Appendix 2

U.K. Policy Response

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The Inclusive Prosperity Commission's conclusions echo to a great degree the political debate in the UK – and the challenge for policy makers here. The aim for progressives in the UK is to show that we can make Britain better off, create more good jobs and build an economy that works for working people.

Reforms will be needed that directly tackle the stagnation in living standards which in the UK has been deep and long lasting - and to show how Britain can earn its way to higher living standards for all over the long term.

The importance of shared prosperity is not just a matter of values, but a matter of economics too. Higher incomes for ordinary families would speed the recovery of the real economy from the effects of the financial crisis in a way that benefited the many and not the few. In the short run, higher incomes lead to higher demand, which will increase growth. In the longer term a high-productivity, high wage economy is the best route to sustained growth and rising living standards.

Raising wages: Full employment in an economy where work pays

Although unemployment has been falling across the developed world and now in the UK too, there are still too many people out of work.

Long-term unemployment and youth unemployment are particularly acute issues which must be addressed. In the sectors where jobs growth is taking place, good jobs with clear career progression must be developed.

For most people in work, the spending power of wages are being eroded. The minimum wage has fallen in value and insufficient enforcement has weakened its effect. The increase in part time work is associated with salaries that are often less than the living wage.

To help sustain living standards, there is an important role for tax credits but they must be used in conjunction with a strong minimum wage to ensure they are an added reward for hard work rather than a subsidy for low pay.

The UK policy response on employment during the financial crisis was a signal success – as the case study of the future jobs fund demonstrates. And thanks to long term reforms taken over decades in the UK, a flexible labour market has meant unemployment levels have not reached levels of previous recessions and have fallen recently. This was despite a new Government in 2010 pulling the rug out from under the recovery and causing a temporary increase in youth unemployment and several years of stagnant growth.

However the quality of jobs, and wages, remains of significant concern. They are an important pre-condition to sustainable public finances. In the UK, despite significant cuts to discretionary spending, public borrowing has been higher than planned in recent years as a result of weaker tax receipts driven by low wages and labour market insecurity.

The policy response should reflect these challenges. This should include;

1. **Support for young people facing long-term unemployment**

- A guaranteed paid starter job for every young person out of work for over a year – which they will have to take or lose their benefits.
- Replace adult out-of-work benefits for young people (aged 18-21) with a parental means-tested youth allowance, conditional on them being in training.
- Introduce a Basic Skills Test to ensure every jobseeker is assessed for basic English, maths and IT skills, with those lacking these skills offered training to improve their chance of finding a job.
- Boost apprenticeships by requiring every firm getting a major government contract to offer apprenticeships.

2. **Family-friendly labor market policies to increase female labor force participation and income**

- Help working parents with 25 hours free childcare for three and four year-olds.
- Guarantee parents access to wraparound (8am-6pm) childcare through their local school if they want it.
- Tackle the gender pay gap by requiring large companies to publish the difference between men and women’s pay.

3. **Raising take home pay for low wage workers**

- Increase the National Minimum Wage to £8 an hour by 2020, with a target of getting it closer to median earnings.
- Give Local Authorities a role in enforcing the National Minimum Wage as well as introducing higher penalties for companies that don't pay it.
- Promote the living wage with government: using its procurement policy to encourage more employers to become living wage employers; providing tax breaks for firms that sign up to become living wage employers; and requiring listed companies to report on whether or not they pay the living wage
- Cut income tax for 24 million working people through a lower 10p starting tax rate.
- Ban recruitment agencies from only hiring from overseas.
- Abolish the loophole in the agency workers regulations that allows firms to pay agency workers less than permanent staff.

4. **Increasing worker voice to increase wages**

A long-term plan to raise productivity and tackle Britain's low skill, low wage culture.

- Increase transparency on pay, by requiring companies to publish the ratio of the pay of their top earners compared to the average employee, and the pay packages of the ten highest paid employees outside the boardroom.
- Simplify executive pay packages and ensure that there is an employee representative on remuneration committees to ensure that the views of ordinary staff are heard when decisions to award top pay packages are made.
- Require investment and pension fund managers to disclose how they vote on pay and all other issues, and ensure that shareholders approve remuneration packages in advance.

5. **Protecting workers who are underemployed**

- End the abuse of zero-hours contracts, including giving employees the right to receive automatically a fixed-hours contract when they have consistently worked regular hours.
- Ban employers from being able to require zero-hours workers to be available on the off-chance that they will be needed and stop employees from being required to work exclusively for one firm if they are on a zero-hours contract. We must also ensure that zero-hours workers who have their shifts cancelled at short notice will receive compensation from their employer.
- Guarantee a part-time, compulsory job to everyone out of work and claiming benefits for more than 24 months.

Educational opportunity for all

In a world where technological change is increasing productivity and mechanising jobs, raising skills levels is essential to increasing growth in the long-term. World class schools, universities, vocational training and apprenticeships are critical.

The UK education system has great strengths, with world class universities and science base, and progress in schools strong since the mid-1990s. But a historic challenge of the UK education system has been an excessive focus on the traditional academic routes through A-Levels and university.

The current Government has abandoned attempts by the previous Government to reverse that trend and to provide high quality alternatives for those who do not choose that path. As a result, many talented young people, for whom a quality vocational qualification would have been a better option, have been let down by a system that offers no clear route to a successful career.

This is limiting life chances for young people while preventing businesses from getting the skills they need to succeed - holding Britain back.

Renewed focus should be given to early years, to building world class schools and an inclusive education system that gives high quality routes to all young people regardless of where their skills and talents lie and the path they choose.

The policy response should include

1. **Early learning and childhood education**

- Extend free childcare from 15 to 25 hours for working parents with three and four-year-olds.
- Introduce a legal guarantee that parents of primary-aged children can access childcare from 8am to 6pm through their local school.
- Reinvigorate Sure Start, reforming the way local services work together to shift from sticking-plaster services to radical early help.

2. **World-class schools**

- Guarantee parents that all teachers in state schools will be qualified.
- Require teachers to continue building their skills and subject knowledge on the job, with more high quality training and new career paths.
- Ensure all schools are locally accountable with new local Directors of School Standards responsible for intervening in underperforming schools.

- End the flawed Free Schools programme and instead prioritise new schools in areas where there are shortages of school places.

3. **Support for vocational education**

- Introduce a new gold standard Technical Baccalaureate for 16-18 year olds.
- Ensure that all young people study English and maths to 18.
- Introduce new Technical Degrees delivered by universities and employers.

4. **Support for apprenticeships to increase productivity and employment**

- Improve the quality of apprenticeships, so that they are focused primarily on taking young people to level three and beyond.
- Hand employers control of £1 billion for apprenticeships, and in return ask that they step up and offer real apprenticeships and training across the country.
- Use public procurement to boost the number of apprenticeships in the UK by requiring every firm getting a major government contract to offer apprenticeships.
- Give businesses more control over apprenticeships in exchange for increasing the number. Raise the standard and quality of apprenticeships so they last a minimum of two years.
- Require large employers hiring skilled workers from outside the EU to offer apprenticeships.
- Create thousands more apprenticeships in the public sector.

Measures to support innovation and regional clusters

The UK has a particular challenge with levels of research and development (R&D). Government-financed gross domestic R&D as a percentage of GDP is now around a third lower than countries like the US, Germany, Sweden and Korea. Industry-financed gross domestic R&D is just half of the level in all these countries and the lowest in the G7 as a percentage of GDP. Increasing both private and public sector R&D levels should be a priority of British national policy. But it is critical that emphasis is placed on the development, demonstration and deployment of new technologies as well as on basic research where Britain has tended to perform well. There is a critical role here for industrial policy tools, which have come back into fashion in the UK, to support existing research and industrial strengths, especially where they are concentrated in regional clusters.

The Adonis Review of growth found that much of the UK's innovation and growth is concentrated in too few areas. The cities and regions outside of London and the South East have industrial clusters but these are not well enough supported. A recent McKinsey report found that there are 31 economically significant clusters spread around the UK, including chemicals in Hull and metals in South Yorkshire. Taken together, they account for 8 per cent of the UK's businesses but generate 20 per cent of UK output. However, the majority of the most successful clusters are located in London and the South East.

The policy response must focus on supporting growth across the country – and in giving strategic powers to local and sub-regional bodies to drive the growth of clusters and diversified and sustainable growth.

It should include;

1. **Supporting innovation clusters**

- A long term funding framework for science and innovation as recommended by the Wright Review.
- Build on Catapult Centres and focus on deepening the links they create between the scientific research community and businesses, especially small and medium sized businesses.
- Cut business rates in 2015 and then freeze them in 2016 for over 1.5 million business properties.
- Reform our banking system to increase banking competition
- Create a British Investment Bank, with a network of regional banks, to boost lending for small businesses to grow.
- Set a long term national funding framework for innovation policy, and giving small innovative firms greater access to government research budgets.
- Establish a new Small Business Administration, to provide support for SMEs across government.

2. **De-centralisation to support innovation clusters**

- Devolution of £30 billion of funding to allow cities and county regions to shape local provision of skills, employment support, infrastructure and business support.
- Reform Local Enterprise Partnerships so that they are strong independent bodies with their own pooled budgets and strong Governance.
- Devolve the revenue from Business Rates to Combined Authorities so that any additional income can fund infrastructure priorities and incentivise investment to drive growth.
- A greater role for employers in designing vocational qualifications and ensuring they have a key role in commissioning and planning skills provision in their area.
- Setting a target for 25 per cent of all government procurement contracts to go to SMEs both directly and through supply chains.

Greater long-termism in the private and public sector

The review into short-termism in the UK economy, led by Sir George Cox, established that short-termism is constraining the ambition of UK business, holding back its development and inhibiting economic growth. The research established that the causes include, but go well beyond, the oft-blamed functioning of capital markets. It concluded that what is required overall is a strategic view of how to utilise the inherent strengths of British business to make it globally competitive in the 21st century. How effectively this issue is addressed will determine the future economic health of the nation.

These findings echo similar concerns highlighted over decades by a great many economic commentators in the UK. The response to these challenges should include

3. **Reforming corporate governance to encourage long-term investment**

- Broaden the public interest test for takeovers to take into account the impact on the UK's science base.
- Restrict who should be able to vote on a takeover to give long-term shareholders a greater say.
- Abolish quarterly reporting rules and put duties on investors to act in the best interests of ordinary savers and prioritise the long-term growth of companies they are investing in over short-term returns.
- Amend the Corporate Governance Code so that firms publish the ratio of the pay of their top earner compared to the average employee and the pay packages of the ten highest paid employees outside the boardroom, and justify top pay if the ratio between the highest and average paid worker is more than 40:1.
- Put employee representatives on remuneration committees, ensuring the views of ordinary staff are heard when decisions to award top pay packages are made. Introduce binding votes on remuneration packages that work, by ensuring shareholders must approve a decision in advance, not after the event.
- Place a duty on institutional investors to act in the best interests of ordinary savers and to prioritise long-term growth of companies.
- Cutting Business Rates for Small Businesses while maintaining the most competitive Corporation Tax rate in the G7.
- Capitalize a British Investment Bank to support small business investment.
- Give control over the full revenue from business rates to powerful new city and county regions which come together in combined authorities to tackle the chronic local problems of poor skills, infrastructure and economic development.

4. **Investment in infrastructure**

- A new independent National Infrastructure Commission, as proposed by Sir John Armitt, to look 25-30 years ahead at the evidence for the UK's future needs across all significant national infrastructure areas and set clear priorities, for example, nationwide flood prevention or energy supply.
- An infrastructure assessment carried out every 10 years and including extensive research and consultations with the public, local government, NGOs, regulators and other interested groups or individuals.
- Parliament to vote on the evidence-based infrastructure priorities and 10 year plans, and scrutinize delivery.
- Mitigating and adapting to the effects of climate change
- A new climate change adaptation plan, which reprioritizes the importance of tackling the risk posed by floods.
- Introduce a 2030 low carbon target to decarbonise electricity and give investors certainty to invest in low carbon technology.
- Delivering the government's commitment to give borrowing powers to the Green Investment Bank.
- New approach to energy efficiency which insulates five million homes by 2025.

Better functioning domestic financial markets

The finance and insurance sector makes up around 8 per cent of the UK economy and employs over one million people. It is a global industry in which the UK plays a leading role, and financial services alone make up more than 9 per cent of UK exports.

The most important role for the banking system should be to serve our businesses, providing the funding they need to start up and grow. This is essential if we are to build a productive economy, with businesses investing for the long-term and creating the secure, well-paid and high-skilled jobs we need.

Small businesses in particular rely on bank finance, and should be able to trust the banks to understand their needs and act in their best interests. Without this we will be unable to raise living standards. In the aftermath of the financial crisis there are four key priorities for the UK's financial sector.

First, stability is needed to underpin long-term investment as set out in the proposals of the Independent Commission on Banking. This includes creating a ring-fence between retail and investment banking. However, there is further to go on areas such as better linking pay to long-term performance and ensuring that there are clear lines of regulatory responsibility.

Second, the lack of competition in the sector must be addressed. This has been clearly identified by the Independent Commission on Banking, the Parliamentary Commission on Banking Standards, the Competition & Markets Authority and others as a long-standing problem.

Third, businesses and households must be given greater access to affordable finance.

And finally the culture of the banking sector needs to change further to deliver the whole package of reforms. The financial crisis and mis-selling scandals have undermined trust in the sector. There is still some way to go before that is restored.

1. **Encouraging greater competition in the banking sector**
- Increase competition in the banking sector, including by reducing the concentration of the sector with at least two new challenger banks. A market share threshold will be introduced – modelled on similar mechanisms in the US – which would trigger a competition inquiry if it were to be breached. The Competition & Markets Authority are now investigating the lack of competition in the banking sector, and the level of the threshold will be set as part of that review.
- Support the growing network of local and regional banks and other local finance providers, with a detailed understanding of the needs of businesses in their area and a remit to support those businesses.
- Ensure a strong ring-fence between retail and investment banking, so that retail banks develop a culture of customer service and recent scandals such as the mis-selling of Payment Protection Insurance and interest rate swaps are not repeated.

2. **Establishing realistic leverage limits for financial institutions**
- The Treasury should set a target for the leverage ratio, which would then be supervised by the Financial Policy Committee to ensure banks are safe.

3. **Reforming the bonus culture**
- Repeat the tax on bankers' bonuses in order to fund labour market interventions and tackle the long-term scarring caused by youth unemployment.
- Ensure that pay and bonuses are better linked to the long-term performance of financial institutions, through mechanisms such as clawbacks.

4. **Improving access to finance**
- Introduce a proper Business Investment Bank which supports small businesses and helps them to access finance.
- Tackle the exploitation of some customers through the high-cost credit of payday lenders, including with a levy on profits to support providers of affordable credit, such as credit unions.