main rate of corporation tax was cut from 28% to 20% and the Employment Allowance was introduced to reduce the employer National Insurance contributions (NICs) costs of employers across the country. In this Parliament the government will go further by:

- cutting corporation tax to 19% in 2017 and then again to 18% in 2020, saving businesses £6.6 billion
- reducing income taxes for all with an ambition to increase the personal allowance to £12,500 and increase the higher rate threshold to £50,000 by the end of the Parliament

2: Rewards for saving and long-term investment

For too long the UK has invested too little in its economic future. The government must create the right conditions to support the long-term business investment needed for productivity, and will:

- set the level of the Annual Investment Allowance permanently at £200,000 from January 2016
- provide the certainty and stability businesses need through a new business tax roadmap by April 2016
- remove a distortion which creates an artificial tax bias in favour of mergers and acquisitions, structured to take advantage of the relief
- build on the stronger incentives for individuals to save introduced in the last Parliament – significant increases in the ISA allowance, the new Personal Savings Allowance, and greater flexibility in accessing pensions – by consulting on the case for reforming pensions tax relief to simplify the system and strengthen incentives to save for the long term
- endorse proposals from some of the country's largest investors to support companies investing for long-term growth and challenge those that are compromising long-term competitiveness and productivity
- engage with some of the country’s most senior business leaders, led by Sir Charlie Mayfield, as they develop their proposals for improving business productivity

3: A highly skilled workforce, with employers in the driving seat

The UK’s skills weaknesses – and failure to grow a serious system of respected employer-led professional and technical qualifications – are of such long standing, and such intractability, that only the most radical action can address them. The government will:

- target ‘coasting’ schools for improvement as well as outright school failure, improve teaching quality, and make schools funding fairer
- respond to businesses’ calls to improve work-ready skills. Reforms are increasing the rigour of GCSEs and A levels, including in maths and science

- introduce a new compulsory apprenticeship levy requiring large employers to invest in their own future so that the 3 million apprenticeships delivered during this Parliament will be well funded, high quality, and meet employers' real needs
- radically simplify and streamline further education qualifications and move away from funding on a per qualification basis; invite local areas to participate in the reshaping and commissioning of local provision; and create a network of prestigious Institutes of Technology, focussed on the higher level skills employers demand

4: World-leading universities, open to all who can benefit

Our excellent university sector cannot be kept competitive, and open to all who can benefit, unless we make hard choices about funding. The government will:

- remove the student numbers cap so that anyone with the right qualifications can study at university
- ensure the long term sustainability of investment in universities by replacing maintenance grants with loans for new students from 2016-17, while providing more cash in hand in real terms than has ever been provided to help students from lower to middle income backgrounds meet the cost of living while studying
- introduce a new Teaching Excellence Framework to sharpen incentives for providing an outstanding education to students
- allow institutions offering high teaching quality to increase tuition fees with inflation, to ensure that the universities sector remains well funded to compete internationally
- open the higher education market to more new entrants to stimulate competition and innovation, increase choice for students, and deliver better value for money

5: A modern transport system, with a secure future

For decades, the UK has not invested well enough in the transport infrastructure that is the lifeblood of business, particularly roads; there have been too many rail failures; and the costs to the economy of not addressing airport capacity constraints are estimated at £30-45 billion.[6] The government will:

- create a new Roads Fund by 2020-21, funded directly by the revenues from Vehicle Excise Duty, to ensure continued high and stable investment in the strategic road network for generations to come
- produce an ambitious second Roads Investment Strategy before the end of this Parliament, for the period 2020-25, based on this new Roads Fund
- ensure Network Rail can deliver effectively and safely, by appointing Sir Peter Hendy as Chairman to develop a plan to get the rail investment programme back onto a sustainable footing
- ask Sir Peter Hendy to continue the work within Network Rail to devolve further to route managers closer to the front line, so that the railways are more focussed on delivering what passengers need

[6] *Airports Commission Interim Report*, Airports Commission, December 2013

- change the way it provides public money through the rail industry, so that Network Rail focusses firmly on the needs of train operators, and, through them, passengers
- establish a dedicated body with a new approach to station redevelopment and commercial land sales on the rail network
- appoint Nicola Shaw, Chief Executive of High Speed 1, to advise on the long term future shape and financing of Network Rail, working closely with Sir Peter Hendy
- take a decision on airport capacity in the south east by the end of the year
- invest £100 billion in all infrastructure over this Parliament, giving long-term certainty and increased funding to the most productive areas of infrastructure spend

6: Reliable and low-carbon energy, at a price we can afford

Energy underpins the operation of a successful and productive economy. We need a better plan to meet the triple challenge of security of supply, affordability and sustainability. To deliver this, the government will:

- ensure the UK attracts the necessary investment to guarantee secure energy supplies, including through the development of shale gas, North Sea oil and gas production, and new nuclear power stations
- continue the long-term decarbonisation of the UK's energy sector through a framework that supports cost effective low carbon investment
- take action to reduce bills for businesses and consumers, by strengthening competition in the market
- conduct a review of business energy tax policy to improve and simplify the landscape

7: World-class digital infrastructure in every part of the UK

Our digital infrastructure is improving fast, but there are still too many businesses hampered by slow connections, and households who cannot play their full part in the digital economy. The government will:

- ensure superfast broadband (at least 24Mbps) is available to 95% of UK households and businesses by 2017; the government's superfast broadband programme is passing an additional 40,000 premises every week
- support the market to deliver near universal 4G and ultrafast (at least 100Mbps) broadband coverage
- make it easier for the market to roll out the fixed and mobile infrastructure the UK needs, including through proposals to reform planning rules on taller mobile masts

8: High-quality science and innovation, spreading fast

Our science base is a vital national asset, but to stand still in science and innovation is to be left behind; and we need new ideas to spread and be used as widely as possible. The government will:

- deliver on the science capital commitment, investing £6.9 billion in the UK's research infrastructure up to 2021
- ensure the UK's excellent science has a focus on those areas with greatest potential, from genetics to quantum technology, and has asked Sir Paul Nurse to lead an independent review on how best to make these strategic choices
- look for opportunities to develop the UK's network of Catapult centres for commercialising technology
- support universities in collaborating with industry and commercialising research, responding to Professor Dame Ann Dowling's review

Dynamic Economy

9: Planning freedoms and more houses to buy

The UK has been incapable of building enough homes to keep up with growing demand. This harms productivity and restricts labour market flexibility, and it frustrates the ambitions of thousands of people who would like to own their own home. The government will:

- introduce a new zonal system which will effectively give automatic permission on suitable brownfield sites
- take tougher action to ensure that local authorities are using their powers to get local plans in place and make homes available for local people, intervening to arrange for local plans to be written where necessary
- bring forward proposals for stronger, fairer compulsory purchase powers, and devolution of major new planning powers to the Mayors of London and Manchester
- extend the Right to Buy to housing association tenants, and deliver 200,000 Starter Homes for first time buyers
- restrict tax relief to ensure all individual landlords get the same level of tax relief for their finance costs

10: A higher pay, lower welfare society

Despite progress during the last Parliament, the welfare bill remains stubbornly and disproportionately high. The welfare system should ensure that people are incentivised and helped to find work which is fairly paid, and that the taxpayer does not subsidise low pay or foot the bill for an unfair system where too many people remain on benefits. The government will:

- further reduce the household benefit cap alongside a four year freeze in working-age benefits (except disability benefits and statutory payments)
- increase the personal allowance to £11,000 in 2016-17, ensuring that 29 million people will keep more of their hard-earned income next year
- introduce a National Living Wage (NLW) for workers aged 25 and over, to reach £9 by 2020
- reform the tax credits system (and its successor, Universal Credit) to focus it on those on lower incomes and end unlimited support for large families

11: More people with a chance to work and progress

There are still too many people for whom there are unfair or distorting barriers to work – including women and disabled people, whose high levels of skill are too often underused. The government has set out stretching ambitions to increase employment and halve the disability employment gap: the government will therefore:

- double the free entitlement to childcare, to 30 hours a week for working parents of three and four year olds
- expect parents claiming Universal Credit to do more to look for work when their youngest child turns 3, and to prepare for work when their youngest child turns 2
- reform Employment and Support Allowance to ensure the right incentives and support are in place for those capable of taking steps back to work, by ensuring that new claimants who are placed in the Work Related Activity Group receive the same rate as those claiming Jobseeker's Allowance
- introduce a new Youth Obligation for 18 to 21 year olds on Universal Credit

12: Financial services that lead the world in investing for growth

Our financial services sector has suffered since the crisis, and we can do more to promote the most productive forms of investment. The government will:

- highlight the importance of ensuring the supply of finance to support productive investment in setting the Financial Policy Committee's (FPC) 2015 remit
- ensure the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) create a joint New Bank Unit to promote competition
- champion the development of new and innovative technologies and ideas, including through the appointment of a Special Envoy for Fintech
- implement a long term plan for the taxation of banks, giving stability and sustainability and securing competitiveness

13: Open and competitive markets with the minimum of regulation

The UK's open and competitive market economy leads the world, but there is no room for complacency in pushing for ever greater consumer power, nor in fighting stifling regulation. The government will:

- cut a further £10 billion of red tape
- introduce clear new principles for consumer switching, and legislate to support quick and easy switching in communications markets
- champion enterprise, stimulating finance for Small and Medium-sized Enterprises (SMEs)
- publish a Digital Transformation Plan, with actions to support the adoption of digital technologies across the economy

14: A trading nation, open to international investment

The government's focus on exports has started to make a difference; but we still trail many of our international competitors, and the ambitious £1 trillion target will not be met without a step change. The government will:

- build stronger trading links with emerging markets, especially China, India and Brazil
- mobilise the whole of government behind exporting, working alongside a more effective UK Trade and Investment (UKTI) and better export finance
- help deliver a Europe that is more dynamic and outward focussed as part of our renegotiation, by accelerating the integration of the single market, completing trade agreements, and improving the quality of regulation

15: Resurgent cities, a rebalanced economy and a thriving Northern Powerhouse

Our economy cannot grow as it should while it is so skewed towards London and the south east. We have started to build the Northern Powerhouse, through: committing £13 billion of investment to transport in the north of England over this Parliament; backing major new science, and technology and culture projects; and agreeing to devolve significant powers over transport, housing, health, planning and policing to an elected mayor for Greater Manchester. The government is also taking steps to enable the Midlands Engine for Growth to reach its full potential. But there is far more to be done if we want resurgent cities and a rebalanced economy. The government will:

- devolve further powers to Greater Manchester and London, including consulting on Sunday trading
- devolve further planning powers to the Mayors of Greater Manchester and London
- work towards devolution deals with the Sheffield City Region, Liverpool City Region, and Leeds, West Yorkshire and partner authorities
- put Transport for the North on a statutory footing and give it a budget, clear leadership and a focussed remit, including working to introduce Oyster-style integrated and smart ticketing across the North
- ensure that rural areas can also contribute to, and benefit from, productivity growth

This plan commits the government to concerted action, covering every major government department. It will also be accompanied by a set of clear actions on public sector productivity, set out in Chapter 16. It is an agenda for the UK's overall domestic policy for the course of this Parliament, and it will be tracked and driven forward by the Cabinet Committee on Economic Affairs, under the leadership of the Chancellor of the Exchequer.

A

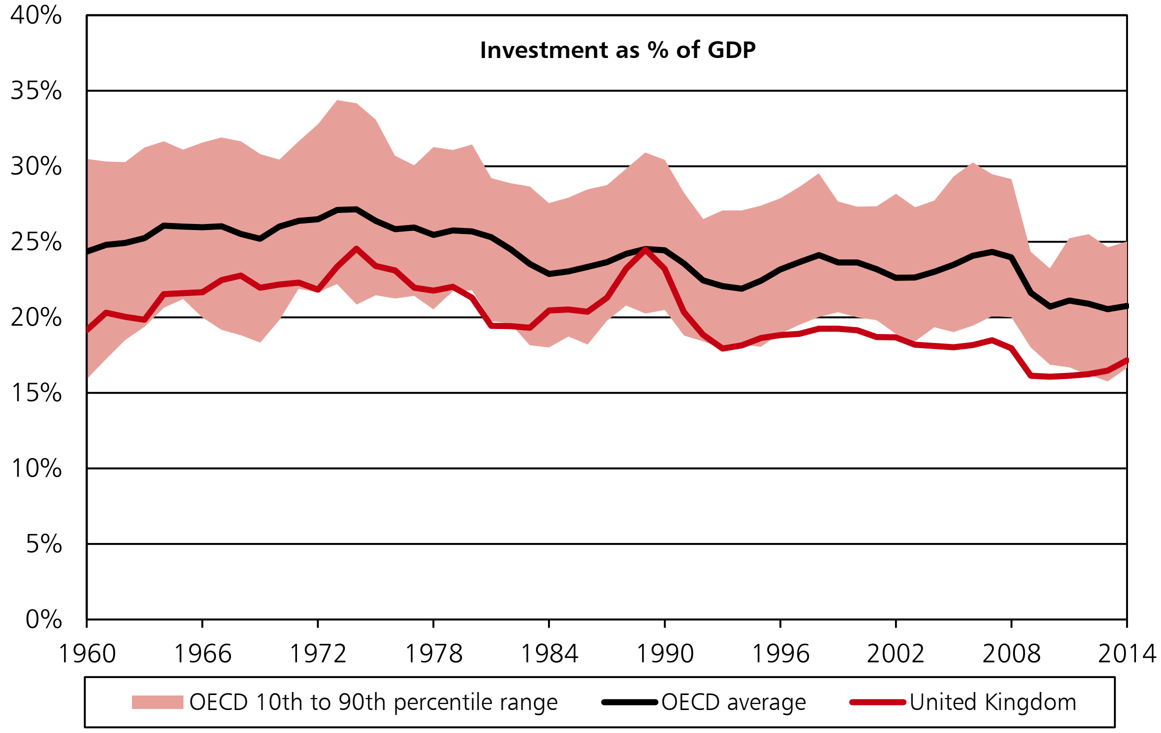
Section A: Long-term investment

Investment is an essential part of raising productivity. In today's economy that is not simply a matter of increasing the stock of machines, equipment and essential physical infrastructure but also, crucially, the development of human and intellectual capital.

The UK has long had a mixed record on investment, in both public and private sectors.[1] Despite strengths in higher level skills, problems remain at basic and intermediate levels. Total spend on Research and Development (R&D) has been under the OECD average but the UK has world-leading science, with high levels of investment in knowledge assets ('intangibles').[2]

Expenditure on physical investment, which captures many forms of critical infrastructure, has been persistently low. As a share of GDP, investment in the UK has ranked in the lowest 25% of OECD countries for 48 of the last 55 years, and the lowest 10% for 16 of the last 21 years[3] (Chart iv).

Chart iv: UK investment since 1960



Source: OECD Dataset: Quarterly National Accounts.

This section of the plan sets out how the government will create the conditions for higher private investment, improve the targeting of public investment to transform vital infrastructure and skills, and promote long-term decision making among companies and investors.

[1] *Investing for prosperity: skills, infrastructure and innovation*. LSE Growth Commission (2012)

[2] Individual references in chapters

[3] OECD stats database: *Quarterly National Accounts*

The government made good progress on improving UK infrastructure in the last Parliament. The first-ever National Infrastructure Plan (NIP) was published, creating a coherent vision for UK economic infrastructure, and providing transparency and clarity on plans to finance and deliver critical projects. Average annual infrastructure investment (public and private) increased by 15%[4] in real terms on the previous Parliament. The government will invest £100 billion in infrastructure over this Parliament, channelled towards projects that make the most difference to improving the UK's productivity.

The government will publish a new long-term National Infrastructure Plan for the key economic infrastructure sectors – transport, energy, flood defences, water, waste, communications and science. **This will be supported by annual updates on progress with delivery. The government will also publish a dedicated National Infrastructure Plan for Skills in the summer,** to provide analysis of current capability and future need and ensure the UK has the right skills base to deliver and maintain world-class infrastructure. The NIP will continue to be underpinned by the Infrastructure Pipeline, which will be published on a regular basis, starting with an update this summer.

[4] *National Infrastructure Plan*, HM Treasury, December 2014

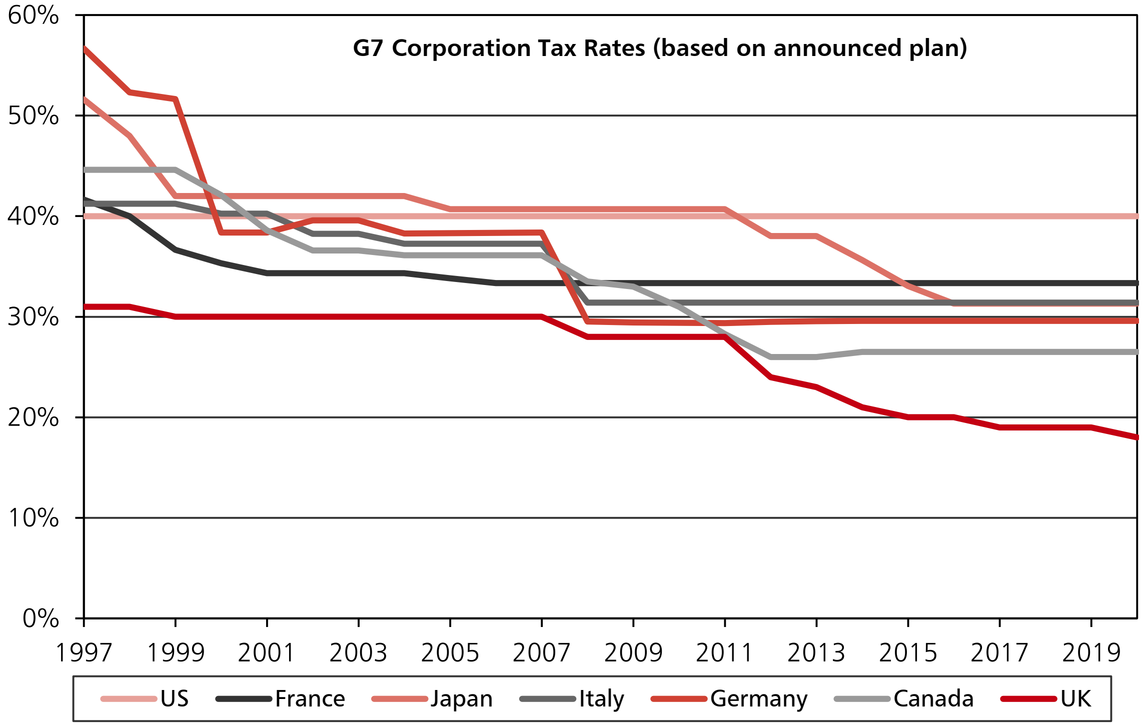
1 An even more competitive tax system, bringing business to Britain

1.1 The tax system can support productivity by providing incentives, stability and certainty for long-term investment and innovation, avoiding distorting economic choices, and minimising the administrative burden of paying taxes.

1.2 Since 2010 the government has cut the main rate of corporation tax from 28% to 20%, cut the small profits rate to 20%, and merged the two rates to simplify the system. Overall the cuts delivered in the previous Parliament will save companies £10 billion a year.[1]

1.3 In this Parliament, the government will go further, by cutting corporation tax to 19% in 2017 and then again to 18% in 2020. These new cuts will save businesses a further £6.6 billion by 2021, benefitting 1.1 million businesses. Reducing corporation tax increases the return a company receives on its investment, so incentivises companies to invest and grow. That investment is vital to long-run productivity growth. As a result of the Summer Budget 2015 announcement, the UK will have the lowest rate of corporation tax in the G20 and by far the lowest in the G7, making the country even more attractive to inward investors.

Chart 1.A: Corporation Tax rates in the G7



Source: Bloomberg, KPMG, HM Treasury

1.4 The government will continue making tax easier and simpler by putting the Office of Tax Simplification (OTS) on a permanent footing and increasing its capacity and remit. By 2020

[1] HMRC analysis

digital accounts will dramatically cut the cost of paying tax for business. The terms of reference for the next OTS reports on the closer alignment of income tax and NICs and the taxation of small companies will be published shortly.

1.5 The government believes in lower taxes. The cornerstone of this commitment is to introduce into legislation a tax lock to rule out increases in the main rates of income tax, National Insurance, and VAT, over the course of this Parliament. The government also has an ambition to increase the personal allowance to £12,500 and increase the higher rate threshold to £50,000 by the end of the Parliament.

2 Rewards for savings and long-term investment

Supporting individuals to save

2.1 Saving by individuals, notably in pension funds, is a key source of finance for investment. In 2011, the value of assets held in UK pensions was over £2 trillion (135% of GDP).[1] Pension schemes invest in a variety of asset classes including equities, government bonds, corporate bonds, property and infrastructure. A further £470 billion is held in ISAs.[2]

2.2 Over the course of the last Parliament, the government made several changes to pensions and savings policy to encourage saving. Employees now have the opportunity to contribute to a workplace pension through automatic enrolment, which by 2020 will generate £11 billion a year more in workplace pension saving. The government has also given individuals greater freedom with their pension savings when they come to retire, which has led to greater engagement with pension savings.[3] At the Summer Budget 2015, the government launched a consultation on the case for reforming pensions tax relief in order to simplify the system and strengthen the incentive for individuals to save for the long term. These steps will support a culture of saving and financial resilience, and ensure that pension funds continue to provide a source of finance for investment.

2.3 The government has also significantly strengthened incentives to save more generally, both by cutting tax and by giving individuals more flexibility. A new Personal Savings Allowance will be introduced in 2016, exempting up to £1,000 of interest from tax. £15,240 can be saved into an ISA this year, with no distinction between cash and stocks and shares, up from a 2010-11 limit of £10,200 (of which only half could be cash). The range of eligible investments has been expanded to support business growth and financial innovation.

A tax system that supports productive investment

2.4 Tax policy influences the returns that firms can make from investment and innovation, and is a critical factor in the willingness of foreign firms to invest and locate in the UK. HM Revenue and Customs (HMRC) analysis shows that £1 of tax relieved by R&D tax credits stimulates between £1.53 and £2.35 of additional R&D investment.[4]

2.5 The government is taking steps to provide certainty to businesses wanting to plan their medium and longer term investment. **From January next year the government will increase the permanent level of the Annual Investment Allowance to £200,000, its highest ever permanent level**. The government will complete a major review on the future of business rates by the end of 2015.

2.6 By April 2016, the government will publish a Business Tax Roadmap which will set out the government's plans for business taxes across the rest of the Parliament. In order to ensure broader stability, the government is also legislating to lock the main rates of income tax, National Insurance Contributions and VAT.

[1] *Pension Trends*, Office for National Statistics, 2013. Includes both accumulation and decumulation.

[2] *Individual Savings Account (ISA) statistics*, HMRC, April 2015. Data for tax year 13/14.

[3] *28% of workers more likely to save into a pension following Budget, finds NAPF survey*, National Association of Pension Funds, April 2014

[4] *Evaluation of Research & Development Tax Credit*, Fowkes et al., 2015

2.7 Tax-advantaged venture capital schemes provide an important incentive for individuals to invest in small and growing UK companies. The government is making changes to ensure that the schemes continue to provide significant and well-targeted support. This includes higher investment limits for knowledge-intensive companies, recognising the importance of supporting innovation.

2.8 To ensure commercial factors drive the structure and price of mergers and acquisitions, the government will stop companies obtaining a deduction from their taxable profits for the acquisition cost of assets linked to the business' reputation and customer relationships. This is consistent with the rules in other major economies, and will remove a distortion in the market which is artificially altering the way companies choose to expand.

Long-term decision making by companies and investors

2.9 For too long, the UK has invested too little in its economic future. This plan focusses on the role that the government needs to play in creating the right conditions for investment. But for companies to thrive and national productivity to grow, firms must be prepared to invest in building the skills of their workforce, developing new and improved products and services, and in new technology. These are all things that require businesses to take a long-term view.

2.10 Over many years there has been a debate around this issue in the UK. For instance:

- equity markets can focus disproportionately on short-term results. Work by the Bank of England, for instance, suggests that investments yielding returns in the longer term are disproportionately undervalued relative to returns in the near term.[5] This can have damaging consequences for long-term growth
- the nature of the 'investment chain', which connects fund managers to those beneficiaries whose money they are managing, can create inefficiencies – for instance through the nature of benchmarks, imperfect incentive structures and an excessive focus on quarterly performance reporting
- some, such as Professor John Kay in a report commissioned by the previous government, argue that an excessive focus on restructuring, financial engineering and mergers and acquisitions in the UK can be a damaging distraction from investment in fundamental productive capacity[6]
- others, like Andrew Smithers and William Lazonick,[7] argue that the structure of executive incentives can put too much emphasis on short-term performance measures and encourage share buy-backs
- elevated levels of cash on company balance sheets and sometimes high hurdle rates for investment have been seen as evidence of a failure by companies to identify or take advantage of good potential investment opportunities[8]

2.11 This debate is not, however, straightforward or altogether conclusive. Many of the forces seen by critics as potentially driving short termism in the UK, such as a rigorous focus by institutional investors on corporate performance, and a culture which exposes underperforming firms to the threat of takeover, are argued by others to be as likely to promote productivity as to

[5] *The Short Long*, a speech by Andrew G Haldane and Richard Davies, Bank of England, May 2011

[6] *The Kay Review of Equity Markets and Long-Term Decision Making*, Final Report, Department for Business, Innovation and Skills, July 2012

[7] *The Road to Recovery*, Andrew Smithers, September 2013; *Stock buybacks: From retain-and reinvest to downsize-and-distribute*, William Lazonick, Brookings, April 2015

[8] *Bad information is bad for the economy*, Andrew Smithers, Financial Times, May 2015; *Private non-financial corporations cash research,* AGFE, in partnership with Experian, for BIS, March 2015

damage it. Moreover the US, the nature of whose corporate and capital market environment has much in common with the UK, nevertheless enjoys substantially higher levels of innovation and capital investment.

2.12 What is absolutely clear, however, is that while the government can do much to create a climate which is conducive to investment, innovation and productivity growth, the role of firms (including non-executive directors) and their investors is fundamental if higher levels of productivity are to be achieved.

2.13 Accordingly, alongside this productivity plan, the government strongly welcomes two developments also announced today:

- a number of the country's largest institutional investors have written to the government with their proposals to support companies investing for long-term growth and challenge those that are compromising long-term competitiveness and productivity
- some of the country's most senior business leaders, convened by Sir Charlie Mayfield, Chairman of the John Lewis Partnership, have written to the government making the case for taking forward a business-led action group for productivity. The work will be practical and grounded, driving direct action to enhance productivity in different sectors and workplaces across the UK. The group has offered to report to the Chancellor and the Secretary of State for Business by the end of the year

3 A highly skilled workforce, with employers in the driving seat

3.1 Over the last century, productivity growth has gone hand in hand with rising human capital, as more people have become educated, and to a higher level. However, the UK suffers from several weaknesses in its skills base that have contributed to its longstanding productivity gap with France, Germany and the US. Results from the OECD show that England and Northern Ireland are in the bottom four countries for literacy and numeracy skills among 16-24 year olds.[1] The UK also performs poorly on intermediate professional and technical skills, and is forecast to fall to 28th out of 33 OECD countries for intermediate skills by 2020. [2] It is imperative that the UK addresses these shortfalls if productivity is to improve.

Schools reform

3.2 The government wants schools to offer a broad and rigorous academic curriculum, building knowledge, skills, character and resilience. The government's goal is for all pupils starting year 7 in September 2015 to study the English Baccalaureate.[3] The government is introducing new, more rigorous GCSE and A-levels in maths and science, and will focus on increasing the take-up of STEM subject[4] A-levels for girls in particular. Young people without good grades in maths and English at GCSE will continue to study the subjects until the age of 18.

3.3 Teaching quality is the most significant factor driving school outcomes, and the government will support England's teaching workforce to be world class, including a new initial teacher training curriculum. Record levels of top graduates are now joining the profession and nearly three quarters of graduates starting teacher training now have a 2:1 level university degree or higher.[5] The government has introduced greater flexibility for schools to pay the best teachers more, and is supporting the establishment of a new independent College of Teaching. In order to ensure that England has the highest STEM teaching quality, the government will train an additional 17,500 teachers in STEM subjects. The government will also encourage greater use of evidence on 'what works' - there remains significant scope for schools to make better use of evidence, such as from the Education Endowment Foundation.

3.4 The government will also improve the quality of schools in all areas of the country. More children than ever are now in a good or outstanding school. There are now more than 4,700 academies, 254 new free schools, 30 University Technical Colleges (UTCs) and 37 studio schools.[6] The government will open a further 500 free schools and ensure there is a UTC within reach of every city. The government will turn inadequate schools into academies and improve their leadership, as well as targeting coasting schools for improvement. The government will make schools funding fairer and focus efforts to support school improvement in

1 *Adult Skills Survey*, Organisation for Economic Co-operation and Development, 2013. Results are not available for Scotland or Wales.
2 *UK Skill Levels and International Competitiveness,* 2013 , Derek L Bosworth, August 2014
3 English, mathematics, science, one modern foreign language and either history or geography
4 Science, Technology, Engineering, Mathematics
5 *Initial Teacher Training: trainee number census - 2014 to 2015,* Department for Education
6 Department for Education open academies and free schools tracker

underperforming areas, including coastal areas, encouraging the best academy chains to expand and bringing new sponsors where they are needed.

Apprenticeships

3.5 Apprenticeships are a key part of some of the most successful skills systems across the world. In many countries they offer young people in particular a high quality training route where they develop skills tailored to a particular sector or industry and earn while they learn.

3.6 The critical need for high numbers of new technical and professional skilled workers to enter the workforce in the coming years presents a strong case for a high quality apprenticeship system in the UK: analysis indicates that by 2022 there will be an additional 3.6 million jobs in medium-skilled occupations, including skilled trades and health care professions.[7]

3.7 The government has therefore committed to significantly increasing the quantity and quality of apprenticeships in England to 3 million starts this Parliament, putting control of funding in the hands of employers.

3.8 In the last Parliament there were over 2.3 million apprenticeships starts in England.[8] Increasing this to 3 million new starts over this Parliament will mean an increase of over 30% on the achievement of the last five years. The government is taking a number of steps to deliver this:

- employer-routed funding reforms, such as the digital apprenticeships voucher, are putting control of funding directly into hands of employers
- apprenticeships will be given equal legal treatment to degrees, to ensure that apprentices and employers can be given confidence in the brand
- the government will abolish employer NICs for almost all apprentices under the age of 25 from April 2016
- the government will set apprenticeship targets for public sector bodies

3.9 However, a step change in the scale of the apprenticeship programme also needs a step change in funding. Achieving this change will require a reversal in the trend of employer underinvestment in training, which has seen a rapid decline in the amount and quality of training undertaken by employees over the last 20 years (Chart 3.A). This decline is in part due to employer concerns that if they invest in training their employees, competing firms will free-ride on their investment. This needs to change.

3.10 A new approach is needed which puts employers at the heart of paying for and choosing apprenticeship training. In recognition of this, **the government will introduce a levy on large UK employers to fund the new apprenticeships**. Levies to fund training are already in place in Germany, France, Denmark and over 50 other countries, often supporting high quality apprenticeship systems.[9] As Professor Alison Wolf has set out in a recent report, it is now time for the UK to do this as well.[10]

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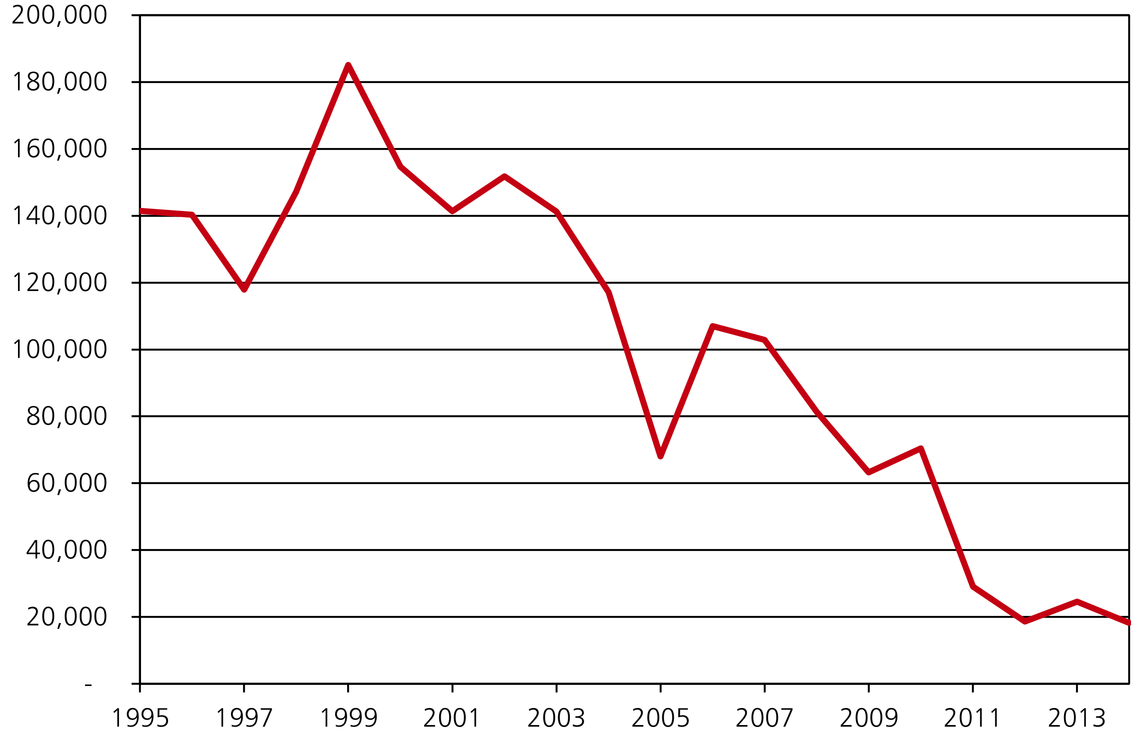
[7] *Winning the global race? Jobs, skills and the importance of vocational education*, J Clifton et al., June 2014

[8] Data from Individualised Learner Record

[9] *Subsidies and Levies as Policy Instruments to Encourage Employer-Provided Training*, OECD Education Working Papers, No. 80, N Müller and F Behringer, June 2012; *A review of national training funds*, Richard Johanson, November 2009

[10] *Fixing a Broken Training System: The case for an apprenticeship levy*, Professor Alison Wolf, July 2015

Chart 3.A: Employees working fewer hours because of training [a]



Source: Office for National Statistics, Labour Force Survey

[a] Number of people in employment whose actual hours worked in reference week was less than usual hours because of training course away from workplace

3.11 The levy will apply to large employers and will support all post-16 apprenticeships. In England, any firm will be able get back more than it puts in by training sufficient apprentices. The government will put control of the funding in the hands of employers via the digital voucher scheme to ensure that it delivers the training they need. Crucially, this will enable an increase in the quality of apprenticeships at the same time as an increase in quantity.

3.12 Formal engagement with business on the implementation of the levy will take place; this will also consider the interaction with existing sector levy boards. Further details will be set out at the Spending Review.

Professional and technical education

3.13 The government's ambition is for a professional and technical education system that provides individuals with clear, high-quality routes to employment, and that supports the government's overall fiscal and economic objectives. To achieve this, the government will simplify and streamline the number of qualifications so that individuals have a clear set of routes which allow for progression to high level skills, rather than thousands of qualifications.

3.14 Professional and technical education provision, of which the majority is currently at level 2 and below, needs to be refocussed to deliver the higher level skills that employers need.[11] Strong institutions are needed to support this ambition. The creation of National Colleges has been announced to provide high-level sector-specific training. The government will go further and invite some colleges to become prestigious Institutes of Technology to deliver high-standard provision at levels 3, 4 and 5. Building on international best practice, Institutes of Technology

[11] For breakdown of learner participation by level, see *Further Education and Skills Statistical First Release*, 2015

will be sponsored by employers, registered with professional bodies and aligned with apprenticeship standards. The government will empower National Colleges, Catapults, and elite professional institutions to design each route, alongside employers and professional bodies.

3.15 The government will improve destination data to enable informed choices. The government is supporting the development of online portals to present all post-16 learning options to young people in a user-friendly way, and is strengthening the provision of destination and earnings data. The new careers and enterprise company will encourage greater collaboration between schools, colleges and employers, helping young people to access the best advice.

3.16 The government wants strong local areas and employers to take a leading role in establishing a post-16 skills system that is responsive to local economic priorities. The government will make an offer to local areas:

- first, the government will invite local areas to participate in the reshaping and re-commissioning of local provision to set it on an efficient and financially resilient footing. A differentiated approach to local involvement will be adopted which will enable areas with the strongest governance and levers to shape provision, building on the skills flexibilities agreed with Greater Manchester, London and Sheffield. These devolution packages could be extended to other regions. The government anticipates that many colleges will be invited to specialise according to local economic priorities, to provide better targeted basic skills alongside professional and technical education, and that some will be invited to become Institutes of Technology
- second, following on from this restructuring process, the government will enable local involvement in the ongoing commissioning of provision, putting power in the hands of people who are best placed to tailor provision to local economic needs

3.17 The government will move away from the funding per qualification model for adult learners and, with input from local areas and employers, will develop options to ensure provision is targeted at training with the greatest impact.

3.18 The government will set out more details of these reforms in the autumn.

4 World-leading universities, open to all who can benefit

4.1 The UK performs well above the OECD average in terms of higher level skills and is home to 4 out of the world's top 10 universities, second only to the US.[1] This represents an important competitive advantage, as technological change continues to increase demand for higher skilled roles. However, further reform is required to ensure the long-term sustainability of investment in universities.

4.2 The government is committed to maintaining the UK's world class higher education system and making it accessible to all who are qualified and wish to study, particularly students from disadvantaged backgrounds, while also meeting its fiscal objectives. Since 2010 student participation has increased, with a higher proportion of students from disadvantaged backgrounds applying to and entering higher education than ever before.[2] This ambition to widen participation has underpinned all the reforms to higher education finance since 2010 and continues to be a government priority.

4.3 The government has therefore committed for the first time to removing the cap on student numbers. This means that thousands more students can access higher education who were not able to previously, widening access to those who have the grades and can gain from university.

4.4 The government will do more to help students with the cost of living while studying, and will **increase the cash available to English students from low and middle income backgrounds**. There is evidence that students are more concerned about the level of support they receive while studying than the long-term repayment of their income contingent loans. [3]Maintenance loan support will rise to £8,200 a year for those studying away from home and outside London. This is the highest ever level and will come entirely as an income-dependent loan.

4.5 The expansion of higher education relies on funding being put onto a sustainable footing in the long term. The returns to individuals from a degree are high: the average male graduate will earn £170,000 more over his lifetime, and a female graduate will earn £250,000 more, than someone with whose highest qualification is A-levels.[4] The government will therefore ask graduates to meet more of the costs of their degrees once they are earning, according to their income. From the 2016-17 academic year, **maintenance grants will be replaced by maintenance loans for new students**, paid back only when their earnings rise above £21,000 a year.

4.6 This change makes it even more important that the long term costs of the student loan book remain affordable and transparent. The government will **consult on freezing the repayment threshold at £21,000 for five years** and will also **review the discount rate applied to student loans and other transactions to bring it into line with the government's long-term cost of borrowing**.

[1] QS World University Rankings, 2014-15; *UK Skill Levels and International Competitiveness*, 2013, Derek L Bosworth, August 2014

[2] *End of Cycle Report*, The Universities and Colleges Admissions Service (UCAS), 2014; *UK application rates by country, region, constituency, sex, age and background report*, The Universities and Colleges Admissions Service (UCAS), 2015

[3] *Student Funding Panel: an analysis of the design, impact and options for reform of the student fees and loans system in England*, Universities UK, June 2015

[4] *The Impact of University Degrees on the Lifecycle of Earnings: some further analysis*, Walker and Zhu, 2013

Excellence in teaching

4.7 The government will introduce a new Teaching Excellence Framework to sharpen incentives for institutions to provide excellent teaching, as currently exist for research. This will improve the value for money and return on investment for both students and the government, and will contribute to aligning graduate skills and expectations with the needs of employers. The government will consult later this year on how a Teaching Excellence Framework can be developed, including outcome-focussed criteria and metrics. The Teaching Excellence Framework will inform student decision-making, continue to support a high average wage premium for graduates and ensure that students' hard-won qualifications keep their value over time.

4.8 To support teaching excellence, the government will allow institutions offering high quality teaching to increase their tuition fees in line with inflation from 2017-18, and will consult on the mechanisms to do this. This will reward excellent institutions with higher fee income, while ensuring students get good value from the tuition loans that the government underwrites.

Opening the market to new and alternative providers

4.9 Widening the range of high quality higher education providers can stimulate competition and innovation, increase choice for students, and deliver better value for money. The government will remove barriers preventing alternative providers from entering and growing in the market, and adopt a risk-based approach that safeguards quality.

4.10 To enable the best new providers to compete on a level playing field with established universities, the government will introduce a clearer and faster route to degree awarding powers for those assessed to offer the best quality education. As part of the review of validation arrangements, the government will explore options to allow the best providers to offer degrees independently of existing institutions before they obtain degree awarding powers.

4.11 The government will also free up student number controls for the best alternative providers by introducing a performance pool of places from 2016-17, which will allocate additional student places to the best providers. The government will continue to monitor the quality of courses offered by providers and will impose sanctions on those where quality is not high enough.

Expanding opportunities for postgraduate study and research

4.12 It is also essential that the UK's research base has the right skills. The government has announced an intention to introduce income contingent loans for postgraduate taught Masters courses and PhDs. Following the consultation launched in March 2015, the government will set out details of how these loans will be delivered later this year.

5 A modern transport system, with a secure future

5.1 Infrastructure expands the productive capacity of the economy by reducing transaction costs and by integrating and enlarging markets. It raises the returns on private investment and enables greater specialisation and economies of scale. This chapter focusses on the importance of modern transport infrastructure.

5.2 Transport has a vital role to play by bringing businesses and people closer together and fostering the agglomeration economies that make cities work. Transport connects people to jobs and products to markets, it underpins supply chains and logistics networks, and it is fundamental to domestic and international trade. The connectivity, condition and capacity of a country's transport network is therefore critical for productivity.

5.3 England's roads carry over 95% of all passenger journeys and are used for over 85% of journeys by distance.[1] However, the road network has suffered from a lack of investment by successive governments, and the cost of this is clear:

- connectivity: since 1990 France has built 2,700 miles of motorway, more than the entire length of the UK motorway network[2]
- condition: there is an estimated backlog of maintenance works on the local road network of up to £8.6 billion[3]
- capacity: levels of congestion on the road network are high and rising, and by 2040 the equivalent of more than 100 million working days could be lost to traffic congestion unless action is taken[4] (Chart 5.A)

5.4 As a result of this, the World Economic Forum ranks the UK 30th in the world for the quality of its road network, behind Namibia and Puerto Rico.[5] The government has already taken decisive action to start to turn this around and ensure the country has a road network it can be proud of, and this document sets out the next stage of this plan.

5.5 Railways are also important, with over 4.3 million journeys being made by rail every day.[6] Since privatisation in the mid-1990s, there has been sustained growth in rail passenger demand, at a rate far in excess of any other mode of transport. Over the last 10 years, passenger journeys in Great Britain have increased by 57%.[7] The government has made a commitment to upgrading the railway and bringing this largely Victorian asset into the 21st century. As problems at Network Rail have become clear, the government has acted decisively to start to put the rail investment programme back on a sustainable footing. This plan sets out the next steps.

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1 *National Travel Survey*, Department for Transport, 2013

2 *Action for Roads*, Department for Transport, 2013

3 Internal analysis conducted by the Department for Transport in 2015. This is based on a central spot estimate from a range of between £4.3 billion and £8.6 billion.

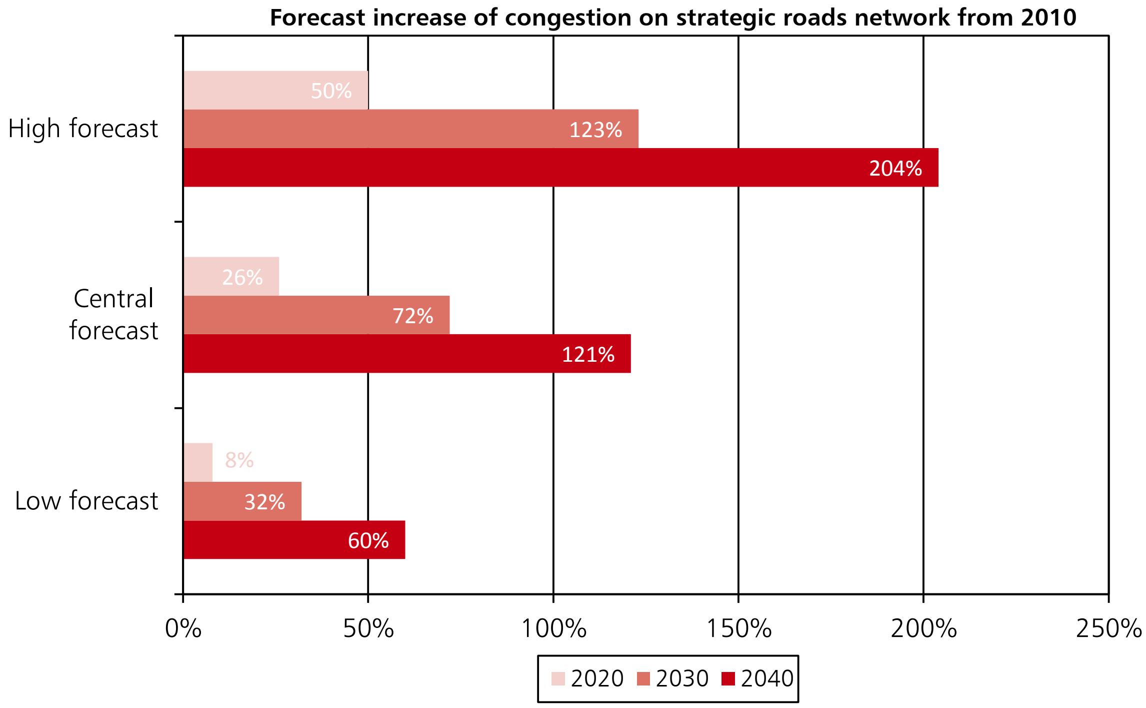
4 *Action for Roads*, Department for Transport, 2013

5 World Economic Forum Competitiveness Index 2014-15

6 Passenger Rail Usage statistics, Office of Rail and Road, June 2015

7 Passenger Rail Usage statistics, Office of Rail and Road, June 2015

Chart 5.A: Forecast of congestion on the strategic road network in England



Source: Department for Transport: National Policy Statement for National Networks, 2014.

5.6 Airports provide critical international connectivity. Aviation contributes £18 billion per year to the UK economy and supports 220,000 jobs.[8] The connections created by air transport enable beneficial activities such as Foreign Direct Investment (FDI), business clusters and specialisation, as well as creating other positive spill-over effects. Air connectivity facilitates productivity benefits by boosting international trade. Around £4.1 trillion of goods now travel by air each year, equating to around 35% of all world trade by value.[9] However, the Airports Commission's analysis suggests that the costs of not addressing capacity constraints in the future could amount to £18-20 billion of costs to users and providers of airport infrastructure, and £30-45 billion of costs to the wider economy.[10]

Establishing a Roads Fund

5.7 In the last Parliament the government published the first ever Roads Investment Strategy (RIS), a five year plan to deliver an unprecedented £15 billion of investment in strategic roads over the course of the current Parliament. This was underpinned by comprehensive institutional reforms to establish Highways England as a new government-owned company, tasked with operating more commercially and efficiently to deliver this programme, together with the creation of the new Office for Rail and Road which will serve to ensure the efficiency of the new company.

5.8 The government is determined to lock in these reforms for the long term. To ensure that future roads investment is sustainable, **the Summer Budget 2015 announced a reform to Vehicle Excise Duty (VED) to create a Roads Fund. VED will be reformed for cars registered from April 2017 to make it fairer for motorists and reflect improvements in new car CO_2 emissions**. The

[8] *Aviation Policy Framework*, Department for Transport, 2013
[9] International Air Transport Association, December 2013
[10] *Airports Commission Interim Report*, Airports Commission, December 2013

new VED system will be reviewed as necessary to ensure that it continues to incentivise the cleanest cars.

5.9 From 2020-21, the government guarantees that all revenue raised from VED in England will be allocated to a new Roads Fund and invested directly back into the strategic road network. This will ensure a better future for the nation's motorways and major trunk roads so that they can better support a growing and highly productive economy, by creating a clear commitment to high and stable levels of investment over the long term. This certainty will also allow Highways England to properly plan for the future; it will allow the supply chain to invest for the future with confidence; and it will help both work together to drive down efficiencies and unit costs.

5.10 As a result of this reform, the government will develop a second Road Investment Strategy for the period 2020-25 which, as a result of the Roads Fund, will be underpinned by another multi-billion pound programme of investment. The second Roads Investment Strategy will be published before the end of the Parliament.

A more efficient, reliable and better rail network

5.11 To keep up with growing demand for rail services, the UK needs to continue with sustained investment to maintain and upgrade its largely Victorian infrastructure. The government has made a clear commitment to improve the rail network across the UK, backed by £38 billion of investment. This is a complex and challenging task, but the delays and cost increases reported on this rail investment programme are unacceptable, and the government will act to put the programme back on track.

5.12 The government has appointed Sir Peter Hendy, formerly the Commissioner of Transport for London, as the new Chairman of Network Rail. The government has asked Sir Peter Hendy to bring his experience and expertise to bear on doing what is necessary to ensure Network Rail can deliver effectively and operate the railway safely, and in particular to report by autumn 2015 with a plan to get the rail investment programme back onto a sustainable footing.

5.13 The government will also take further action to improve incentives and drive improvements in Network Rail and the wider rail industry:

- the government has asked Sir Peter Hendy and Mark Carne, Chief Executive of Network Rail, to continue with the work started in Network Rail to devolve more power to route managers closer to the front line, so that the railway is more focussed on delivering what passengers need and to drive comparative benchmarking of the efficiency and effectiveness of individual routes – to drive up performance across the network
- the government will also change the way it channels public money through the industry, directing it through the train operating companies, so that Network Rail focusses firmly on the needs of train operators and, through them, passengers. This will put the customers of the railway back in the driving seat in demanding efficiency and improvements that matter to them, making the best use of scarce capacity on the rail network
- the government will introduce a new approach to station redevelopment and commercial land sales on the rail network, building on the experience of successfully regenerating land around Kings Cross Station and Stratford in East London. The government will establish a dedicated body to focus on pursuing opportunities to realise value from public land and property assets in the rail

network, to both maximise the benefit to local communities and reduce the burden of public debt

5.14 The government has also asked Nicola Shaw, Chief Executive of High Speed 1, to advise the government on how it should approach the longer-term future shape and financing of Network Rail. Ms Shaw will work closely with Sir Peter Hendy in conducting her work, which will be concluded before Budget 2016.

Taking a decision on airport capacity in the south east

5.15 In the last Parliament the government tasked the Airports Commission with considering how the UK could maintain its status as an international hub for aviation. The Commission concluded that there was a need for further airport capacity in the south east of England. The government will now assess the Commission's analysis and decide by the end of the year whether it agrees with that assessment and, if so, the best route for achieving planning consents and getting a new runway built.

6 Reliable and low-carbon energy, at a price we can afford

6.1 Energy underpins the operation of a successful and productive economy. It is important that the government strikes the right balance in meeting the three challenges of security of supply, affordability and sustainability.

6.2 Achieving security of supply consistently allows individuals and firms to invest and plan ahead with the confidence that energy networks will be able to support their future needs, while competition, research and innovation within the energy sector can help businesses by lowering bills.

6.3 The government is committed to attracting much-needed investment in energy infrastructure and production, ensuring security of supply whilst promoting competition in energy markets and networks to keep bills as low as possible. Alongside this, the government will also seek to meet the UK's climate change commitments cost-effectively, including promoting innovation to make a cost-effective transition to a low carbon economy.

6.4 The government aims to improve productivity in energy generation, production, supply and usage. This will be achieved through:

- a strengthened role for competitive markets. The government welcomes the provisional findings of the Competition and Markets Authority's energy market investigation, and will ensure that energy markets work better for households and businesses across the country. As a first step towards this, the government will aim to introduce 24 hour switching by the end of 2018, working with Ofgem
- reforming the oil and gas fiscal and regulatory regime to maximise economic recovery from the UK Continental Shelf by driving down costs and increasing production efficiency
- developing the shale industry, which has the potential to increase energy security whilst supporting thousands of jobs in producing areas, including through a sovereign wealth fund for communities that host shale gas development
- continuing the long term decarbonisation of the UK's energy sector through a framework that supports cost effective low carbon investment
- seeking to ensure that EU energy policy supports affordable and secure energy for the UK, and that the European Commission's Energy Union package strengthens the single market, improves physical energy interconnections, encourages research and development, and supports cost-effective decarbonisation
- delivering a significant expansion in new nuclear power in the UK. The Hinkley Point C power station alone could generate 7% of the UK's electricity needs[1]

[1] Job stats from EDF

- the government is also conducting a review of business energy tax policy to improve and simplify the landscape

7 World-class digital infrastructure in every part of the UK

7.1 Reliable and high quality fixed and mobile broadband connections support growth in productivity, efficiency and labour force participation across the whole economy. They enable new and more efficient business processes, access to new markets and support flexible working and working from home. Investment in high speed broadband will support long-term economic growth, with GVA increasing by £6.3 billion, causing a net increase of 20,000 jobs in the UK by 2024.[1] Geographic coverage and take-up of superfast broadband in the UK is already the highest of the 5 largest EU economies.[2] The government's superfast broadband programme is passing an additional 40,000 premises every week – superfast speeds of at least 24Mbps will be available to 95% of UK households by 2017.

7.2 By reducing regulatory red tape and barriers to investment, the government will support the market to deliver the internationally competitive fixed and mobile digital communications infrastructure the UK's businesses need to thrive and grow, and which will enable the UK to remain at the forefront of the digital economy**.** The government is working with business so that the market can play the lead role in delivering against the ambitions set out in the Digital Communications Infrastructure Strategy, published in March, of near-universal 4G and ultrafast broadband coverage.

7.3 The government will take decisive action to make it easier for the market to roll out the fixed and mobile infrastructure that the UK needs:

- the government proposes to extend permitted development rights to taller mobile masts in both protected and non-protected areas in England. A call for evidence on these proposals has been published today
- the government intends to introduce legislation in the first session of this Parliament to reform the Electronic Communications Code, which regulates the relationship between electronic communications network operators and site providers
- the government will be consulting later this year on implementation of the EU Directive on measures to reduce the cost of deploying high-speed communications networks
- the government is also considering making the 2013 planning relaxations supporting fixed high speed broadband infrastructure rollout permanent

7.4 These measures will make it cheaper and easier for providers to build the infrastructure UK businesses need.

7.5 Electromagnetic spectrum is a valuable and scarce resource. By securing more efficient use of public sector spectrum (while safeguarding departments' ability to deliver critical operational public services), the government will be able to share or release more of its spectrum, realising

[1] *UK Broadband Impact Study*, SQW Consulting, 2013.

[2] *European Broadband Scorecard Q1 2015*, Ofcom, 2015.

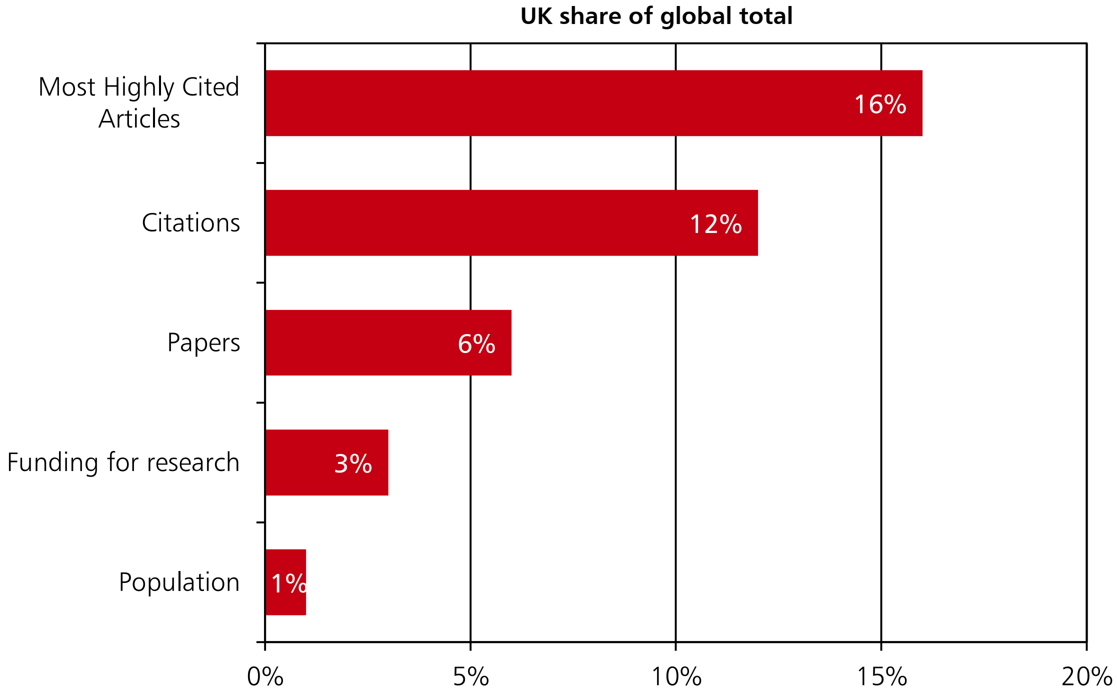
wider economic benefits both in terms of generating capital receipts and by supporting digital communications innovation and the development of new technologies. To deliver this, the government has implemented a new model for the centralised management of public sector spectrum.

8 High quality science and innovation, spreading fast

8.1 The creation and application of new ideas is critical for long-run productivity growth. There is clear and robust evidence of a link between R&D spending and national productivity.[1]

8.2 Science and innovation is an area of great UK strength. The UK produces 16% of top quality published research findings, with less than 1% of the world's population.[2] Foreign investors are drawn by the strength of UK research, including the opportunity for knowledge sharing with universities and access to high quality R&D personnel. The UK is ranked 4th in the world for business and university collaboration, and attracts more R&D funded from abroad than Finland, Russia, Canada, Japan and China combined.[3]

Chart 8.A: The UK's strengths in science: proportion of research inputs and outputs



Source: Elsevier International Comparative Performance of the UK Research Base - 2013.

8.3 To build on these strengths, the UK needs to ensure that it retains its position of international excellence in science, while increasing its strategic focus. The last government maintained the ring-fenced science budget in cash terms at £4.6 billion per year.[4] But there is more to be done to ensure all elements of the funding system are aligned with areas and markets of strategic importance and potential for the UK economy.

[1] *The policy and institutional drivers of economic growth: new evidence from growth regressions*, OECD Economics Working Paper 843 (2011)
[2] *International Comparative Performance of the UK Research Base*, Elsevier, 2013
[3] *Global Competitiveness Index 2014-15*, The World Economic Forum, 2014; Main Science and Technology Indicators, OECD, 2015
[4] *Spending Round 2013*, HM Treasury

8.4 The UK's research benefits from strong links between universities and industry, but there is still further to go in commercialising discoveries made in the research base and in ensuring the diffusion and adoption of these discoveries. The UK ranks second overall in the Global Innovation Index, but performs poorly on SMEs introducing product or process innovations.[5] Even adjusting for differences in the UK's industrial structure, the private sector under-invests: R&D investment from industry has stagnated at 1.1% of GDP since 1995, compared to an OECD average of 1.6%.[6]

Excellence in science

8.5 The UK's system of funding science is central to ensuring the best researchers have the flexibility to innovate and to maintain the UK's position as a world leader. The commitment to excellence, facilitated through a dual support system, must remain absolute.

8.6 But the wealth and breadth of possibilities in science and innovation mean that prioritisation is needed. The government will ensure these strategic choices are made through:

- investments in national infrastructure; **the government will deliver on the science capital commitment, investing £6.9 billion** in the UK's research infrastructure up to 2021
- ensuring the UK's excellent science has a focus on those areas with greatest potential, from genetics to quantum technology
- clear strategies in cross-departmental areas of research interest such as health, where the government works closely with medical research charities. The Accelerated Access Review offers a significant opportunity to improve quality of care and cost effectiveness, and the UK is leading the fight against the global health risk posed by antimicrobial resistance

8.7 It is crucial that the UK supports excellence wherever it is found. **The government will therefore invite universities, cities, Local Enterprise Partnerships (LEPs) and business to work with the government to map the strengths of different regions through a series of science and innovation audits.** These will provide a new, powerful way to build on different regions' strengths and to maximise the economic impact from the UK's research base.

8.8 Sir Ian Diamond's review highlighted that collaboration has an important role to play, both in improving the efficiency and supporting the quality of research. The government **encourages universities to strengthen local collaboration wherever this will achieve these objectives.**

8.9 **The government will also introduce new Regius Professorships** in order to recognise excellence in universities across the UK. The government will launch a competition later this year, with a view to making awards in early 2016 to celebrate the Queen's 90th birthday.

8.10 The government has asked Sir Paul Nurse to examine how Research Councils can evolve to support research in the most effective ways. His independent review, which will report later this year, will help to inform the government's decision-making in the Spending Review.

Industry collaboration and commercialisation of research

8.11 The government will continue to support universities in collaborating with industry and commercialising research. **The government therefore welcomes Professor Dame Ann Dowling's review** on this topic. The report acknowledges recent progress but has identified where more

5 The Global Innovation Index 2014, Cornell University, INSEAD and WIPO, 2014; EU Innovation Union Scoreboard, European Union, 2015

6 Main Science and Technology Indicators, OECD, 2015

can be done. The government will respond in full by the Spending Review, including on how to make it easier for business to find help and support from universities and government. The government's ambition is that UK universities will continue to increase their collaboration with industry to drive research commercialisation, and increase the income they earn from working with business and others to £5 billion per annum by 2025.

8.12 The government can confirm significant industrial support for specific science investments including £128 million in the UK Collaboration for Research in Infrastructure and Cities (UKCRIC) and £200 million industry funding from IBM to drive forward Big Data research at Hartree.

8.13 At the March Budget 2015 the government announced a Research Partnership Investment Fund competition of £400 million to support capital investment in scientific grand challenges. The government can confirm that this will focus on proposals that not only meet expectations for excellent research, but also recognise the potential for local economic growth, local collaboration and leverage.

8.14 With close to €80 billion of funding available from 2014 to 2020, Horizon 2020 is the principal means of financing research and innovation projects using EU budget funds. Under the predecessor to Horizon 2020, the Seventh Framework Programme for Research (FP7), the UK performed well amongst academia and researchers, but less well for business uptake. Improving UK business participation in Horizon 2020 will contribute to the drive to commercialise UK research.

Innovation and industry

8.15 The government has made a clear commitment to make the UK the best place in Europe to innovate and create the ideas that help grow a business. Significant support for research and development and bringing new products to market is provided through Innovate UK, and also through sector-specific funds including the Aerospace Technology Institute (ATI) and the Advance Propulsion Centre (APC). **The government will work to ensure that the means through which businesses access this support are simplified and customer-focussed.**

8.16 Support to business will be focussed on where it will deliver the most innovation, growth and jobs. The government will **use its Challenger Businesses Programme to identify and address barriers to expansion for early-stage disruptive businesses.**

8.17 The government has also created an extensive network of Catapult centres, bringing together businesses, scientists and engineers to drive the commercialisation of technology. Innovate UK, working with Research Councils, has now identified further areas where a Catapult might be the right way to ensure the UK is at the forefront of commercialising technologies which offer global opportunities, and will come forward with proposals shortly.

B

Section B: A dynamic economy

It is not just the quality of skills, machines, or even the technology available that matters for productivity; it is also how well they are matched to their best use. This relies on a dynamic economy where good ideas spread rapidly, workers are well matched to jobs, productive firms can scale up, and where people move into jobs that use their skills and can own homes close to where they want to work.

The UK already ranks highly on many measures of economic dynamism,[1] but there is no room for complacency and there remain significant areas of weakness that must be addressed. This plan addresses particular challenges in the form of a planning system regarded by many as one of the most significant constraints facing the economy, bringing delay and inflexibility; a labour market that has performed well but still does not make use of everyone's talents; the need to increase exports; and a financial sector that has, in recent years, acted as a drag on productivity through both its own performance and its impact on the wider economy.

Cities are at the heart of a dynamic economy, providing deep markets for labour and enabling the rapid diffusion of ideas and vibrant competition between firms. The concentration of activity within cities itself contributes to productivity through the sharing of knowledge and ideas, the pooling of labour, the specialisation and matching of supply and demand and the sharing of infrastructure. This plan sets out further measures to build dynamic, resurgent cities and to build up a Northern Powerhouse. The Northern Powerhouse is a vision based on the solid economic theory that while the individual cities and towns of the north are strong, if we enable them to pool their strengths, they could be stronger than the sum of their parts.

[1] Individual references sourced in chapters.

9 Planning freedoms and more houses to buy

9.1 The UK has been incapable of building enough homes to keep up with growing demand. This harms productivity and restricts labour market flexibility, and it frustrates the ambitions of thousands of people who would like to own their own home.

Building more homes that people can afford to buy

9.2 An effective land and housing market promotes productivity by enabling the economy to adapt to change, helping firms to locate where they can be most efficient and create jobs, and enabling people to live and own homes close to where they work.

9.3 Housing starts fell by nearly two-thirds between 2007 and 2009,[1] and the number of first time buyers fell by more than 50% between 2006 and 2008.[2] The government implemented significant reforms over the last Parliament to turn this situation around, including reforms to the planning system, and support for homeownership, particularly first time buyers.

9.4 An excessively strict planning system can prevent land and other resources from being used efficiently, impeding productivity by:

- increasing the cost and uncertainty of investment. Previous estimates have put transaction costs for major housing developments at £3 billion per annum[3]
- hindering competition by raising barriers to entry, adaptation and expansion
- constraining the agglomeration of firms and the mobility of labour, with previous estimates suggesting that planning constraints on commercial space are the equivalent of a 250% regulatory tax on office space[4]
- encouraging firms, households and financial institutions to speculate on land, diverting resources away from productive activities

9.5 As a result, the government made significant reforms to the planning system over the last Parliament, introducing a new National Planning Policy Framework, streamlining guidance from over 7,000 pages to a simple online guide, and reducing regulation for house builders. For aspiring home owners, the government reinvigorated the Right to Buy, introduced Help to Buy, and delivered a stamp duty cut for 98% of homebuyers who pay it.[5]

9.6 This approach is working: planning permissions and housing starts are at 7 year highs,[6] the number of first time buyers last year rose by more than 20%,[7] and more than 100,000 households have been helped onto or up the housing ladder by Help to Buy.[8]

[1] *Permanent Dwellings Started*, Department for Communities and Local Government, May 2015

[2] *Halifax First Time Buyer Review*, Lloyds Banking Group, January 2015

[3] *Housing Supply and Planning Controls*, Michael Ball for NHPAU, January 2010

[4] *Office Supply Restrictions in Britain*, Paul Cheshire and Christian Hilber, 2008

[5] Autumn Statement 2014, HM Treasury

[6] *Permanent dwellings started*, Department for Communities and Local Government, May 2015; Housing Pipeline report, Home Builders Federation, March 2015

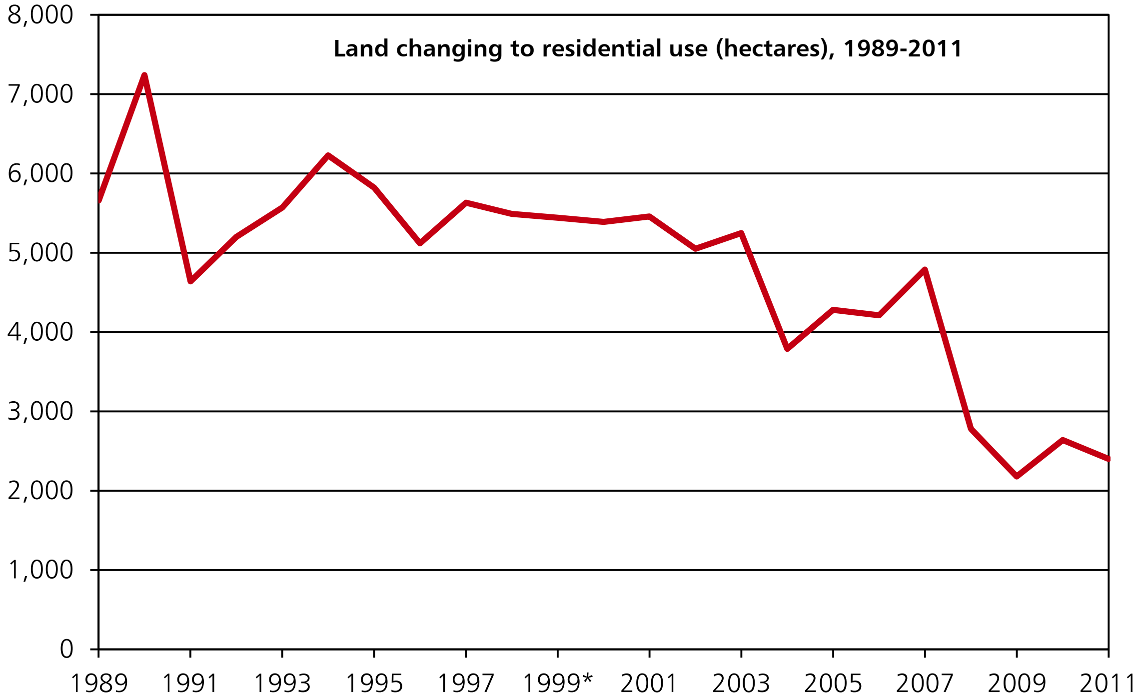
[7] *Halifax First Time Buyer Review*, Lloyds Banking Group, January 2015

[8] *Help to buy creates 131 new homeowners a day*, Department for Communities and Local Government, June 2015

9.7 There remains more to do. As the London School of Economics (LSE) Growth Commission found, 'under-supply of housing, especially in high-growth areas of the country has pushed up house prices. The UK has been incapable of building enough homes to keep up with growing demand'.[9]

9.8 This plan sets out the steps the government will take to ensure more homes are built that people can afford, through planning reform, progress on delivering 200,000 Starter Homes and the extension of the Right to Buy, and reforms to the Buy to Let market.

Chart 9.A: Reduction of land changes to residential use over time



*1999 data is unavailable

Source: Department for Communities and Local Government: Live Table P226 'Land Use Change: residential land'.

Releasing land for the homes people need

9.9 Over the previous Parliament, the government removed top-down regional strategies and placed local authorities at the forefront of deciding how to meet the need for housing through their local plans.

9.10 It is vital that local authorities use these powers to put in place local plans that set the framework for the homes and jobs local people need. The government will take further action to ensure that local authorities put local plans in place by a set deadline to be confirmed by summer recess. The government will publish league tables, setting out local authorities' progress on providing a plan for the jobs and homes needed locally. Where they are not, the **Secretary of State for Communities and Local Government will intervene for those local authorities that do not produce them, to arrange for local plans to be written,** in consultation with local people.

9.11 The government will also take steps to ensure that local plans are more responsive to local needs. **The government will bring forward proposals to significantly streamline the length and**

[9] *Investing for Prosperity*, London School of Economics Growth Commission, September 2013

process of local plans, helping to speed up the process of implementing or amending a plan. The government will also bring forward proposals to improve cooperation between local authorities. The National Planning Policy Framework is clear that local authorities should look to meet their housing need, as far as is possible within constraints. Where they cannot meet their need in full, they should cooperate with other local authorities to do so. The government will strengthen guidance to improve the operation of the duty to cooperate on key housing and planning issues, to ensure that housing and infrastructure needs are identified and planned for.

9.12 Areas around commuter transport hubs offer significant potential for new homes. The government will work with mayors in London and across the country to use new powers in the Devolution Bill to use development corporations to deliver higher-density development in designated areas. The government will consider how policy can support higher density housing around key commuter hubs. The government will also consider how national policy and guidance can ensure that unneeded commercial land can be released for housing.

A zonal system for brownfield land

9.13 The government is committed to an urban planning revolution on brownfield sites, including funding to provide infrastructure, strong local leadership to shape development and assemble sites, and the removal of unnecessary planning obstacles.

9.14 Previous studies have found that the country's planning system – where development proposals require individual planning permission and are subject to detailed and discretionary scrutiny – can create the sort of "slow, expensive and uncertain process" that reduces the appetite to build.[10] The government is clear on the need to promote use of brownfield land, and will remove all unnecessary obstacles to its re-development, including these sorts of planning obstacles.

9.15 The government has already committed to legislating for statutory registers of brownfield land suitable for housing in England. The government will go further by legislating to grant automatic permission in principle on brownfield sites identified on those registers, subject to the approval of a limited number of technical details. On brownfield sites, this will give England a 'zonal' system, like those seen in many other countries, reducing unnecessary delay and uncertainty for brownfield development.

9.16 In the spring, the government consulted on reforms to bring forward more brownfield land for development by making the compulsory purchase regime clearer, faster and fairer for all parties. This first round of reforms will be introduced through legislation in this session of Parliament. A number of additional proposals have been received from that consultation; the government is considering the case for these additional compulsory purchase reforms to further modernise the system, and will bring forward proposals in the autumn. These will allow local authorities and others to drive forward and shape brownfield development, and will not alter the principle of Secretary of State sign-off on compulsory purchase orders.

Improving the planning process - ensuring planning decisions are made on time

9.17 Evidence suggests that delays in processing planning applications may be a significant factor preventing housing supply from responding to upturns in the market.[11] Significant progress has been made, with the proportion of major applications dealt with on time rising

[10] *Planning Delay and Responsiveness of English Housing Supply*, Michael Ball, 2011

[11] *Planning Delay and Responsiveness of English Housing Supply*, Michael Ball, 2011

from 58% in 2012-13 to 77% in 2014-15.[12] The government wants to see further progress, with all planning decisions made on time. This is particularly important for SMEs. The government will therefore:

- legislate to allow major infrastructure projects with an element of housing to apply through the Nationally Significant Infrastructure Regime (NSIP)
- tighten the planning performance regime, so that local authorities making 50% or fewer of decisions on time are at risk of designation
- legislate to extend the performance regime to minor applications, so that local authorities processing those applications too slowly are at risk of designation
- introduce a fast-track certificate process for establishing the principle of development for minor development proposals, and significantly tighten the 'planning guarantee' for minor applications
- repeat its successful target from the previous Parliament to reduce net regulation on housebuilders. The government does not intend to proceed with the zero carbon Allowable Solutions carbon offsetting scheme, or the proposed 2016 increase in on-site energy efficiency standards, but will keep energy efficiency standards under review, recognising that existing measures to increase energy efficiency of new buildings should be allowed time to become established
- introduce a dispute resolution mechanism for section 106 agreements, to speed up negotiations and allow housing starts to proceed more quickly

More devolved planning powers

9.18 Housing is a national priority, and the government will work with mayors and Combined Authorities to provide the tools they need.

9.19 In London, the Mayor's 2020 Vision has set out the scale of the challenge, with at least 42,000 homes needed a year over the next 20 years. The government has already taken significant steps, including the Chancellor and Mayor jointly announcing £400 million investment to support 20 Housing Zones on brownfield sites. Housing starts in London have risen by 24% since 2012-13.[13]

9.20 Building on this investment, the Chancellor set out in the Long Term Economic Plan for London that the government would enter into discussions for the devolution of major new planning powers to the Mayor of London, beginning with powers over wharves and sightlines, to be used in consultation with Londoners. The government confirms its intention to proceed with devolution of wharves and sightlines, and will also look to bring forward proposals to allow the Mayor to call in planning applications of 50 homes or more, allowing him to support more planning applications that will help to meet London's needs.

9.21 As the Mayor's housing strategy set out, any increase in housing supply in London will be overwhelmingly brownfield development, and is likely to involve increasing densities.[14] Helping London to 'build up' in this way will reduce the need to 'build out', helping to provide homes for Londoners while protecting the countryside. Planning processes can create unnecessary burdens for proposals seeking to increase density on brownfield land. The government is keen to

[12] *Planning applications received and decided by district planning authorities by speed of decision*, Department for Communities and Local Government, June 2015

[13] *Housebuilding: permanent dwellings started and completed, by tenure and LEP*, Department for Communities and Local Government, May 2015

[14] *Homes for London*, the London Housing Strategy

support the Mayor's aims, where there is local consent. The government will therefore work with the Mayor of London to bring forward proposals to remove the need for planning permission for upwards extensions for a limited number of stories up to the height of an adjoining building, where neighbouring residents do not object. In cases where objections are received, the application will be considered in the normal way, focussed on the impact on the amenity to neighbours.

9.22 The government will devolve new powers to the future Mayor of Greater Manchester, giving them the tools to drive forward complex, brownfield developments. The government will bring forward proposals to allow the mayor to produce Development Corporations, and promote Compulsory Purchase Orders. These powers will be exercisable with the consent of the Cabinet member representing the borough in which the power is to be used.

Starter Homes and Right to Buy

9.23 The government will deliver its commitment to get 200,000 Starter Homes built by 2020, at a 20% discount for young first time buyers. The government is bringing forward proposals to help deliver this commitment, which include:

- requiring local authorities to plan proactively for the delivery of Starter Homes
- extending the current exception site policy, and strengthening the presumption in favour of Starter Home developments, starting with unviable or underused brownfield land for retail, leisure and institutional uses
- enabling communities to allocate land for Starter Home developments, including through neighbourhood plans
- bringing forward proposals to ensure every reasonably sized housing site includes a proportion of Starter Homes
- implementing regulations to exempt these developments from the Community Infrastructure Levy, and re-affirming through planning policy that section 106 contributions for other affordable housing, and tariff-style general infrastructure funds, will not be sought for them
- putting in place new arrangements to monitor their delivery

9.24 The government is committed to extending the Right to Buy to housing association tenants. Since the Right to Buy for council tenants was reinvigorated in the last Parliament, the number of sales has increased by nearly 320%.[15] The government will extend the same opportunity to buy to the tenants of housing associations through the Housing Bill, to be introduced in this session of Parliament.

9.25 In the Spending Review, the government will take further steps to re-focus Department for Communities and Local Government (DCLG) budgets, focussing on supporting low cost home ownership for first time buyers.

Buy to Let

9.26 The current tax system supports landlords over and above ordinary homeowners. Landlords can deduct costs they incur when calculating the tax they pay on their rental income. A large portion of those costs are interest payments on the mortgage. Mortgage Interest Relief was withdrawn from homeowners 15 years ago. However, landlords still get the relief. The ability to

[15] DCLG Live Table 671 (Annual Right to Buy Sales for England)

deduct these costs puts investing in a rental property at an advantage. Tax relief is particularly beneficial for wealthier landlords with larger incomes, as every £1 of finance cost they incur allows them to pay 40p and 45p less tax respectively. The Bank of England has also noted in its recent Financial Stability Report that the rapid growth of buy to let mortgages could pose a risk to the UK's financial stability.

9.27 The government will restrict the relief on finance costs that landlords of residential property can get to the basic rate of tax. The restriction will be phased in over 4 years, starting from April 2017. This will reduce the distorting effect the tax treatment of property has on investment and mean landlords are not treated differently based on the rate of income tax that they pay. It will also start to shift the balance between landlords and homeowners.

10 A higher pay, lower welfare society

10.1 Getting the public finances under control is helping to create the best conditions for sustainable growth. Despite progress during the last Parliament, the welfare bill remains stubbornly and disproportionately high. The welfare system should ensure that people are incentivised and helped to find work which is fairly paid, and that the taxpayer does not subsidise low pay or foot the bill for an unfair system where too many people remain on benefits.

10.2 In the last Parliament, the government started reforming the welfare system to make it fairer and more affordable. Universal Credit, which brings together 6 benefits into 1, represents the most fundamental reform of the welfare system since its inception and will mark a turning point towards a system where work will always pay more than a life on benefits. In addition, the government introduced the household benefit cap to ensure that out of work households would not be better off than the average working family. **The Summer Budget 2015 announced further reductions in the household benefit cap, alongside a four year freeze in working-age benefits from 2016-17 to 2019-20 (except disability benefits and statutory payments).**

10.3 Full details of the changes to the welfare system are set out in the Summer Budget 2015

10.4 Tackling tax credit spending is also an important part of the plan to move to a higher pay, lower welfare system. **The government will therefore reform tax credits (and its successor, Universal Credit) to focus support on families on the lowest incomes. The Summer Budget 2015 also limits support provided through tax credits to 2 children for new cases, and removes the Family Element in tax credits (also for new cases).**

10.5 Alongside action on benefit dependency, a key part of the government's commitment to making work pay is to ensure that people can keep more of the money they earn by cutting taxes. Increases in the personal allowance over the parliament have ensured that people can keep more of their earnings. **The Summer Budget 2015 announced further increases in the personal allowance to £11,000 in 2016-17. A basic rate taxpayer will be £80 better off in 2016-17, compared to 2015-16 and £905 better off compared to 2010.** This is the first step towards meeting the government's commitment to raise the personal allowance to £12,500 by the end of this parliament. **The government will legislate to ensure that once it has reached that level, it will always be set at least at the equivalent of 30 hours a week on the National Minimum Wage.** This will ensure that those working up to 30 hours on the National Minimum Wage will not pay income tax in the future.

10.6 But there is still further to go to ensure that work always pays. The National Minimum Wage is due to rise to £6.70 an hour in October - the largest real-terms increase since the financial crisis. While productivity growth is key to ensuring that real wages rise across the economy, the government believes that now is the right time to take further action to tackle low pay to ensure that low wage workers can take a greater share of the gains from growth. **The government will therefore introduce a new National Living Wage (NLW) for workers aged 25 and above. The government will ask the Low Pay Commission to recommend a path for the new National Living Wage to reach 60% of median earnings by 2020, expected to reach the government's target of over £9 an hour by 2020.** To support businesses with the cost of this change, from April 2016 the government will increase the National Insurance contributions Employment allowance from £2,000 to £3,000 a year.

11 More people with a chance to work and progress

11.1 A productive economy must make the most of its labour force and effectively mobilise people into jobs. A central part of this is to ensure that work always pays, and that people are incentivised and helped to find employment.

11.2 The government has a strong track record on this: both employment and participation in the labour market have been rising rapidly in recent years. The UK's labour market performance has stood out among advanced economies, and recently overtook Canada to have the third highest employment rate in the G7.[1] Employment is around record levels, at 31.1 million, with an extra two million people in work since the start of the last parliament, and unemployment is now very close to pre-recession lows.[2]

11.3 But there is further to go to ensure that as many people as possible are able to find and stay in a job, and the government remains committed to its full employment ambitions. There is no reason why the UK should not have the highest employment rate in the G7, but this will mean continuing to back business, reform welfare and reward work. It will also mean ensuring that all groups in society are given the support they need to find and keep a job.

Enabling employment, so that the UK has the highest employment rate in the G7

11.4 In the last Parliament the government announced a wide range of reforms intended to promote and enable work. Support for employers has been at the forefront of this, with the introduction of the Employment Allowance from April 2014 (which gives businesses up to £2,000 off their National Insurance bill), and the abolition of employer National Insurance Contributions for virtually all people aged under 21 a year later.

11.5 Additional help to find work has been introduced for more specific groups. This has included a more intensive system of support for Jobseeker's Allowance claimants and the Work Programme, an innovative payment-by-results employment support scheme designed to help those who are at most risk of becoming long-term unemployed. But the government wants to ensure no one is left behind and is determined young people should not start life on benefits. So it is introducing a new Youth Obligation for 18-21s on Universal Credit. There will be an intensive regime of support from day one and, after six months, young people will be expected to apply for an apprenticeship, traineeship, gain work-based skills or go on a mandatory work placement to give them the skills and experience they need to get into sustainable employment.

11.6 Increasing employment levels among people with disabilities and health conditions is a key part of the government's aim to achieve full employment. The current system creates a financial incentive to remain on sickness benefits instead of moving closer to the labour market. From April 2017, new claimants of Employment and Support Allowance (ESA) who are placed in the

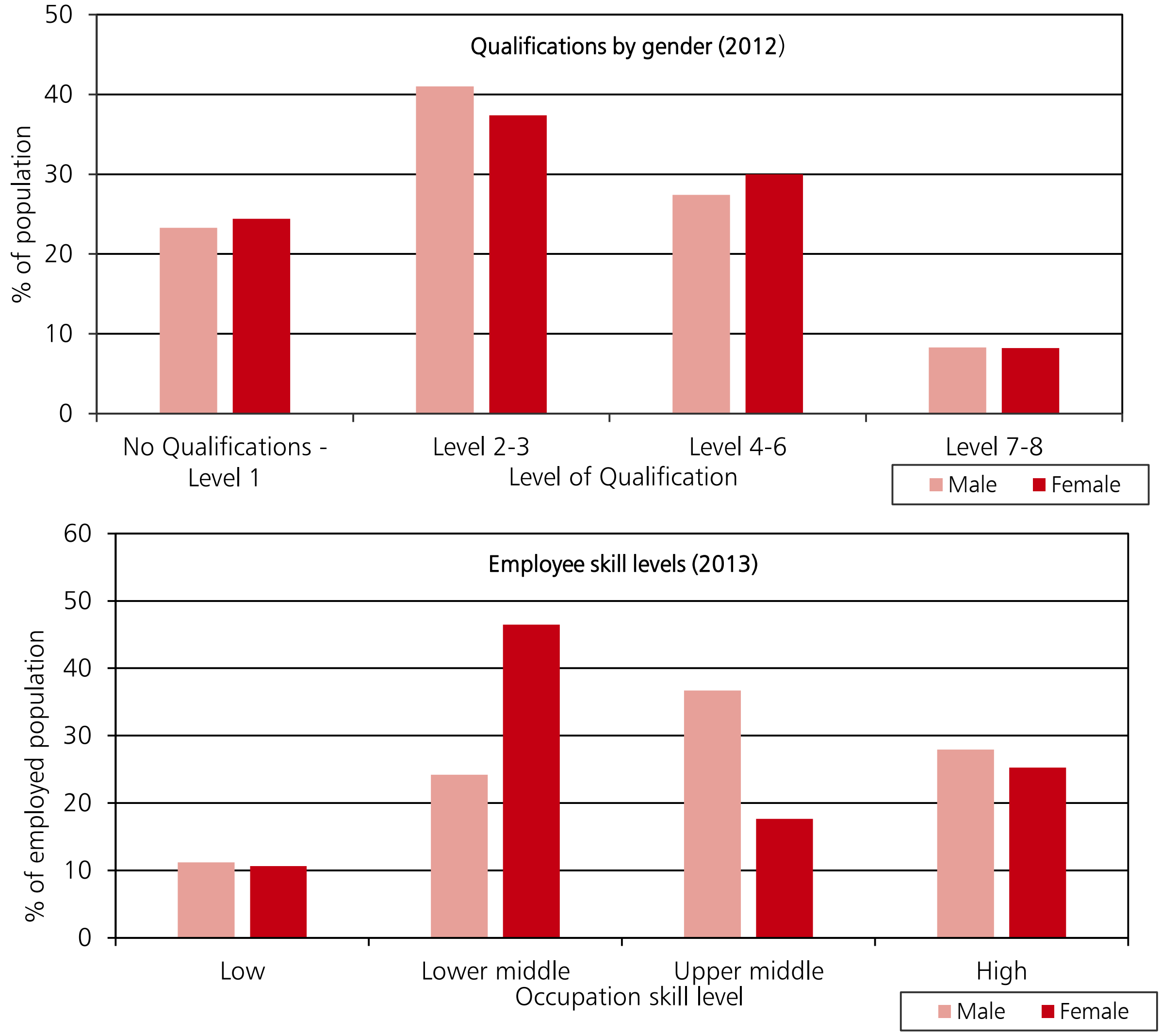
[1] *OECD short term labour market statistics*, Organisation for Economic Co-operation and Development

[2] *Labour Market Statistics*, Office for National Statistics

Work-Related Activity Group will therefore receive the same rate as those claiming Jobseeker's Allowance, alongside additional support to help them take steps back to work.

11.7 It is also important to ensure that parents are able to better combine work and caring responsibilities, so that they are able to work in jobs that match their skills and that those who want to work more can. This is particularly important in terms of women's labour market participation as, while progress has been made, gender inequalities in employment remain - the female employment rate now stands at 68.6%, around 10 percentage points lower than men (78.3%).[3] Much of this relates to childcare: according to the 2012-13 DfE childcare and early years survey of parents over half (54%) of non-working mothers agreed that they would like to go out to work if they could arrange good quality childcare that was convenient, reliable and affordable.[4] There is potentially a huge economic prize from enabling women to play a fuller role in the economy, where they want to. The OECD have estimated that equalising the role of men and women in the labour market could increase GDP by 10% by 2030.[5]

Chart 11.A: Qualifications and occupation skill levels, by gender



Sources: UKCES UK Skill Levels and International Competitiveness, 2013; ONS Women in the Labour Market, 2013.

[3] Office for National Statistics, labour market statistics

[4] *Childcare and Early Years Survey of Parents, 2012-13*, Department for Education, January 2014.

[5] *Effects of Reducing Gender Gaps in Education and Labour Force Participation on Economic Growth in the OECD*, Organisation for Economic Co-operation and Development, December 2012

11.8 The government already provides significant support to help parents enter and stay in work, including 15 hours of free childcare during term time for all 3 and 4 year olds and for the most disadvantaged (around 40%) of 2 year olds. **From September 2017 onwards, this free entitlement will be doubled to 30 hours a week for working parents of three and four year olds, worth around £5,000 a year to parents. The government will implement this extension of free hours early in some local areas from September 2016**.

11.9 To further support families, in the last parliament the right to request flexible working was extended to all. Shared parental leave was introduced from April 2015 to help parents balance the responsibilities of childcare between them. And under Universal Credit, the previous government increased support available to low-income families to cover up to 85% of childcare costs, where all parents are in work. Finally, from early 2017 Tax-Free Childcare will provide working families with 20% support on childcare costs up to £10,000 per year for each child. This means that families could receive up to £2,000 in support for each child per year.

11.10 In the context of the extensive childcare support offered to parents of 3 and 4 year olds, the government will also change the conditions for parents claiming out of work benefits. **From April 2017, parents claiming Universal Credit will be expected to look for work from when their youngest child turns 3, and to prepare for work when their youngest child turns 2**. In return, Jobcentre Plus will increase the support available for parents with younger children.

12 Financial services that lead the world in investing for growth

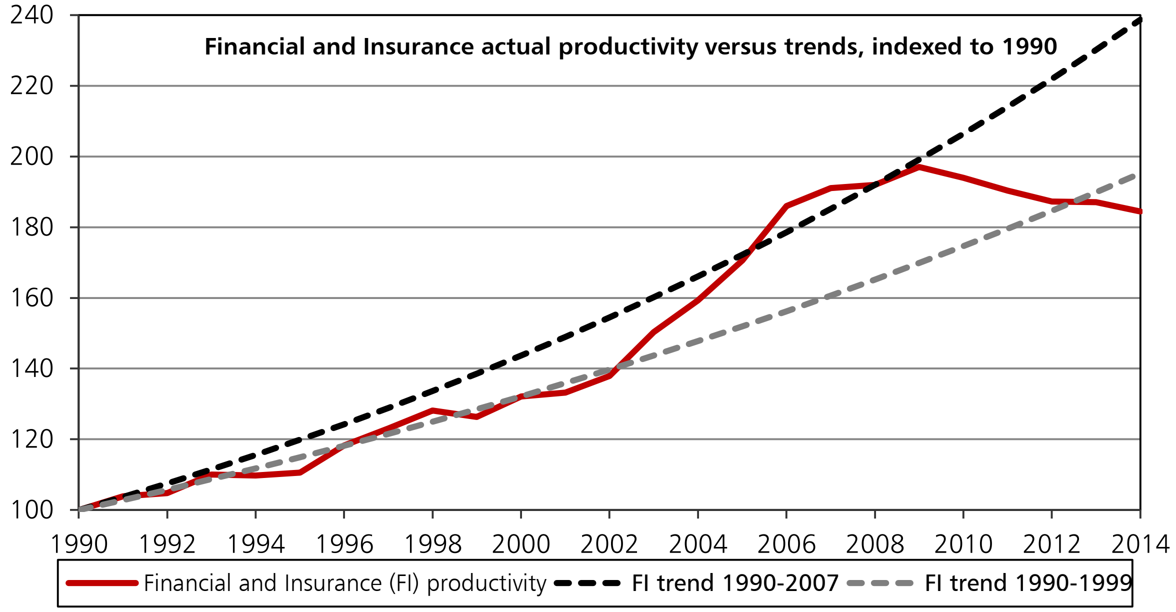
12.1 The financial services sector has a dual role in supporting UK productivity. It is critical for supporting the rest of the economy, allocating resources and facilitating long term productive investment. As a major contributor in its own right to the UK's economic success, its own productivity performance matters too.

12.2 The financial sector is a major source of comparative advantage in the UK, generating £58 billion in net exports and contributing 8.4% of GVA in 2014.[1] Among the critical issues to ensuring that the UK remains the premier global financial hub and that the UK's financial sector continues to support the UK economy are: securing the stability of the financial sector, which is necessary for sustainable growth and where enormous progress has been made over the last Parliament; ensuring a thriving financial services sector positively supports the rest of the economy by helping to allocate resources efficiently; and restoring the financial services sector to a path of positive yet sustainable productivity growth to get the economy back to its full potential.

12.3 Financial sector productivity is currently over 20% below trend growth from 1990-2007 (Chart 12.A). Strong and effective competition across financial services will incentivise firms to innovate and provide the best possible products to their customers in the most efficient way.

[1] Office for National Statistics, Balance of Payments and Gross Value Added releases

Chart 12.A: Financial services before and after the crisis



Source: HM Treasury, ONS UK GDP (O) Low Level Aggregates Q1 2015 - Month 3, June 2015; Workforce Jobs, ONS, June 2015.

Promoting the provision of finance to support productive investment

12.4 In the last Parliament, a new regulatory structure put the Bank of England at the centre of the UK's financial regulatory regime. The primary objective of the Financial Policy Committee (FPC) is to ensure financial stability, which is essential to support long-term productivity growth, while its secondary objective is to support the government's economic policy. **In the FPC's 2015 remit, the Chancellor has highlighted the importance and priority that the government attaches to ensuring the supply of finance to productive investment, to competition and innovation, and to the competitiveness of the financial services industry.**

12.5 To promote the provision of finance to support productive investment, it is important that it can be measured accurately. **The Chancellor has therefore asked the Governor of the Bank of England, working with HM Treasury, to initiate research to create better measurement of 'finance for productive investment'** covering all asset classes and all stages of finance, with a view to publishing the data on a regular basis.

12.6 The UK's vibrant capital markets have played and will continue to play a vital role in supporting productive businesses. HM Treasury, working collaboratively with partners such as the Bank of England, the Financial Conduct Authority (FCA) and other EU Member States, will:

- support actively the European Commission's overarching initiative to create a Capital Markets Union (CMU), which aims to improve access to finance for all businesses across Europe (in particular SMEs), benefitting both UK companies and the UK financial services sector
- promote the development of simple, transparent and comparable securitisation
- continue to work to remove barriers to the development of a private placements market

- support efforts to improve the Initial Public Offering (IPO) market, including reform of the Prospectus Directive
- catalyse a market-wide discussion of the costs and benefits of greater standardisation in corporate bond markets

Restoring the financial services sector to a path of positive but sustainable productivity growth

12.7 The government's vision is that five years from now UK financial services will be the best regulated in the world, with the highest standards of conduct; there will be more competition, more innovation and more choice for consumers; the UK will be the leading FinTech centre in the world; there will be more high quality jobs in finance across the UK; the City of London will remain the world's leading international financial market; and the UK will remain a highly attractive location for domiciling internationally active financial institutions.

12.8 To support the productivity of the financial services sector, the government will promote banking competition, support the FinTech sector to encourage innovation, and ensure that both regulation and taxation remain proportionate.

12.9 The government has already taken extensive action to increase banking competition, including through giving both the PRA and the FCA competition objectives; working with both regulators to lower barriers to entry for new banks; delivering the 7-day switching service and midata; creating the Payments Systems Regulator to ensure all banks can access the payments systems on fair terms; and legislating to help businesses secure finance from alternative lenders.

12.10 As a further step, the PRA and FCA have agreed to establish a joint New Bank Unit to help new, prospective banks to enter the market and to support them through the early days of full authorisation. The PRA and FCA will undertake a review of the effectiveness of the Unit after three years to ensure it is working in the best interests of new banks.

12.11 To track how the UK ranks against its international competitors, the government will launch an international FinTech benchmarking exercise in the autumn. The Chancellor has also appointed a Special Envoy for FinTech, Eileen Burbidge, to champion FinTech across the UK and at an international level.

12.12 It is vital that regulation remains proportionate and regulators support effective competition. The government intends to issue remit letters to the PRA and the FCA in order to highlight those aspects of government economic policy that are most relevant to the regulators' duties. Both regulators have a duty to have regard to the desirability of sustainable economic growth in the medium or long term. These new remit letters will outline the government's priorities for increasing competition and innovation in financial services, for ensuring that the UK remains an attractive location for financial services businesses, and for securing London's role as the leading international financial centre. The government has also asked both the PRA and FCA to publish Annual Reports on how they are delivering against their respective competition objectives across financial services, to set out clearly the steps being taken to drive more competition and innovation and to help ensure that the right incentives exist for new banks to enter the market.

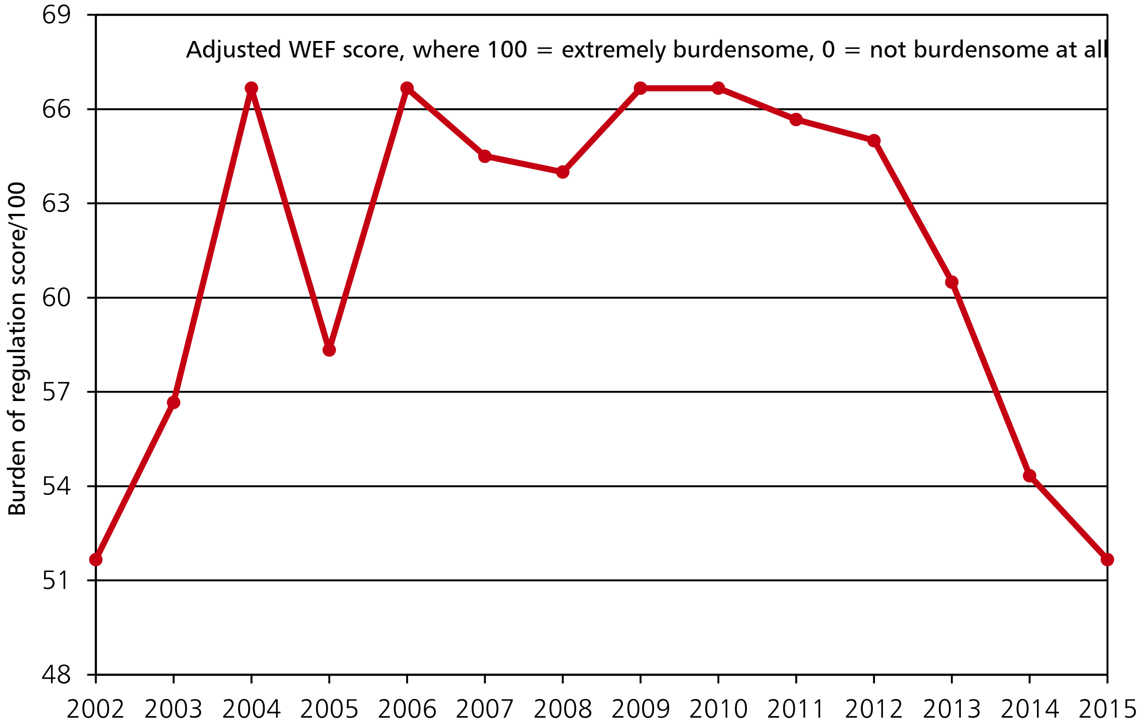
12.13 The UK has a competitive tax environment for financial services. While the government maintains that banks should make an additional contribution to reflect their unique risks, it recognises the need to balance this with considerations around UK competitiveness and banks' ability to support to the broader economy. The Summer Budget 2015 therefore announced a long-term plan for the taxation of banks. The plan sets out in legislation a path towards a structure where banks have a 26% corporation tax rate – the lowest rate among G7 nations – and a 0.10% levy on their UK balance sheet liabilities, less than half the current rate, and ending the imposition of the levy on non-UK liabilities with effect from 2020-21.

12.14 The financial services sector is well placed to lead the way on issues that matter across the economy. To expand female representation in senior leadership positions, Jayne-Anne Gadhia, CEO of Virgin Money has agreed to lead a review into representation of women in senior managerial roles in the financial services industry.

13 Open and competitive markets with the minimum of regulation

13.1 Competitive markets are fundamental to fostering productivity growth. They compel firms to be more efficient and innovative, allow new businesses to enter markets and ensure that the best firms grow. A regulatory environment that encourages innovation by allowing new competitors to enter and expand into markets is a key part of this – for example, in the decade to 2002, opening up the market to new providers of international telephone calls led to a decrease in prices of up to 90%.[1] And simplification of regulatory requirements – or deregulation – can free-up resources for businesses to put to more productive uses, raising long-run productivity and growth.

Chart 13.A: Perceptions of the UK regulatory burden[a]



Source: WEF Global Competitiveness Report 2014-15

[a] *WEF question: In your country, how burdensome is it for businesses to comply with governmental administrative requirements, e.g. permits, regulations, reporting? (1=extremely burdensome, 7= not burdensome at all) (HMT analysis to adjust to score/100)*

13.2 The UK's competition framework is a clear strength - research suggests that improvements in competition policy may have accounted for 20% of industry productivity growth in the UK in the decade to 2005.[2] This active development of competition policy is a huge advance from the

[1] *The Benefits from Competition: Some illustrative UK cases*, Department of Trade and Industry, Economics Paper NO.9, July 2004

[2] *Factsheet on how competition policy affects macro-economic outcomes*, OECD, October 2014

feather-bedding of national champions that was identified as a major contributor to the UK's weak economic performance in the 1950s and 1960s.[3]

13.3 To maintain and develop this strength, the government's priorities are; maintaining a strong, independent competition regime, to effectively tackle competition problems; ensuring consumer choice can drive competitive forces which will reward productivity; and ensuring the UK stays at the forefront of regulatory excellence and that its regulatory frameworks allow new and innovative firms and business models to start up and grow.

Greater competition in markets

13.4 During the last Parliament, the government created the independent Competition and Markets Authority, bringing existing competition authorities into a more streamlined body and modernising the competition toolkit. The government's role is to ensure that the regime continues to be amongst the best in the world. To do this it will consult on a new Strategic Steer to the Competition and Markets Authority, which includes an increased focus on productivity and a commitment to innovation and encouraging new entrants, and will review Trading Standards to ensure that consumer enforcement capability effectively supports competition and better regulation objectives.

Active consumers

13.5 Active consumers can play a key role in pushing firms to compete more and offer greater choice. One of the ways consumers can exert their influence is to switch suppliers. The government will introduce and act on principles for consumer switching so that consumers can switch quickly and reliably and have access to their own data in a way that helps them exercise choice. The government intends to launch a call for evidence on how to implement the principles for consumer switching over the summer. As well as the action on energy markets (see paragraph 6.4 above), the government will legislate to support quick and easy switching in communications markets. Easy switching is important in the fast moving communications markets, particularly with the development of bundled services.

Regulatory frameworks that support disruptive business models, innovation, emerging technologies and the digital economy

13.6 The spread of high speed communications infrastructure is driving forward the development of new business models and disruptive technologies. These businesses are shaking up markets, creating competition and generating more choice. The government wants to ensure that the UK is supporting these businesses, breaking down barriers and boosting UK productivity. To do this the UK's regulation and enforcement frameworks must be able to adapt more effectively to rapidly changing technologies. The government will therefore require departments to work with regulators to publish Innovation Plans by spring 2016. These will set out how legislation and enforcement frameworks could adapt to emerging technologies and disruptive business models.

13.7 The success of the sharing economy demonstrates how new technology can drive industry transformation, new markets and greater competition. The sharing economy is already worth over £500 million in the UK and could be worth up to £9 billion a year by 2025.[4] In order to unlock the potential of this sector, the government will build on the measures announced at March Budget 2015 and will launch an Emerging Industry Action Group for the sharing

[3] *British relative economic decline revisited: The role of competition. Explorations in Economic History*, Crafts, N., 2012

[4] *Five key sharing economy sectors could generate £9 billion of UK revenues by 2025*, PWC, August 2014

economy, to ensure continued engagement with the industry to identify and act on barriers to business expansion.

13.8 The UK's digital economy is vibrant and growing rapidly. To ensure that these benefits are felt throughout the whole economy the government will publish a Digital Transformation Plan by autumn 2015 that sets out concrete actions the government will take to support the adoption of digital technologies across the economy, and the ways in which the government will assist in tackling barriers to new businesses entering and creating new markets.

13.9 The government welcomes the EU Digital Single Market (DSM) initiative, launched by the European Commission in May. The creation of a DSM will support investment in digital infrastructure, provide opportunities for companies to grow and innovate and benefit consumers through increased access to a wider range of digital products and services. The potential gains of a fully functioning DSM are estimated to amount to around 0.5% of EU GDP, perhaps significantly more.[5] The UK in particular stands to gain given its leading position in e-commerce and the tech sector. Over the next 18 months the Commission will be making detailed proposals on the each of the 16 initiatives proposed in the strategy.

Cutting red tape

13.10 In the last Parliament, the government embarked on an ambitious deregulatory agenda through flagship programmes such as One-In-Two-Out and the Red Tape Challenge, cutting the net burden of regulation by £2.2 billion per annum.[6] Building on this, the government has committed to cut at least a further £10 billion of red tape on business. The Better Regulation Executive will launch the Cutting Red Tape programme to help deliver this ambitious target, working in partnership with industry to identify and address red tape resulting from legislation and enforcement activities in sectors. The government will launch reviews across: enhancing the effectiveness of the Anti-Money Laundering and Terrorist Financing regime, Energy, Mineral Extraction, Agriculture, Waste and Care Homes. The government also recognises that regulators' actions need to minimise unnecessary burdens on business. The government will therefore legislate through the Enterprise Bill to extend the government's target for cutting red tape to cover the activities of regulators.

13.11 In parallel, the government will continue to support the better regulation agenda at EU level. The government welcomes the European Commission's Better Regulation package in offering the opportunity for the EU to improve the way it regulates and makes policy.

Championing enterprise

13.12 Economies stagnate without a dynamic and enterprising firm culture. Entrepreneurs can be vital sources of competition and disruptive innovation, driving productivity by ensuring that firms continually strive to improve their efficiency and better meet customers' needs.

13.13 Enterprise is not just about the number of start-ups. In fact, most new businesses are no more productive than existing businesses, even after 5 years.[7] Raising the productivity of the whole economy depends on facilitating the growth of new and existing businesses with the greatest potential. But this is a relatively select group: typically, over a three year period, less

[5] The Cost of Non-Europe in the Single Market – III – Digital Single Market, European Parliament, September 2014 suggests an increase in EU GDP of 0.4% in 2020 (equivalent to €60 billion in 2014 prices); The Economic Impact of a European Digital Single Market, Copenhagen Economics, March 2010 puts the estimate at around 4% of EU GDP.

[6] *One-in, two-out: ninth statement of new regulations*, Department for Business, Innovation and Skills, December 2014.

[7] *The Other Productivity Puzzle*, Nesta, October 2014.

than 1% of small and medium sized businesses will achieve high growth, although that same group will generate 20% of all job growth amongst established firms which grow.[8]

13.14 The priorities are to make sure that it is easy to start a business, that the best new businesses can scale up rapidly, and that they can fulfil their long term potential. This requires:

- access to finance, which is essential for many would-be entrepreneurs to launch a new venture, and for small businesses with growth potential to scale up. Credit conditions for smaller businesses have improved over 2014-15, but remain challenging, and the market in equity finance could also work better
- building a stronger enterprise culture and improving management skills. The UK has a thriving entrepreneurial culture relative to the rest of Europe, but lags behind the US.[9] In particular, many businesses recognise that their management and leadership capabilities need to improve. According to some academics, one quarter of the productivity gap between the UK and the US is associated with such capabilities[10]

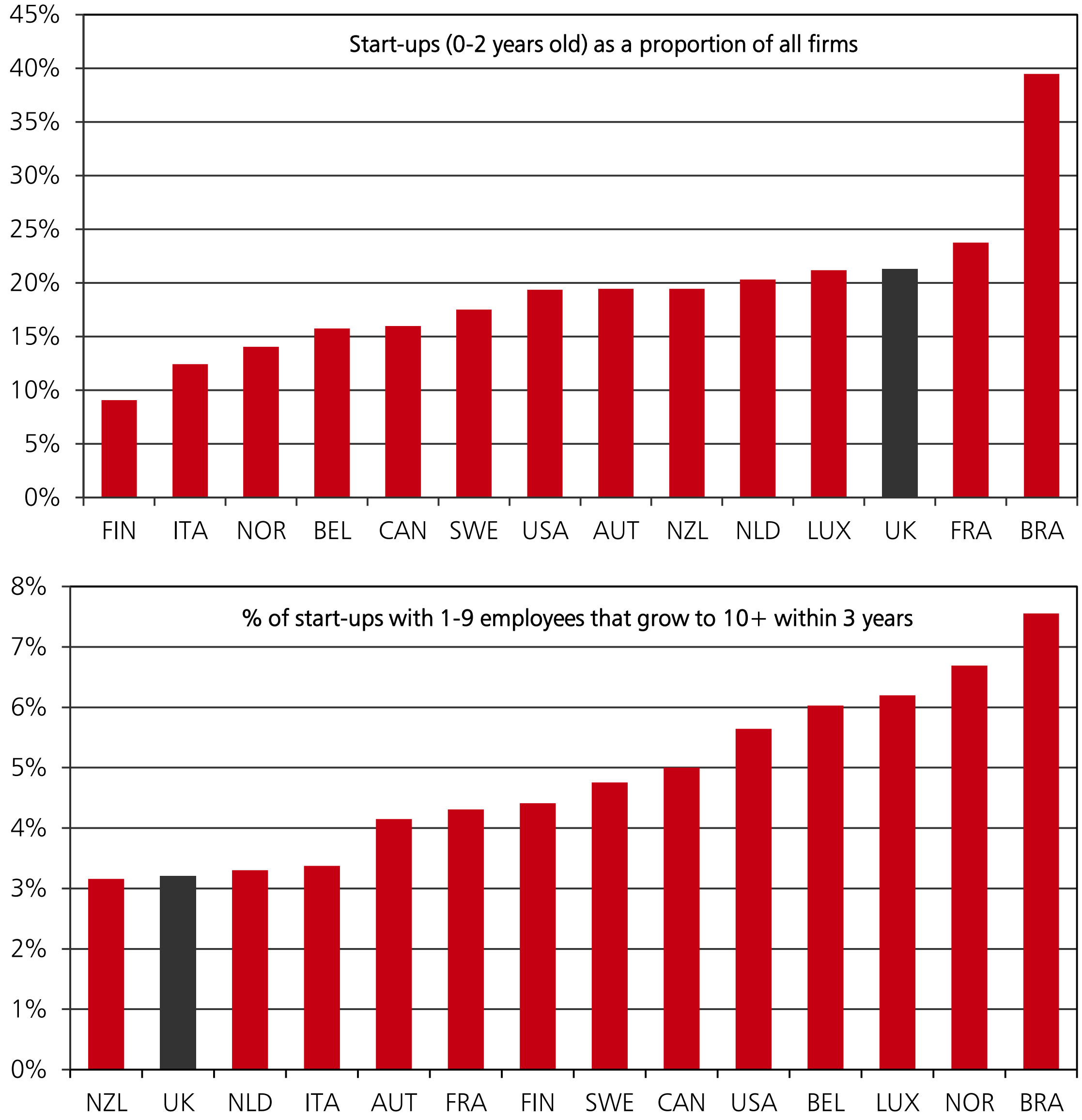
13.15 Since 2010, the government has increased banking competition and set up the British Business Bank, expanded tax reliefs and cut regulation for smaller businesses, simplified business support through the Business Growth Service, and strengthened the prompt payment code. The UK had a record 5.2 million private sector businesses at the start of 2014, an increase of 760,000 compared with start of 2010.[11] But the government wants the UK to be a place where doing business is even easier. To achieve this aim, the government will develop and retain the best enterprising talent, and will build on the UK's already strong position, ranked 8th worldwide and 3rd in Europe, aiming to be number 1 in Europe and in the top 5 worldwide.[12]

13.16 The government funds advice and support to develop management capability in SMEs and will explore options for devolving responsibility for designing and delivering this to local areas as part of city devolution. Evidence suggests that bespoke, in-work development is most effective among small business owners and managers,[13] and it follows that locally delivered schemes are more likely to be able to facilitate this kind of tailored support cost-effectively.

13.17 To support wider improvement in the management capabilities that underpin the ability of firms to make the best use of skills, to adopt new technology and to innovate and grow, **the government is announcing plans to introduce a new employer-designed degree apprenticeship in Leadership and Management to boost the capabilities of future business leaders** and **proposes that new income contingent loans for postgraduate taught masters students are also made available to contribute to the costs of an MBA**. Following consultation, the government will set out details on how these loans will be delivered later this year.

[8] *ERC Insight: Contribution to job creation by high growth SMEs*, Enterprise Research Centre, 2015.
[9] *UK 2014 Report*, Global Entrepreneurship Monitor, 2015.
[10] *Management as a Technology*, Nicholas Bloom, Raffaella Sadun and John Van Reenen, 2015 (public draft).
[11] *Business Population Estimates for the UK and Regions 2014,* Department for Business, Innovation and Skills, November 2014.
[12] *Doing Business Rankings*, World Bank, 2014.
[13] *Supporting Sustained Growth Among SMEs*, Stephen Roper and Mark Hart, 2013; 'Towards 'Leaderful' Communities in the North of England', Richard Thorpe et al, 2008.

Chart 13.B: The UK does well on start-ups, but is less effective at growing them



Source: Organisation for Economic Co-Operation and Development; 'The Dynamics of Employment Growth: New Evidence from 18 Countries', Chiara Criscuolo, Peter N. Gal and Carlo Menon (OECD), 2014.

13.18 The plan also reconfirms the government's intention to help new and existing challenger banks to inject fresh competition in the market, including through the British Business Bank. The Business Bank is increasing the supply of debt and equity finance available to smaller businesses, including start-ups, as well as diversifying the market to give a greater choice of options and providers. The Business Bank aims to facilitate up to £10 billion of finance by 2019, the majority of which will be through providers other than the big 4 banks.

14 A trading nation open to international investment

14.1 The UK has benefited hugely from its openness to the world. Exports matter, both to earn money to pay for imports, and because they help rebalance the economy. But the economic benefits of trade go much further. Trade increases UK productivity by allowing firms to specialise in sectors in which the UK has a comparative advantage, and through exposure to new ideas and international competition. Imports also provide cheaper inputs for our own goods and services, as well as lower prices and more variety for consumers. Inward investment is something the UK has excelled at, particularly in recent years (with the FDI stock reaching £1 trillion this year) and is hugely important, as is outward investment.[1]

14.2 Among the critical issues are:

- improving export performance, especially to emerging markets. Historically the UK has under-exported to emerging markets compared with major competitors. This has begun to change, with exports to emerging markets increasing faster than the average in the last decade. But even now, exports to China, the world's second largest economy, are only just over one-third of those to Germany.[2] Getting the UK's existing exporters to diversify into more markets is a key challenge
- further integration of international service sector markets. The UK is one of the world's leading exporters of services, second only to the US in 2013,[3] and could benefit hugely from a more integrated market for services. Within the EU, estimates suggest the single market has increased EU GDP by around 2% to 5%,[4] and full liberalisation of the single market in goods and services could increase EU GDP by 14% and UK GDP by 7%[5]
- supporting trade agreements beyond the EU. The European Commission estimates that completing all current trade talks could add a further 2.2% or €275 billion to EU GDP,[6] while estimates by the Centre for Economic Policy Research suggest an EU-US FTA could boost the UK economy by up to £10 billion annually in the years following a deal[7]

[1] *UKTI Inward Investment Report 2014/15*, UK Trade & Investment, 2015.

[2] *Pink Book, exports of goods and services*, Office for National Statistics, 2014.

[3] OECD Balance of Payments database (MEI), Organisation for Economic Co-operation and Development, 2015.

[4] *Steps towards a deeper economic integration: the Internal Market in the 21st Century*, Ilzkovitz, F., et al., 2007; *The Economic Impact of European Integration*, Boltho, A. & B. Eichengreen, 2008.

[5] *The economic consequences for the UK and the EU of completing the Single Market*, Aussilloux, V., et al., Department for Business Innovation & Skills Economics Paper No. 11, February 2011

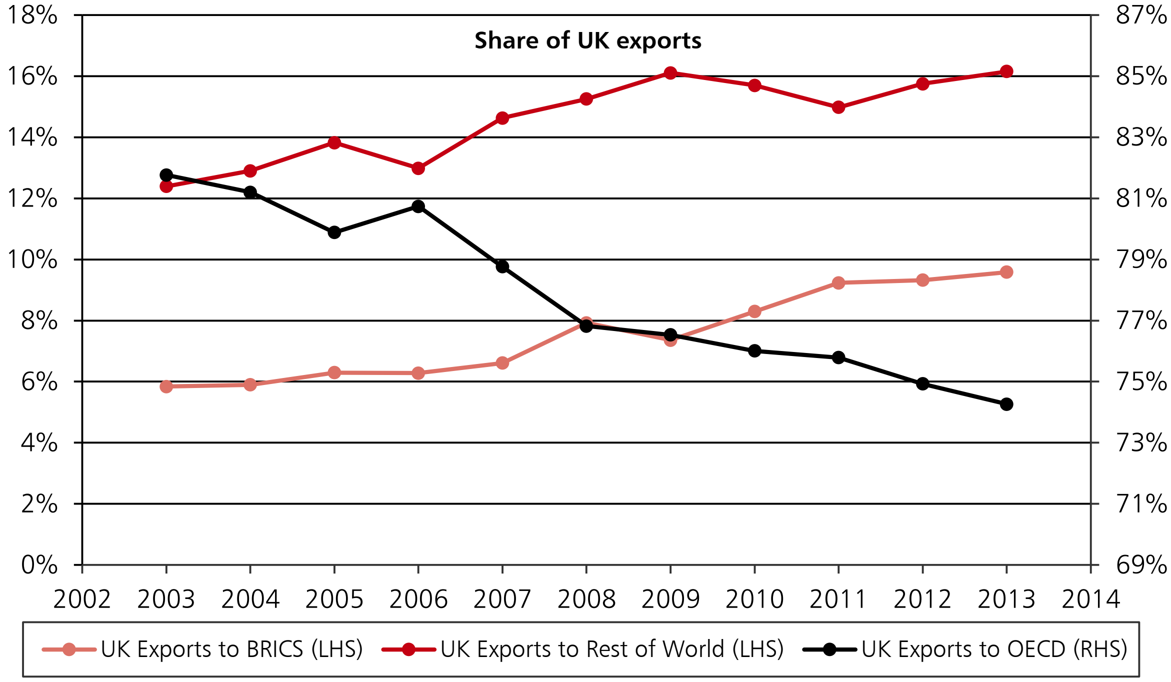
[6] *The EU's bilateral trade and investment agreements:* where are we?, European Commission Memo, 2013

[7] *Estimating the economic impact on the UK of a Transatlantic Trade and Investment Partnership Agreement between the European Union and the United States*, Centre for Economic Policy Research, 2013

£1 trillion of exports by 2020 and 100,000 more companies exporting

14.3 UKTI has more than doubled the number of businesses it helps on an annual basis since 2010, supported by extra resources.[8] Given the scale of the export challenge it is essential that the broad range of relevant government activity works effectively for all companies across multiple sectors and markets. The government will conduct an internal review of expenditure across departments that supports the government's prosperity objectives. The review will report in time to inform the next Spending Review and the Strategic Defence and Security Review.

Chart 14.A: UK Export share to advanced and emerging economies as a % of total



Source: HM Treasury calculations from ONS The Pink Book 2014, Part 3: Geographical Breakdown.

14.4 The government will remodel its delivery on trade, exports, investment and prosperity. In the past, too much of the burden of promoting exports has fallen within government on UK Trade and Investment and UK Export Finance. The government will now mobilise the whole of government behind exporting, enhancing and modernising government support. A cross-Whitehall Implementation Taskforce has been established, reporting to Cabinet.

14.5 It is important that the government continues to boost exports to fast-growing emerging markets. Goods exports to China totalled £14.1 billion in 2014, an increase of 68% since 2010.[9] The government will continue this progress by enhancing the UK's relationship with key emerging markets, including by: tackling regulatory and other barriers to trade and economic growth; continuing to double support to UK firms in China; and identifying and creating opportunities for UK firms in markets like China, India and Brazil including by using the annual Economic and Financial Dialogues' focus on financial services and infrastructure.

14.6 Export finance is also a vital component of government support to exports. UK Export Finance is exploring further ways to increase its product range. The government expects to invite

[8] UK Trade & Investment, PIMS Database

[9] UK Trade data, Office for National Statistics, April 2015

banks, as from next month, to submit applications for working capital support to UK exporters' suppliers. The British Business Bank will work with UK Export Finance to review the access to finance challenges facing SMEs looking to export to ensure that government support best addresses their needs.

14.7 It is also the case that many Low Income Countries are growing faster than the emerging market average, and the government believes they should have access to the best international expertise, including from UK companies, to meet their development objectives. The government will therefore consult on opportunities through increased export finance to improve competition to solve development problems in Low Income Countries, including a potential Concessional Export Credit Facility. It is anticipated that UK company exports would be part of the solution.

14.8 The government is firmly committed to ensuring that the UK remains the world's leading financial centre. In March 2013, the government launched the Financial Services Trade and Investment Board (FSTIB) to ensure that government departments and industry work in close partnership to promote trade and investment in priority markets, such as China, India and Brazil, and priority sectors, such as Islamic Finance, FinTech, insurance and reinsurance and investment management. The FSTIB has successfully delivered on these objectives, and the government is re-launching the Board with new industry external members and a renewed mandate to identify and actively lead on key opportunities to support the industry to trade, attract inward investment and remain globally competitive.

Trade liberalisation

14.9 Recent years have seen a World Trade Organisation (WTO) agreement on trade facilitation in 2013, and agreement of the EU Canada Comprehensive Economic and Trade Agreement in 2014. The government will pursue further trade liberalisation, working to conclude key trade agreements where negotiations are already underway (such as the EU-US Free Trade Agreement), and to initiate negotiations with key trading partners where they are not.

Single EU market in goods and services

14.10 The government will work to secure agreement to reforms that will complete the single market in goods and services, and welcomes recent European Commission initiatives in respect of Capital Markets Union, Energy Union, and the Digital Single Market.

15 Resurgent cities, a rebalanced economy and a thriving Northern Powerhouse

15.1 A dynamic economy needs thriving cities that can expand and adapt to meet the challenges of the 21st century. Cities attract high value firms and skilled workers, and, in turn, they help to boost the productivity of those that locate there. They provide deep markets for labour, vibrant competition between firms, and enable the rapid diffusion of new ideas. Their success also matters because cities and their surrounding areas are home to three-quarters of the UK's population and even more of the nation's jobs.[1]

15.2 London is one of the world's greatest global cities and a huge asset for the national economy. However, in recent decades the UK has relied too heavily on the capital to generate growth.[2] Economic power is more evenly spread across the country in economies like Germany and the US. In 2010, London accounted for 28% of UK GDP, whilst Berlin and New York accounted for much smaller shares, at 5% and 7% of their respective national GDP.[3] The UK's continued national prosperity depends on cities outside the capital doing better.

15.3 To rebalance the economy, cities need effective governance. OECD research has shown that cities around the world with fragmented governance structures have up to 6% lower levels of productivity than those that do not.[4] England currently has 353 local authorities with over 18,000 elected members.[5] This can lead to fragmented decision making and blurred accountability; even within the same city region, urban and suburban leaders do not always work together on shared objectives. The experience of London and other major international cities suggests that a directly elected mayor can cut through these difficulties. The government has therefore been clear that devolution of significant powers will rest on cities agreeing to rationalise governance and put in place a mayor to inspire confidence.

15.4 Cities also need long-term investment in effective transport links. It is currently quicker to travel the 283 miles from London to Paris by train than it is to travel less than half that distance between Liverpool and Hull.[6] Excellent connectivity will bring cities closer together to help create the critical mass to compete globally. Better connections between economic centres allow clusters to develop even where companies are located apart, supporting more trade, more interactions between businesses and the generation of more products and ideas.

[1] *Unlocking growth in cities*, HM Government, December 2011

[2] ONS Regional Gross Value Added (Income Approach), December 2014. London and the South East have accounted for half of all Gross Value Added (GVA) growth since 2010, whilst London alone has accounted for over a quarter of all GVA growth since 1997.

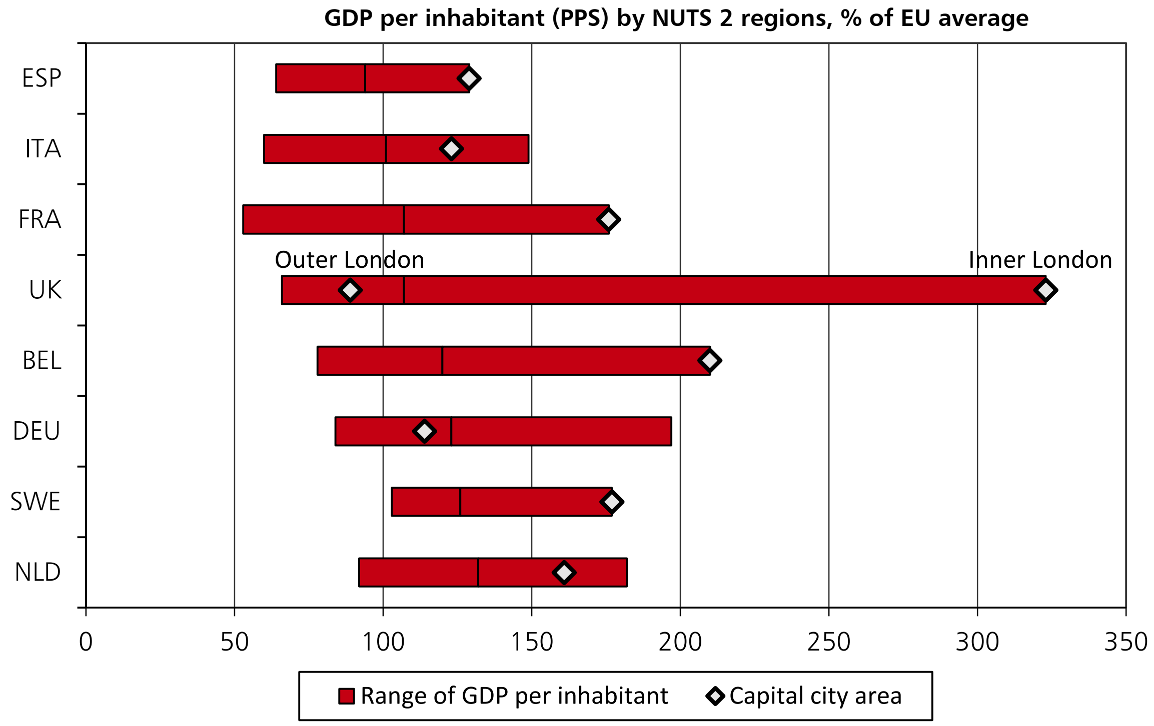
[3] *Metropolitan eXplorer*, Organisation for Economic Co-operation and Development, October 2013

[4] *What makes cities more productive? Evidence on the role of urban governance from five OECD countries*, Organisation for Economic Co-operation and Development, 2014

[5] *Local Government Finance Statistics England No.24 2014*, Department for Communities and Local Government, June 2014'

[6] *Northern Powerhouse: One Agenda, One Economy, One North*, Transport for the North Partnership Board, March 2015

Chart 15.A: GDP per person as % of EU average[a]



Source: Eurostat online database.

[a]NUTS 2 divides the EU into areas with populations between 800,000 and 3 million

15.5 Finally, cities need the right support to build their human capital and generate innovation. The gap in labour productivity between the UK's two largest city economies, London and Manchester, is larger than in any other G7 country and more than double that in both Germany and Japan.[7] Reform of the skills system is necessary to provide cities with the skilled labour businesses need and innovation policy needs to support the development and diffusion of ideas.

15.6 Successful rebalancing will not be achieved by pulling down the capital city, but by building up the Northern Powerhouse and creating strong city regions, led by powerful, democratically elected mayors, that benefit from investment in world-class transport and have the support they need to foster innovation.

[7] *Metropolitan eXplorer*, Organisation for Economic Co-operation and Development, October 2013

World class governance

Box 15.A: Greater Manchester Devolution Deal

The government is committed to giving cities the opportunity to drive growth within their metro areas. That is why, on 3rd November 2014, the Chancellor and Greater Manchester civic leaders signed a ground-breaking agreement for Greater Manchester to create the first directly elected metro-wide mayor outside of London, with powers over transport, housing, planning and policing.

Following the initial deal, Greater Manchester and NHS England signed up to arrangements to bring together £6 billion of NHS and social care budgets so that joint planning of these services can deliver better care for patients.

In addition, the March Budget 2015 announced a pilot scheme in Greater Manchester and Cheshire East to enable the retention of 100% of any additional business rate growth.

15.7 Just as strong local leadership is what made cities successful in the past, it also has the potential to transform competitiveness in the present. The government wants to build on the success of the deal with Greater Manchester, to give more cities the freedom and powers to enable investment and make decisions in the best interest of their metro area. That is why the government has invited major cities to come forward with proposals to elect a mayor and take greater control and responsibility over all the key things that make a city work, from transport to housing to skills, and key public services like health and social care. By the end of this Parliament, a regional network of cities, working together to take responsibility for their own prosperity, will underpin a thriving Northern Powerhouse and growth across all of the country's regions.

15.8 Building on the ground-breaking devolution deal agreed in November 2014, the government is making further progress in devolving powers to Greater Manchester. This includes putting Fire Services under the control of the new directly-elected mayor, establishing a Greater Manchester Land Commission, granting the city region more powers over planning (subject to the agreement of the Cabinet member representing the district in which the power is used), and further discussion of collaboration on children's services and employment programmes. The government will also consult on devolving powers on Sunday trading to city mayors and local authorities. This will look at allowing mayors and local authorities to extend Sunday trading for additional hours within parameters that they would determine.

15.9 To fulfil the government's commitment to rebalancing the economy and further strengthening the Northern Powerhouse, Summer Budget 2015 also announced that the government is working towards further devolution deals with the Sheffield City Region, Liverpool City Region and Leeds, West Yorkshire and partner authorities, to be agreed in parallel to the Spending Review. If agreement is reached, including on an elected mayor working with local leaders to oversee new powers devolved from ministers, these city regions will be granted significant additional powers and the opportunity to take control of their own affairs to support economic growth.

15.10 The government also remains open to any further proposals from local areas for devolution of significant powers in return for a mayor, in time for conclusion ahead of the Spending Review.

Widespread transport devolution

15.11 Cities require high-quality transport if they are to be successful, as well as the powers to deliver a fully integrated public transport system that truly serves the needs of their residents and businesses. The government also recognises that transport plays a vital role outside major city regions in meeting the needs of local communities as well as driving economic growth. The government is committed to significant transport devolution in all of the country's city regions that elect a mayor. This includes the roll-out of Oyster-style smart and integrated ticketing systems that will provide people with quicker and easier door-to-door journeys, greater choice, as well as simpler and more flexible fares.

15.12 Building on the government's commitments set out in Chapter 5 to improve transport connections throughout the country, the government is launching an ambitious new transport devolution package for the North to take the Northern Powerhouse to the next stage and create a single northern economy that is genuinely stronger than the sum of its parts. Building on the Northern Transport Strategy that was jointly published by the government and Transport for the North (TfN) earlier this year, the government is now committing to:

- devolving far reaching powers over transport to the North's mayor-led city regions to deliver fully integrated public transport systems, supported by Oyster-style smart and integrated ticketing systems
- establishing TfN as a statutory body with statutory duties to set out its transport policies and investment priorities in a long-term transport strategy for the North, underpinned by £30 million of additional funding over three years to support TfN's running costs and enable them to advance their work programme
- appointing by the autumn an interim Chief Executive and executive team for TfN to accelerate TfN's work programme, and appointing a Chair by the end of the year, with an update on the Northern Transport Strategy to be published by Budget 2016
- working with TfN to advance the introduction of Oyster-style smart and integrated ticketing systems across bus, tram, metro and rail services throughout the region, making this one of the top priorities for TfN's newly accelerated work programme
- working with TfN to push forward plans to transform east-west rail and road connections via TransNorth and options for a new TransPennine Tunnel, with a prioritised list of scheme options to be produced by Budget 2016, and an interim report in time for the Spending Review

Empowering local leaders to drive growth, through skills, science and innovation

15.13 Cities need a deep pool of human capital to attract investment and develop knowledge-intensive clusters. As set out in chapter 3, the government will ensure cities take a leading role in developing the skills they need, including inviting local areas to participate in the restructuring and commissioning of professional and technical provision, including the ability to invite colleges to become specialist Institutes of Technology.

15.14 The development and diffusion of ideas is a vital component of cities' productivity advantage. To support this:

- the government will invite universities, LEPs, businesses and cities to work with the government to map research and innovation strengths and identify potential areas of strategic focus for different regions through a series of science and innovation audits

- the government will encourage universities to strengthen local collaboration, to be recognised through funding stream such as the Research Partnership Investment Fund, building on successful models such as the N8, the M6 and W4
- flexible land markets are central to harnessing the productivity benefits that cities can offer. A more flexible, responsive planning system will enable people to afford to live and work in successful cities, allow firms to expand and urban economies to adapt to new opportunities. The reforms set out in chapter 9 will help improve the planning system in all cities and city-regions. Planning powers can be an important component of devolution arrangements, as has been the case with Greater Manchester and London

15.15 The government is inviting Local Enterprise Partnerships to bring forward bids for a new round of Enterprise Zones. They will be able to work with DCLG to develop their business cases, and only proposals with strong economic potential will be awarded Enterprise Zone status.

Rebalancing growth

Midlands – Engine for Growth

15.16 The government is committed to driving economic growth throughout all of the country's regions and is strongly supportive of the steps taken in the Midlands to develop a pan-regional approach to transport.

15.17 The local transport authorities across the East and West Midlands have come together through the voluntary partnership, Midlands Connect, to develop their collective vision for transforming the region's transport connectivity and driving economic growth. The government is therefore committing to providing £5 million of funding to the Midlands Connect partnership to further develop a transport strategy for the Midlands.

15.18 In the Long Term Economic Plan for the Midlands, the Chancellor committed to working with the Midlands LEPs to support a regional approach to skills. The government will work with LEPs, the local partners and the emerging combined authorities to scale up this work across the Midlands, looking to agree a clear and detailed delivery plan in autumn 2015.

15.19 The government supports the extension of the Birmingham Enterprise Zone, which will support Birmingham to build on the government's investment in HS2 to generate further benefits for the city of Birmingham, and will consider a business case as part of the Spending Review.

15.20 The government also strongly supports the recent publication of a West Midlands Statement of Intent for devolution, which sets out ambitious proposals for a strong and coherent West Midlands combined authority. The government is also pleased to have received two Combined Authority proposals from local authorities in the East Midlands.

Supporting the rural economy

15.21 While cities are the driving force of the economy, it is important that all areas of the economy contribute to, and benefit from, productivity growth. That is why the Secretary of State for Environment, Food and Rural Affairs will launch a new '10 Point Plan' for rural productivity. This will set out the government's ambitions to:

- enable communities to allocate land for Starter Homes developments, including through neighbourhood plans
- as part of the new bidding round, encourage towns and districts within rural areas to work with LEPs on producing bids to become an Enterprise Zone, so that rural areas can also benefit from the new programme
- review the current threshold for agricultural buildings to convert to residential, to further support delivery of new homes in rural areas
- extend permitted development rights to taller mobile masts, in order to support improved mobile connectivity in rural areas; a call for evidence on these proposals has been issued today
- complete the superfast broadband programme on time and on budget, ensuring 95% of the UK has access to superfast by 2017

Rebalancing growth across all regions and nations of the UK

15.22 In Scotland, Wales and Northern Ireland, many of the levers available to promote and support productivity, economic recovery and growth are devolved responsibilities of the Scottish Government, Welsh Government and Northern Ireland Executive. For example, the devolved administrations are responsible for local government, including its structure and financing, housing, regeneration and the planning framework.

15.23 The government wants increasing productivity across all regions of the UK. Where responsibilities are retained at the UK level, the government will continue to deliver for the whole of the UK, ensuring the benefits of the union are felt in every part of the country, including:

- signing an ambitious city deal for Glasgow and the Clyde Valley in 2014. Going further, March Budget 2015 announced that the government would work with local partners and the Scottish and Welsh Governments towards City Deals for Cardiff, Aberdeen and Inverness
- supporting key infrastructure projects in Wales, funding the upgrade of the Swansea-London mainline, and paying almost half of an estimated £500 million to electrify the Valley lines
- devolving Corporation Tax rate-setting powers in Northern Ireland to address the common objective of the government and the Northern Ireland Executive to rebalance the Northern Ireland economy and drive faster economic growth

16 Public Sector Productivity

16.1 Public services represent around 20% of the economy, and so improving their productivity and efficiency will have major benefits for the economy, taxpayers, and those who use these services.[1]

16.2 Between 1997 and 2010 the Office for National Statistics (ONS) estimates that public sector productivity – measured as the amount of output produced for each unit of input, adjusted for service quality – was broadly flat. In the subsequent two years, they estimate that productivity increased by 2.5% and 1.2% respectively, as service outputs increased during that period, despite reduced budgets. This was driven largely by positive improvements in the NHS and education.[2]

16.3 Over the last Parliament the government also became more efficient, reducing the cost of inputs to protect frontline services. By the end of the current financial year government departments' administration budgets will have been reduced by 40% compared to 2010. This was enabled by a range of initiatives to reduce 'back office' expenditure, for instance the government's moves to consolidate its office estate mean that the government estate is now more efficient on average than private sector comparators.[3] The government also increased the use of digital technology in key public services, such as tax returns and voter registration, to reduce transaction costs and improve service quality.

16.4 Since 2010 many public services have improved their performance. Crime has fallen, despite reduced spending on the police,[4] and the proportion of officers in frontline roles has increased to over 90%.[5] In education, 1 million more pupils are in good or outstanding schools.[6] In the family courts, the time taken to make the important decision on whether a child should be taken into care has been halved since 2011 – now at 29 weeks instead of 56.[7]

16.5 In order to meet the fiscal challenge, the government will need to build on this success and introduce further reforms to ensure that services can meet continued - or in some cases increasing - demand at a time of reducing budgets. **The government will do this through the introduction of new Single Departmental Plans, which will identify key priorities for every department, and will act as a vehicle to link inputs to outputs. The Spending Review will outline specific initiatives, based on the following principles:**

- service redesign: shifting delivery to the local level, to put the public at the heart of service delivery; integrating front line services; and promoting early intervention to unlock savings
- organisation and workforce: promoting the use of shared services across government; spreading best practice; and improving leadership and capability

[1] *General Government consumption as a share of nominal GDP*, OBR, 2015
[2] *Public Service Productivity Estimates: Total Public Services*, ONS, 2015
[3] Cabinet Office benchmarking on office space, against the private sector *State of the Estate*, 2015
[4] *Crime Survey for England and Wales – year ending September 2014*, ONS, 2015
[5] *Policing in Austerity*, Her Majesty's Inspectorate and Constabulary, 2014
[6] Ofsted data, http://dataview.ofsted.gov.uk
[7] *Family court statistics quarterly: January to March 2015*, MoJ statistics bulletin, 2015

- technology and data: increasing the use of digital technology and data sharing across government to enable services to reduce costs and increase outputs

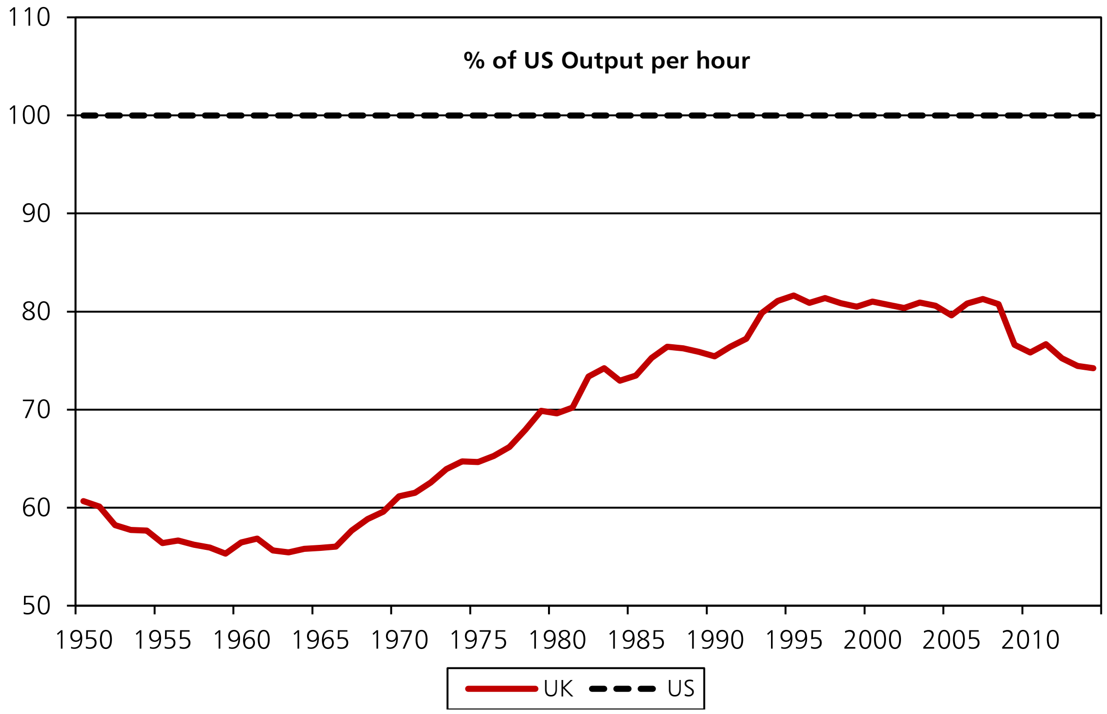
16.6 By March 2017 the government will also implement a new commercially-driven approach to land and property management across the central government estate. A new body or bodies will be created which will charge departments market-level rents for relevant freehold assets. This will drive efficiencies and the release of land and property for productive use, including for new homes. **The government will now appoint a shadow Chair to lead the development and implementation of this transformation programme**.

A Annex A

Historical performance

A.1 UK productivity has increased more than seven-fold over the past 100 years, with huge benefits to wages, to living standards and to the goods and services people can enjoy.[1] The UK's productivity growth has been uneven and relative performance has fluctuated, reflecting domestic policy choices as well as external factors (Chart A.1).

Chart A.1: UK productivity relative to the United States



Source: The Conference Board online Total Economy Database.[2]

A.2 At around the turn of the twentieth century, the UK lost its position as world productivity leader, as the US benefited from its growing internal market and easy land availability. In the inter-war period the UK fell further behind, partly due to policy choices that reduced competitive pressures by encouraging collusive behaviour and restricting international trade. After the Second World War, the UK experienced the fastest growth in its history but European peers did much better: this was an era of missed opportunity, a failure to take full advantage of the huge scope for catch up with the US. Again, policy is likely to have dampened productivity growth by

[1] Output per hour; *Three Centuries of Data*. Bank of England, 2015

[2] The Conference Board is an independent research association based in the US. Users should be aware that the conference board data are not equivalent to ONS data earlier in the document.

protecting firms from failure, often through nationalisation, and failing to tackle a dysfunctional relationship between trade unions and business.[3]

A.3 The UK's performance improved, first relative to the US, and then from the mid-1970s onwards, compared to other advanced economies. The UK began to catch up with leading European economies and to converge with the US. Policies helped to inject competitive intensity into the UK economy, by integrating with the Single European Market, strengthening competition policy and reforming industrial relations.[4]

A.4 Despite the improvement, a gap with the US, France and Germany remained at the onset of the financial crisis and this has grown. International comparisons of productivity are sensitive to the exchange rates used, but most plausible methods show a large gap between the UK and the most productive countries. The ONS estimate that UK output per hour is 17% below the G7 average, 27% below France, 28% below Germany and 31% below the US.[5] Matching the productivity of the US would raise GDP by 31%, equating to over £21,000 per annum for every household in the UK.[6]

A.5 There are likely to be a number of reasons for the UK's lower levels of productivity and it is difficult to identify the precise role that each of these factors plays. Lower levels of investment are likely to contribute to the gap with France and Germany, particularly in regards to R&D. Other relevant factors include skill levels and, in the case of France, the exclusion of low-productivity workers from the labour market. The gap with the US is explained less by differences in inputs, and is likely to be a combination of factors including more rapid diffusion of new innovation, stronger competition, economies of scale stemming from larger market size and superior management practices.[7]

A.6 The task of raising productivity is shared by all countries, with particular challenges and opportunities for Europe. European-level rules and agreements affect a range of policy areas, from energy to financial services, as well as influencing the terms on which British businesses can access markets in the EU and beyond.

The productivity puzzle

A.7 In recent years, a significant shortfall has opened up between the UK's actual productivity performance and the level implied by the pre-crisis trend. The productivity slowdown is an international phenomenon, experienced by the vast majority of advanced economies following the severe and enduring impact of the 2008 financial crisis: G7 annual productivity growth has slowed from 1.9 % between 1997 and 2007 to 0.9 % since the crisis.[8]

A.8 The causes of the global productivity slowdown have been widely debated, and any ranking of the potential explanations is subject to significant uncertainty. In the UK, the productivity slowdown has multiple inter-related causes, which have varied in importance before, during and after the financial crisis. These factors can be ranked under five distinct dimensions.

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[3] *British relative economic decline revisited: The role of competition*. Crafts, N. Explorations in Economic History 49 (2012)

[4] *British relative economic decline revisited: The role of competition*. Crafts, N. Explorations in Economic History 49 (2012)

[5] *International Comparisons of Productivity – Final Estimates, 2013*, ONS, February 2015.

[6] Note: GDP per household is not a household income metric as GDP also includes Gross Operating Surplus of corporations and other measures of domestic income/production. HMT calculation: 2014 nominal GDP (YBHA) divided by 2014 ONS household estimates; *Quarterly National Accounts*, ONS, June 2015 and *Families and Households*, ONS, January 2015

[7] *Britain's Productivity Gap with the United States and Europe: A historical Perspective*. Broadberry, S. and O'Mahony, M. NIESR (2004)

[8] *International Comparisons of Productivity – Final Estimates, 2013,* ONS, February 2015.

A.9 The first relates to the idea that the financial crisis has resulted in impaired resource allocation across the economy, preventing capital and labour from finding their most productive uses and weighing on productivity growth.[9] A range of evidence supports this idea, including:

- the slowdown in total factor productivity (TFP) growth, which accounts for almost all the slowdown in UK productivity growth since 2008.[10] TFP can be thought of as the productivity gains from any given level of inputs (labour and capital) working better together – or in other words, better 'mixing' of the ingredients for growth
- a marked increase in the dispersion of rates of return on capital, and a break down between firms' employment growth and their relative productivity ranking.[11] This implies that resources were less efficiently allocated across firms following the crisis and that successful firms have been less able to expand
- the proportion of employees who move from one employer to another each quarter (the 'churn rate') fell substantially in the aftermath of the crisis and has subsequently remained low. Since the beginning of 2010 the churn rate has averaged around 28% less than it did in the five years to the crisis[12]

A.10 Second, it is likely that some sector-specific factors are also at play. Five sectors – financial services, ICT, professional services, wholesale & retail and transportation & storage – represent around 40% of the economy but have accounted for around 65% of the productivity shortfall.[13] In part this is driven by unsustainable pre-crisis trends, for example the financial sector grew around 8% annually between 2002 and 2007, a pace of growth which is now considered unsustainable.[14]

A.11 Third, the relatively low cost of labour since the crisis may have led firms to substitute away from investment, reducing the effective amount of capital workers can use and thus reducing productivity.[15] The Bank of England estimated that the weakness of business investment relative to its pre-crisis trend contributed around 2.5 percentage points to the puzzle by the end of 2013.[16]

A.12 Fourth, it is likely that 'labour hoarding' by firms may have reduced productivity in the initial phase following the financial crisis, as firms sought to hold on to labour despite falling demand for their output.[17] However, this cannot explain developments in more recent years, as employment and hiring have grown very strongly.

A.13 The fifth set of factors relates to measurement issues, which the Bank of England find could explain a small part of the shortfall.[18] Although there have been some recent statistical improvements,[19] the changing nature of economic activity in the modern economy poses measurement challenges: capturing fully the increasing quality of new goods and services for example, along with financial services measurement, forms a distinct part of the puzzle. To deliver the very highest standards Professor Sir Charles Bean has agreed to lead an independent

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9 *OECD Economic Surveys: United Kingdom*, OECD, February 2015.

10 *Accounting for the UK Productivity Puzzle: A Decomposition and Predictions*, Goodridge, P., Haskel, J. and Wallis, G., March 2015.

11 *Productivity and the allocation of resources*, speech by Ben Broadbent, September 2012; and *The UK Productivity Puzzle 2008-2013: Evidence from British Business*, National Institute of Economic and Social Research (NIESR) discussion paper, Riley et al, May 2015.

12 *ONS Economic Review*, October 2014

13 HMT calculations using ONS GDP low level aggregates, Quarterly National Accounts and Workforce Jobs.

14 ONS Quarterly National Accounts, GDP low level aggregates

15 The UK Productivity and Jobs Puzzle; Does the answer lie in Labour market flexibility? Pessoa and Van Reenen.

16 *The UK productivity puzzle*, Bank of England Quarterly Bulletin, Q2 2014.

17 *The productivity puzzle: a firm-level investigation into employment behaviour and resource allocation over the crisis*, Bank of England Working Paper No. 495, April 2014.

18 *The UK productivity puzzle,* Bank of England Quarterly Bulletin, Q2 2014.

19 Such as the UK implementation of the ESA10- the European System of National and Regional Accounts

review of the quality, delivery and governance of UK economic statistics. The review will build on the established principle of independently produced statistics and make interim recommendations in the autumn with a final report to be published by Budget 2016.

Raising productivity

A.14 Productivity is a measure of how well resources are converted into goods and services. Raising productivity can be achieved by improving the quality of the resources, and the way that we combine them. There is an analogy to cooking: we can raise living standards by improving the ingredients we have, and by using better recipes.

A.15 The government's framework for raising productivity is built around two pillars:

- **encouraging long-term investment** in economic capital, including infrastructure, skills and knowledge
- **promoting a dynamic economy** that encourages innovation and helps resources flow to their most productive use

Encouraging long-term investment

A.16 Nearly every theory of productivity growth retains a central role for investment and the accumulation of capital. Investment raises the long run productivity of nations by increasing the level of capital that each worker has at their disposal.

A.17 In today's economy, investment is about much more than machines, equipment and physical infrastructure. It also encompasses the development of human capital from education and training, and intellectual capital stemming from research, as well as the development of software and improved business processes. These are all interlinked and thrive in an economy that has well developed institutions and high levels of social capital.[20]

A.18 There is evidence of insufficient or ineffective investment in the UK, notably in developing economic infrastructure and improving the basic and intermediate skills of the workforce, particularly technical and vocational skills.[21] Firms have held back on capital investment since the crisis, and this exacerbated a persistent UK weakness.

A.19 There is clearly scope to do better, but these simple comparisons of spending do not tell the whole story. After all, the UK experienced faster productivity growth than most other advanced economies during a period where this investment 'gap' was large.

A.20 The effect of investment depends not just on its volume, but on how it is spent and how effectively it is allocated across the economy. As an example, the UK's expenditure on science is below the OECD average, but it achieves much better outcomes in terms of research quality. [22]

A.21 Many of the UK's comparative strengths are in sectors that tend to have less need to invest in machines and equipment. Knowledge assets ('intangibles'), many of which are not captured in national accounts, are critical for these firms. Research shows that these investments make an important contribution to productivity growth for the UK economy as a whole. The UK now invests 44% more in intangibles than in traditional assets, and more than many other advanced countries as a share of GDP. [23] When all forms of investment are considered together, the investment gap with other countries narrows significantly – over the period 1995-2007, total

[20] *Growing – fast and slow*, Haldane, A. Speech at the University of East Anglia (2015); 'Institutions as the fundamental cause of long-run growth' Acemoglu, D., Johnson, S. and Robinson, J. NBER Working Paper 10481 (2004)

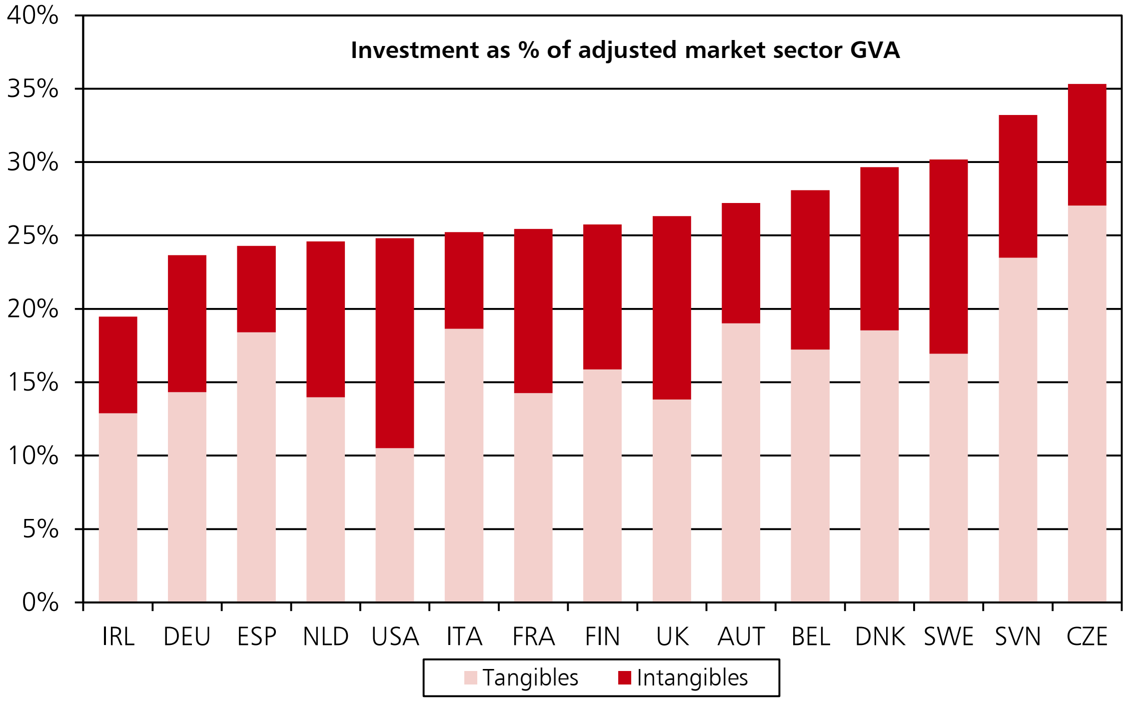
[21] *Investing for prosperity: skills, infrastructure and innovation*. LSE Growth Commission (2012)

[22] See Chapter 8.

[23] *Estimating UK investment in intangible assets and IP rights*. Goodridge, P., Haskel, J. and Wallis, G. Intellectual Property Office (2014)

investment as a share of GDP was higher in the UK than in France, Germany and the US (Chart A.2).

Chart A.2: Investment in tangible and intangible assets, 1995-2007



Source: HM Treasury calculations, Corrado, Carol; Jonathan Haskel, Cecilia Jona-Lasinio and Massimiliano Iommi, (2012), Intangible Capital and Growth in Advanced Economies: Measurement Methods and Comparative Results Working Paper, June, available at http://www.intan-invest.net.

A dynamic economy

A.22 A dynamic and productive economy is one that deploys its resources to greatest effect, enabling them to flow where they create most value. Recent OECD research shows that poorly allocating resources within the economy can have significant negative effects on aggregate productivity.[24] The evidence of impaired resource allocation since the crisis suggests a lack of dynamism may also have contributed to the puzzle.

A.23 Aggregate productivity improves in two ways: when individual firms become more efficient and when capital and labour move to firms or sectors that are relatively more productive. The importance of each of these mechanisms varies by sector, and over time. A recent study estimated that approximately one half of productivity growth in the pre-crisis period was the result of re-allocation across firms.[25]

A.24 There is considerable variation in firm productivity levels across the economy. On average, some sectors are more productive than others, but the variation within sectors is much greater, as demonstrated by recent ONS research on productivity dispersion in three broad sectors.[26]

[24] *The Future of Productivity*. Adalet McGowan, M., Andrews, D., Criscuolo, C. and C Nicoletti, G. OECD. (2015)

[25] *The productivity puzzle: a firm-level investigation into employment behaviour and resource allocation over the crisis*. Barnett, A., Chiu, A., Franklin, J. and Sebastia-Barriel, M. Bank of England Working Paper 495 (2014)

[26] *Microdata perspectives on the UK productivity conundrum – an update*. ONS. Values are at 2005 prices.

Large variation persists even when sectors are narrowly defined: the top 10% of firms in each industry can be as much as five times as productive as the bottom 10%.[27]

A.25 Economies suffer if too many resources get tied up in unproductive firms. Likewise, there are potentially significant gains for an economy that enables the most productive firms to expand, facilitates market entry by disruptive innovators and ensures competitive pressure on the tail of low productivity firms. This requires an open economy with flexible and competitive markets, where expanding firms can access the labour, land and finance they need.

A.26 Dynamism is also important for new ideas – new technology and processes do not have a transformative effect on productivity until they spread throughout the economy. One study estimated that just 13% of UK growth in recent decades came from knowledge created in the UK.[28] The challenge is to make the most of ideas from wherever they come, and to help best practice to spread.

A.27 Although the labour market is a great strength of the UK's, still more can be done to help move skilled workers to the right jobs. Reducing skills mismatch to the level of the best in the OECD could raise productivity by approximately 5%.[29] In particular, the UK economy under-utilises the talent of women: girls outperform boys at school and women have the same relevant skills as men, yet 57% of women are in low or lower middle skill jobs, compared to 36% of men.

A.28 Cities are the foundation of a dynamic economy, providing deep markets for labour and enabling rapid diffusion of ideas and vibrant competition between firms. The concentration of activity within cities itself contributes to productivity through the sharing of knowledge and ideas; the pooling of labour, through specialisation and the matching of supply and demand.

The sectoral dimension

A.29 Aggregate productivity masks significant variation across the economy and three groups of sectors can be identified in terms of their pre- and post-crisis performance:

- sectors such as oil and gas where productivity growth was weak both before and after the crisis. These are likely to have contributed to both the long term productivity gap and the more recent productivity puzzle
- sectors such as financial services, which performed well pre-crisis but have fared badly since. These are likely to be contributing to the more recent productivity puzzle, but less so to the long run productivity gap
- sectors such as automotive where productivity growth was strong in both the pre-crisis and post-crisis periods. These are unlikely to be contributing to the productivity puzzle but may still have a role to play in helping to tackle the UK's productivity gap.[30]

A.30 While the sources of productivity growth are similar across the whole economy, they vary in importance for different sectors. A sector level approach can be appropriate, for example targeting competition and deregulation measures where they can have the greatest productivity benefit.

A.31 This plan responds to the recent slowdown of productivity across the UK and, perhaps more importantly, to the long-standing gap compared to other countries.

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[27] *Building the evidence base for productivity policy using business data linking* Criscuolo, C, Haskel, J and Martin, R (2003), Economic Trends 600

[28] *International Technology Diffusion: Theory and Measurement*, Eaton, J. and Kortum, S. (1999)

[29] *Labour Market Mismatch and Labour Productivity: Evidence from PIAAC Data*, OECD Economics Department Working Papers 1209 (2015)

[30] BIS calculation: *Quarterly National Accounts*, ONS, June 2015; *Labour Market Statistics,* ONS, June 2015

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