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Early questions for Sunak's growth policy

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Introduction

When the first Conservative leadership election of 2022 began at the height of summer, the central topic was how to restore economic growth in the UK. Liz Truss won that first race in part because the party membership loved her pitch of "growth, growth, growth" and the promise to pursue it boldly. For Truss that meant with little attention paid to the naysayers worrying about such problems as the affordability of tax cuts. She was to be a growth booster, and soundly defeated the chief naysayer, Rishi Sunak.

We all know what happened next. After Sunak won the second leadership election of the year, less than two months after losing the first, he shifted the government's priority to something markedly different: restoration of the economic stability so heedlessly lost during Truss's short premiership. Far from clamouring for tax cuts, his party – after briefly peering into the electoral abyss – is now reluctantly supporting tax rises and future spending austerity, to fill a fiscal gap made worse by the loss of market confidence since September.

But Truss's failures are no reason for Sunak to drop the growth agenda altogether and focus exclusively on stability and sound finance. Not least because in part, as both Truss and her chancellor Kwasi Kwarteng recognised, growth and fiscal sustainability are related. Achieve higher growth, and fiscal problems become easier to solve (although not, as Truss and Kwarteng appeared to think, made to vanish). And a smart fiscal policy can generate the incentives and macroeconomic confidence needed for a return to higher growth.

Sunak, moreover, has a philosophy of growth, as set out in his Mais lecture less than a year ago. It was a solid, evidence-led piece of work that identified low business investment and skills as key weaknesses holding back the long-term potential of the UK economy and reflected the very Treasury mindset of its author. Industrial intervention was downplayed in favour of a focus on broader attributes associated with growth – people, capital and ideas. It offered, however, too little of how he would address those failings and was naively against interventionism when many of the challenges that define his own government's programme demand intervention of one sort or another.

The same day as the then chancellor delivered his lecture, Russia began its invasion of Ukraine. Gas prices have since rocketed, inflation climbed to record levels, and public policy become consumed by cost-of-living issues.

With Sunak now prime minister, it is right to ask what has become of the government's growth strategy, in today's sharply changed circumstances. Below, we list some of the issues Sunak and his chancellor, Jeremy Hunt, should think about when generating one robust enough for more difficult times. We do not put forward a comprehensive 'plan for growth'; there have, after all, been quite a few such documents in the past few years.[1] Rather, this paper is something akin to a guide the prime minister might present to the rest of Whitehall's economic machine on the question of long-term growth.

Raising long-term growth remains the pre-eminent challenge for the UK government

Britain's growth problem is arguably the greatest challenge facing this government and will undoubtedly face its successors too. Weak productivity growth since the 2008 financial crisis has led to a much smaller economy today than it might have been. Previous analysis from the Office for National Statistics found that the UK economy had missed out on up to 25% of growth since 2007, relative to its previous trend – in figures calculated in 2019, before the onset of the Covid pandemic.[2] If even a quarter of that were recovered the UK's fiscal situation, and its politics, would be transformed.

In economic terms at least, Liz Truss deserves some small credit for putting higher long-term growth at the heart of her governing programme. Sunak should similarly acknowledge its importance, as he did in February, albeit in a more measured way than Truss. While the short-term imperative is to restore stability, a new demand, the long-term challenge is the same. And as the Confederation of British Industry (CBI) has put it: "It's important we get that stability because we can't have growth without it. But we also can't afford to lose sight of the long-term picture."[3]

Do not expect much visible progress before mid-2024

Supply-side reform is a frustrating topic, in political terms. Simply put, it takes a long time to work, and there are few good ideas that show an impact within a normal political timeframe. The extensive reforms of Margaret Thatcher's government in the 1980s, for example, probably achieved their fullest impact a decade after she left office.

Over the two years leading up to the next general election, at the latest January 2025, the felt performance of the economy will be driven by demand-side considerations and forces beyond the government's direct control: gas prices, global interest rates, household and business confidence. Forecasts from both the Office for Budget Responsibility and the Bank of England point towards two years of mildly negative growth and stuttering recovery, higher interest rates, slightly elevated unemployment and lower living standards.[4] There is no easy strategy to avoid this, given the current inflationary situation. The "eye-wateringly difficult" fiscal measures that the chancellor, Jeremy Hunt, unveiled in his autumn statement on 17 November, while helping to calm the markets, are not otherwise positive for growth.

Short-term decisions and events will have an impact on the long-term ability of the economy to grow and, as we discuss later, it is important that the fiscal measures are evaluated with an eye towards those effects. But to plan policy in the hope that supply-side impacts might show up much earlier is to risk making bad policy. This is arguably one of biggest errors made by Truss and Kwarteng – to hope for a 'big-bang' style impact upon something as slow-moving as the UK's supply potential and choose abrupt and risky policies in chasing that goal.

No.10 should not take direct control over this agenda

Sunak, as the first former chancellor to rise to the top job since Gordon Brown in 2007, must be tempted to take more direct control of growth as a topic. Economic growth is already a preoccupation of his – he will have a greater understanding of the policy issues than most if not all his colleagues in government.

However, to give No.10 more direct control over the growth agenda would be a mistake. Even in normal times, prime ministers are seldom able to focus on just one issue and can be derailed by emergencies across the whole field of government, from foreign affairs to the NHS and migration. Ukraine and the Home Office's asylum backlog are just two examples of urgent matters to have arrived on the prime minister's desk in his short time in office. The nature of his job is constantly to turn from one topic to another, and the prime minister rarely controls their own agenda.[5] Long-term economic growth demands a steady and consistent approach regardless of where political attention lies that week.

This winter will reinforce the point. Sunak will be preoccupied with urgent political and cost-of-living problems for at least the next six months – after that, he will turn to the run-up to what will be a very challenging general election. No.10 is simply not equipped to do it all, and Sunak himself enjoys the counsel of just a handful of qualified advisers. Downing Street cannot 'own growth'. It should not attempt to.

Sunak should 'hard-code' his growth policy into his government

In government, it is not uncommon for the urgent to crowd out the important. When headlines are dominated by the level of the pound, government borrowing yields, inflation or unemployment, it is hard to focus on slower-moving and distant improvements in the economy's fundamental characteristics.

However, this kind of bias is what political institutions were developed to counter. Like a deep ocean current, government is perfectly capable of driving a long-term agenda even while political storms rage on the surface. Consider how the policy goal of lowering carbon emissions has been maintained over the past 15 years (since the Climate Change Act 2008), despite five changes of prime minister.[6]

As we argued in *How to design a successful industrial strategy*, the key is to rely on institutions to shape and drive economic activity, rather than the inspired and bold actions of politicians.[7] Sadly, the approach pursued by Truss and Kwarteng during their brief spell in power was a perfect illustration of the opposite. The decision to launch a giant, universal energy support scheme and, rather than fund it, supplement it with a flurry of expensive tax cuts, was in clear opposition to the institutional constraints that had hitherto shaped UK economic policy. Truss and Kwarteng acted as if the multi-hundred-billion-pound problem of flagging growth was soluble by a single giant act of political daring, rather than the steady accumulation of countless small improvements within a predictable framework.

An institution, in economic terms, can mean the same thing as its normal English usage – an organisation set up for a particular purpose. But it can also mean the 'rules of the game' guiding how economic agents such as the government are to behave.[8] In the broader economy these might include the rule of law and stable property rights.[9] Within the government it includes the systems, procedures and strategies that the state allows itself to be guided, and limited, by. Granting the Bank of England operational independence, in 1998, is the classic modern-day example – and is credited with calming the habitual macroeconomic instability that had plagued the UK in the 20th century.

Institutions are vehicles to enable positive action, but equally valuable in preventing damaging behaviour. Nick Macpherson, the former permanent secretary to the Treasury, expressed it well, recently saying:

> **"The disasters of 1967, 1976, 1992, 2008 and September 2022 are etched in the collective consciousness of the Treasury. This perhaps accounts for the Treasury's obsession with frameworks designed to save the government from itself."**

It is neither wise nor possible to take ad hoc decisions across the field of economic policy. Government leadership should concentrate on the institutional level instead. For example:

- The major focus of fiscal policy should be on establishing the correct fiscal rules – albeit they have been honoured as much in the breach as in the observance, at least since 2010.[10]
- The same goes for monetary policy. While there may be a case for re-examining the 2% inflation target set for the Bank of England, the broad framework established in the Banking Act 1998 remains fit for purpose – in particular, the operational independence of the Bank.
- There is a question as to how much Sunak intends to allow a more interventionist industrial policy. Whatever the answer, the method by which he should pursue it should be high level and strategic, setting out clear goals and priorities, as seen for example in 2021's *Life Sciences Vision*, used to shape lower-level interventions.[11]
- Another good organisational example was the decision to set up the Vaccine Taskforce, a body that was given a clear remit, and became a clear, effective focal point through which vaccine policy and delivery was centralised. The same model might be pursued in other areas, such as the delivery of nuclear power or battery manufacturing capacity.
- This government cannot afford straightforward tax cuts as a means of boosting the supply side. But revenue-neutral tax reform is underexploited in this regard.[12] As explained in other Institute for Government publications, a long-standing failure to push reform stems from a variety of technical and political obstacles.[13] Again, this is an example of where an institutional approach is appropriate, by setting out a process that starts with building a public narrative around the case for change and develops clear objectives for Treasury ministers to pursue. In other words, rather than a series of tactical thrusts the prime minister and chancellor should favour a committed strategy, within a framework that binds him and brings along other key political actors.[14]

Institutions: favour stability over radical reform, for now ...

A specific question is how far to push the question of institutional reform, or whether stability here is now of paramount importance.

From July to October there was an unusually intense focus on the role of UK institutions, in particular the Treasury, Office for Budget Responsibility and Bank of England, and their relationship with growth. The willingness of the Truss government to attack economic institutions began with the dismissal of the permanent secretary to the Treasury then reached its nadir in the mini-budget. This saw the OBR sidelined, despite a hugely consequential set of fiscal decisions, and the Bank of England forced to intervene in government bond markets in response to those decisions. The financial panic of late September 2022 only began to subside when this hostility towards key institutions started to ebb. Jeremy Hunt mentioned the OBR ten times in his autumn statement speech (compared to just twice for Kwarteng in September). Although actual fiscal measures are what count in the end, markets also clearly took seriously the tone adopted towards the institutions by the government.

Sunak clearly appreciates the importance of a sound institutional framework for an economy to prosper. In February in his Mais lecture he said that "a new culture of enterprise" meant:

> **"creating a stable foundation, by reinforcing some of those enduring principles of free market economics: sound money, respect for the rule of law, protections for private property rights, openness and free trade, a stable relationship with allies, regulation that encourages competition and innovation, and, especially at a time of high inflation, an independent central bank with a clear and unambiguous mandate for low and stable inflation."**

After the tribulations of early autumn, this should make his position clear on how the UK's economic institutions need to be treated: with respect. That does not mean they should be immune to reform or review. The OBR, for example, has played a valuable role bolstering confidence in the accuracy of forecasts of fiscal revenues – but its purview does not extend to any evaluation of decisions about departmental spending, which is worth considering. Twenty-five years after it gained operational independence over monetary policy, it would not be inappropriate to review the Bank of England, its target, and its performance in pursuing it.

However, now is a dangerous time to attempt anything radical in this area. It would be quite acceptable for the prime minister to emphasise stability and leave the topic of institutional reform to the period after the election.

But watch out for the return of the over-mighty Treasury

If there is an exception to this cautious advice, it concerns the power of the Treasury. An accusation made throughout the Conservative leadership election was that Treasury dominance was a major reason for the UK's extended period of disappointing growth. The implication was that simply by reforming or even breaking up the Treasury, higher growth might be unleashed. It was an unprovable and unfair theory: in the biggest decisions, such as the timing and depth of the post-2010 fiscal consolidation, the choice and responsibility lies entirely with politicians, not nameless Treasury officials following an anti-growth dogma.

However, during periods of austerity, there can easily arise a problem of unbalanced power between the Treasury and other departments. For example, we argued in a recent publication that the vital agenda of raising business investment has too often been treated like the sole responsibility of the Treasury, leading to a disproportionate focus on tax policy to the detriment of better and cheaper solutions.[15]

One manifestation of this is a disproportionate focus on short-term financial balance, at the expense of other considerations. The shocks of the past two months have led to an urgent search for ways to find taxes to raise and savings out of departmental budgets. If this is done with an eye only on the need for savings, there is a high risk of actions that damage growth. Without challenging the overall aim, both No.10 and Downing Street should be alert to the risk of the Treasury voice drowning out all others.

It is true that the Treasury faces an unenviable task in finding savings sufficient to achieve its fiscal targets. As we have explained elsewhere, any cuts to spending will damage public service provision or growth.[16] But the difficulty of the Treasury's job is no reason to give it a free hand. The interests represented by the other departments, and their deep expertise in their own policy areas, need to be heard in a considered way.

Sunak's growth vision can be pursued in part through continuity with the Johnson agenda...

Boris Johnson's premiership ended halfway through the parliamentary term. Despite the disruption of Covid and Ukraine, the manifesto upon which his government was elected in 2019 was being delivered on to a significant degree. A 'half-time report' produced by the Institute for Government found that over half the manifesto's promises were completed or on track, with a further 23% under way.[17]

But this tells only part of the story. Much of what a government needs to do is implicit and not set out in an electoral document. Having functional public services is an obvious example, as is achieving an adequate rate of economic growth. Manifesto pledges can also be vague, high-level or focused on inputs rather than outputs. 'Levelling up', for example, played a prominent role in the 2019 manifesto but was ill-defined and a white paper that went some way to explaining it emerged only a year ago.

Sunak's Mais lecture in February set out his own attempt to articulate a long-term agenda around growth, centred on **people, capital and ideas**. He characterised these as features of an economy that contribute towards higher production and are not improved quickly or easily. But as of February 2022, the government's 'Johnsonian' policy programme contained plenty of ideas that were well suited to the structure Sunak aspired to:

Under **people**, the *Skills for Jobs* white paper published in 2021 marked a shift towards more emphasis on further education and lifelong learning. Policies such as the lifelong loan entitlement, the lifetime skills guarantee, T-levels, new apprenticeship standards and institutes of technology were all promising and contributed towards a coherent overall approach. There was also a well-funded programme, 'Help to Grow', aimed at addressing the UK's long-standing problem of weak management skills.

For **ideas**, one of the signature policies of the Johnson government was to raise spending on R&D and provide more certainty on how the money might be spent. The public sector R&D budget is to rise faster than it has in many years.[18] UKRI, the major science funding body, has a three-year budget and has published a five-year strategy to provide guidance to stakeholders. The Department for Business, Energy and Industrial Strategy (BEIS) produced an innovation strategy in 2021 with seven named 'technology families' where the UK has a technological and R&D edge. It also promised a programme of 'innovation missions' aimed at specific goals.

Under **capital**, as chancellor Sunak signalled a shift in emphasis within the business tax system, with higher headline profits taxes balanced by stronger inducements to invest. A consultation on a more generous capital allowance system was being considered before the onset of this summer's political turmoil.[19] Our recent examination of the topic warned against a reliance on tax policy to drive business investment.[20] A strong macro economy and predictable business environment tends to be more important; as an illustration of this, the Bank of England's most recent forecast suggests business investment will shrink in each of the next three years. This is a reminder of the importance of the institutional stability mentioned above, as well as the need to not take unnecessary risks with the new trading relationship with the EU. However, once stability has been achieved and fiscal room found, there is a case for a more generous capital allowance system to kick-start investment. Proponents of this idea, including at the Adam Smith Institute, are right to point out that the UK's overall tax environment for investing is not impressive.[21]

There are other important policy processes from the Johnson era that have been stalled by political uncertainty. The creation of a Digital Markets Unit to regulate competition in the technology sector, for example, was first foreshadowed by a report on the subject published over three years ago.[22] 'Levelling up', described as "a moral, social and economic programme for the whole of government", in the words of its white paper,[23] also dropped out of the political lexicon for much of the summer. It is also meant to be defined by its missions – policy commitments designed to transcend individual governments. As the Institute for Government wrote, it is when there is a change of administration that we learn if they can provide the consistent long-term policy focus needed for the significant 'systems reform' required to address regional inequalities.[24] The key to such reform is to push for more regional devolution – it is striking that even the business lobby is enthusiastic about this agenda, and sees more power for local areas as a way of boosting growth.[*]

… the exception being policy towards the EU

If the government wishes to enhance business confidence in the short run, it ought to take a different approach to Brexit matters than either the Truss or Johnson governments. It is sensible that Sunak has already backed away from his frankly unrealistic promise to 'revoke or reform' all EU-derived law by next year.[25] The threat to do so under Truss was alarming to everyone from the environmental lobby and exporting businesses to the trades unions.[26] Doing so was set to occupy hundreds of civil servants' time, and Sunak's latest, more sensible approach has been welcomed by the CBI, which warned that unnecessary change would simply be a drag on growth.[27] A less reckless attitude towards renegotiation of the Northern Ireland protocol is important too.

On net zero, the government needs to stay on track

Even the more committed antagonists of Boris Johnson recognised that his steady support for net zero was an impressive aspect of his premiership.[28] His leadership on the issue, through promotion of strategies such as *The Ten Point Plan for a Green Industrial Revolution*, established a broad and ambitious framework through which the UK might lead and prosper from the energy transition.[29] The UK's hosting of the COP26 conference was widely regarded as a success.

Progress has stalled somewhat in 2022. Energy security concerns understandably overtook carbon emissions as the leading preoccupation.[30] The strategy published to address this urgent problem did not quite meet the mark – the Institute for Government concluded that it was at best a long-term energy supply strategy, without adequate measures for lowering demand through home efficiency, and a regrettable refusal to support onshore wind.[31] Much relies on a new development vehicle, Great British Nuclear, to improve rapidly the UK's ability to deliver more nuclear capacity. The government's reaffirmed commitment in the autumn statement to the Sizewell C nuclear power station, backed by a £700 million direct investment, is a helpful sign of progress.

During his time as chancellor Sunak was not regarded as a particularly strong advocate of net zero, and sometimes even as a blocker, on classic Treasury grounds of affordability or economic efficiency.[32] Now he is prime minister, he should make efforts

* British Chambers of Commerce, Business Manifesto: Proposals for delivering growth for the business community, 6 November 2022, www.britishchambers.org.uk/media/get/Business%20Manifesto%20%28FINAL%29.pdf. Historically, business groups have been nervous about local areas gaining more powers, particularly any related to raising revenues.

to get net zero back on track. After the inelegant confusion over his attending, or not, COP27 in Egypt, he should abandon his Treasury mindset and put the weight of No.10 behind the co-ordination efforts to get the economy and the public behind the agenda.

In 2020, the Institute for Government called for a systematic approach that included taking the responsibility for net zero out of BEIS.[33] It is late in the parliamentary term for radical machinery of government changes – but by appointing Grant Shapps, an energetic backer of net zero, as business secretary, Sunak has made a reasonable start. As with other positive agendas carried over from the Johnson era, there is real value in emphasising continuity towards a business community becoming shell-shocked by drastic changes in direction. This is particularly important when it comes to energy, when investments are exceptionally long term (nuclear in particular) and extremely dependent on government policy.

Do not intervene against interventionism

Sunak's Mais lecture made his view on the issue of economic intervention clear:

> **"We have seen a steady drift away from some of the very principles that make the free market effective. We can see this in the assumption that government should decide which sectors will be important in the future; should take a view on more and more prices in the economy; and the growing tolerance for businesses to be reliant on taxpayers' support and never allowed to fail. Corporate welfare and ill-thought through subsidies are unfair to taxpayers, who pick up the bill."**

But the circumstances of February are quite different to those today, in political as well as economic terms. Sunak, hitherto seen as more of a small-state politician, had overseen giant Covid-era interventions from the Treasury that affected business lending and labour markets in a profound way. They had made him immensely popular but were quite at odds with the usual approach of a Conservative. Alongside a decision to raise corporate taxes to fund public spending, Sunak had received criticism for pursuing an un-Conservative approach to the economy, and the Mais lecture should be read in that light: as part of an attempt to re-establish his free-market credentials.

As prime minister, it would be more disruptive if Sunak tried too hard to showcase his anti-interventionist credentials. The Johnson-era policies discussed above were generally interventionist in nature: the innovation strategy and pursuit of net zero both involve the government backing particular technologies, sectors or missions. When carefully pursued, there is nothing contradictory about pursuing interventionism in selected parts of the economy and a broad free-market approach in other areas. As we have set out elsewhere, any industrial strategy needs to have 'edges' around it.[34] What is of greatest importance is to avoid unnecessary disruption merely for the purpose of demonstrating a political point.

The major focus of Jeremy Hunt's autumn statement was upon the measures needed to bring down figures for future government borrowing. But in his discussion of growth, he indicated a more interventionist philosophy than in Sunak's Mais lecture. Hunt outlined three priorities: energy, infrastructure and innovation. The first of these was supported by the boost given to new nuclear capacity, as mentioned above, as well as a large new investment in energy efficiency. Infrastructure benefited from some protection from cuts to the capital budget in the next two years, as well as ongoing support for some big named projects like HS2. In innovation, Hunt showed a willingness to adopt a more sector-focused approach than is typical at the Treasury, being happy to name some like green energy, life sciences and digital technology as "growth industries". There are many details to follow – thus far, Hunt only hinted at vague "changes in regulations" as his means of boosting these sectors, as well as the appointment of Sir Patrick Vallance to look into the regulation of new and emerging technologies.

The prime minister should support this approach. Since 2010, there have been multiple oscillations around industrial intervention by business secretaries. First the 'new industry, new jobs' policy of Lord Mandelson was abandoned; a new version was resurrected by his successor, Vince Cable; Sajid Javid scrapped this approach in 2015, before Greg Clark introduced his industrial strategy in 2017 – which was changed again by Kwasi Kwarteng. What industry needs to hear above all is that there are not going to be any more sudden moves, whatever the policy is christened. From this point of view, it is encouraging that the prime minister has restored the National Science and Technology Council and intends to chair it. This is a cabinet committee set up under Johnson to provide strategic leadership and co-ordination to the research and development agenda, and briefly suspended under Liz Truss. It is a quintessentially 'industrial strategy' kind of organisation in its purpose, and this act suggests Sunak's anti-interventionist outlook does not suffer from too much purism.

Conclusion: there is no 'dash for growth'

Every government needs a growth policy – the UK's weak long-term prospects are a chronic problem that needs to be addressed. But Sunak's government needs to be realistic about what it can achieve in the immediate future and must avoid the mistake of acting as if higher growth is something it can lunge at or dash towards, as his short-lived predecessor did. It already inherits a large growth agenda from the Johnson era, much of it half-finished and simply in need of a period of stable, diligent government to carry forward.

At frequent intervals in this paper, it has been useful to recommend actions that are a contrast to those taken by the short-lived government of Liz Truss. A patient approach instead of a big bang; realism about how long measures take, rather than assuming their success up front; reliance on institutions instead of political instinct or ideology. There is an optimistic lesson from this. Britain does have latent growth capacity, even if it has been badly damaged by policy missteps of the past few years. The further that the country has fallen behind its potential, the more that successive governments have acted as if reversing the trend demands some act of political genius or daring, an abrupt shift in policy, a spell of creative destruction.

What we argue is the opposite: to unlock that capacity demands patience, a commitment to delivery and consistency, and a period of steady competence. These are rare during times of such political ferment, and since 2016 have been largely absent. It doesn't make for much of a slogan, but what the growth strategy needs is not some 'rocket boost' or 'drive', or for something to be 'unleashed', but just a period of calm.

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