House of Commons

Business and Trade Committee

Oral evidence: Financing the real economy, HC 1220

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Watch the meeting

Members present: Sarah Edwards (Chair); Antonia Bance; John Cooper; Sonia Kumar; Charlie Maynard; Mr Joshua Reynolds.

Questions 1-21

Witnesses

- Professor Tera Allas CBE, Chair, Productivity Institute;
- Professor Jagjit Chadha OBE, Professor, University of Cambridge;
- Lord Adair Turner;
- Professor Jonathan Haskel, Professor, Imperial College London.

Examination of witnesses

Witnesses: Professor Tera Allas, Professor Jagjit Chadha, Lord Turner and Professor Jonathan Haskel.

Q1 **Chair:** Welcome to this session, in which we will look at financing the real economy. I thank the witnesses for joining us.

The Government have made economic growth their No. 1 mission. They are aiming to secure the highest sustained growth in the G7, but the UK has consistently lagged behind its peers. For 2025, the IMF has projected UK growth of just 1.2%, below that of most major competitors. Low investment is at the core of the challenge. We want to hear your thoughts. The purpose of this inquiry is to examine the causes of the persistent under-investment in the UK and to explore how the UK can raise capital formation by mobilising greater levels of private and public finance, both domestic and foreign, into British firms and infrastructure.

My first question is, how would you assess the UK's growth outlook, compared with its G7 peers? I will ask you first, Professor Haskel.

Professor Haskel: Thank you for inviting me along. Not hopeful, I am afraid, is the answer. Some good things and some bad things are going on. Some of the good things include planning reform, which is increasingly important in an intangible economy, but some of the bad things include additional labour market regulation, which is really bad. Let us see more of the good stuff and a bit less of the other stuff, otherwise the good stuff will go away.

I will say one more thing, if I may. A feature of the economy in previous decades, before the pandemic, is that the public sector was net neutral in productivity growth. Since the pandemic, the public sector, and health in particular, has been a drag on productivity growth. If one's objective is productivity growth, I think public sector reform is incredibly important, especially on the health side.

Q2 **Chair:** May I get your initial thoughts, Lord Turner?

Lord Turner: It is difficult to be terribly optimistic. I think we have to break it into two things. Are we in a position to change the disappointing pattern of the last 15 years? And where are we this year and next year? The fact is that, although all major advanced economies have disappointed in the last 15 years compared with the previous 15 years, the UK has been more disappointing—the disappointment factor has been bigger. We have fallen further below trend than either the US, Europe in general or most other European countries.

Why did we perform worse than those other countries over that period? We were more exposed to the financial sector in the global financial crisis, because our financial sector was a larger part of GDP, so that was a bigger hit to us. We needed either to recover growth in that sector, or to reallocate it to other sectors of the economy. Also, Brexit did do harm, and we are now struggling with the fact that we are in a world of trade pressures, with American protectionism, in an environment where we are more exposed than most other countries in the world, because we are not China, a country of 1,400 million people, and we are not in the European Union single market. To be in a world of protectionist activity when we do not have a continental-scale economy ourselves and are not part of one is a disadvantage.

Can we change that? I do not think we will be able to change it quickly. Those factors are deep, and then there are still-deeper factors about why our investment has lagged behind that of other countries for a long period of time. To switch to the "this year and next year" question, however, I think we have to accept that we are currently held back by a lack of confidence in the economy. I am talking with several hats on, but one is as the chairman of a bank called OakNorth, which lends money primarily to the lower mid-market sector of the economy, inevitably with large exposure to property, the healthcare sector, restaurants and so on. We have lots of capital and liquidity, and we want to lend, but this year the demand for our loans is down compared with last year—sorry, it is not down, but it is not growing as fast as we anticipated or as fast as it was last year.

What do I believe is happening? I think the unresolved fiscal position is a short-term problem. Having a situation in which everyone knows that there will have to be a significant element of fiscal tightening, because of the debt situation, but with no one able to work out where the Chancellor will do that, just creates a "wait and see" uncertainty. To be blunt, it would have been much better, last year, had the incoming Government had the guts to increase income tax, VAT or employer NI—one of the big three—because if we exclude the big three, we create an environment in which everyone is thinking: "Is it going to be this, or that? Or will it be this?" What people say in such circumstances, as a business or as a consumer, is "Let me hold off spending. Let me hold off making a decision."

Q3 **Chair:** Professor Allas, how do you think we are doing?

Professor Allas: I echo many comments we have heard. Policy stability, or lack thereof, is an enormous issue. Uncertainty of any kind creates a block on investment. Investment is what we are here to talk about, and it is a real problem for the UK's productivity and growth. I want to highlight a little positive, which is that our population is not ageing quite as fast as the Italians or the Germans, so there is a little extra potential in workforce participation over the next couple of years. Other Government targets are per capita, so in that sense they wash out a little. That workforce participation is a positive that we should maximise as far as we possibly can. But McKinsey Global Institute research, for example, is very clear that participation will not be anything like enough to get us to the growth numbers we want in a few years—we need labour productivity. As we will discuss, the UK's labour productivity performance has been very bad. While AI might produce some beneficial outcomes in the longer term, in the short term we have not seen the investment needed to boost productivity.

I specifically want to emphasise the lack of business dynamism in the UK, which we need to understand in order to understand the investment problem. What do I mean by that? In the last 15 years or so, the bottom half of all businesses created zero productivity growth. All of the productivity growth was basically created by the top half, which we really need to champion and encourage. When we asked businesses that made significant investments in the UK, only 10% said that those were risky investments. Again, we need risky investment from businesses to drive innovation, productivity, exports and all those beneficial things in the economy. When the Government are thinking about the tax, planning or spending environments, they need to think about how to encourage risk-taking and private sector investment.

I will make a final point, although we will come back to this later. It links to Jonathan's point about public sector productivity. If we can spend some of the limited money on investments that unlock private sector investment—whether that is because we are unlocking transport bottlenecks, increasing the energy connection capacity for data centres or whatever—we can get a multiplier effect going. That is the positive and hopeful side of the story.

Q4 **Chair:** Last, but not least, we come to Professor Chadha. We have a not very good outlook here, issues with productivity have been raised and there is a lack of stability in the policy environment. What would you add? Or would you say that everything is fantastic? Where do you land on how the UK is doing?

Professor Chadha: I thank the Committee for allowing me to give my evidence online. It is not my preferred way of doing it, but I am constrained for a number of reasons. Thank you for your patience.

I would love to tell you that everything is hunky-dory. It is not. It is far from hunky-dory. If we were marking the UK economy in an exam, I am afraid we would fail it. It has failed on nearly every measure since the financial crisis, for the reasons that my esteemed colleagues have already outlined, and I do not want us to repeat ourselves.

That has stirred a huge level of disappointment in the country, both relative to expectations and in terms of actual performance, which brings us almost immediately to question the Government's target to have the highest growth in the G7. You can grow a bit faster, but unless you do it for a very long time, your level of income will not make up for the shortfall we have suffered for the best part of a generation. We need to look at the actual levels, not the growth rates. Of course, growth rates are highly choppy, highly volatile and difficult to measure across countries, and they are subject to extreme revisions.

A better target, but one that you cannot hit in the short run in any circumstances, is to think about things like income per head and how that has performed relative to our trading partners and our expectations. The point is that if you drew a line in about 2008—or, dare I say, did an econometric analysis—or projected where we thought income would be today, all those lines would suggest that income per head would be some 15% to 20% above where it is. I am not saying that is the unicausal explanation, but it is the thing that helps us to understand why people around the country are so upset. There is a sense of having lost a generation, and nobody really understands how we are going to catch any of that back.

We need to be clear that building up again will require investment of the type that Jonathan, Adair and Tera have talked about, but that it is going to take time. Tera recently authored a paper saying that it will take the best part of a century to build up capital. I think it is more like 40 to 50 years. I would be terribly happy if the current Chancellor stayed in post for 40 to 50 years if it helped to build up capital to the levels that we want.

One of the problems—everyone has alluded to this to some extent—is that we have such high policy turnover and uncertainty in this country. I did a quick mental calculation just now. We have had something like nine Chancellors of the Exchequer since the financial crisis, with an average tenure of less than two years. It is no wonder that no one takes responsibility. If I were Alan Sugar, I would be asking who is responsible for the failure of this task. It has been an enormous economic policy failure on behalf of the UK. We need to pick up the pieces and stop dancing around it merrily and saying, "Well, we'll sort it out with a bit more money here or a bit of a tax on wealth." This is a huge issue that needs to be addressed.

I could go on, at the risk of boring everyone, but I am sure we will deal with some of these things in detail as the session continues, so I will stop there. What I want to get across is the large and extended nature of the problem we face. It is a generational, existential issue that all parties and all people ought to get behind.

Chair: It sounds as though time is of the essence, and we have lost too much time already.

Professor Chadha: Very much so.

Chair: Hopefully, as we go through the rest of the questions, we will get some ideas about how to turn the oil tanker around.

Q5 **Mr Reynolds:** We know that investment is critical to productivity and long-term growth, yet investment in the UK is among the lowest in the G7. Is the level of investment in the UK enough to facilitate the economic growth that the Government are aiming for? If not, what do they need to do?

Professor Allas: It is nowhere near enough. We invest about 19% of our GDP, and other countries invest more like 22%. That is a 3 percentage point difference. We are at the bottom of the league table. We will come on to talk about the capital gap, but because it has been going on for decades, there is an important thing to understand about capital: it accumulates and depreciates. If you do not invest more than what your capital is depreciating by each year, you are not actually growing the capital base that then helps your people to be more productive.

In our paper, which has been mentioned, we tried to put this into the quantum of, "How much capital are we lacking in the economy today?" We came up with the number of £2 trillion. When the Government say that they will invest £10 billion here or £100 billion there, the quantum is still not enough to get us to the level of higher productivity countries. As Jagjit says, we need to raise investment by several percentage points of GDP over several decades in order to make a dent in this problem. We will come on to talk about what sort of things we could do to move that needle.

Q6 **Mr Reynolds:** What should the Government be doing to encourage that? It will need to be significantly above the G7 average for us to start closing that gap.

Professor Allas: Exactly. To start closing the gap, we need to be above the average. Many things have already been alluded to but, most importantly, you need to take away barriers from investment. What does that mean? Planning, permitting and all kinds of regulations that add risk to private sector investment. That diminishes the capacity and the willingness of private sector investors. That needs to be a radical reform, not an incremental thing.

Public sector investment can be much better targeted to crowd in private sector capital. I have looked at the roughly £100 billion that the Government said in the spending review they will spend on capex each year. Only a third of it has anything to do with growth, such as removing transport bottlenecks. We either need to borrow more and spend more, or we need to redirect that capital to be much more growth-oriented.

We need to do something about the business dynamism issue. I do not know exactly what the answer is yet, but there is a sense in which we allow businesses that are not very good to survive and continue—we even subsidise them through the tax system and NICs.

To take an example, one full percentage point of productivity growth per year in the US comes from letting businesses fail and letting the businesses that are succeeding take over their market share. We have not even had 1 percentage point of productivity growth, full stop, in the last 20 years. We need to figure out how businesses can feel more able to take big risks—more able to fail, if that needs to be the case—and allow more creative destruction to take place.

Q7 **Mr Reynolds:** Lord Turner, what do you think the Government should do to try to get that investment?

Lord Turner: I do not have any magic answers, but let me suggest two things that I think are important to this whole debate about productivity and investment—one may surprise you. I think our taxation of property is a complete and utter disaster. We have an incredibly low level of property tax on staying put—that is, council tax—and an unbelievably high level of taxation on moving around, which is stamp duty. In a rational world, we would very significantly increase the higher rates of council tax, possibly by as much as four or five times, and slash stamp duty to a minute fraction of its current level.

I know this personally, as I am sitting on a large house in Kensington after my daughters have left. I ought to sell it and release it, but I do not because I would lose an enormous amount to stamp duty when I trade down. The council tax that I pay is, for me, so small that I do not even pay attention to it. In general, the taxation system is designed to produce labour immobility. It means that people do not move around. One of the things you need for businesses to grow is for people to move to different locations. That is one idea.

The other thing is that we have to break down the investment side into both private investment and public investment. With private investment, it is clearly the case that the levers are indirect; they are about certainty, appropriate taxation, planning and regulation.

The Government have a greater handle on public investment. It is really interesting to look at things like NHS productivity, and it does not surprise me that it is very low, because we do very little capital investment in the NHS. We are now not far off the average health spend across European countries, as a percentage of GDP. But for the NHS, we are spending almost all of it on current expenditure and very little on capital expenditure. Current expenditure soared during covid and has not come back down again.

We also have a major challenge on the investment needed for a zero-carbon economy. Most of that will come from the private sector, but I think we are not being imaginative enough about the use of what one might call the quasi-Government balance sheet. We have the national wealth fund, Great British Energy and the British Business Bank, but in total these do not deploy anything like the resources that institutions like KfW deploy in Germany.

That is partly because we take a much more purist approach to counting as public borrowing the borrowing of those institutions owned on Government balance sheets. We could take a much stronger development bank-style approach to those institutions—to give them equity investment from the Government while allowing them to go out into the market and borrow money. That would enable us to increase some important categories of public investment, and some things where the public sector could play a greater role, particularly in the investment needed to create a zero-carbon economy.

Q8 **John Cooper:** We talked about churn and Chancellors. There might be quite a lot of churn in politicians if we suggested increasing council tax by four or five times; I think that would be quite a tough sell.

Professor Chadha, you seemed to indicate that perhaps the Government were looking at this issue through the wrong end of the telescope when they set their target to have the highest sustained growth in the G7. You seemed to suggest that is the wrong thing to be aiming for, because it is simply the wrong target. I wonder if you could just expand on that. If that is not the target, what should it be?

Professor Chadha: Unlike inflation, which we have pretty good models and understanding of, so it can be controlled pretty well by manipulating short-term interest rates, growth is a little bit more difficult to explain. You may have noticed that the Nobel prize in economics was given yesterday to three people who have worked extensively on growth throughout their careers, and it is not something that we completely understand. A lot of it is treated as exogenous—outside the system. A lot of it is hugely complicated, a result of institutions learning skills, and things that you cannot change very quickly or understand. Having a target for something that you cannot actually control is a problem.

The more I think about this, and it has been developing over the year for me, it would be better for the Government to focus on—I hope that this does not sound too heretical—a commitment to reduce concerns about the fiscal position and to reduce fiscal fragilities in the economy. We seem to be reaching our limit in terms of the debt that we can take on, or financial markets are worried. That has led to excessive volatility in borrowing rates, which is then reflected in the private sector's ability to borrow, and in the public sector's ability to invest. We are now spending over £100 billion a year on interest payments alone on the debt.

This is a kind of indirect mechanism to create more fiscal space and a more stable economy, which would allow investment to occur. And, of course, the fiscal position is, by and large, within the control of the Chancellor. As Adair said in his opening remarks, a commitment in the first Budget to think hard about tax revenues would have been very helpful to alleviate the concerns that we have about fiscal position, which have very much dominated economic debate this year. That leads to all kinds of uncertainties, as people think, "What taxes are they going to change next? What are they going to do now?", rather than that just having been sorted out.

A counterpart of that is that one reason we are scrambling around for reasons to raise revenues or taxes is that the state has become too large, which helps us to understand why productivity is relatively low. We have increased the number of people working in the public sector to over 6 million. If you increase the number of people, it is not a surprise that productivity is low.

We then also need to think hard about where we can trim the size of the public sector. Total managed expenditure by the state is 45% of GDP; the post-world war two average was around 40% of GDP. If we can think hard about how to have fiscal consolidation through a reduction in expenditure, we would also alleviate some of the fears about the fiscal position and reduce the need for an increase in taxes, which I think is part of the problem in terms of holding back investment, because entrepreneurs and other people are thinking, "Am I going to do this? And am I going to be taxed heavily on it?"

One extra point that I would make very briefly, following on from the points that have already been made, is that neither the national wealth fund nor the three development banks that have been set up are large enough to provide the level of risky capital investment that the country needs. As an example, in the last seven or eight years of our membership, the European Investment Bank would typically lend us £6 billion to £7 billion a year. In the last year that I have numbers for, our collection of development banks, or whatever we want to call them—the replacement banks that we have—lent only £2.4 billion. So the institutions that we have put in place have not replaced what we have lost from the European Investment Bank.

Alongside that, there are huge differences in regional capital allocations, or accumulation. Certain areas are doing very well, and you will know where they are. But if we look at the peripheral regions—if I could describe them as that, and I certainly do not want to upset any Members here by using that phrase—Northern Ireland, Wales, Cornwall, Scotland, the east midlands and north-east England have low levels of capital relative to GDP or GVA, which means that we are not spatially allocating capital very well across the country either.

So I think there are two aspects: a low level of capital, but also a poor level of regional allocation, which we might want to turn to a proper development bank to carry out for us. But what we have at the moment is not large enough to replace what we have lost.

Q9 **John Cooper:** You touched on the capital gap. Professor Allas, you mentioned the capital gap as well, which is broadly the gap between the supply of capital relative to demand, as I understand it. Is that broadly right? You might be able to put me right on that.

Professor Allas: What we mean by the capital gap is not the difference between the supply and the demand. We should come back to whether this is a supply of capital problem or a demand of capital problem. My view is that an awful lot of the problem is that we do not have enough entrepreneurs and people willing to make risky investments. If we had those, the capital would flow. We do not have those risky investments, because of all the reasons we have described: policy uncertainty, planning regulations, labour market regulations and changes to regimes too often.

The capital gap that we refer to in our paper is a little different. It looks at high productivity countries, which we picked to be our peer countries—the US, Germany, France and the Netherlands—and the UK. We literally just looked at how much capital each worker in each country has available to help them be more efficient? If you are an accountant and you have a laptop, you are going to be more efficient than if you do not. If you are a farmer and you have a combine harvester, you are going to be more efficient than if you do not. If you are a risk assessor at a bank and you have an AI system that allows you to figure out transactions, that will be more efficient than if you do not.

If we add up all the capital available to workers in the UK versus in these other higher productivity countries, we find that for each hour worked, UK workers have a third less capital—so 33% less. In some ways, it is no wonder that they are not as efficient and as productive as workers in their peer countries.

Then we track back to why that is, and it is for precisely the reasons we have already discussed. Capital accumulates over a very long period of time, and if you have a deficit over 20 or 30 years, then by definition, at the end of the road, you are going to end up with this enormous gap. I should say that I do not actually think it is realistically ever going to be filled—£2 trillion is a big number—and Jagjit and I both think it is going to be decades. In order to fill it, even in decades, we would have to have an enormous increase in our investment rate. That is possibly not something we can do very quickly or even at all.

So we then need to focus on how we use the capital that we do have as effectively and as efficiently as possible. I want to mention something that Jagjit alluded to. It is not enough for the public sector to say, "We are going to spend more capital." It has to be spent in the right place at the right time with associated intangible capital. There is no point just spending it on a machine somewhere if you do not have the nurses who can operate the machine, or spending it on a railway or a piece of network somewhere if you do not have the trains or the drivers. The point is that, at a really minute level, there is not a very good system of scrutiny in the UK Government to look at where all the money goes and whether it delivers any returns. If we learn from that, let us not give money back to the people who did not deliver returns; let us reallocate quickly to the areas that are really going to deliver growth.

Q10 **John Cooper:** Professor Haskel, it seems we have an enormous problem: £2 trillion is an incredible, mind-blowing number, and we are talking about decades to try to address this. Have you any thoughts on that? We are not going to solve this overnight—that is obvious—but where might we begin to head in the right direction?

Professor Haskel: I will say two things, if I may. A number of speakers have talked about the role of the public sector. As I mentioned in my opening remarks, this used not to be a problem, but it is now a very big problem.

To your question, Mr Cooper, this productivity problem is a moving target. Here are two numbers that I find it helpful to keep in my mind: since 2018, or since the pandemic, in the UK we have had, on average, productivity growth, as you know, of 0.3 percentage points. That is a laughably low number, as everybody on the panel has just said. That is the first number.

The second number to keep in mind is that the drag from negative productivity in the health service has pulled that down by minus 0.2 percentage points. In other words, if we just had flat productivity in the health service—not growing productivity, but flat productivity—we could raise our productivity by 66%, from 0.3 percentage points, because we would remove the drag of the minus 0.2 percentage points. This is a major, major issue that we need to get a grip on. That is the first point.

The second point, in answer to your question about what we can do about all of this, is that, in the spirit of this being a moving target, the moving target on productivity has now become the public sector. The other part of the moving target, in the private sector, is that the drivers behind productivity have changed from the more tangible assets—ships, aircraft, cars, planes, machines and this, that and the other—to the much more intangible things. What drives private sector productivity? Nowadays it is more software, better design, better Harry Potter scripts, improved AI and improved marketing so that we buy stuff and all that kind of thing.

To answer your question, what we need in order to go forward is an improved set of institutions, which will help us on the intangible side. That is around financing, which Adair has talked about, and your Chair talked about in his article as well. It is also about regulation in the labour market and the product market. I should say more, but I will stop there.

Q11 **John Cooper:** Lord Turner, briefly, do you have any thoughts? Where do we begin? Are you in agreement with that—better Harry Potter scripts?

Lord Turner: I think the Harry Potter scripts are pretty good already, so unless we are going to clone J. K. Rowling, I do not know how we are going to do that. By the way, on council tax, I hope the record will show that I said three or four times on the upper bands of council tax, not across the board. Let me be clear that that is what I meant.

The question you asked first was, is it good to have a target that says, "We are going to have the best growth rate in the G7 this year"? The answer is no. That is not a helpful way of expressing what we need to do. First, it suggests that there are levers available to the Chancellor or anybody else that will work over that period of time. The whole point that Tera and Jagjit have been making is that these things take a long time to fix.

Secondly, it is a target that, if you meet it, you will primarily meet it because other people did badly, not because you did well—you can pat yourself on the back, but so what? If you meet it because you went at 2.1% and France went at 2%, that is completely "So what?", because the imperfections of the measurement of GDP are so great that I consider 2.1% and 2% exactly the same.

We have to get away from any short-termism and say, "We have a fundamental problem of productivity. We have a fundamental problem of a lack of investment. It will take many years or decades to do this. We are going to slowly build towards the things that make a difference. Within the course of a Parliament, that should be able to take the growth rate up to an order of magnitude of 1.5% or 2%, rather than the lower levels we are having. And we are going to do the institutional things that make it likely that we can sustain that for the decade or the decade thereafter, without being all that worried about whether that is a little bit faster or a little bit slower than Italy or Germany." That seems a technical point, but it is an important point about tone and about being honest with people about what can be achieved.

In terms of the specific things we can do, I was struck by Jagjit's numbers, which illustrated the point that I was making without numbers, which is that, with development bank institutions like the EIB and our national wealth fund, we are playing around at the margins in terms of the quantity of money we are giving them, if we want them to play a serious role in addressing the capital stopgap that we have described. One big thing is that we should get much more serious about the use of these Government-owned institutions with a development mandate.

Q12 **Chair:** We are not sure about the G7 comparator table as our measure of how well we are doing, so what about measuring our economic growth with GDP per capita or real household disposable income? That is one of the approaches that the Government have taken. Professor Allas, what do you think about that? Is that better? My constituents, for example, will think about what their household has, which is perhaps a little bit easier to understand. What do you make of those two measures?

Professor Allas: I think they are more meaningful. I believe that the Government's target is that they are higher than at the beginning of the Parliament, which is honestly an incredibly low bar. Jagjit used some important words earlier; he said, "relative to expectations". I do not think people in Britain go about measuring themselves against the Germans, the Italians or even the Americans; they measure themselves against the people they see around them or maybe on social media. What matters to them is the actual quality of life that they are able to have. In that sense, something like our disposable income per head is a decent number. However, that still has problems around its measurement. What is in scope or what is out of scope is always where you draw the line.

I also spend a bit of my time looking at things like wellbeing and what makes people happy and satisfied with their lives, and there are huge distributional issues here. We know from some latest analysis from wellbeing economics that if your income—net equivalised household income—is more than, say, £40,000 a year, beyond that, you do not really need any more money, or you do not become more satisfied or happy with more money. If all that extra GDP and disposable income goes to that part of the population, it is not helping the people who really would benefit from having a bit more disposable income.

A smarter target would be to think about people's actual quality of living and measure it through multiple different lenses, not just the lens of money. In terms of the lens of money, as soon as you aggregate it into a totality for the British population, it is a bit of a nonsense, because there will be people doing really well and people doing really badly.

Q13 **Charlie Maynard:** Going back to public sector involvement in the economy, the Government aim to increase public sector investment by more than £100 billion between 2024-25 and 2029-30. I have a grid in front of me that is about the policy impacts on real GDP as a result of that. By 2029-30, it actually has minus 0.1%, which is pretty horrific as an outcome. To your point about a third being useful and two thirds being not that useful—I think Jonathan mentioned a kind of framework—do you have any directions as to who has the best framework, and who has done the best thinking about this, in terms of how public sector investment could be better directed? Maybe Tera would like to start.

Professor Allas: If I may clarify, when I said one third and two thirds, "useful" is maybe not the word I should have used. If I used that, I apologise. Let us call it growth-enhancing. The Government rightly have all kinds of other objectives. Defence is a big receiver of a lot of this capex. I am not saying it is un-useful; it is just not necessarily going to boost growth very much, even though lots of people want to believe it does. I do not believe it does a huge amount, but I believe we need defence. Do you see what I mean? Some of that capex also goes to the public sector, like the NHS or whatever, which should help people's quality of life, in the sense of healthy life expectancy and health. Again, it is useful, but it is not necessarily growth-enhancing. That is what I meant by that point.

I think the numbers in your grid are from the OBR. I sit on the OBR's advisory panel, and it is fair to say that there is not agreement on several different ways in which you might attack this question of, "How much does a certain amount of capex actually add to GDP?" There are two big reasons why. First, you need to make a choice about whether you believe the capex crowds in or crowds out private sector capital. I believe that some of the reason why the numbers from the OBR might look negative at the moment is that it believes that quite a lot of the Government capital crowds out private sector capital. I am actually more on the crowding in side; I think that if you target it well, you are easily going to crowd in R&D investment or machinery, equipment, skills or whatever.

The second reason is that capital is not a uniform thing, as I mentioned earlier. It depends what you spend the capital on. The OBR, necessarily, is looking at the macro effects. I used to work as the chief economist at the Department for Transport. We had projects that were enormously growth-enhancing, and we had projects that were, frankly, not very growth-enhancing. That was just within one Department, and you would expect transport in general to be slightly more growth-enhancing than some kinds of, let's say, defensive-type investment. It is really difficult to know exactly, and therefore it is a bit of a misleading thing even to try to say, "Is it 0.1% of GDP or minus 0.1% of GDP?"

Q14 **Charlie Maynard:** I totally accept that but, maybe focusing on the process, is there anything we can do more cleverly about the process as a country? Jonathan, would you like to have a shot at that?

Professor Haskel: I would say two things. One is that I would echo very strongly what you just heard from Tera. The point about Government R&D investment, precisely as Tera said, is that it crowds in private sector R&D investment. Other types of Government investment are often not as successful at crowding that in, and may often even displace it. That is a very important subdivision of public investment, which we must be alert to.

The second thing behind your question, if I have understood it correctly, is how do we set our fiscal rules, and what is the right way to put in public sector investment when we are thinking about fiscal headroom and that kind of thing?

Q15 **Charlie Maynard:** I am heading there next, but I was thinking more about the third that is not growth enhancing. Who has the best ideas on how to use public money in a more growth-enhancing way?

Professor Haskel: I defer to the public sector management experts who can tell you all of that. The figures for the health service are not hopeful on the productivity side. It could be that other things are going on, and that other things are being measured. However, on that basis, it does not look good.

Q16 **Charlie Maynard:** Running with that point about health productivity, who has the best thoughts on how to change that?

Professor Haskel: Again, I would happily defer to health management experts. I can find colleagues at Imperial who would be delighted to come and talk to you about that, if that would be helpful.

Professor Allas: If I could mention one thing about institutions, we do not have an institution that actually scrutinises public money in that sense—on a line-by-line basis. The OBR does its job as a macro regulator or watchdog, but it is not its job to go line by line and look at whether it is growth enhancing or not.

I used to work as a Government economist, and in theory there is such a thing as the Green Book, and in theory every investment has to go through an appraisal. In theory, that should feed into decisions about whether such an investment is taken up or not. Slight problems include the fact that, by definition, the Green Book is not about GDP, which it should not be. It is about social welfare or, in other words, this broader sense that people have a good life. I think it should be like that, but it is not going to align 100% with GDP. The real, bigger problem is that it does not really have any teeth. As far as I know, nobody in Government polices whether this is happening. Rightly or wrongly, a lot of decisions are political—I think rightly—but there is not an institution anywhere that is scrutinising that.

Q17 **Chair:** I am conscious of time, and I want to make sure that we get through the various questions that I know my colleagues have. Do you want to come in briefly, Professor Chadha?

Professor Chadha: I will be brief. First, I want to back Jonathan's point on R&D. A whole gamut of research papers over the years from various microeconomists and macroeconomists have demonstrated that R&D in clusters absolutely does help potential growth in an important way, and we ought to think about how to implement those.

On Tera's excellent point about the low estimates of the impact of capital on growth, that is because the models that are generally used assume very little by way of an output gap. They have a fixed level of output in their mind, so when you introduce capital investment, you are just increasing demand in the economy. In the model, interest rates rise and that stops there being an impact on growth, so there needs to be some more flexibility in the way that gets modelled, which is why we get the very low numbers.

I am not criticising the OBR, per se, but I think there needs to be more flexibility on the supply side. That comes back to the point that we have been hearing all kinds of drip-feed arguments about: something called dynamic scoring, which is the extent to which we think bits of public investment will help potential output in the longer run. What we need is not the drip, drip of rumour and innuendo but a serious study of it so that we can have some proper numbers and understand what public investment might do to the supply side.

One final point, which I will try to summarise very quickly, is that we also need commitments to complete public investment. We are sometimes good at announcing that we will do public investment and then not doing it, or starting bits of public investment—I could mention all kinds of railway projects that do not quite get off the ground—and then not actually completing them. Of course, that creates its own level of uncertainty. If I were an entrepreneur and I wanted to set up a business, I would want to know with certainty that the railway line and transport links that I require for my business to succeed will actually be laid down. Generally, I would not believe the Treasury when it says that it is going to invest in some part of the country, because I am not sure it always happens. I think there are some issues there that need to be ironed out.

Q18 **Charlie Maynard:** Jagjit, there will obviously be lots of gossip and innuendo going on over the next few weeks about our fiscal framework. What problems do you see with that framework in which we are having to play, and what changes to that framework would you recommend?

Professor Chadha: I ought to keep my answer as brief as possible, as it could occupy us for the rest of the day. We need to accept that the framework has failed. Debt to GDP has practically doubled since the framework was adopted in 2010, and we need to understand why. We got some shocks that help us understand it—Brexit, covid and the energy price shocks in the early part of this decade—but we have not managed to get things under control. We have a fiscal framework that projects where debt to GDP will be at the end of the Parliament as a forecast, and we know that forecasts will tend to be wrong. It is not really a very good way of controlling Government behaviour, because the next year we will get another forecast that also says that we will meet the target.

I want to make a point about the nature of the target. Generally, the rules have said that debt to GDP has to fall in the final year of the Parliament. You could have four years where it is increasing, and in the final year if it comes down by epsilon—where epsilon is a very small number—somehow we have met the fiscal rule, but debt to GDP is higher at the end of the Parliament than it was at the beginning. To use a phrase that I used the other day, and I apologise if it upsets anyone, this is cockamamie. It does not bring about a reduction in debt to GDP.

It is incredibly important that we have a fiscal consolidation, for two direct reasons. If we do not have fiscal consolidation, first, many entrepreneurs and other people will start to worry about what taxes will be introduced and hold back activity in expectation of some radical changes in the tax regime, and secondly, there is a real danger—and this is what the bond markets are picking up—that central banks will feel constrained, which is a problem that we see in many western countries. We will have a world of fiscal dominance, where central banks cannot raise interest rates to the level that they want because it might threaten fiscal stability in an economy. I am not saying it is going to happen, and I am not saying that it has happened. But bond markets are forecasting and thinking about things that might happen in the future. If debt levels are high, and we have Governments that reverse promises to cut expenditure and increase taxes, which we have seen throughout the western world, it is not surprising that bond markets start to say, "What is going on here?" Debt is going to continue to rise, and at some point monetary authorities may lose control of the price level, which is only going to lead to further problems down the line.

We absolutely need a fiscal framework that acts on what we actually see, rather than what we are forecasting. What we want to see over any five-year period is a specific fiscal consolidation plan to bring down debt to GDP. If we can bring down debt to GDP, partly by reducing Government expenditure, partly by increasing some taxes, which we can talk about, we will be creating some fiscal space that allows us to have some of the public investment we desperately need. The problem is that we are up against our borrowing constraints. It is very hard for us to have the public investments that we want.

Chair: That is excellent.

Q19 **Sonia Kumar:** The Committee has already highlighted some of the evidence that the UK's financial mobilisation lags behind our international peers in terms of public sector investment and crowding in private capital. What lessons do you think we could learn from places such as Singapore?

Professor Allas: It is going to be very similar to what we have already discussed. I do not want to say policy certainty, because that is never a realistic thing to say, but there needs to be a road map towards how we are going to close the gap and invest more and spend less, as it were, on a day-to-day basis. Generally, if you invest more, then your opex costs can go down. It is also about the quantum of the development banks that we have just discussed. The ones that we have in the UK may be incredibly effective, but they are incredibly small, relative to the quantum of the gap that we have here. If one were being negative, one could say that they are even a distraction, because people latch on to the idea of them fixing this problem when they cannot possibly fix the problem, having such small capitalisation.

Basically, it is about having a long-term plan and sticking to it. I want to mention one good thing: I think the Government's industrial strategy is pretty good. It is solidly built up from a coalition between private sector and public sector, and it has a 10-year timeframe and a very wide remit: it looks not just at things that DBT can do, but at what we can all do. It has commitments. I think it now needs to be implemented. It has 150 different measures across 20-plus different Departments. That is going to be a nightmare to implement unless there is some real political capital behind it. If there is not, it will be another example of what Jagjit has said: Government promising to do something and then not properly implementing it.

I want to end on this point about implementation and execution. Stability comes from seeing and believing—seeing is believing, right? Part of that goes for some of the other countries that we compare ourselves with—Germany and France, for example.

Lord Turner: I am always wary of trying to learn too many lessons from Singapore, which is a very different society. I am a huge admirer of it, I go there a lot and I know a lot of people in the policy framework. It is a country with an enormous structural savings surplus, and therefore current account surplus, which creates a certain set of opportunities and challenges. Its institutions, like Temasek and GIC, are excellent organisations. They have been given public money to invest—they are public institutions—but they do so through a ferociously analytical and thoughtful approach. It is true, of course, that a lot of GIC and Temasek investments are outside Singapore; that is the classic approach when you have a large current account surplus but you are trying to anticipate the money you will want when an ageing society switches around the other way. They are certainly very effectively run institutions.

You asked a question earlier about GDP per capita against GDP. It should definitely be GDP per capita. Tera has made some points about whether even GDP per capita is not sufficient. The focus on GDP has been a bit of a harmful delusion. You can boost GDP by having huge immigration and a rising population. Since 2000, the UK population has gone up by 18%, France's has gone up by 12% and Germany's has gone up by 2%. There is no suggestion whatsoever that that has helped us to increase our GDP per capita. Indeed, it is quite interesting to note that since 2005, UK GDP per capita growth has been slower than that of Japan, which many people think is a stagnant, slow-growth economy. It is growing its GDP per capita faster than we are.

Q20 **Chair:** Professor Haskel, we have heard about the difference between the amount of investment in tangible and intangible assets, and the issue of where the UK's investment level stands. Could you give us your thoughts on that conundrum? Where have we gone wrong, and where do we need to be headed?

Professor Haskel: As I said, in this moving target about understanding how we are going to get more growth and investment, intangible investment has become the most important metric. The good news is that the UK performs rather well in comparison with our European competitors. I do not know about Singapore—we do not have the Singapore data yet—but we perform rather well relative to our European competitors.

We do so, however, as an uneasy compromise between a number of factors. The thing that helps us is our support for universities, which, as we mentioned earlier, crowd in private sector intangibles. The thing that holds us back is the fact that we cannot form meaningful clusters in this country because we have bonkers planning legislation—almost as bonkers as the local taxes legislation that Adair Turner was talking about. The other thing that helps us is that we have relatively open product markets. Of course, that was hurt by Brexit, but Brexit is Brexit.

That takes us to the labour market situation. We are helped by having a relatively liberal labour market, which you need in order to get intangible investment. Many intangible investment projects will fail, unfortunately—as your bank will know, Adair—so you need a labour market to encourage them where that is not too costly. In terms of concrete policy proposals, where that takes us is that I think the Employment Rights Bill will subtract from growth. It is bad for intangible investment. Given the weak situation that firms are in, I just do not think we should be going ahead with it.

Chair: Thank you. Since we have time, I am going to bring in Joshua Reynolds to ask a final question.

Q21 **Mr Reynolds:** Thank you, Chair. In that case, it is going to be the speed-fire round, everybody, if that's all right. It is an incredibly simple question: ahead of the Budget in November, what one or two things should the Chancellor be doing to drive business investment, given the current financial constraints?

Professor Allas: Do not change anything about business taxation. Not up, not down—just stick to what you have already done and say, "We are going to have stability in this Parliament."

Lord Turner: Increase VAT, income tax or employees' national insurance and make it clear that because one has done that, there will be no need to seek further taxation from business at any time for the rest of the Parliament.

Professor Haskel: I agree with what Adair has just said. And postpone implementation of the Employment Rights Bill until firms are in a stronger position to withstand the costs.

Professor Chadha: There is some scope for broadening some of our incidence of VAT, which could raise some money. Also, if we look at income tax on those in the 50th to 90th percentiles, they are looking increasingly undertaxed compared with those above the 90th percentile. We might want to look at that. For example, last year, people in that group—the 50th to 90th percentiles—were responsible for something like 41% of income but paid only 31% of income tax. At the turn of the century, they were responsible for about 38% of income and paid 30% of income tax. So we could certainly think about raising income tax a little bit—not a huge amount; just a little—for those people who are above median income. That would certainly help to alleviate the fiscal position, and if we backed that up with statements about no more kite flying, no more discussion of other types of taxes, whether stealth or not, that would certainly help to build confidence and get people ready to get on with their lives and their businesses.

Chair: Thank you. That is wonderful. We have heard that we have some quite large challenges. We possibly don't agree with some of the targets. We have a lack of confidence that we need to overcome, and a productivity challenge. We want to hear that there is more stability, particularly for businesses and the environment. And we have a rather large—up to £2 trillion—investment gap to fill. Thank you all very much for your thoughts.