Time to Rewrite the Rules for the British Economy

Essay for Tribune Group of MPs

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What a state we're in…

Ten years on from the Great Financial Crash, millions feel no further forward. Because they're not. We're mired in the worst squeeze on living standards since the days of Dickens. And now this crippling, seemingly endless malaise, has provoked the worst crisis of cooperation for a generation; we are divided between rich and poor, between young and old, and now with our closest neighbours with the vote for Brexit.

Like the 1930's, and like the 1970's, this new moment demands a new model; a new settlement, a new economic order. And that is what we must fashion on the foundation of Labour's brilliant manifesto.

We should be clear-eyed about what's gone wrong.

The Third Way, pursued in Europe and in America, sought to transform the New Right's supply-side revolution of tight money, maximum markets and minimal states. We were not neoliberal. But we were liberal.

In Europe and America, progressives doubled down on the 19th century 'religion' of free trade and free exchange of ideas, creating NAFTA, the World Trade Organisation, doubling the size of Europe, and pumping billions into skills and science. We bet that trade and tech together would deliver the tax we needed to rebuild public services and roll-back inequality. And for many years, we were right.

But the creation of vast new global markets transformed the commanding heights of capitalism; huge new companies bigger than countries took shape with unprecedented market power.[1] Long ago, Joseph Schumpeter forecast the phenomenon of 'creative destruction'; but people forget he also forecast the flip-side: the destruction of competition.[2] Well, he was right. A $20 trillion merger wave inside America and around the world has created exactly the sort of oligopolies Schumpeter predicted; giant new

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[1] Few have argued this point as early or as effectively as Prof Peter Nolan. See for instance: https://academic.oup.com/cje/article-abstract/32/1/29/1685937/The-global-business-revolution-the-cascade-effect

[2] See Joseph Schumpeter, Capitalism, Socialism and Democracy, (1942)

firms with unparalleled power to set prices - and wages.[3] For just as they formed, one billion people were entering the labor force in a massive movement from "farm to factory"[4] offering these new global firms new power to outsource production to wherever costs were lowest, while the transformation of technology meant that in industries like automotive, robots are already two-thirds cheaper than people.[5]

These trends together meant, that as Obama White House put it, mega-corps acquired monopsony power,[6] the ability to dictate wages while workers lost all power to 'vote with their feet' and move to different firms paying better, because those alternative opportunities simply did not exist.[7]

This fundamental change ruined the political economy of 'trade, tech and tax'. First, the new inequalities created by low wages, were simply too big to bridge with a politically plausible level of redistribution. By 2009, I calculated we needed an extra £2 billion a year in tax credits to help the squeezed middle keep up just with average levels of economic growth.[8] We could not turbo-charge 'trickle-down'.

Second, the innovation that creates high wages simply didn't diffuse throughout the marketplace in the way it once did. Good ideas anywhere did not become custom and practice everywhere. They were hoarded by what the OECD call 'frontier firms',[9] high-tech behemoths like Apple, or Boeing or GE which dominated all around them. If you were lucky enough to work there, you did well. But if you didn't, you didn't.

Third, creating global markets without effective global regulation created huge new risks in the booming, unbalanced, inter-connected banking sector, which, when it collapsed brought down the roof on all of us.

We thought the old law of comparative advantage would mean new trade and wealth that would lift all boats. Instead, the old law of comparative advantage became a new law to advantage the comparatively rich. Proof? Today, half of global wealth is owned by just 1% of the world's population; 85 families own more than 3 billion of the world's people. No wonder, as the IMF puts it, 'although technological advancement and global economic

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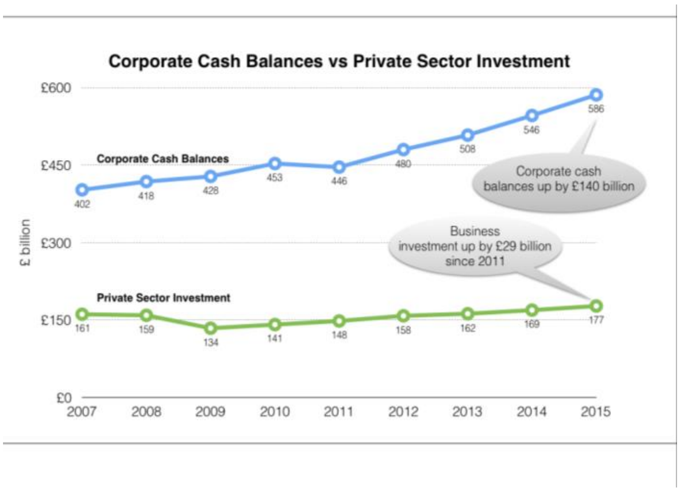
[3] See for instance, https://obamawhitehouse.archives.gov/sites/default/files/page/files/20151016_firm_level_perspective_on_role_of_rents_in_inequality.pdf or https://www.economist.com/news/briefing/21695385-profits-are-too-high-america-needs-giant-dose-competition-too-much-good-thing
[4] McKinsey & Co, The world at work: Jobs, pay, and skills for 3.5 billion people
[5] In the American, European and Japanese car industries, it costs $8 an hour to employ a robot for spot welding, compared to $25 for a worker
[6] See Council of Economic Advisors Issue Brief, Labour Market Monopsony: Trends, Consequences, and Policy Responses, October 2016
[7] https://stats.oecd.org/glossary/detail.asp?ID=3265
[8] See HM Treasury, Draft paper on Issues and Prospect for Medium and Low Income Households, 2010 at http://liambyrne.co.uk/research_archive/challenge-equality-britains-squeezed-middle/
[9] https://www.oecd.org/eco/growth/Frontier-Firms-Technology-Diffusion-and-Public-Policy-Micro-Evidence-from-OECD-Countries.pdf

integration have been key drivers of global prosperity, their effects on labor shares challenge policymakers to find ways to spread those benefits more broadly.'[10]

Now the IMF is right to say, 'trade, tech and tax' brought gains. The purchasing power of the poorest was transformed by some 62%. Choice of imports tripled.[11] But for millions, the power to earn a good life was destroyed as global value chains moved routine jobs to low cost countries.[12] Hence the paradox of modern life: spoilt for choice but strapped for cash.

So, where do we go from here?

The supply-siders of the Right, of which Phillip Hammond is one, will continue to argue that it's the supply of capital and labour that is key. Cut taxes on the wealthy and strip away the welfare state, and magically growth will follow. This is simply wrong. We are now close to full employment but wages are still not rising. And while we cut taxes for big firms, they simply hoard the cash. Stacks of corporate cash stuck in the bank have risen nearly five times faster than investment. With over half a trillion pounds on hand, the British economy is not short of capital. It's short of opportunity.



That's why we should champion the real world insights of complexity economics[13] and offer a British new growth theory that recognises that in today's world, knowledge not

[10] https://blogs.imf.org/2017/04/12/drivers-of-declining-labor-share-of-income/
[11] Research quoted New York Times, 'Perils of Globalization When Factories Close and Towns Struggle,' 18 May 2015 at https://www.nytimes.com/2015/05/18/business/a-decade-later-loss-of-maytag-factory-still-resonates.html
[12] See: https://www.brookings.edu/research/measuring-and-analyzing-the-impact-of-gvcs-on-economic-development/
[13] See, for instance, Eric Beinhocker's superb *The Origin of Wealth*, Random House (2007)

capital is the chief factor of production and shared gains from productivity growth are the key to long term prosperity,[14] for the many and not the few.

This takes us beyond the old demand-management of the Keynesians (as important as that is), and our 1990's view of inequality what you earn depends on what you learn. While this basic insight remains true, 'fixing human capital' is simply not enough to remedy the biggest ever productivity gap with the rest of the G7. Right now, what our competitors finish making on a Thursday night takes us until the end of Friday to get done, not least because their investment in research and development is vastly more than ours.

Over the last decade, countries that spent more on R&D have become much more productive. Britain, by contrast, has one of the lowest spends on R&D in the OECD. Indeed, to hit the international benchmark of 3% of GDP we need to raise science spending by something like £23 billion a year. This helps explain the reality of why only one in five British workers earn their crust in 'knowledge intensive industries' where on average pay is 40% higher than average (that's £161 a week).[15]

Our second task is to find new ways of reconnecting productivity growth and wage growth, and this requires a plan to rewrite the rules of the institutions that make up our marketplace, for today, it is the very rules of our marketplace are the problem.[16]

	GERD, % of GDP		**Productivity growth over whole period**	
	2005	2015	2005-15	2010-15
Korea	2.6	4.2	39%	10.0%
Israel	4.1	4.3	13%	5.7%
Austria	2.4	3.1	11%	4.6%
US	1.6	2.8	10%	1.6%
Germany	2.4	2.9	8%	4.7%
Denmark	2.4	3.0	8%	5.1%
Japan	3.3	3.5	8%	2.0%
Sweden	3.4	3.3	8%	5.1%
Switzerland*	2.7	3.0	7%	1.1%
UK	2.5	1.7	5%	1.4%
Finland	3.3	2.9	4%	1.0%
OECD average	2.2	2.4	9.3%	3.9%

Source: OECDstat

[14] See Robert Atkinson, *Supply-Side Follies*, Rowman and Littlefield, (2006)
[15] See Liam Byrne, Robbins Rebooted: How We Earn Our Way in the Second Machine Age, SMF (2015)
[16] See J Stiglitz, Rewriting the Rules for the American Economy, Roosevelt Institute (2015) http://rooseveltinstitute.org/rewriting-rules-report/

For the new right, progress is only made by getting government out of the way. Maximum market; minimal state. But from the earliest English market charter, we see markets have been and always were social institutions. There are no 'natural' laws. Society gets to write the rules.[17]

In my book *Dragons: Ten Entrepreneurs Who Built Britain,* I tell the story of 700 years of British capitalism through the lives of ten of our greatest entrepreneurs. The story that emerges is clear. Entrepreneurs make history by inventing the future. But, down the ages there would have been no British entrepreneurial miracle if it wasn't for our social technology; the great national institutions we invented, reformed, adapted like Parliament, the Royal Navy, the Royal Exchange, the Royal Courts of Justice, the Royal Society, monopolies created and abolished, limited liability companies and the welfare state first pioneered in places like Bournville, Port Sunlight and the board rooms of John Lewis.[18] Institutions matter.

The 'visible hand' of the public realm has always helped the invisible hand of the private market to deliver, creating that treasured 'cooperation without coercion.'[19]

Today, our institutions are not fit for purpose. What is needed therefore is a new settlement that rewrites the rules of the marketplace around a new role for the state; not a 'producer state' but an 'collaboration state' which organises the institutions needed to democratise the opportunities of this new world; using both monetary and fiscal policy to keep demand high and stable; encouraging long term investment in good jobs; keeping skills at the cutting edge, and encouraging new ideas; and trading fairly with the world around us.

Where to start?

1. In monetary policy, let's change the mandate for the Bank of England, so it must prioritise full employment and price stability, just like the American Federal Reserve.

2. In fiscal policy, let's fix our tax base by requiring the OBR to report to Parliament on how we close the tax-gap created by giant firms and the very rich sheltering upto $7.5 trillion in havens like Panama. And while we're at it, lets rewrite the rules of our trade treaties to include new labour and environmental standards, and for the first time, an insistence that firms declare where and how they're paying their taxes.

3. To incentive long term investment in good jobs, lets rewrite the company code (section 157 of the Companies' Act to be precise), so boards can opt for a fiduciary duty to prioritise workers, customers and creditors and not just shareholders.

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[17] For a longer account of this argument see Robert Reich, *Saving Capitalism,* Icon Books (2016)

[18] This is, if you like, a verification of the the insight offered by the late, great Nobel economist Douglass North: the quality of a country's economic growth depends on the quality of its institutions. See http://www.ppge.ufrgs.br/giacomo/arquivos/econ-crime-old/north-1991.pdf

[19] Milton Friedman's famous phrase

4. Let's change the rules for capital markets to incentive long term shareholding and rewrite the tax code, so firms are encouraged to invest, for example with investment allowances. Let's build new regional banks to transform the supply of 'patient' capital for a new British Mittlestand.

5. In our labour market, let's rewrite the rules for social security to offer retraining to those who face 'technological unemployment' just as Beveridge originally proposed. Let's join together schools, colleges and technical universities to create 'technical university trusts' to revolutionise technical education. Let's connect the Open University, the Workers Education Association and UnionLearn to create the greatest, open source MOOC on earth, offering workers a genuine path from literacy to advanced research, "from ABC to pHD".

6. Let's rewrite the national curriculum, to include new emphasis on skills of the future from coding, to starting a business and change procurement rules to use public contracts to support fledging firms, just as they do in the US.

7. And let's rewrite the rules for science policy, raising the budget on the one hand, but requiring universities to develop University Enterprise Zones that connect research to local firms, backed by a vastly larger Higher Education Innovation Fund

I offer these ideas, merely to get the ball rolling. Are they radical? Yes. Would they make a difference? Certainly. Can we do it? Well, why not?

Liam Byrne was Chief Secretary to the Treasury. He chairs the All Party Group on Inclusive Growth. His history of British capitalism - Dragons: Ten Entrepreneurs Who Built Britain - is published in paperback this year.