Written evidence submitted by Standard Life Aberdeen (PEG0247)

About Standard Life Aberdeen

At Standard Life Aberdeen our purpose is *together we invest for a better future*. We do it to make a difference to the lives of our clients and customers, our employees, society and our shareholders. We are headquartered in Scotland and listed in London, with around 6,000 employees in over 50 locations worldwide. We manage and administer £511.8bn of assets on behalf of our customers and clients.

We meet the evolving needs of investors and savers. We do this by building lasting relationships and developing innovative products and services. We offer:

- Active asset management to institutional, wholesale and strategic insurance clients around the world
- Wealth management, financial planning and advice services, either directly to customers or through financial advisers, in the UK

We also have significant holdings in associate and joint venture businesses: Phoenix in the UK, HDFC Life and HDFC Asset Management in India, and Heng An Standard Life in China.

**As at 30 June 2020*

Executive summary & recommendations

The COVID-19 pandemic is an ongoing global health crisis in which many lives have been tragically lost and an even greater number of people are now facing financial and social hardship as a result of the ensuing economic recession and long road to a full recovery. The long-term consequences of the downturn will only become clear in time but it is already apparent the damage will be extensive, persistent and in many cases permanent.

A programme of economic reconstruction is both urgently needed and an opportunity to address long-standing issues such as sluggish productivity growth and large inequalities across individuals and regions. There is also an emerging consensus that now is the moment to put sustainability at the heart of economic policy and put the UK on a pathway to 'net zero' by 2050.

This transformative potential can only be realised through better regulation of and more investment in key aspects of the UK economy such as corporates, education, skills & training, R&D, technology and infrastructure while ensuring sufficient resources are directed at social infrastructure such as health, welfare and social care.

There is also an opportunity to make better use of the UK's strong, diverse and innovative financial services industry which can access the pools of capital needed to underpin economic recovery and sustainable growth.

As a leading global investment company we recognise our role and that of the asset management industry as a conduit for the flow of capital between investors – such as pension funds, insurers, sovereign wealth funds and individual savers – and areas of the economy where it can be best deployed to support sustained growth aligned to Economic, Social and Environmental objectives.

However, the private sector cannot act in isolation. The Government will need to put in place an ambitious and integrated policy framework to combine the respective resources and strengths of the public and private sectors. If this can be achieved the UK has the opportunity to reshape its economy into one which is cleaner, fairer, more competitive and resilient.

The forthcoming autumn Budget will be pivotal in shaping the UK's economic direction in the long-term. We therefore welcome the opportunity to contribute to this inquiry and make the following recommendations:

- Continue to protect jobs and support business sectors that will take time to recover and for which it is still unclear whether COVID-19 related disruptions will be permanent.
- Adopt a more flexible approach to debt servicing and re-write the monetary and fiscal rulebook to give policymakers the tools to better counter further economic stress.
- Work towards an UK/EU trade deal to reduce the risk of a further economic shock.
- Invest in the economic and social infrastructure needed for a 'green recovery' and long-term decarbonisation of the economy.
- Develop long-term investment vehicles, fund structures and tax incentives for raising and channelling capital into public companies, SMEs and infrastructure.
- Extend devolved powers and empower local bodies to take decisions which reflect regional economic characteristics.
- Invest in education, skills and training to support the transition to a digitalised economy.
- Monitor the market impact of immigration policies to ensure the UK continues to have access to global talent and labour supply across all sectors of the economy.
- Rebuild the social safety net to improve the economy's ability to withstand economic shocks and help address the inequalities that undermine equality of opportunity and broader social cohesion.

1. **What core/guiding principles should the Government adopt/prioritise in its recovery package, and why?**

<u>Economic context</u>

The UK, like many other economies, faces a long road to full recovery. Data published by the Office for National Statistics (ONS) shows the UK economy contracted by a record 20.4% in the three months to June, the biggest quarter-on-quarter fall recorded by any of the G7 leading economic powers and also the largest decline in Western Europe. This follows a 2.2% fall in the first three months of the year, which means that the UK is now officially in recession. The ONS said the drop had wiped out 17 years of economic growth.

The pace of recovery can be expected to accelerate through the remainder of the year following the gradual easing of lockdown restrictions. However, Government policy will need to tread a fine line between economic considerations and triggering a second wave of COVID-19 infections through the autumn and winter.

Added to this, the outcome of UK/EU trade negotiations carries a risk of further economic disruption later in the year. Our base case scenario is that the UK and the EU will reach a narrow Free Trade Agreement (FTA) but this is far from certain. A narrow FTA would still result in a high degree of disruption but nowhere near the magnitude of economic shock which would be inflicted by a no-deal exit.

Irrespective of the pace of recovery it is clear there will be significant fallout in the labour market as demonstrated by recent corporate announcements of job losses across a range of sectors. This is likely to continue as government support schemes are wound down during the autumn.

The immediate priority must be to minimise disruption to the labour market. We recognise the Government cannot support businesses indefinitely and to do so would potentially protect jobs which no longer exist. However, we still see a need for strong, targeted interventions until the economy has gained greater momentum and there is more clarity around which businesses can be saved and those which do not have a viable future.

The welfare safety net also needs to be enhanced for those people who through no fault of their own will find themselves displaced by corporate restructuring or insolvencies. Unfortunately the groups most impacted will be those least equipped to deal with further hardship, particularly young people and those on lower incomes.

Beyond addressing the immediate economic fallout caused by the pandemic, the longer term objective should be to put in place the foundations of sustainable growth. This means addressing pre-pandemic economic weaknesses such as sluggish growth, flat-lining productivity, stagnation of real wages, slow progress towards climate change targets and large disparities in income – and more importantly opportunity – across society and regions.

Putting the UK economy on a 'green growth' trajectory which addresses such a broad range of objectives is a formidable task but achievable with strong political leadership and a clear strategy for delivery. We therefore believe the policies required to reshape the economy should be tested against four basic questions:

- **Will it address regional inequalities?** The disparities between the country's least and most productive regions is high by OECD standards, which both reflects and reinforces large differences in access to services and opportunities. For example, in 2017, the most productive region in the UK was West Inner London, with productivity 2.1 times higher than Cornwall, the least productive region. In Germany this difference is 1.7, while it is 1.6 for France and 1.4 for Spain. It is therefore to be welcomed that the Government is committed to tackling regional differences through its levelling up agenda. However, it is far from the first government to have attempted to address these issues. To stand any chance of success will require significant investment, political will and ambitious policymaking.

- **Will it contribute to a more sustainable economy?** While the EU continues to give a high priority to the climate agenda many governments have switched their immediate attention to the health crisis. However, these should not be seen as competing priorities. Strong, well-designed mitigation policies, including appropriately pricing carbon emissions and ensuring all government policy, including public investment, is aligned with net zero emissions objectives, can help accelerate the recovery. The period of lockdown is also expected to reduce emissions by around 8% relative to the status quo. But this can only be repeated during the recovery in the way necessary to meet the objectives of the Paris Agreement if policy is pointed at decoupling economic growth from the usage of fossil fuels.

- **Will it contribute to competitiveness and productivity?** There is a wealth of evidence connecting skills, education and human capital to long-term productivity growth. Those with higher levels of human capital are more likely to become innovators themselves. Innovations stand a greater chance of being commercialised and diffused when complementary skills are present. A better educated workforce will also be more able to adapt to the disruptions that accompany technological change.

- **Will it improve the UK's resilience to further external shocks?** The UK's response to the pandemic was predicated on its ability to reorganize the resources of the NHS and impose a sustained lockdown to suppress the spread of infection. However, the crisis also revealed weaknesses in the economy's ability to absorb sudden and severe shocks. Building greater resilience into the UK economic model is a complex challenge but cannot be achieved unless policymakers have the tools to respond quickly and effectively. As we set out below, we believe this requires a major re-think on debt servicing rules and the interaction of fiscal and monetary policy. It will also require a greater investment in the capacity of the health and social care system.

2. How can the Government borrow and/or invest to help the UK deliver on these principles?

While the Chancellor's summer economic update provided some welcome interim measures to forestall the anticipated rise in unemployment – particularly across the 18-25 cohort – much bigger and more important decisions will need to be taken ahead of the autumn Budget.

The low interest rate environment gives the Government considerable scope to invest in the economy. The current level of public debt relative to GDP is high in historic terms but within the limits of what is tolerable in a low interest rate environment. What is required is a more flexible and less dogmatic approach to debt servicing with sufficient fiscal latitude to allow the economy to recover in its own time.

We also believe monetary and fiscal policy needs to be overhauled to ensure the economy is better able to cope with any new shocks. With base rates already at 0.1% the Bank of England has limited room for manoeuvre while past experience has shown that premature fiscal consolidation – such as that put in place following the Global Financial Crisis (GFC) – is counter-productive.

To provide sufficient headroom to invest in growth and future-proof policy we would make the following recommendations:

- **Avoid fiscal consolidation in the short term**: As spending on various emergency schemes is wound down through the second half of this year, the impact of current fiscal policy on the economy will turn sharply negative in 2021 contributing to a drag of about 7% of GDP. We doubt the economy will be in a position to withstand this level of fiscal contraction, with unemployment still significantly elevated and growth below potential. Fiscal policy needs to remain looser and more supportive for much longer than the Government currently envisages and avoids arbitrary calendar-based cliff edges which suddenly tighten policy regardless of the state of the economy or the evolution of the virus. Furthermore, the deficit should be allowed to reduce as the economy normalises, but only at a rate that ensures it is aiding the recovery rather than weighing on it.

- **Review the Bank of England's mandate**: We suggest a review of the Bank of England's remit with an explicit mandate to consider a price or nominal GDP target rather than a 2% inflation target. The virtue of a level target is that the central bank is required to make up for past misses. For example, if inflation has spent several years below target, the Bank will need to engineer a stronger recovery and higher inflation in the future to make up for this miss. This automatic catch-up means the Bank has more credibility in committing to easier policy, and should help to anchor inflation expectations at target over time.

- **Stronger use of fiscal policy**: In future downturns fiscal policy must play a more formal role in supporting demand even if monetary policy remains an important stabilisation tool. Automatic stabilisers which kick in immediately when the economy weakens (thereby avoiding delays while policymakers reflect on possible responses) are a powerful mechanism for confronting downturns. This should include measures to improve welfare provision as it puts money directly in the hands of households facing severe cash constraints, and so have a very high marginal propensity to spend.

- **Pursue an alignment strategy in UK/EU trade:** There is overwhelming evidence that openness to trade and economic integration boosts long term growth. Trade improves productivity growth by allowing for greater specialisation, increased competition, greater innovation, and a larger market allowing firms to exploit economies of scale. Various studies show that a 'no deal' exit will be highly disruptive to the economy. To avoid the loss of productivity which would be caused by breaking up existing supply chains and trading relations the Government should pursue a relationship which prioritises high alignment and minimal trade frictions.

3. What measures and support will businesses need to rebuild consumer confidence and stimulate growth that is sustainable, both economically and environmentally?

Access to capital in its various forms (equity, debt, credit, etc.) will be vital to enable businesses to overcome any short-term challenges they may be facing – such as the need to re-start production and rebuild inventories pending the arrival of new orders – and invest for the longer term. In some cases businesses may need to revise their strategy or transition to a new business model.

The UK has as distinct advantage in having a strong, diverse and innovative financial services industry which can access the capital required to finance sustainable growth. This has already been demonstrated by the significant amounts of equity capital channeled into FTSE-All Share companies since the start of the pandemic.

There will be circumstances in which it is more appropriate - or perhaps even a matter of economic necessity - for the Government to take a lead because the cost of private capital makes it an impractical option (such as the type of investments that would come within the scope of HM Treasury's Project Birch).

Public and private sector investment should not be regarded as mutually exclusive. There may be instances in which co-investment and hybrid capital models are an optimal solution for aligning risk and returns.

Where it is expedient for the Government to intervene with state aid or through direct ownership it should be on the basis of clear strategic objectives, defined timescales, maintaining market competition and protecting the interests of various stakeholders, including those who provide other forms of capital.

The financial support provided to businesses through various loan schemes (CBILS, CLBILS, Future Fund and the BBLS) will need to be recovered but this should be on terms which do not represent an existential risk for businesses with long-term viability.

In its recent report the Recapitalisation Group led by TheCityUK estimated that the UK corporate sector is currently exposed to around £100bn of unsustainable debt, around half of which is held by SMEs. This underlines the need for mechanisms through which privately owned companies can exchange debt for equity.

This type of 're-equitisation' is commonplace among listed public companies which can access capital markets more easily than SMEs. While private companies have other sources of capital (credit, loans, venture capital, private equity, etc.) access to capital markets would create greater choice and potentially increase capital flows into the SME sector particularly at the upper end of the scale.

To channel high levels of equity capital into the SME sector is not without its challenges and is likely to require new vehicles and fund structures – such as the Long Term Asset Fund proposed by the Investment Association – to ensure the expectations of investors are aligned with those of investee companies in areas such as liquidity, transparency, regulation and governance.

Of equal importance is the need to unlock sources of private capital which could be used to finance the recovery. New incentives may be required to convert private savings held in cash and other low risk assets into equity capital. The benefits of connecting private firms with long term investors could be significant in view of the SME sector's pivotal role in the economy.

4. **Whether the Government should give a higher priority to environmental goals in future support?**

We do not doubt the Government's commitment to climate adaptation and transitioning to a net zero economy but we do not see this being achieved by the target date of 2050 on the current glide path. Fulfilling this aim will require a major step-change to improve energy efficiency and reduce carbon emissions with a particular focus on energy, aviation, automotive, public transport, buildings and farming. This investment should not be seen as a non-recoverable cost: there is strong evidence that 'green' investment is a powerful economic multiplier.

As a global investment company we increasingly use Environmental, Social and Governance (ESG) factors in our investment processes across a range of asset classes. For example, we engage regularly with companies in which we invest to understand the action they are taking to mitigate or adapt to climate change risks. The Government can support his process in a number of ways:

- Sending out clear carbon-pricing signals and provide stable and sustainable incentives for low carbon solutions which will reduce climate damage. The longer action is delayed, the higher the cost of transition and adaptation.
- Putting in place mitigation for transition risks such as stranded assets, negative social impacts (e.g. job losses in high carbon industries) and energy affordability.
- A progressive, proportionate and predicable regulatory regime which is aligned to environmental objectives and the interests of asset owners (private investors, pension funds, charities, etc.). For example, we are supportive of the Government's expectation that all listed companies and large asset owners will be making disclosures in line with the recommendations of the Taskforce on Climate-related Framework Disclosures by 2022 and believe this should be mandatory (as a voluntary approach would almost certainly result in limited take up).
- An emphasis on 'smart' climate policy, whereby all public policy initiatives, including new regulations and investments, are evaluated for their consistency with broader climate objectives. For example, climate criteria should be explicitly taken into account in the cost-benefit assessments for infrastructure projects, with a high barrier to approving projects that would inhibit progress.

In pursuing a 'green recovery' it will be vital to ensure social fairness. Structural shifts in energy supply and the transitioning of carbon intensive industries (and their supply chains) will inevitably bring changes in the labour market with some jobs becoming obsolete and others being created.

Some regions may have a disproportionately high exposure to transition risks due to their historic dependency on high emission industries. Investment in transition will therefore need to be carefully targeted to deliver a 'just transition' without which regional disparities will be exacerbated and reinforced.

5. **Whether the Government should prioritise certain sectors within its recovery package, and if so, what criteria should it use when making such decisions? What conditions, if any, should it attach to future support?**

Government interventions in the economy in the form of financial safety nets and liquidity, coupled with increased healthcare spending, have undoubtedly helped to mitigate the short term impacts of shutting down large parts of the economy.

Some of this support can be safely wound down as consumer demand begins to return, but the pace of recovery will vary across sectors and remains vulnerable to further outbreaks of COVID-19. As stated above, we see a strong case for ongoing targeted support for businesses which need longer to return to normality or adapt to significant changes in their operating environment.

Indeed, there are still so many uncertainties about the long-term consequences of the pandemic and associated recession that it is vital the Government takes a patient and flexible approach. By pre-judging those consequences there is a danger of locking in the long-term damage it seeks to prevent.

This ongoing support could take various forms from the extension of existing interventions to state aid and direct shareholdings. Providing this support will inevitably be accompanied by increased regulatory oversight and scrutiny on governance (executive pay, boardroom diversity, dividends & share buybacks), management of climate risks and employment policies.

We believe it is entirely justifiable for the provision of state support for businesses to be linked to standards and targets across a range of behaviours to ensure boards and senior managements are aligned to what the public would expect in return.

As a long term investor we already set out such expectations for investee companies. In March of this year we wrote to UK companies in which we have an active investment to reiterate our commitment to doing everything we can to support the corporate sector through the pandemic and, where appropriate, consider requests for additional capital. The letter clarified our expectations of the companies in which we invest in areas such as dividend policy, capital raising and executive remuneration.

6. **How can the Government best retain key skills and reskill and upskill the UK workforce to support the recovery and sustainable growth?**

We see three key elements to the skills challenge: job retention, reskilling/upskilling and access to talent.

<u>Skills retention</u>

Job protection and retention of the existing skills base must be the immediate policy priority and as stated above we believe it may be necessary for the Government to consider further interventions until the recovery has gained further momentum. This could be through a narrow extension of loans and grants under existing schemes of support or new interventions aimed at fulfilling the same purpose.

<u>Reskilling/upskilling</u>

As is already apparent many employees will be displaced from existing employment and need to re-skill out of necessity. There will also be those who want to improve on their existing skills so they can take advantage of job opportunities in growth areas of the economy. This is a complex area but we would offer the following policy options for consideration:

- **Apprenticeship Levy**: Reform of the levy to increase training provision aligned to future skills needs with a stronger correlation between employer contributions and accessibility of funding.
- **Tertiary education**: Increased availability of means-tested fees and cost of living grants to remove structural barriers to university and college for students from disadvantaged or low-income families.
- **Vocational education**: Expanded access to income-contingent loans (as part of a life-time allowance) that can be used to pay for accredited vocational education programmes and skills development.
- **Labour market programmes**: Prior to the pandemic the UK had a low incidence of long-term unemployment due to a relatively flexible labour market but has a bigger problem matching people with secure jobs with sufficient hours and pay levels to avoid in-work poverty. Unemployment is also likely to rise as a result of the current crisis. An expansion of well-targeted programmes would help prevent this unavoidable near-term fall in labour utilisation from becoming structural and long-term.
- **Education funding:** The UK's total spending on primary and secondary education is higher than the OECD average but has fallen in real terms over the past decade by 8%. In our view the Government should ensure that no school sees a cut to real funding over the lifetime of the current parliament and ideally modest increases.
- **Welfare provision**: Addressing cuts in welfare spending should be a major priority in creating a fairer economy. Targeted increases for working families that also lower effective marginal tax rates should be a particular priority to complement increases in minimum wages, increase incentives for workers to take on more hours, and ensure that in-work poverty declines over time
- **Sure Start:** In spite of its positive impact on children in disadvantaged families funding for Sure Start has been cut dramatically over the last decade. Given the comparatively small budgetary requirements, especially compared to aggregate education or welfare spending, restoring funding would be an important step towards putting young people on a path to a more positive destination.
- **Child care:** While the previous government doubled the entitlement to free child care for working parents of three and four year olds in England to 30 hours a week take up has been lower than hoped. These gaps should be addressed so that all eligible parents can access the services they need.

<u>Access to talent</u>

The concerns of the business sector in relation to the UK's new points-based immigration system are well documented. We believe close attention must be given to how the system works in practice to ensure the UK remains attractive to global talent and business sectors are not stifled by an inability to recruit sufficient numbers of skilled or unskilled workers.

7. **Is the Industrial Strategy still a relevant and appropriate vehicle through which to deliver post pandemic growth?**

The Industrial Strategy continues to be relevant but needs to take account of significant structural changes in the economy. This will be apparent in two ways: a significant shortening of global supply chains and increased digitisation.

Supply chains

Prior to the COVID-19 shock, growth in the cross-border integration of goods markets had already weakened substantially. Looking forward, global trade is expected to contract even more than GDP in 2020 due to the severity of the global downturn and disruption to supply chains.

Indeed, the pandemic has highlighted the vulnerabilities in a system where companies operate long and complicated supply chains to optimise their labour, regulatory and tax costs. In response supply chains are likely to be shortened and reoriented to focus on resilience and diversification, amplified by government policies and regulations.

From a UK perspective a trend towards on-shoring production of essential goods (e.g. medical supplies, food, durable goods, industrial components, etc.) could create new jobs and other spin-off benefits. Equally, it could lead to reductions in foreign inward investment as other countries adopt a similar approach to insulating output from future disruption.

We would therefore argue that a comprehensive review and update of the industrial strategy would help to identify the risks and opportunities of on-shoring and consideration to the support which can be given to firms in navigating these additional challenges.

More generally, drives to increase self-sufficiency, actioned through increased barriers to trade, investment and capital flow, tend to weaken potential growth rather than enhance it. As such, policies designed to improve the resilience of supply chains should be implemented within the context of an overall liberal trade and investment strategy.

Digitalisation

Digitalisation – in which we include 5G, cloud computing, artificial intelligence (AI), big data, the ‘internet of things’, robotics and 3D printing – will likely be the source of the next general purpose technologies and therefore play a pivotal role in the growth of the UK’s industrial and social landscape. The scale and nature of the crisis has provided further incentives for the adoption of digital technologies.

- Making greater use of AI in disease detection, crisis management and healthcare provision;
- Advancing automation and use of robotics in retail, distribution and manufacturing processes to make them more resilient to social distancing;
- Accelerating growth in digital services, amplified by the roll-out of 5G networks, with social distancing already having generated five years of progress in digital adoption in just 8 weeks;
- Facilitating a faster transition to more agile work arrangements, including a greater prevalence of remote working, reducing commuting and the use of large offices;
- Increasing the use of e-payments as COVID-19 lowers willingness to exchange physical money.

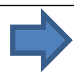
However, while the crisis is increasing the incentives to innovate and deploy digital technologies, a number of other consequences work in the other direction. For example, credit constraints are already tightening pro-cyclically while even firms with access to credit may be unwilling to invest in new technologies due to heightened uncertainty over the outlook, depressed earnings or already elevated leverage.

The increased trend towards digitalisation and the factors that will contribute to its growth such as investment in education, skills & training, R&D and physical infrastructure will therefore need to be considered as part of the future industrial strategy.

Indeed, it is important the Government's digital strategy is not too narrowly focused. Encouraging innovation is critical, but the largest gains to innovation come when they are deployed and commercialised widely across sectors, and diffused through the entire firm structure.

The more narrowly the gains from innovation are held within specific firms or individuals, the smaller the aggregate benefits to the economy and more likely they will lead to increased inequality. Government policy and regulation therefore has a vital role to play in ensuring that all the co-dependencies in the digital innovation and commercialisation pipeline are pointing in the right direction.

How Covid-19 is influencing the cyclical and structural drivers of technological change

Driver	Impact on innovation, its commercialisation and diffusion	Direction of travel
Nature of the crisis	Social distancing increases the need to build pandemic resilient business models, creating incentives to adopt a range of digital technologies such as remote working, automation and online services.	
Availability of credit	While not a financial crisis, bank lending standards are tightening sharply, reducing the capacity for firms to finance investment. This is likely to be particularly challenging for small firms and start-ups.	
Risk appetite	Long term economic and policy uncertainty is likely to remain elevated, increasing the hurdle rate of return to new investment.	
Policy stimulus	Government support for firms is preventing sharper financial distress, but there is a risk that this protects unproductive 'zombie' companies.	
Regulation	The continued growth of giant tech companies underlines concerns over market contestability in these sectors. It is not yet clear if this crisis will accelerate the push for stricter regulation to support competition.	
Globalisation	Further developments in digital infrastructure should drive acceleration in cross-border data flows, but this will be offset by a populist backlash, illustrated fragmenting standards around politically sensitive technologies.	
Human capital	An increased use of digital technologies will help build skills and competencies in these areas, but further investment in education is still required to facilitate a much faster adoption of these technologies.	
Tax policy	The growing importance of the digital sector will strengthen efforts to better capture this activity in tax nets. However, tax incentives for digital innovation are increasingly popular part of industrial policies.	
Links with academia	Links are strengthening in the pharmaceutical sector, but there are fewer signs of progress elsewhere (particularly outside well-developed clusters).	

Source: Aberdeen Standard Investments (May 2020)

8. **How should regional and local government in England, (including the role of powerhouses, LEPs and growth hubs, mayoralties, and councils) be reformed and better equipped to deliver growth locally?**

The UK remains a highly centralised country by international standards, with many policy decisions taken at a government level. While this has its benefits in terms of consistency and in some cases greater efficiency, it his often leads to policy decisions that bias already productive regions, and does not allow for experimentation or the tailoring of policies to particular local needs.

However, it is important that power is devolved to the appropriate level, as ineffective devolution can worsen regional differences if there are large variations in the quality of governmental institutions and their ability to make use of the newly developed powers.

We propose further powers should be devolved to combined authorities including the ability to set business rates and stamp duty. If local authorities can retain this revenue it helps to incentivise the attraction of business investment and construction activity. It will also encourage local authorities to weigh demand for local services against their capacity to raise revenues, based on local preferences.

9. **What opportunities does this provide to reset the economy to drive forward progress on broader Government priorities, including (but not limited to) Net Zero, the UK outside of the EU and the 'levelling up' agenda? What should the Government do to ensure that delivering on these priorities does not exacerbate the vulnerability of businesses, consumers and communities/workers that have been impacted by COVID-19**?

The post-pandemic recession is a potential disaster for the diversity, inclusion and fairness agenda. This is already becoming apparent in various ways:

- White people are less likely to die from COVID-19, have lost their jobs on a smaller scale, and are less likely to be working in unsafe environments.
- Female fatality rates have been lower than those of men but women have endured much larger job losses and borne more of the burden of home schooling and other unpaid work even when working.
- Low-skill, low-income workers have seen larger job losses than high-skill, high-income workers and more likely to become structurally unemployed amidst the recovery.
- Children from poorer households have received less education during home schooling than children from better-off households. Recent exam re-grading decisions underlined the structural disadvantages built into the current system and the importance of policy redress.

The upshot is that we are only at the beginning of an enormous economic and social repair job. The Government will need to re-open the economy at a pace which does not invite a second wave of infections.

Amid what is likely to be a fragile recovery, fiscal policy will need to be accommodative while rotating support towards spending that boosts long-term growth, social and environmental goals. And where governments seek to increase their regulatory footprint they must take care to improve the functioning of markets and broader society rather than undermine it.

Above all will be the need to remain flexible and responsive to unforeseen deviations from desired outcomes including the need to create a fairer society. In this context we would suggest two areas for consideration: the introduction of a Universal Basic Income through which each individual would receive a non-means tested income and an Employment Guarantee through which all adults would be guaranteed a job in the public or private sector.

Though these policies would be highly redistributive each comes with an array of pros and cons as well as complex design challenges that would need to be overcome. However, at the very least there should be a willingness to consider policy options which have the potential to strengthen the speed of the recovery, while ensuring that its benefits are widely dispersed. To retreat into conventional thinking risks further deepening of social disadvantage and inequalities.

10. **What lessons should the Government learn from the pandemic about actions required to improve the UK's resilience to future external shocks (including – but not limited to – health, financial, domestic and global supply chains and climate crises)?**

The pandemic crisis has revealed significant variations in the ability of different countries to manage a combined health and economic crisis. Divergences in health system capacity, the ability to coordinate resources amidst the crisis, and the strength and effectiveness of labour market institutions and safety nets has generated a large dispersion in infection and fatality rates across countries, as well as the scale of the economic and employment fallout.

Addressing these 'capacity' and 'efficiency' constraints will take many years, vary significantly across countries and heavily influence the economic recovery, potential for secondary outbreaks and future crisis risks (and some will argue the next global crisis could be climate related).

Governments already have a wide range of crisis-response tools at their disposal (see table below). The extent to which governments are willing to these tools and if so at what point in the crisis are driven by a wide range of factors but inevitably political considerations will be a key determinant.

In the UK, the fallout from the pandemic will define the choices and perceptions of the current government. Its initial public health response was consistent with the long-term grain of current policy: the NHS was already the top priority for spending and will remain so. We also expect the Government to continue with its plans to lift public infrastructure investment.

However, it could be argued the UK's substantial fiscal response in this crisis goes against the grain of policy over the past four decades for smaller government, tightly controlled welfare spending, low taxation and minimal state intervention. As business support schemes begin to taper off the Chancellor will eventually face difficult choices between large-scale fiscal consolidation and supporting financially stretched households and companies through an extended crisis.

There will also be complex choices to be made about how to apportion any longer-term fiscal consolidation between taxation and spending, the composition of both of those components, as well as how to redesign economic and financial regulation. While necessarily political, decisions about the size of government should be guided by the principles we have outlined earlier in the paper – boosting long-term potential growth, reducing a variety of inequalities and achieving net-zero emissions objectives.

If there is one important lesson emerging from the crisis it is the need for governments to be flexible, responsive and where necessary deviate from political ideologies when wider health, economic and social considerations demand it.

A framework for understanding government intervention

Government intervention	Examples
Demand management	Fiscal policy, monetary policy, their coordination and objectives

The social safety net	Income protection, labour market programmes, housing/child support, retirement incomes
Public investment	Infrastructure, education, R&D, health care
The corporate safety net	Loan support, payroll support and regulatory relief during periods of acute stress
Product market regulation	Privatisation, competition policy, licensing, administrative burden
Labour market regulation	Employment protection, minimum wages, collective bargaining, OH&S
Climate mitigation	Carbon pricing, renewable energy targets, command and control mechanisms, energy security
International regulation	Multilateralism, supply chains, tariff and non-tariff barriers to change, capital controls, migration controls, ITC transfers
Surveillance state	Monitoring, cybersecurity

Source: Aberdeen Standard Investments (May 2020)

11. What opportunities exist for the UK economy post Brexit and the pandemic for export growth?

As noted in our answer to Question 7 cross-border integration of goods markets was already slowing even before the pandemic. The disruption caused to long and complex supply chains has exposed their vulnerability in a crisis, as a result of which we anticipate a shift towards more strategic micro supply chains which are decentralised, have flexible supplier contracts and manufacture closer to the final point of purchase.

As a result we see a greater trend towards a fragmentation of the global trading system into regional blocs. China and the US are the largest sources of demand in their regional blocs and thus will be crucial in determining how companies square off the demands of minimising cost and supply chain disruption while maintaining maximum market access. And this will all take place against a backdrop of deteriorating China-US trade relations.

Smaller economies – including the UK – will need to adapt to this shift in the new trading order in which export-led models will be less viable and economies with large domestic markets have a strong advantage through their ability to implement reforms and increase the efficiency of their domestic industries.

Against this backdrop the UK export potential will be dependent on the export products and services into markets where it has a competitive advantage. As stated above, there remains at ongoing risk that the UK and EU are unable to settle on a future trade agreement. This can be expected to create severe supply line disruption which will add further strain to the recovering economy. Even if an agreement can be reached – and our scenario analysis continues to point towards a narrow FTA – there will be longer term consequences.

The UK's economic relationship with the EU and other major trading partners around the world – including emerging blocs – will therefore be vital to its long-term competiveness.

12. What role might Government play as a shareholder or investor in businesses post-pandemic and how this should be governed, actioned and held to account?

As stated above we believe there may be instances where it is necessary for the state to assume or share investment risks which cannot be sustained by the private sector. This increased state involvement – whether through state aid, loans and grants or direct shareholdings – will bring further scrutiny of the companies and their social licence to operate.

It could be argued that when the Government provided much needed interventions in the banking sector during the GFC it gave a disproportionate priority to the interests of taxpayers over investors.

While this is understandable we would argue that consideration should be given to a much wider range of public interests, including using interventions to promote social as well as economic interests.

Furthermore, we do not see public and private support for business as being mutually exclusive. There is no reason in principle why co-investment cannot be used as a means for supporting firms through challenging periods providing due protection is given to the interest of all stakeholders, including taxpayers and private investors. Risks and rewards should be apportioned fairly and without prejudice to either group.

We would however recommend that state interventions are on a time limited basis with an exit strategy designed to protect the interests of all stakeholders, including the taxpayer.

September 2020