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PLAN B

A good economy for a good society

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Edited by Howard Reed
and Neal Lawson

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Executive summary

Plan B: a good economy for a good society

- Britain faces a unique historic economic crisis. First, a global downturn, which may at any moment become a double-dip recession as the financial markets teeter on the edge of another credit crunch.
- And second, if that were not enough, the country is burdened by a set of economic policies – the coalition government's 'Plan A' – which are making the situation not better but worse. Current policies are holding back recovery and may do the very opposite of their avowed intention, by actually increasing the deficit.
- It is time for Plan B – a plan that will do four things:
  - get Britain emerging from recession as quickly as possible
  - restructure the economy so as to be low carbon
  - restructure the economy for greater equality, with more emphasis on public goods instead of just individualistic consumerism
  - set out the long-term terrain of a new economy so that we can begin to match emergency recovery policies to a long-term vision of Britain and its economic future.
- As Plan A visibly falters, a consensus is emerging on the need for an alternative. Across industry and academia, across the world, in the UK from Labour through to the Liberal Democrats and now even some Conservatives, from the Confederation of British Industry (CBI) to the International Monetary Fund (IMF) and from the people of Britain comes the demand for a Plan B.

Plan A isn't working

- The country has been told it's on the verge of bankruptcy to justify the government making deeper and faster cuts in public expenditure than at any time since the 1930s.
- But the government is taking a terrible gamble: that reducing spending by £130 billion over five years will have no effect on economic activity.
- This presumes that the private and public sector are separate, when they clearly aren't. Cuts in the public sector have knock-on consequences for the private sector. The IMF has calculated that attempting to close a deficit equal to 1% of national output with the Bank of England base rate already nearly at zero, and with similar austerity measures being imposed across the other developed economies of the world, is likely to lead to a decline of around 2% in national output.
- Already for 2011/12 it looks as if the government will miss its deficit target reduction and, as the economy slows, the deficit could increase.
- This is not to argue that the deficit can be ignored indefinitely. But if demand could be restored and the employment rate increased, a significant portion of the structural deficit would disappear, leaving the rest to be financed through a combination of controls on spending at the right moment when the economy is growing again and tax revenue increases.
- In every case where governments have pursued austerity measures to stave off the threat of the bond market, the ensuing contraction in their economies has increased market doubts about a default, leading to higher interest rates and therefore a vicious cycle of economic decline.
- Plan A isn't working and isn't going to work. Britain needs a Plan B.

The context of Plan B

- A Plan B that works for the long term is going to have to be set within the context of the world as it is now. That means the recognition of both the way in which the economy has globalised and the environmental constraints placed on any recovery.
- We therefore set out proposals for the reform of global finance to increase stability, for a reduction in carbon emissions, and investment in key declining ecosystems.
- The only viable economy of the future is a green economy, not just because one planet is all we have but because climate change and environmental limits are already impacting on the economy, pushing up energy and food prices.
- Another part of the context for Plan B is the recognition that gross domestic product (GDP) is not a sufficient measure of economic performance.

- There is no point 'fixing the deficit' only to return to 'business as usual'. Instead we need reform in the short term that will boost the chances of recovery of a sort that can in the longer-term create a different type of economy for a good society.

Plan B

Emergency recovery measures

- The starting point for the government is to stop cutting. Cuts now will make things worse. Spending adjustments can be made when the economy is growing, taxes are increasing and expenditure on benefits and so on is reducing.
- The economy needs a kick-start, which the private sector cannot manage, and which only the state can achieve. We therefore set out a range of immediate measures to get the economy moving:
  - Introduce a new round of quantitative easing (QE) to invest directly in a real Green New Deal.
  - The first step of the Green New Deal will be to train a vast carbon army to crawl over all the buildings in the UK making them energy efficient and fitting renewables such as solar photovoltaics. This will generate a huge range of jobs from engineers, energy accountants through to solar roof fitters, loft insulators and draught strippers.
  - In addition, using QE we could cancel out long-term private finance initiative (PFI) debts such that £50 billion invested now would eventually save a staggering £200 billion in debt.
  - Raise benefits levels for the poorest families, such as the Working Tax Credit and Jobseeker's Allowance to ensure that money goes to people who most need it, and who will spend it, thus boosting aggregate demand.
  - Implement a financial transaction tax to reduce dangerous volatile capital flows and raise income for public investment.

A fairer tax and benefit system in the long run

- Close the £70 billion lost tax gap with a range of measures that include the introduction of a general anti-avoidance principle to tax law.
- Make the tax system progressive, so that those at the bottom don't bear the greatest tax burden.
- Introduce a tax on unearned land value increases to raise revenues and stop another debt fuelled boom.

Using government intervention to promote business investment and innovation

- It is time for state-led investment in British industry . Not 'picking winners' but rather using the state in a wider enabling role, to actively create markets for new technologies. This approach is associated with successful Asian economies such as South Korea and China. This will mean revamping the UK government's Small Business Research Initiative and a large-scale reform and expansion of the Technology Strategy Board along the model of the US Defense Advanced Research Projects Agency (DARPA), as recommended by the CBI in 2006.
- The centre piece of a new investment model would be the creation of a British Investment Bank (BIB) modelled on successful arm's-length banks the world over. Its remit would be to use funds not just to make loans but as a reserve to back a guarantee for investment in key sectors and to leverage in private sector investors. The focus of BIB investment would be low carbon, high employment sectors such as housing, transport and renewable energy.

Reforming the city and the banks

- Future stability requires better regulation of the banks and encouragement for them to invest in the real economy. The following range of reforms is therefore essential:
  - the full separation of utility or retail banking and casino or investment banking
  - measures to tackle excessive pay and bonuses in banking that leads to excessive risk taking
  - new institutions, like a Post Bank, to pluralise and localise banking services
  - increased competition in the sector and much higher customer standards
  - much fuller accountability of credit ratings agencies to the public via parliament and regulators, and the creation of public rating agencies that can license new financial products.

Social investments and social justice

- Britain must fundamentally shift in the way we view social investment. At the moment most state spending is curative not preventative. This is economically expensive and socially damaging.
- Instead the country must switch social investment to stop problems occurring, rather than just waiting to clear up the mess. This requires the creation of a social investment state. Take one example: if the incidence of obesity in all social classes had been the same as for social class 1, the cost to the NHS of treating obesity would have been £2.2 billion in 2009 compared with the actual figure of £4.8 billion, a reduction of 54%.
- A small investment in policies for transport and diet could save money, increase well-being and reduce carbon emissions.
- From welfare to education and health, we need to switch investment from symptoms to causes and transform the nature of the state as a vehicle to create a strong and more equal society more efficiently and effectively.

Time and the core economy

- To live balanced lives there has to be a fundamental shift to ensure that the economy becomes a subset of society and not, as at present, the other way round. The economy depends on healthy, flourishing people. The key component of this 'core economy' is time.
- Over time, moving to shorter paid work time could help to address a range of urgent, interlinked problems: overwork, unemployment, over-consumption, high carbon emissions, an impoverished welfare system, low well-being, entrenched inequalities, and lack of time to live sustainably, to care for each other, and to enjoy life.

A new bargain at work

- Real wages for most have been stagnant over the past five or six years, are now falling and are set to continue to fall for at least the next two to three years. A successful economic strategy requires tackling the growing pay–output gap. This can be achieved by:
  - raising the level of the minimum wage at a faster rate than median earnings while guaranteeing all public sector (and contracted) staff the living wage
  - tackling excessive pay at the top, for example, by introducing new powers for shareholder groups to be able to vote to block excessive executive remuneration packages
  - reviewing the dominant 'shareholder first' doctrine, which has ruled business for 25 years; as Paul Polman, the boss of Unilever, has argued publicly, this concept 'has passed its sell-by date'.
- Companies are more efficient and productive when they harness the ingenuity and commitment of their staff. A voice and influence in the workplace is critical in building successful companies. This requires:
  - workers' councils for large firms along the lines successfully practised in Germany
  - encouragement for trade union membership
  - encouragement for the creation of more employee owned and cooperative models of firms.

The new state and how to spend better

- It is not just the economy that Britain has to reform but the state. The state needs to become more accountable, innovative and productive. This demands a set of constitutional and public services reforms - a Plan B for the state.
- One major step forward would be the introduction of co-production techniques to all aspects of public sector delivery. Evidence from places such as Newcastle and sectors such as health demonstrate that where staff and users of services are directly involved in the production of those services, efficiency gains through innovation rise dramatically.

Plan B shows there is an alternative, not just to cuts, austerity and stagnation, but to a return to business as usual and all that means for growing inequality, climate change and people's well-being. Plan B shows we can have a good economy for a good society.

Introduction

This report is about two very different plans for the future of the British economy. The current plan, Plan A, isn't working and everyone knows it, even if they aren't admitting it yet. Plan A, and the political economy that inspires it, isn't just not working in the short term but has no vision for the long term.

As a realistic alternative to Plan A, we offer Plan B – a good economy for a good society**.** Plan B shows how we can fix the deficit in the public finances by boosting the social and economic potential of the UK through emergency measures and targeted investment – and in doing so, start to make the transition to a low-carbon green economy that is fair to all.

What we all want is a safe place to put our money, a rewarding job and a natural environment enhanced for the next generation; an affordable home; security, though not necessarily in purely financial terms; a society committed to nurturing, and prepared to pay for the health and development of its people; communities where we can belong, that have some autonomy and identity; and the chance to get off the consumer treadmill more often and find a life balance that leaves enough time to engage meaningfully with family and friends, and pursue interests outside work. We need a political economy to help us achieve all this. Plan B is the start the country is crying out for.

Plan B is concerned with four main things: emerging from recession as quickly as possible; restructuring the economy so as to be low carbon; restructuring the economy for greater equality with more emphasis on public goods instead of just individualistic consumerism; and setting out the long-term terrain of a new economy, so we can begin to match emergency recovery policies to a long-term vision of Britain and its economic future.

Our economy has suffered a once in a generation shock to its system. But the horrible truth is that other, potentially bigger shocks – financial and ecological – might be just around the corner. We have to insulate the real economy and our people from such events as far as possible and work, in a coordinated way, to try and stabilise the world economy. These unique and historically challenging times require unique and challenging responses.

Just like other governments around the world, the UK needs to devise new forms of state economic intervention that work. Our challenge is to recognise that the world's economies have globalised, and that this is particularly true of finance, and therefore any Plan B has to be international as well as national. Finally, we must also recognise that growing out of recession has potentially disastrous environmental and commodity price consequences, and so Plan B needs to have policies to deal with and balance the need for profit and the needs of the planet.

There is no point fixing the deficit in the short term to go back to a 'business as usual' approach, which characterised the period between the early 1980s and 2008. Instead, we need to accept the systematic challenges of climate change, peak oil and a broken financial system, and develop visions, ideas, polices and support to transform our economy. We need a transformation that works for people as workers, carers, parents and citizens, for productive businesses, for the whole of society and of course the planet. The way we fix the deficit cannot be separated from such long-term economic transformation.

A new economic consensus is starting to emerge, which is breaking down old political barriers. The International Monetary Fund (IMF), President Obama and most of the leadership of the Eurozone countries are searching for a new approach. Labour is starting to admit the scale of its errors in government and is searching for a new economic paradigm. Many Liberal Democrats, from Vince Cable down, know that Plan A is failing and want a way out. Even many commentators on the right of the political spectrum such Charles Moore and Peter Oborne know that something new and better is required. They are supported by thousands of business people, investors, economists and campaigners who know a Plan B is now essential. For the first time in a generation the context exists to replace the political economy of market fundamentalism with a political economy for a good society.

Section 1 sets out precisely why Plan A is failing and why it was always bound to fail. The government is turning off the oxygen just when the economy desperately needs air pumped into its lungs. This section also places the rest of Plan B in the current context of a globalising, climate-changing world in which other countries have used the state more effectively than the UK.

Section 2 sets out the detail of Plan B: first to stop cutting; then a a set of emergency measures to end austerity are listed, including better use of quantitative easing (QE), reform of the tax and benefit system and introduction of a real Green New Deal; following that a medium-term prosperity strategy based on realistic investment and reform measures, and the creation of a British Investment Bank to sustain the economy and pay down the deficit. The private sector lacks the confidence to kick start investment and too often puts short-term profits before people and the planet. The moment demands new ways for the state to intervene and help private business grow, especially small and medium size companies in the green economy.

This is not an ordinary post-war recession but the product of global demand deficiency. The experience of Japan over the last two decades indicates how long the current situation might persist. To get the economy and the private sector moving the state must act. But uniquely the state can act in a way that helps rebalance the economy towards investments that are low carbon and which help rebalance society by closing the enormous income and wealth gap between the rich and poor. The bureaucratic state tried to pick commercial winners, the market state just stepped back, but the new investment state will intervene, as in other countries like South Korea and Germany, to maximise the chance that productive winners will emerge in a way that helps ensure prosperity that is balanced and sustainable.

Plan B can't be and isn't about everything. Much more needs to be done on issues like the emergence of Brazil, Russia, India and China, the BRIC nations, and areas like pensions. These and other critical issues will be addressed by the strong and growing collection of economists, thinkers, politicians and campaigners who have been involved in producing Plan B.

The tectonic plates of Britain's political economy are now decisively shifting. The once intellectually, morally and politically dominant paradigm of market fundamentalism is in decline. It still has a hold on some of our political elite, but while it inevitably and necessarily results in an unpopular capitalism that isn't working for the country or most of its people, the demand from below for a new economic paradigm will only grow. It is a paradigm that will prioritise fairness over greed, the needs of productive capital over finance capital, the long term over the short, and the needs of people and the planet over the excessive and underserved profits of a few.

Section 1
Plan B: the context

A Why Plan A is failing

Plan A myth vs reality
In the June 2010 Emergency Budget, six weeks after the Conservative–Liberal Democrat coalition government entered office, Chancellor of the Exchequer George Osborne announced 'Plan A' for the economy – an attempt to eliminate the structural deficit (explained below) in the public finances over just five years, reaching balance by the tax year 2015/16. These plans entail £99 billion of spending cuts and £29 billion per year of net tax increases by 2015/16; taken together, these spending cuts and tax rises amount to around 6% of gross domestic product (GDP) allowing for inflation, which is an unprecedented degree of fiscal tightening over such a short period of time. Undoubtedly, spending cuts and tax rises of this magnitude will cause, and are already causing lots of pain – especially to families on the lowest incomes, who benefit most from public services in relation to their incomes.[1] But will the gain be worth the pain?

Since the June 2010 Budget, YouGov has conducted fortnightly polling on the economy.[2] Although the proportion of people who think spending cuts are good for the economy has fallen over the last 12 months from half to around a third, only about a quarter think the cuts are fair, and almost half think they are too deep. However, around 58% of the population still thinks the cuts are necessary.

This section exposes the arguments underlying Plan A, in particular:[3]

- The UK is not 'on the verge of bankruptcy' as George Osborne and other adherents of Plan A have claimed.
- Trying to clear the structural deficit in five years is an act of economic sado-masochism, which could leave the public finances in a worse state than ever by 2015.
- The assumptions about economic growth in the UK and elsewhere underlying Plan A are in the process of falling apart.
- Most of the current deficit may not in fact be 'structural' at all.
- Arguments that the UK has to cut its deficit as quickly as possible or risk crippling interest rates on government debt at the hands of the 'bond vigilantes' are totally misleading.
- The prospects for 'expansionary fiscal contraction' via export led growth, exchange rate adjustments or increased business investment are largely an illusion.

The UK is *not* on the verge of bankruptcy
In 2010, at the end of the last parliament, the UK's national debt stood at about 52% of GDP, and was projected to rise to a maximum of about 80% of GDP under the previous Labour government's spending plans, before falling back.[4] While this level of debt is higher than at any point in the previous 40 years, it is well below the level of debt the UK had between 1918 and the mid-1960s. If the UK was capable of setting up the NHS and founding the welfare state while carrying debt levels far in excess of where they are now, it makes no sense whatsoever to say that the UK is on the verge of bankruptcy or that we have 'maxed out our credit card'. Moreover, recent results from a detailed survey of household wealth and assets in the UK suggest that total household wealth in the UK is currently valued at around £9 trillion, of which £4 trillion belongs to the wealthiest 10% of households.[5]

Although the UK national debt is not large by long-run historical standards, and interest rates on servicing the debt are currently very low (because the global economy is in such a weak state at the moment), Conservative politicians have argued that the deficit needs to be reduced at breakneck speed, in order to start bringing down the size of the overall debt. In June 2010 David Cameron said: 'In five years' time… for every single pound you pay in tax, 10 pence would be spent on interest. Is that what people work so hard for, that their taxes are blown on interest payments?'[6]

On the face of it, this is an argument that any kind of public debt is wasteful expenditure – taking Cameron's argument to its logical conclusion, the UK should have a zero national debt or indeed a national surplus. But this is a crazy argument, for two reasons. First, any business would accept that running a debt to pay for investment spending, which can produce returns later, is totally acceptable – indeed it would be bad economic policy *not* to invest in such circumstances. Similarly, deficit-financed government investment spending delivers returns to the economy later on, as we explain in Section 2 of this report. Second, the vast majority of the current public finances deficit and the increase in the national debt has been caused by the severe economic recession of 2008–2009 (as explained in more detail later in this section), and was therefore largely unavoidable.

Economic sado-masochism

The Treasury appears desperate to clear the structural deficit within five years at all costs – a course of action which has no sound basis in economic theory whatsoever. The current government ignores the risks, and is proceeding on the basis that is possible to reduce a fiscal deficit of around £130 billion in just five years without the reduction in the deficit having any impact on economic activity. But this is a fantasy, which is not backed up by research from any of the leading authorities around the world, including the UK Treasury itself.

The International Monetary Fund (IMF) has performed simulations which suggest that implementing spending cuts and/or tax rises to close a fiscal deficit equal to 1% of national output typically reduces output by around 0.5% within two years and raises the unemployment rate by about 0.3%. Domestic demand – consumption and investment – falls by about 1%.[7] The UK Treasury's own estimates of the effect of changes in economic output on public sector net borrowing are similar: the Treasury suggests that a 1% reduction in GDP relative to trend increases the public sector borrowing requirement (the annual deficit) by around three-quarters of 1%.[8]

The reason for this is that the public and private sectors are interdependent. Cuts in the public sector mean that it buys less from the private sector, and public sector employees buy less from the private sector too. In a depressed economy, public spending cuts, far from creating space for the private sector to grow, tend to reduce private sector growth.

This in turn affects the size of the deficit. If the private sector is doing badly, it creates less tax revenue for government, at the same time as rising unemployment increases welfare bills. The result can be that what is intended as a deficit reduction policy actually turns out to increase the deficit, because of lower government revenue and, in some areas, also higher spending.

The IMF results suggest that the effects of 'fiscal consolidation' in current economic conditions could be as much as *four times worse* than normal – closing a deficit of 1% of national output could lead to a decline of around 2% in national output – because:

- interest rates are at or near zero (and have been since 2009), leaving no room for interest rate cuts to be used to offset the impacts of fiscal contraction
- most major developed economies are trying to tighten fiscal policy at the same time as the UK is, hence reducing the potential for boosting the economy through exports, rather than the UK being an isolated case.

The implication of this is that the effect of the government's breakneck fiscal consolidation is likely to be a substantial reduction in national output, an increase in unemployment, and a decline in business investment. It is possible that the economic contraction caused by trying to eliminate the structural deficit in five years *will be so large that the deficit will be approximately unchanged, and it could actually even increase*. Thus, there is a significant chance that Plan A will be a complete failure even on its own terms – the spending cuts will inflict huge amounts of damage on some of the most vulnerable people in the UK, while not actually achieving the primary aim of closing the structural deficit.

Simulations performed earlier in 2011 by the respected macroeconomic research institute the National Institute for Economic and Social Research (NIESR) support the IMF's fears.[9] NIESR suggested that because of the weakness of the economic recovery, even if the government manages to meet its targets for spending reductions over the next four years, public sector net borrowing will fall only to 3.6% of GDP in 2015/16, rather than the 1.5% which the Office for Budget Responsibility (OBR) projects. The government will miss its target for balancing the budget by around 2% of national output – about a third of the total size of the fiscal consolidation – if the NIESR figures are correct. The increasingly serious global economic slowdown since May when those figures were estimated means that the situation is almost certainly more serious even than this.

Figures for government borrowing so far in the 2011/12 fiscal year confirm the government is unlikely to meet its borrowing targets for the first year of deficit reduction. In the five months April to August 2011 the government borrowed £52 billion compared with £137 billion for the whole of the 2010/11 fiscal year.[10] The target for the full year is £122 billion. Given that forecasts suggest that the economy will slow significantly in the last quarter of 2011 and the first quarter of 2012, it looks very likely that the target will be missed by a considerable margin. The overall deficit for 2011/12 might actually be *worse* than 2010/11. It would be hard to find a clearer demonstration of the self-defeating nature of Plan A.

A forthcoming 'double-dip'?

The successful response by governments to the near collapse of the global banking system and the Great Recession of 2008 involved use of fiscal stimulus packages across many parts of the world (tax cuts, increased spending on unemployment benefits and welfare to work packages, plus targeted additional government spending on areas such as infrastructure and green investments). But as these measures have petered out during 2010 and 2011, in the face of criticism from the political right that each country was 'living beyond its means', the global economic outlook has worsened considerably.

Every month the UK Treasury publishes a round-up from a range of leading economic forecasts for the economy for the current year and the next year.[11] Between May 2010 and August 2011, the average independent forecast of projected GDP growth for 2011 has fallen from 2.3% to 1.2%, while projected growth for 2012 has fallen from 2.5% to 2%. This worsening environment for growth reflects a combination of the planned cuts in the UK together with fiscal belt-tightening abroad, leading to the prospect of what respected *Financial Times* economic journalist Martin Wolf has called 'the longest depression in this century or the last'.[12]

The OBR has also revised its growth forecasts downwards. In the forecasts that accompanied the June 2010 Budget the OBR projected growth in GDP of 2.3% for 2011 and 2.8% for 2012; in the March 2011 Budget, the growth projections had fallen to 1.7% for 2011 and 2.5% for 2012. Further downward revisions are likely in the March 2012 Budget. Most recently, the IMF projected growth for the UK of only 1.1% for 2011 and 1.6% for 2012 in its September 2011 *World Economic Outlook*.[13] The recent growth in UK unemployment to a 17-year high of 2.57 million in the three months to August 2011 underlines the severity of the slowdown.

In short, it looks increasingly likely that a severe economic slowdown – in the worst case, a double-dip recession – is going to be upon us in 2012, wrecking the prospects for Plan A. Indeed, Plan A is making a double-dip considerably *more* likely than would otherwise be the case.

Cyclical or structural deficit?

Most economists, although not all politicians, recognise that the public finances are affected by the business cycle. Tax revenue rises in booms and falls during slumps, while the reverse is true for benefit payments. Because of this, the deficit in the public finances has cyclical and structural components. The structural deficit is the size of deficit that the UK would be running if the economy was operating at full employment, whereas the cyclical deficit is that part of the deficit which results from the UK being below full employment – with spare capacity to grow.

Analysis by the NIESR suggests that before the Great Recession of 2008, the UK economy was running a small structural deficit of around 1% (excluding investment spending, which is vital for generating future growth potential). In retrospect this was unwise, as was the preposterous claim that 'boom and bust' economics had been abolished, and the UK would have weathered the Great Recession better if the public finances had been running a small structural surplus.

However, the main reason for a structural deficit of 10% of GDP opening up in 2008–2010 was that the recession was so deep that it permanently destroyed productive capacity, particularly in the financial services sector, which had contributed large amounts of tax revenue in the run-up to the crisis, and then required huge bailouts during the crisis itself – amounting to over 100% of annual GDP in 2009 according to calculations by the IMF.[14]

As Bill Martin of the Centre for Business Research at the University of Cambridge has argued, a careful reading of the evidence suggests that at least some of the so-called structural deficit is actually a particularly acute *cyclical* deficit – the economy is operating well below full employment and full capacity utilisation, largely because spending cuts in the UK and elsewhere in the global economy have reduced demand.[15] Furthermore, the effects of the crisis on capacity will depend greatly on the technologies and organisation of production in particular sectors, and there are good reasons to believe that the capacity loss figures have been greatly overestimated. In particular, capacity in financial services, construction and large areas of manufacturing is highly flexible in the modern economy, with spare office space, equipment and labour readily available. Reinforcing this is the idea that deficit-financed investment in the economy can create the potential for future growth (for example, through investment in infrastructure, technology and skills). This is covered in detail in Section 2 of this report.

To summarise, if demand could be restored and the employment rate increased, in combination with investment in growing the UK's productive capacity, a significant portion (though probably not all) of the structural deficit would disappear, leaving the rest to be financed through a combination of controls on spending at the right moment (when the economy is growing again) and tax revenue increases (as we suggest in Section 2).

Interest rates, austerity and the 'bond vigilantes'

We are also told by the Conservative-led government that one of the main reasons why the deficit has to be reduced as a matter of urgency is that otherwise we will face action by the 'bond vigilantes' in the market for the UK's sovereign debt. David Cameron suggested in June 2010: 'The more government borrows… the less confidence there is… and when confidence in our economy is hit, we run the risk of higher interest rates.'[16]

Economic theory suggests that the bond markets demand higher interest rates as a risk premium where there is a significant probability that a country will default on its interest payments. And at various points over the last two years, the interest rates on government debt have increased to completely unmanageable levels in Ireland, Greece and Portugal (necessitating Eurozone bailouts for those countries), while rising dangerously close to such levels in Spain and Italy.

However, in each of these cases, the imposition of savage austerity measures – involving huge spending cuts and tax increases in an attempt to eliminate the structural fiscal deficit – has actually *made the interest rate problem worse*. The Irish, Portuguese and Greek economies contracted further *after* the austerity measures, resulting in a vicious spiral; the markets became less convinced that each country would be able to avoid a default – or at least a bailout whereby bond investors took a 'haircut', significantly reducing the value of their investments – and so demanded higher interest rates, leading to further austerity measures, followed by higher interest rates, and so on.

The medicine is making the patient worse, not better, but cuts are the only cure the dominant neo-liberal model knows.

This is certainly not to say that deficits can be ignored completely *ad infinitum*, or allowed to explode upwards uncontrollably. But the evidence is that a single-minded focus on austerity measures as an attempt to reduce the deficit – while ignoring the macroeconomic impact of such measures – tends to make the problem worse, not better. While the UK has not (yet) been in any danger of attention from the 'bond vigilantes', this is largely because as a country with our own currency we have been able to undertake a substantial devaluation to keep our exports competitive – which is not an option open to Eurozone members. But over the next few years it is much more likely that extreme austerity will result in a sovereign debt crisis for the UK than that such a crisis will be caused by high levels of public debt.

What scope to offset the effects of austerity measures?

The UK government has argued that it is possible for the UK to undertake 'expansionary fiscal contraction' even in the face of austerity measures by loosening monetary policy rather than fiscal policy. However, the options for this are limited. The Bank of England has held interest rates at almost zero for over two years, while QE – the mechanism whereby the Bank of England purchases assets with electronically created money in an attempt to stimulate economic activity – seems to have driven up asset prices but had little impact on productive activities in the economy.[17] There is very little additional potential for QE as practised thus far in the UK to stimulate the economy in current circumstances, although there is potential for using QE more creatively to fund essential investments for the UK economy directly, as we discuss in Section 2 of this report.

The other alternative strategy for recovery that has been touted is 'export-led' growth based on a recovery of export-orientated manufacturing and service industries with a low exchange rate. While this is a good strategy for an individual country looking to grow its way out of recession, in a global slump such as the current one there is an obvious problem: it is impossible for every country to be a net exporter and have a low exchange rate all at the same time.

Meanwhile, the OBR's projections for the components of UK demand for goods and services show that, even on its own projections (which as argued earlier, are probably too optimistic), the path to fiscal balance is fraught with difficulty.[18] The OBR suggests that there will be an export-led recovery with imports into the UK growing more slowly than over any five-year period since 1948, and that business investment will grow by an average of almost 9% per year between 2011 and 2015. With domestic and global demand in their current states these projections seem implausible. Meanwhile, given slower forecasts of output growth, the OBR's forecasts of total household debt in 2015 have also been revised substantially upwards – from £1,823 billion to £2,126 billion – since last year.[19] If these forecasts turn out to be accurate, Plan A will simply return the UK to the kind of unsustainable economy fuelled by explosive private debt that characterised the 20 years before the 2008 crash.

Summary: a recipe for disaster

This section has shown that the coalition government's Plan A is a recipe for economic disaster for the UK. It is based on a false set of economic assumptions that the government is using to deceive the British public. The UK is not bankrupt and has not 'maxed out its credit card'. We are not one step away from an attack by the 'bond vigilantes'. The doctrine of 'expansionary fiscal contraction' is a mirage, which is being used as cover for sweeping cuts in public spending. Combined with similar austerity measures elsewhere, these cuts are pushing the UK into a double-dip recession, which is increasing the deficit rather than reducing it.

Before setting out a workable set of alternative proposals in Section 2, the remainder of this first section sets out the global and environmental context of Plan B.

B The global context for Plan B

The UK recession has come about as the result of a combination of the consequences of Plan A and the global situation following the financial crash of 2008. There is much worse to come if the government sticks with Plan A. At the same time, the prospects for growing out of recession in the medium to long term are crucially constrained by environmental limits (e.g. climate change), the tendency for economic growth on a finite planet to push up commodity prices, and the structural instability of global financial markets. Economic policy has to be fashioned in a way that enables the productive economy to prosper, within the context of globalisation and climate change. Many polices can be pursued at a national level, while other policies require some degree of international agreement, although agreement does not have to be total in order for useful progress to be made.

It is impossible to plan a road to recovery without setting policy within the rapidly changing global context. It is critical to understand the new global context.

Crisis in the West and the rise of emerging powers

A multi-polar world now depends for its sustained growth and trade and investment flows as much on countries that are not members of the Organisation for Economic Co-operation and Development (OECD) 'industrialised' club as on those that are. More generally, middle-income countries of all sizes are increasingly supplying development finance, technology, and expertise and market linkages to other developing as well as developed countries, in mutually beneficial networks. In this environment, North–South perspectives become less relevant and South–South ones more complex. This rise of emerging powers is related to financial crisis in the West, which has led to a loss of faith in aspects of the western development model.

Growing inequalities

Recent decades have been characterised by significant increases in wage dispersion in most (although not all) industrialised economies. In almost all countries in the world the low-wage sector has increased. Precarious employment and informality have also increased, especially in the sector of non-tradable goods and services. Globalisation trends, therefore, cannot directly explain the emergence of these sectors. They are at least partially the result of labour market deregulation.

Resource constraints

As Rio 2012 approaches, our understanding of our resource-constrained world has progressed in recent decades. 'Land grabs', 'water wars' and food crises have become common phrases in the development lexicon. For the poorest, this can mean further insecurity as land comes under pressure. The 2011 world food crisis shows no sign of diminishing and imposes hardship on individuals, but also additional strain on public budgets and import bills. New demands will be made on sources of development finance, to provide balance of payments support, or to underwrite social protection programmes designed to cushion the poor against the effect of higher prices. The West's consumption of resources is unsustainable and will increasingly contribute to tension, conflict and injustice.

Financial deregulation and volatility

Since the collapse of the Bretton Woods system of fixed exchange rates in 1971, the international financial system has been substantially deregulated. For instance, in the UK foreign exchange controls were abolished in 1979, the mortgage and savings markets were liberalised in the 1980s, and the 'Big Bang' swept away many of the protectionist practices in the City of London in 1986. Combined with similar moves in many other countries these measures – allegedly introduced to increase the efficiency of the financial sector – have instead resulted in increased volatility, as described by the respected economist and *Financial Times* commentator John Kay:

> The credit crunch of 2007-08 was the third phase of a larger and longer financial crisis. The first phase was the emerging market defaults of the 1990s. The second was the new economy boom and bust at the turn of the century. The third was the collapse of markets for structured debt products… [In each case] financial institutions identified a genuine economic change – the assimilation of some poor countries into the global economy, the opportunities offered to business by new information technology, and the development of opportunities to manage risk and maturity mismatch more effectively through markets. Competition to sell products led to wild exaggeration of the pace and scope of these trends. The resulting herd enthusiasm led to mispricing – particularly in asset markets, which yielded large, and largely illusory, profits… Eventually, at the end of each phase, reality impinged… Governments, and particularly the US government, reacted on each occasion by pumping money into the financial system in the hope of staving off wider collapse, with some degree of success… Each boom and bust is larger than the last. Since the alleviating action is also larger, the pattern is one of cycles of increasing amplitude.[20]

The consequence of the global context described above is that the coming years are likely to be dominated by concern about instability and uncertainty in the world economy. Growth and financial stability will dominate the G20 agenda. The global economic situation will affect growth prospects, create the need for shock facilities of various kinds, and lead to calls for better global regulation.

A Plan B for the European and world economy

A global Plan B must first and foremost tackle the asymmetry between economic and financial activity which is globalised, and regulatory frameworks which are still largely national. Existing structures for the regulation and governance of the world economy are too weak or have too little reach, although economic processes have long had a global dimension, and this has increased in recent decades. This problem is not confined to the economy in the narrow sense, but also encompasses many other areas, such as environmental questions.

One function of global governance would be to establish a more stable international exchange rate regime and a mechanism that prevents excessive current account imbalances. Without a certain degree of control of international capital flows, stability is impossible to establish. Free capital flows are not in themselves a fundamental component of good economic policy. In many cases they have increased volatility, created shocks and currency crises, and not growth and prosperity.

Not everything can or should be regulated and governed at supranational level. A great deal can remain at the national level. Which measures should be regulated at which political level should be decided on a case-by-case basis. What is needed is to furnish economic policy institutions with macroeconomic governance mechanisms – either by introducing new ones or by restoring some that have been lost over the past few decades – in order to be better able to control and correct market developments which jeopardise the stability of the national and global economy or even the future of humanity.

Global financial market regulation is a classic international public good. There is an inherent danger that, in the absence of international coordination, this good will be in short supply. A step in the right direction of better regulation in the wake of the outbreak of the subprime crisis was the establishment of the Financial Stability Board and the upgrading of the IMF. However, simply replenishing the funds of the IMF does nothing to resolve its legitimacy problems or those of other international organisations. Until their organisational structure reflects the current geo-economic importance of the different countries of the world, and as long as their traditional domination by the industrialised countries continues, this legitimacy deficit will persist. The IMF and other international organisations must also learn from their past mistakes. They must now become the drivers of new regulation at global level.

In order to avoid a concentration of power at the global level, the creation of a powerful global financial supervision authority, located at the Bank for International Settlements, as a successor of the Financial Stability Board is a strong option. Also at the global level, institutions should be established that carry out up-to-date and independent analyses of the development of international financial and capital markets, propose appropriate measures for worldwide regulation, and ensure there is ongoing and binding communication between international institutions. A Global Economic Council of Experts at the United Nations could be a new institution performing this function.

The crucial aspect is coordination. Uncoordinated regional or even unilateral reform might only create new problems. By the nature of such a reform process, each jurisdiction will in the end treat some activities more strictly than other countries and regulate some other activities more lightly. Moreover, the outcome will certainly lack a comprehensive global oversight structure. The result would create the conditions for new regulatory arbitrage, with activities being shifted to the jurisdiction that regulates them the least.

The latest regulatory steps (CRD IV, Basel III, the Vickers Rule and so on), which are supposed to increase capital requirements over the next decade in order to provide better protection against potential banking losses in the future, are steps in the right direction. They should have a potential effect on the solidity of the financial system, but there are too many shortcomings still to make it an effective reform. Capital requirements are still too small, and they neither get a grip on the shadow banking system nor reform the role of rating agencies in a significant way.

At a European level, where we have greater locus, there are a number of key reforms that need to be made:

- A one-size-fits-all European Union (EU) approach clearly no longer works. We need to work out a multi-tier EU that works.
- The Eurozone will need stronger institutional integration and cooperation.
- A new investment strategy for the deficit countries is required. There needs to be struc-

tural adjustment, but this can only be introduced via growth not stagnation or recession.

- The European Financial Stability Facility (EFSF) should be strengthened, in part through the creation of limited Eurobonds.
- The new Eurozone and EU will need its own taxes and a financial transaction tax is the best start for this (ideally on a global basis).
- Europe needs to examine the creation of a new post of minister of finances for the euro area as a political counterpart to the European Central Bank (ECB).
- An Institute for European Economic Reconstruction should be created – the EU equivalent of the British Investment Bank (set out in Section 2).
- Finally, Europe requires democratic reforms so economic integration is matched by political integration.

The second pillar of a global Plan B is a more equitable income distribution. It is crucial to reverse the negative changes in income distribution and grant all population groups an adequate share in the wealth created in society. These unjustified income inequalities among wage earners must be dismantled by means of labour market reforms. The collective bargaining system must be strengthened, backed up by other labour market institutions to achieve the decent work conditions stressed by the International Labour Organization. Labour market regulations are important not only to reduce income inequality, but also to establish a nominal wage anchor against deflationary money wage cuts. The third pillar is the environment.

C The environmental context of Plan B

Although much of Plan B focuses on the immediate future and the constraints on prosperity that face the country now, it is also important to recognise there is another set of constraints, which will become increasingly important as we move into the medium and long term. These constraints derive ultimately from the finite nature of the planet, and have already begun to make an impact.

There is plenty of evidence for this. The three most important parts concern climate change, ecosystems and commodities. No economic strategy that ignores this evidence is going to be relevant or useful to our country or its people.

Despite all the talk about limiting emissions, world total greenhouse gas emissions are continuing to rise, and therefore so are global average temperatures. This is already bringing disruption to weather patterns, droughts, floods and consequent impacts on agriculture and food production. As a result of existing trends and policies, the world is heading for a disastrous period of climate change, resulting in increased numbers of environmental refugees, the spread of tropical diseases, and instability in weather patterns.

Climate change will also have an impact on economic growth. As the Stern Report argued, the situation is not simply that the economy has effects on the environment which we may not like, but also that the environmental impacts have consequences which feed back on the economy.[21] We are living in an economy–environment–economy loop.

Just as we face the problem of global climate change, most of the world's ecosystems are in decline. This will lead not only to extinctions and loss of biodiversity, and a reduction in the capacity for coping with climate change, but also to an undermining of the 'natural infrastructure', which provides basic physical ingredients for economies and livelihoods – such as water availability, good soil quality, good air quality, genetic resources, pollination and climate stability. The recent studies on the economics of ecosystems and biodiversity (TEEB) argued, in much the same way that the Stern Report did, that environmental impacts in turn have economic costs, and that sensible investment now can avoid those costs becoming much greater in the future.[22]

Huge commodity price rises are to a large extent symptomatic of the effort to combine a finite planet with infinite economic growth. If economic growth is carried out in a way that means there will be ever-increasing demand for metals, foods, oil and other commodities, the consequence is likely to be increased prices for those commodities. That increases firms' costs, tending to lead in the direction of stagflation, with firms limiting the resources they buy and usually also the output of their products.

Many of the problems created by environment and resource constraints on current patterns of growth can only be fully addressed at an international level. Fortunately, there is soon an opportunity for doing exactly this, at the United Nations conference on sustainable development in Rio de Janeiro, Brazil, in June 2012 – exactly 20 years after the original Earth Summit in Rio in 1992, and 40 years since the United Nations Conference on the Environment in 1972. The 2012 conference has the 'green economy' at the top of its agenda, and it is to be hoped that Rio will become a major focus for public, political and media debate on these issues. This applies not only to the conference itself, but also to the international process leading up to it.

Within UK economic policy, there is also a clear need for a shift of emphasis. 'Environmental' issues need to be brought out of their peripheral role within government at the Department for the Environment, Food and Rural Affairs (DEFRA) and the environmental side of the Department for Energy and Climate Change (DECC), and into the heart of decision-making in the Treasury and 10 Downing Street, and particularly in processes to decide the allocation of government expenditure and the pattern of taxation. Policies to address the environment and resource constraints on growth should include:

- a major expansion of renewable energy and energy efficiency, including home insulation
- investment in public transport, to improve provision and reduce the price to passengers, reducing the current incentives to travel by car
- investment in training for green jobs, so that more people have the necessary skills to contribute to the transition to a green economy, with the building industry as a priority
- much tougher restrictions on misleading and exploitative advertising
- the use of the tax system to penalise inefficiency in resource use and damage to the environment
- reforms in the political system and machinery of government to bring in more long-term thinking, representing where possible the interests and rights of future generations; this would reverse the present government's drift in policy – shown by its abolition of the Sustainable Development Commission, the Royal Commission on Environmental Pollution, Whitehall's Sustainable Development Programme Board and many of the environmental safeguards in the planning system
- strengthening rules on company reporting to require much fuller reporting on social and environmental factors
- a government-led programme, in partnership with the private sector, to invest internationally in maintaining and improving key ecosystems, with incentives and payments systems being created to make this work.

Many of these policies are spelled out in detail in Section 2 of this report, but the key message is that although environmental limits are an underlying and long-term problem, they are already causing economic damage. There should be no further delay in taking them fully into account when drawing up policies for the UK economy. This is one reason why we need to move to different measures of economic performance.

D Plan B and going beyond GDP

Almost everyone now agrees that GDP is an inadequate measure of progress. It was never designed to be one, and has only achieved its pre-eminence because there is lack of agreement about what should be used as an alternative, although efforts are under way in several countries to develop other measures. The UK is leading the field, and the EU and the OECD are trying to coordinate, with a view to creating international standards.

This has the potential to make policy more progressive. Inequality, attacks on sustainability, weakened communities and 'flexible' (insecure) employment are all often justified because of their contribution to GDP growth. Sometimes these arguments are correct – or at least credible. However, if contribution to growth is not the be-all and end-all, then even if they are correct, other priorities may be more important.

People experience well-being when life goes well. It is hardly controversial to say that public policy should maximise citizens' well-being. Self-evidently, the economy influences levels of well-being. An economy is more or less 'well-being efficient' depending on how much well-being it creates for each unit of output. Threats to environmental sustainability are sometimes conceived of as a form of capital depletion, with the capital equal to our current distance from certain environmental limits. However, the impact of this form of depletion may not be marginal decline (as with other forms) but catastrophe. It therefore needs to be considered separately. An economy is more or less environmentally efficient or environmentally sustainable depending on the impact on our distance from environmental limits of each unit of output.[23]

A complete set of measures of progress would track well-being, the capital stock (human, social, natural and so on)and distance from environmental limits, as well as the impact of the economy on each of these (well-being efficiency, accumulation rate and environmental efficiency).

All this raises a number of questions: in particular, how do we define and measure the various forms of capital, environmental limits and well-being? The debate continues, but at least on well-being we are moving towards a consensus. Well-being is best thought of as 'flourishing', an active state that involves living a life with meaning and purpose, being free to make your own choices and having good relationships with those you are close to and a wider group. This, the evidence suggests, gives rise to positive feelings of happiness and satisfaction with life. The level of flourishing can be measured using self-reported surveys, and the external conditions which foster it can be identified through statistical analysis.

This analysis is ongoing, but evidence already points towards seven main priorities for economic policy to replace the priority of GDP growth:

- **As many incomes as possible to be within a target band:** The evidence shows that income is important to well-being, but only up to a certain level, which varies from society to society (and of course from household type to household type).[24] After this point there are sharply diminishing returns. It also shows that equality is positively associated with well-being, although the relationship is complex.
- **Economic and social stability:** The evidence shows that economic instability is negatively associated with well-being because of its impact on job security (and associated fears) and community stability, social trust and children's well-being.
- **Minimal unemployment**: The evidence is very clear that unemployment is very damaging to well-being; the damage is significantly greater than that caused by the associated loss of income (while loss of income is itself much worse than the equivalent gain is good); in addition people do not adjust to it (although they do to some other forms of loss).
- **Satisfying work for all**: The opportunity to undertake interesting, stretching work is highly valued, as are good relationships at work.
- **Work for all in the right quantities**: Well-being rises as hours worked rise but only up to a certain point, after which it starts to drop. Most people in Europe say they would like to work fewer hours and would even accept a corresponding drop in income to achieve this.
- **Ensuring active forms of consumption and correcting the biases created by advertising:** There is evidence that consumption decisions do not maximise well-being, that they are influenced by manipulative advertising and that more active forms of consumption are more conducive to well-being than more passive ones. There is also evidence that short-term debt damages well-being.
- **Negative externalities which have been shown to damage well-being (such as noise) should be minimised**.

None of the above objectives should be bought at the cost of failing to accumulate sufficient capital for the future or failing to maintain our distance from environmental limits. National economic policy should be designed to support not hinder international negotiations to secure an environmentally sustainable global economy.

So, we have a rigorous well-being approach to measure economic performance against, and a recognition of the global and environmental context in which Plan B must set. And most compelling of all, we have the evidence that Plan A isn't just failing on its own terms but is highly likely to make the nation's deficit worse. The second section of this report sets out the alternative in detail: the emergency growth measures and the long-term investment policies needed to build a good economy for a good society.

Section 2

Plan B: saving the economy in the short run while ensuring no return to business as usual in the long run

Britain urgently needs a Plan B – a radical set of short-term measures, but in the context of parallel longer-term reforms to ensure sustainability and stability for the nation's economy, society and the environment. The two timescales have to be brought together if we are to avoid bubble economics, a widening inequality gap, environmental disaster and weaker economic performance. This moment has to be used as a turning point to move to a different type of economy, which can support a different type of society.

A Emergency growth measures

In the long run, of course, we are all dead. The UK economy desperately needs first aid now – in the form of a large-scale discretionary stimulus – to avoid a double-dip recession, which would have devastating consequences for unemployment and lost productive capacity.

Stopping the cuts

In the short run, Plan B would start by severely limiting the coalition government's spending cuts programme, which, as shown in Section 1, is likely to increase the deficit rather than reduce it over the current parliament, failing to achieve the government's primary objective while imposing huge suffering on many of the UK's most vulnerable households. Limiting the cuts would go a long way toward spurring economic recovery and avoiding a double-dip recession. In the longer run, of course, we need to make sure that the public finances are on a sustainable footing and the tax and spending implications of this are discussed in parts b and h below respectively. But in the short run the economy is too weak to impose large-scale spending cuts.

However, the economy is in such severe trouble at the moment that limiting the cuts is not a sufficient measure to ensure recovery by itself. We need additional emergency growth measures. This first part of Section 2 outlines two short-term measures which can help: green quantitative easing (QE) and stimulus through the tax and benefit system.

Green quantitative easing

It is now widely agreed that the £200 billion programme of quantitative easing (QE1) launched in March 2009 mostly benefitted the bankers.[25] The theory was that banks would lend to businesses in the real economy some of the money they received from the Bank of England when it purchased their government bonds (gilts). The money was instead trousered by the banks, to be poured into stock markets, commodities and emerging economies like Brazil and China, damagingly inflating values, in all cases with knock-on consequences we are still seeing. QE's other goal of keeping interest rates low appears to have worked – but they would doubtless have stayed low anyway given the weakness of demand in the UK and other developed economies.

In October 2011 the Bank of England announced a new £75 billion QE package (QE2). But using QE to give banks a further £75 billion in the hope that this time they will lend enough to business will be a hugely unproductive missed opportunity. QE should instead have been used to increase economic activity and hence jobs and business opportunities. Without that the policy fails to address the real problem, which for many businesses is increasingly a shortage of sales and not a shortage of capital.

We recommend instead using a large scale package of QE to finance a Green New Deal to make all UK buildings energy efficient. This would help kick start the economy by training a 'carbon army' to implement a multi-billion pound, carefully costed programme to fit energy efficiency and appropriate renewable generation equipment to all UK buildings, thus generating tens of thousands of jobs where people live. The savings from household and business fuel bills would be recycled into the UK economy, providing a further badly needed stimulus.

The first step of the Green New Deal will be to train a vast carbon army to crawl over every building in the UK, making them all energy efficient and fitting renewables such as solar photovoltaics. This will generate a huge range of jobs from engineers and energy accountants through to solar roof fitters, loft insulators and draught strippers. The Green New Deal approach, kick-started through QE, will over time be funded in part by the new tax revenues generated by this huge nationwide programme, as well as from repayments from some of the savings in energy bills.

Of course, green QE could also be used to fund improved transport infrastructure and the building of homes on brownfield sites (transport and housing are discussed in more detail in Part b of this section). But beyond that there is also one form of government debt that could be cancelled using QE cash, with large-scale benefits for the UK economy: the £50 billion or more of debt tied up in Private Finance Initiative (PFI) schemes. Using QE2 to pay off the money owed under PFI schemes would allow those contracts to be cancelled and so rid future generations of the need to have to pay for past mistakes in government finances. The sums involved are estimated over the decades to come to a total of a staggering £252 billion. Saving around £200 billion by buying out these contracts now, if necessary using a statutorily laid-out compensation formula, could then ensure adequate funding for the future social priorities such as the NHS, care for the elderly and education, which we discuss in Part e of this section.

Short run stimulus via the tax and benefit system

To counteract the collapse in demand in the UK economy as a result of the Plan A austerity policies, a temporary fiscal stimulus is desperately needed. Shadow Chancellor Ed Balls has suggested reversing the increase in VAT from 17.5% to 20%, which George Osborne enacted in January 2011. This would cost approximately £13 billion. As a short-run measure to increase demand, this would certainly be better than nothing, but it is not the most effective way of increasing spending. Because expenditure is closely related to household income, most of the gain from lower prices resulting from a VAT cut goes to higher income households, who are (on average) more likely to save any extra income they get than are poorer households. This means that the impact of a VAT cut on demand would be diminished because a significant proportion of the extra cash would simply be saved. The above-inflation increases in the income tax personal allowance which the coalition government has introduced are even worse in this regard, because most of the gain from these tax cuts goes to middle- to high-income families.[26]

Several commentators including ex-Bank of England Monetary Policy Committee member David Blanchflower have suggested there should be a temporary holiday on National Insurance Contributions – specifically, Blanchflower recommends a two-year holiday on NICs for anyone under the age of 25.[27] This would help address youth unemployment, which is now at record levels. However, there is a clear danger that the measure leads to an increase in employment for under-25s at the expense of over-25s, because under-25s would be considerably cheaper to employ under a scheme of this kind.

A better option for temporary stimulus than tax cuts would be to increase net incomes for the poorest families in a more targeted way. The best way to do this would be to increase benefits and tax credit payments for low-income non-working and non-working families, and also pensioners. The benefit system we have for working age people is not fit for purpose at the moment. At the moment, the Jobseeker's Allowance payment for a single working age person under 25 is £53.45 and for a person over 25 it is £67.50. Research by the Centre for Research in Social Policy at Loughborough University shows that a single working age person with no children requires a weekly income of around £185 'to reach a minimum acceptable standard of living, covering essential requirements and allowing people to participate in society'.[28] It is clear that benefit levels for working age single people fall far short of what is required to alleviate poverty. Raising the levels of Jobseeker's Allowance and other working-age benefits such as Employment and Support Allowance so that they are at, or at least much nearer to, the minimum income standard is an essential prerequisite for the benefit system to be effective at preventing poverty among people searching for work. This is more important than ever at a time when youth unemployment is reaching record levels.

For families with children, the benefit system is more generous, largely because of the substantial above-inflation increases in tax credits which New Labour delivered. However, the coalition government is now cutting back severely on in-work benefits. For example, in April 2011:

- The Working Tax Credit (WTC) for families with children was frozen in nominal terms (a real cut of around 5% using the Retail Price Index measure of inflation).
- The withdrawal rate of tax credits for families earning over £6,420 per year rose from 39p to 41p for every pound of extra gross income.
- There was a reduction in the proportion of childcare costs for which working families could receive a WTC payment from 80% to 70%.

Research by Landman Economics for the single parents charity Gingerbread shows that working families with children who do not use childcare can lose up to £400 per year from the changes, and substantially more than this for those using paid childcare (e.g. up to £1,400 per year for a family with two children with childcare costs of £300 per week or more).[29] On average, Landman Economics estimates that the April 2011 cuts to tax credits reduced the gain to work for single parents claiming WTC by around 5%. Reversing the cuts to WTC would have the dual impact of putting more money into the pockets of low income families with children, thus boosting demand. Furthermore, increasing WTC boosts work incentives, and to the extent that this helps increase employment it would boost demand in the economy still further, as well as improving the public finances.

A financial transactions tax

Another economic boost could come from a financial transactions tax. There are two key arguments in favour of this. The first is that, with governments struggling with high levels of public sector debt and deficits throughout, it is only right that the financial sector makes some contribution in the form of new revenues. The second argument is broader: the financial sector is the primary cause of the current crisis. Therefore, while raising tax revenues from the financial sector, it is possible that the tax will have a deterrent effect on financial transactions in total. This would reduce the amount of speculative trading in particular.

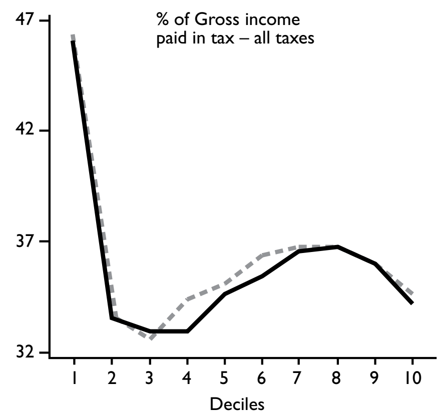
The UK government opposes the imposition of a financial transactions tax at a national or European-wide level on the grounds that trading will migrate to other centres such as New York, Switzerland or Singapore. It argues instead that any financial transactions tax must be imposed multilaterally, with at least all the current major trading centres signing up simultaneously. Otherwise total transactions will not decline but simply move to overseas centres, with the consequent loss of jobs and taxes from the British economy. However, banks and other financial services firms currently have huge investments residing in London, and switching personnel away from London would entail an enormous cost – particularly as the European Commission recently indicated it is in favour of a financial transactions tax, and so if such a tax were introduced it should be possible to introduce it for all trading centres in the European Union simultaneously. What is most likely is that a financial transactions tax would curb low-margin high-volume trading such as is undertaken by hedge funds. But this outcome would itself have major potential advantages in reducing volatility in the global economy.

Research on the possible revenues from a financial transactions tax published by Tax Research LLP in 2010 suggested that total global yields from a tax of one half of a basis point (one 200th of 1% or 0.005%) on spot and derivative foreign exchange dealing would raise approximately $33 billion annually, while a tax at a similar rate on exchange-traded and over-the-counter bond, gilt, derivative, swap and other trades could yield approximately $118 billion per year.[30] Obviously these are global figures, but the large volume of trades taking place in the UK suggests that the UK's share of this revenue would be substantial.

B A fairer tax and benefit system, with assets for all

Short-term stimulus measures to prevent double-dip recession are important, but in the longer run the UK's tax and transfer system needs more fundamental reforms. The system could be made fairer, and more revenue could be raised, by making it more efficient and simpler, and by collecting the full amount of tax that is owed. Our present tax system charges the lowest tax rates of all to the largest companies, which operate their in-house banks in tax havens (courtesy of new corporate tax legislation from George Osborne[31]) and which pay just 5.75% tax on the resulting profits. As shown in figure 1, taken from Compass's previous publication on tax reform, *In Place of Cuts*,[32] the UK's tax system is regressive overall: the highest earning in the population pay a lower proportion of their overall income in tax than those earning the least do.

Figure 1 The percentage distribution of UK taxation by decile group (poorest to richest), 2006/07



Source: *In Place of Cuts*[33]
Notes: decile 1 is poorest, decile 10 is richest.

While it is not yet clear whether we will need to increase overall the tax burden once the economy has recovered, we certainly need to review who does and does not pay tax and shift the structure of the entire tax and benefit system so that the tax burden falls on those with the ability to pay. This subsection now presents proposals for tax reform under several broad headings.

Closing the tax gap

To secure a fair tax system, we need to make sure that those who owe tax pay it. The UK has a massive tax gap. HM Revenue & Customs say it is £42 billion – made up of £35 billion of illegal tax evasion and £7 billion of unacceptable tax avoidance. But the true figures are possibly as much as £70 billion and £25 billion a year, respectively, to which can be added £25 billion of tax paid late.[34]

While all of this will not be recoverable, there is a great deal that could be done, such as:

- Require UK banks to tell HM Revenue & Customs which companies in the UK have bank accounts. At present 500,000 companies a year simply 'disappear' from the Register of Companies without paying their tax or filing their accounts. This could cost us £16 billion in lost tax annually – tax we could have if only we'd invest in the people to collect it.
- Demand full, automatic information exchange from tax havens, and threaten that we will withhold tax from all payments of interest, dividends, royalties and rents to those places unless they cooperate.
- Introduce a general anti-avoidance principle to tax law. This would mean any business adding an artificial step into a transaction solely to get a tax advantage parliament did not intend would not receive that tax advantage.
- To make sure we know which multinational corporations are using tax havens we could also demand that all such companies include country-by-country reporting in their accounts. This would require that a profit and loss account and balance sheet be included for every country in which they operate, exposing the cheats, the non-payers and the tax haven abusers to proper scrutiny. HM Revenue & Customs admit this would help them raise more tax.

Ensuring the tax system better reflects ability to pay

To ensure the tax system better reflects ability to pay, the most obvious reform would be to simply restrict the total allowances and reliefs anyone could claim against their tax. So, for example, we could say no one should offset more than £5,000 of allowances against their income. More than that is claiming too much state subsidy. The impact would fall almost entirely on the top few per cent of income earners.

We could also claw back some of the excess profits made by banks and finance to repay the support we gave them in their hour of need by increasing their corporate tax rate by 10%. They'll scream, of course, but there's a precedent for doing so very close by – this happens in all the UK's crown dependencies of Jersey, Guernsey and the Isle of Man.

Reducing wealth inequalities

A person's wealth crucially affects their freedom and opportunity. It provides a crucial cushion against economic shocks.[35] It enables us to look to the future with creativity and ambition, and grounds an economic independence which makes us less vulnerable to exploitation.[36] These are just some of the reasons why we ought to be aghast at the inequality of wealth in the UK. Making the income tax system more progressive, coupled with the recommendations made in the previous section on increases to benefits and tax credits, will reduce income inequalities. But wealth inequality is much greater than income inequality, and there is evidence that it has increased in recent years.[37] Wealth divisions are strikingly reflected in housing – the rise in house prices over the past two decades has made it increasingly difficult for first-time buyers – and in the unevenness of pension provision.

To bear down on wealth inequality, we need to support asset-building more widely and require the very wealthy to contribute their fair share. Here we present some promising tax and transfer proposals to assist with this aim.

Capital accounts for all

The community should ensure that all citizens have a decent sum of capital on maturity. The Child Trust Fund used a mix of state grants and family saving to advance this goal. Abolished by the coalition government, we should aim to restore it or introduce a similar policy. Another important model is the use of matched saving (the state matches personal saving with a contribution) to help low-income families accumulate an asset. This idea lay behind the Saving Gateway, another innovative policy abolished by the coalition, which we should consider reviving.

Fairer taxation of wealth

Richer households have benefited from the inflation of house prices. Since this is largely 'unearned' – the rise in value is typically unconnected with work or enterprise by the property-holder – there is a very strong moral case for making a portion of it available to the community. The most direct method would be to introduce a land value tax (a tax on the rental value of land, deducting the replacement cost of any development on it).[38] Such a tax can also help to stabilise the economy and improve the supply of housing.[39]

In addition, inheritance tax should be reformed. The tax should explicitly fall on those receiving inheritances. Individuals would be able to receive wealth up to a certain amount (e.g. £250,000) over their lifetime from gifts and inheritances without tax, with progressive taxation of transfers over this threshold.[40]

Fairer and better pensions

The government currently provides around £38 billion per year of tax relief for private pensions – equivalent to 5.5% of government spending.[41] However, much of this support goes to those who are already well off – over 50% of pension tax relief benefits the top 10%.[42] One proposal to tackle this envisages a shift from tax relief to a system of matched saving. The matching rate could be set so as to ensure a much fairer sharing out of public subsidy.[43]

How funds are invested

As important as the distribution of the subsidy is how funds are invested. Pension funds under-invest in the real economy, thereby failing to create a genuine asset base on which future pension commitments can be met. To rectify this it should be a condition of public subsidy that pension funds invest at least a minimum share of their resources, say around 25%, in real assets in the UK.[44] This could include investment in local authority bonds to support local regeneration and in a British Investment Bank for green projects (see below). To encourage responsible investment, pension fund managers should also be required to give more transparent accounts of how they invest policy-holders' savings. In addition, a way to encourage pension funds to support local investment might be to implement London Citizens' call to use a fraction of the eventual payback from the bank bailouts of 2008 to set up new community-based investment funds.[45]

Administering tax effectively

Finally, collecting what is owed means providing tax offices in each town in the country where people can get the help they need to get their tax right. This is fundamental to democracy, and tax justice, but the government is closing tax offices instead.

We should put many more people on the task of correctly assessing and collecting tax. The ratio of tax collected to the cost of overheads (wages etc) is around 10:1. Spending £1 billion employing another 20,000 tax staff would allow us to collect an extra £10 to £20 billion of tax per year.[46]

C Promoting business investment and innovation

A new investment policy for the UK

For more than two decades, successive governments have adopted a hands-off approach to economic management. The assumption was that private enterprises, through the market, would make wise investment decisions. All government had to do was maintain fair competition between businesses and correct the markets' worst injustices through taxation and redistribution.[47]

That approach has failed, and the recession is partly a consequence. Lax financial regulation helped inflate a bubble of consumer debt, but average real incomes stagnated.[48] Business investment, always low in the UK, was shaky even before the recession broke. And research has shown that while 1.3 million manufacturing jobs were lost in the last decade, they were not replaced by new jobs elsewhere in the private sector. Financial services created only 35,000 new jobs over the same period. Public sector employment took up the slack where the private sector would not.[49] Regional disparities widened.[50]

This high-debt, low-wages, low-investment model is very obviously no longer tenable. A new strategy is needed. David Cameron has spoken of his desire to create the 'industries of the future', but the coalition government is in fact pursuing an even more rigidly market-led approach than its predecessors, relying on the private sector to take up the slack as the state shrinks. But this is unrealistic. Government must instead be prepared to use its powers to create the opportunities for investment and innovation that will drive sustainable job creation.

The negative image of industrial policy in recent public policy debates is perhaps understandable given the failures of the approaches pursued in the 1960s and 1970s of bureaucratic nationalised industries and 'picking winners'. However, while old-school industrial policy didn't work, neither has the neoliberal approach of a market-led free-for-all combined with tax incentives for research and development.

There are two clear problems with the UK's industrial base. First, business research and development is much lower as a percentage of UK Gross Domestic Product (GDP) than in any of our major industrialised competitors – for example the USA, Japan and Germany.[51] Second, the UK is currently suffering from a huge dearth of investment. Investment by UK businesses was lower than in other major economies even before the Great Recession of 2008 to 2009, but has slumped even further in the recession, falling nearly 20% from 2007 to 2009. A feeble recovery over 2010 has collapsed this year. Business investment is some £44.9 billion below its pre-recession peak.[52] Corporations are hoarding cash, with capital spending out of their retained earnings the lowest since records began.[53] Those small businesses prepared to invest still find banks unwilling to lend. Private investment is now just 15% of GDP – well below its historical average, and no base on which to build a recovery. The slump in private investment accounts for 80% of the output lost since 2008. The UK is suffering from long-term structural deficiencies in innovation and investment which have been compounded by the post-2007 economic crisis.

As several authors have recently pointed out, well thought out industrial policy can address these deficiencies in the UK business sector and boost investment and innovation.[54] This should not be done by 'picking winners' but rather by using the state in a wider enabling role, to actively create markets for new technologies to come into being by bringing together the right networks of private and public actors in order for radical innovation to occur. This approach is often associated with successful Asian economies such as South Korea[55] and China, which helped drive their own growth miracles as part of their national development strategies. But an equally pertinent example is the USA, which has promoted successful innovations by private sector businesses backed with public funding, through initiatives such as the Defence Advanced Research Projects Agency (DARPA), which built the early internet, the Small Business Innovation Research (SBIR) scheme, which channels a proportion of US government departments' research funding to a large number of highly innovative start-up firms, and the National Nanotechnology Initiative, where the Clinton administration in the late 1990s provided billions of dollars of funding to promote what it saw as the 'next big growth sector'. While the USA is seen by many commentators as a hotbed of *laissez-faire* small government ideology, the reality in industrial policy could not be further from this caricature.

The key question for the future of UK industrial policy is how the state can help the private sector maximise its potential for innovations to deliver sustainable prosperity. Following recommendations from recent research by the innovation expert Professor Mariana Mazzucato[56] we suggest that a Plan B industrial policy should include revamping the UK government's Small Business Research Initiative (SBRI) scheme and reforming and expanding the Technology Strategy Board along the US DARPA model.

The UK government's SBRI scheme, which was set up a decade ago in an attempt to emulate the success of SBIR in the USA, but has suffered from a lack of funding and an unsympathetic procurement culture in government departments, should be revamped. Using SBRI to leverage hundreds of millions of pounds of additional research funding per year to small- and medium-sized enterprises (SMEs) would increase innovative business investments more effectively than further increases in the research and development tax credits scheme, which the previous government mainly relied on. It would also allow more funding to be allocated to areas which the government sees as particularly important – not in the sense of picking individual technological solutions to problems but in mapping out the general area for innovations which are likely to be the most useful.

There should be large-scale reform and expansion of the Technology Strategy Board along the US DARPA model, as recommended by the CBI in 2006. With a much expanded budget, the Technology Strategy Board should become a dynamic commissioner of innovative solutions at the cutting edge of innovation and research, bringing together government departments, research councils, local economic partnerships and other public bodies to address specific challenges, such as those around green technology.

These reforms would entail some additional investment, but not on a huge scale. They could be partially paid for by scrapping badly targeted and counterproductive policies such as the 'patent box' scheme, which will operate from 2013, allowing companies to pay a lower rate of corporation tax on profits arising from patents.[57] But much bigger reforms are needed to ensure the UK invests sufficiently and effectively.

A British Investment Bank

Providing additional incentives for innovation and research and development will help fix the UK's innovation deficit compared with its major competitors, and should also help increase business investment in the long run. However, the sheer scale of the recession that began in 2008 means that the state also needs to intervene directly in the market for investment capital to boost investment.

The main institutional mechanism for generating investment capital is the bank – and Britain has long been a world leader in the production of banks. But although we have handed important public functions and enormous influence to these institutions we have never truly harnessed the power of banking for public ends. Now, as a byproduct of the 2008 banking crisis, which left much of the banking sector in public ownership, we have a unique opportunity to create a British Investment Bank (BIB) that could do just that.

There are various models for such an institution. The US government guarantees large scale private investment vehicles, while France has a state-led investment fund and state investment banks are used in Scandinavia and Germany. These institutions can leverage private investment that generates the most beneficial impact in the wider economy, rather than the highest returns to the short-term, speculative investor.

Though state owned, and with an explicit remit to invest in long-term productivity, the BIB should be at arm's length from government, to enable it to take the technical and commercial risks the civil service finds hard. It can thereby catalyse and harness the variety and ingenuity of the private sector. The lesson from successful state investment banks around the world is that decisive state-guaranteed investment can be extremely effective at kick-starting productive activity and leveraging in private finance to follow where public investment has led. The BIB would vary its investment portfolio counter-cyclically, stepping into the gap during downturns in demand and investment to mobilise otherwise idle resources and then stepping back during boom periods to avoid crowding out private investment.

The coalition government's Green Investment Bank has similar features to what we are proposing – and all credit to the Liberal Democrats for securing it in the coalition agreement – but the sums the government is committing are tiny: £3 billion or about a fifth of 1% of GDP, which can hardly have a huge effect on the economy. And the bank will not be able to borrow on its own account before 2015/16. In short, on current plans the Green Investment Bank will be far too small to produce the size of investment boost the UK needs.

A state bank could issue bonds with a full government guarantee. So long as that borrowing went to finance investments with an expectation of returns, it would not be part of the general government deficit. There is no reason why the BIB should not access the capital markets even as the government attempts to reduce its 'own' deficit. A useful comparison is with the German Landesbank (regional state-owned savings banks). These are banks owned by the German *Länder* rather than by the federal government, but they are regarded as having an implicit guarantee. It is hard to think a BIB with a central government guarantee would be regarded as less creditworthy. Credit default swaps on the Landesbank cost generally less than 3%. This means that the coalition government's pledge of £3 billion for a green bank would be best employed not to make loans but as the reserve to back a guarantee. At 3%, it could then underpin a balance sheet of £100 billion. That is a material sum, which disbursed over five years or so could raise investment in the UK by over 1 percentage point of GDP per year. If these investments levered in private capital (as they should try to) then a very important boost to investment would be entailed. The BIB would be able to commit state funds to developing new low-carbon technologies – thus providing a degree of certainty and commitment to the transition to a low carbon economy, without which the private sector finds it difficult to invest.

At present, government ten-year bonds carry an interest rate of below 3%; 30 or 50 year bonds also have low interest rates, no more than the current rate of consumer price inflation. With a government guarantee, the bank could borrow on similar or only slightly more expensive terms. A great many projects should make a positive return at those interest rates, while generating employment and improving the structural productive capacity of the economy at the same time. Moreover, the BIB itself will not internalise all the benefits of its operations. To the extent that it helps companies and individuals to generate skills and know-how in emerging technologies it will benefit the economy more widely. That should in turn benefit future government net tax receipts.

Another area where the bank can make a contribution is in raising the standards of carbon auditing. If the BIB is to be truly green, its projects should meet two separate criteria: they should be self-financing to the bank (whether or not they take advantage of subsidies from other sources) but they should contribute to a reduction in carbon emissions. To ensure the latter is the case, full whole-life carbon audits will frequently be required. Those will surely improve general understanding of what are sensible approaches and what are not.

In addition to green technology investment the second priority of the BIB would be SMEs. Many of these firms, particularly start-ups, are not currently profitable but are looking to invest to produce profits in the future. Recent statistics from the Bank of England show that the lending environment for these businesses is very tough.[58] Lending to SMEs has been falling year-on-year since late 2009; the annual rate of growth in spring 2011 was minus 3%. The BIB would therefore have a division to focus investment at key sectors with low rates of interest. This would be more effective than either the government's attempt to agree lending targets with the banks (Project Merlin) or George Osborne's suggestion of 'credit easing' – using QE to buy corporate bonds – which he suggested during his speech at the Conservative Party Conference in October 2011.

Targeting green investment through the BIB

A state-led, growth orientated, sustainable investment strategy through a BIB would focus on three key areas: housing, transport and energy, because they will use idle labour and other resources and develop an infrastructure for a low carbon economy. In this way the BIB can be the investment hub of a proper long-term Green New Deal.

Housing

Investment in house building is the easiest and quickest way to provide productive stimulus to the economy. Unlike most infrastructure projects, house building could start almost immediately because the lead times are relatively short – particularly now, when there are plenty of sites with planning permission sitting empty, and plenty of construction workers sitting idle. Housing supply plummeted in the crash and has never recovered, worsening the housing shortage. This spare capacity in the industry means there is no danger of crowding out private investment – a common argument against public intervention.

Construction is also relatively labour intensive, providing lots of low and highly skilled jobs. The rule of thumb is that building one new house employs one worker for one year – and house building is perfectly suited for apprenticeships and job training programmes. Combined with the retrofitting programme envisaged by the Green New Deal (see above), a major house building programme offers the opportunity to train a whole new generation of workers in sustainable construction.

On the demand side alone, house building generates a multiplier of 3.51 – meaning that every pound invested generates £3.51 of economic output.[59] And almost all of that investment will stay in the country: you can't export a house, the work is intrinsically local, and construction materials are too heavy for many to be imported.

On the supply side, housing investment scores well too. A decent supply of affordable housing is essential to labour market mobility, as evidenced by the fact that one in five businesses regards high housing costs as a constraint to their business growth. The presence of attractive, accessible and affordable housing is also a key determinant of place competitiveness – a critical factor in the economic success of local areas, especially those seeking to adapt to the new knowledge economy in the wake of industrial decline.[60] There is no doubt that we need the homes either: household formation has been exceeding housing supply for many years, such that the latest estimate suggests that unless something major is done, demand will outstrip supply by 750,000 homes by 2025.[61]

Finally, housing is almost unique among channels for government investment, in that it generates both an asset and an income stream. Most state spending creates neither, or at best leaves an asset with a nominal value but a real running cost attached. Public housing pays for itself through the rental income it earns, and because houses last a long time, the state is left with a valuable asset for many decades after the cost of construction has been paid down.

Transport

The country is crying out for a better transport system. A BIB would be the focus for investment, but choosing where to invest resources is key. It is tempting to go for big-ticket items, but concentrating too many resources on them would be a mistake.

Rail has recently taken up a lion's share of available money for investment – with good reason. There has been tremendous growth in demand over the past 15 years and rail schemes are generally far more environmentally sustainable than road projects. Moreover, many rail schemes already under way like Crossrail and Thameslink in London, and the northern hub – improving rail services in the Manchester area – offer widespread economic benefits, although at considerable cost. Rail also offers several possibilities for future investment. London has too few Underground lines, given that only two have been built in the past 100 years, and would benefit from the long mooted line between Chelsea and Hackney.

Electrification is accepted by all major political parties as an essential improvement for the rail network, with Network Rail now suggesting, for example, electrifying the Midland Main Line between St Pancras and Sheffield, but so far this is an unfunded commitment. A rolling programme of electrification is needed, which would save on costs and was how the Southern Railway was electrified between the wars.

However, focusing only on major rail projects would be a mistake. Network Rail has a long list of projects that offer benefit cost ratios of four or five, compared with the two or three of most large schemes. One such example is the Todmorden Curve near Burnley, closed by the Beeching cuts, which could be reinstated relatively cheaply and greatly improve connectivity for a very deprived area. There are countless other such examples. Many commuter routes in provincial cities, too, have a desperate shortage of new rolling stock or need line improvements. A national policy to acquire new rolling stock, at a steady rate, rather than the feast and famine situation that has existed since privatisation, would allow British firms a much better opportunity to compete for the work.

Most transport is essentially local – long distance journeys are the exception, not the norm – and consequently that is where investment is most needed. On the roads, there are many local projects worthy of support and this is where investment should be focused. Filling in potholes, which are both hazardous and contribute to a deteriorating environment in poorer areas, would be a good start. Resources, therefore, should be concentrated on where they will make the most difference, both economically and environmentally. In most cases, this will, again, be on small schemes where the benefit–cost ratio can be very high. Making roads safer, creating better links to vital services such as hospitals and schools, improving facilities for walking and cycling, pedestrianising shopping centres, using technology to improve public transport information, and establishing viable bus services all have their part to play in creating what used to be called an integrated transport policy. Buses, in particular, are used by the poorest sections of the community and without them many people are cut out of the jobs market. Buses are the least sexy mode of transport but in many respects the most needed, given that 20% of households (and a higher percentage of individuals) do not own a car.

Investment in housing and transport is not just good for the economy, it helps create the basis of a good life and good society. It is exactly this kind of public investment the social fabric of the country needs.

UK energy

The final area of focus for the BIB will be energy. Tens of billions will need to be spent imminently to upgrade the UK energy supply system and expand enormously the country's energy efficiency programmes. The choices we make now and over the next few years about how we power our industries, our buildings and our transport system must be ones that avoid locking ourselves into an energy system that is still dependent on the continued burning of damaging levels of carbon.

Germany is showing the way. In renewables it has doubled its wind and solar renewable energy capacity in the last decade. Through its long running feed-in-tariff system, German power prices have become lower than they were in 2008. In the area of energy efficiency in buildings, €4.5 billion is being allocated over the next three years.

In the UK, we need to open up new sources of investment for renewables and energy efficiency, both public and private. Yet the Green Investment Bank for example is prevented by the government from being allowed to operate like a real financial institution – by raising money in the markets and issuing green bonds before 2015 at the earliest. This will hardly act as an incentive to pension funds and other institutional investors to fund the tens of billions required for new energy finance over the coming decade. Indeed as the *Financial Times* pointed out: 'The government should have used –it still could use – the current exceptionally low costs of borrowing as an opportunity to promote a much enlarged programme of investment in infrastructure.'[62]

Yet there are some encouraging examples of efforts to raise both public and private money in substantial amounts by some local authorities. Birmingham is in the lead here with its plans to invest £100 million to make 15,000 homes in the city energy efficient. This is the largest such scheme so far proposed in the UK. By working with around 20 other local authorities in the region there is also now a commitment to expand this initially to £250 million, with an option to extend it to an £1.5 billion initiative by 2020. Other local authorities such as Newcastle are taking a similar approach, and the intention is that once these local authorities have investments of the order of £300 million then a bond issue could be raised to bring in the pension funds. A BIB could help funnel investment to local authorities and regions for exactly these types of projects.

The creation of a state investment bank is critical if the conditions for successful new businesses are to emerge in the UK. But it's not just a new bank we need, but the reform of the exiting banking sector, not just so it too can invest in productive industries but also to ensure it cannot again be the cause of an economic crisis of the scale and with the implications of 2008.

D Reforming the City and the banks

The British banking system is a special case and a paradox. It exhibits some of the most extreme and destructive behaviour associated with free market ideology and yet, uniquely, it is underwritten against failure by the state. Any Plan B for banking has to begin with the extraordinary admission by Mervyn King, Governor of the Bank of England, that, 'Of all the many ways of organising banking, the worst is the one we have today.'[63]

But, what exactly do we want our financial system to do? As the report of the Good Banking Forum observed, that question was not properly asked, let alone answered, by the Independent Commission on Banking, set up by government to advise on bank reforms. Although couched rather formally, the answer offered by the new economics foundation (nef) is:

> To facilitate the allocation and deployment of economic resources, both spatially and temporally, to ecologically sustainable activities that maximise long-term financial and social returns under conditions of uncertainty.[64]

That is to say that, in a shaky world, we need a financial system able to provide resources where and when they are needed, to support socially and economically useful activities that also help us to live within our environmental means. In yet other words, we need our banking system to operate like an intelligent financial utility, rather than a greed-and-hormone fuelled casino.

Yet most of the chief executives of the major banks were schooled in the speculative investment wings of finance and have resisted virtually all proposed reforms designed to produce a safer, more useful system. Understanding the deep resistance to change from within, and finance's pathological lack of concern for the broader economic and social infrastructure on which it depends, is an important background to framing an alternative for banking.

If within banking there is permanent resistance to implementing necessary checks and balances, and to the re-engineering of finance to be the useful servant of real economic activity, then nothing short of structural reform is likely to succeed. For example, as Ismail Erturk argues, instead of the elaborate ring-fencing of retail from investment banking, a full separation of high street banking from complex, speculative finance (gambling) would be simpler and more effective.[65] The latter function is then stripped of its morally hazardous public underwriting and free to fail without wrecking the broader system.

In his book on the Great Crash of 1929, JK Galbraith noted, 'The sense of responsibility in the financial community for the community as a whole is not small. It is nearly nil.'[66] That realisation led to the legal separation of banking functions in America, which was only repealed, disastrously, decades later. In a close, historical parallel to the UK's current situation, Beatrice Webb wrote in 1931, 'It is certainly a tragically comical situation that the financiers who have landed the British people in this gigantic muddle should decide who should bear the burden.'[67]

Banking has become hugely concentrated, against the interests of the general public. Many push greater competition as the answer. Yet even proposals to increase competition modestly with the banks that we have could leave small businesses and individuals with the choice of swimming in a financial lagoon in which there are a few more medium-sized sharks as opposed to four huge ones.

So, what does a good banking system look like? It will have more banks and they will be different in scale, focus and the way in which they are owned and run. The Post Office network, for example, can become the foundation for a universally accessible Post Bank, providing the full range of basic banking services to support local economies and communities. The Royal Bank of Scotland could stay in public ownership and retain certain core administrative functions, but be scaled down into a network of county banks, following the successful German model, where local government could be obliged to bank safely. The Green Investment Bank could be scaled up, as we suggest above, into a British Investment Bank with real clout to stimulate the transition to an employment-creating low carbon UK economy.

Under the current financial system, the government effectively franchises the creation of credit to the commercial banks whose lending has created unsustainable asset price inflation, in housing notably, while poorly serving 'useful' economic activity. The franchisees, the banks, have been appalling at allocating resources, even as they have benefited hugely from having the privilege to create and issue credit. As nef has pointed out, there has also been little *quid pro quo* for their public underwriting in 2010, which was worth £46 billion to the big four UK banks.[68] There is nothing to stop the government and the Bank of England demanding, on one hand, a much better deal for the British public in return for the extraordinary privileges enjoyed by the banks and, on the other, reclaiming a share of credit creation for public benefit. The Independent Commission on Banking hardly made a start. Much more needs to be done. A Plan B for finance and banking would lead to [69]:

- the full separation of utility or retail banking and casino or investment banking
- measures to tackle excessive pay and bonuses in banking, which leads to excessive risk taking
- a universal obligation to provide simple, honest and affordable finance to all customers
- the creation of new institutions like the ones suggested above to pluralise and localise banking services
- increased competition in the sector and much higher customer standards
- much fuller transparency and accountability of credit ratings agencies.

Getting the economy going again through state investment and a reformed banking sector is essential. But it is not just investment in economic resources we need but people. It is to that side of Plan B that we now turn.

E The social investment state and social justice

If the investment state is about greening the economy, it also has to be about investment in people and communities. Central to Plan B is the notion that society and people are not a subset of the economy; rather the economy is a subset of the planet and society.

Spending on social protection (tax credits and benefits including pensions) is the largest component of state spending (29% of total public expenditure in 2010/11) – and the one over which governments have the least short-term discretion. While capital expenditure on battleships or social housing can be cut swiftly when revenues fall, the cost of meeting benefit and tax credit entitlements rises precisely at these times, and it requires protracted and painful legislative change to rein them in, as George Osborne is discovering. The amount any government spends on social protection shapes the whole of the budget.

A social investment state recognises the productive long-term benefits of public investment in people, their livelihoods and communities, and directly challenges the ideology peddled by neoliberalism that the state is an unproductive burden on the private sector. Many elements of public expenditure – for example social security expenditure, health, social services and education – can be seen as 'preparing' not 'repairing', preventing social problems emerging upstream, not compensating for them when they occur downstream.

In the field of social benefits, education and employment, a social investment state entails investment in human capital – education and life-long learning, early years support, reconciling work and family life and good employment. In the field of health it entails intervention in the early years, prevention of poverty, harmful environments and over-consumption, and policy integration to minimise ill-health in later years.

Plan B needs to take the concept of the social investment state much further than previous generations, extending it to the much broader goal of sustainable well-being, not just in economic efficiency, important that is, but also on the grounds of social justice and human need. As discussed in Part D of Section 1, the ability to do this requires a system of measurement that takes us beyond GDP.

A social investment framework recognises, for example, that investment in education yields both private and social returns. In the UK private returns in the form of higher net lifetime incomes are estimated as being between 15% and 20%, and social returns at around half this.[70] Other policies, such as providing publicly provided childcare, reward the Treasury by enabling carers to minimise breaks in work and thus contribute more to tax revenues. The Wanless Report of 2004 showed the clear cost-effectiveness of health policies to manage such conditions as Type 2 diabetes.[71] The benefits of safe communities can be approached via the lower insurance premiums paid in low crime areas – a direct private benefit of investment in communities.

The central finding of the Stern Report was that the costs of action to mitigate climate change are a fraction of the costs of unabated global warming. The inability of markets to require people to pay for the consequences of their actions has created 'the greatest market failure the world has seen'. To correct this requires public action in numerous areas of life, such as repricing carbon, subsidising renewables, regulating product energy efficiency and incentivising changes in behaviour. Some of these programmes (such as cavity wall insulation) have negative marginal abatement costs – the net cost is less than zero.

Most calculations of social return to the economy rely on assumptions from conventional (neoclassical) economics about earnings and marginal productivities. Even within the mainstream framework certain public services are seen to be productive. Beyond this we can estimate social rates of return to elements of the welfare state. Taking into account the costs of a range of social problems, including mental ill-health, crime, family breakdown, drug use and obesity, studies find that investing in, for example, targeted interventions and universal child care and paid parental leave would generate large social returns, such that these could be financed through annual bond issues with ten-year maturities.[72]

Not all welfare state expenditure is potentially productive in this sense, for example that on health and care for the very elderly. In no way can the social investment rationale trump equity and human capability rationales. But even here there can be indirect economic benefits. For example, basic needs for care must be met somehow, and if public provision is inadequate and private provision cannot be afforded then family members usually step in. This reduces their paid work, earnings and contributions to tax revenues.

Above all, the welfare state enhances human well-being by enabling basic human needs for health, agency and social connectedness to be met. This is achieved in two ways. First directly, as when an ill person is cured or cared for, a child is enabled to realise their creative abilities, an unemployed person or lone parent is provided with a basic income to manage, or a neighbourhood is saved from remorseless decline. Second, it can occur as a collective result of the entire social investment edifice, such as a more equal or solidaristic society. There is decisive evidence that more equal societies enjoy lower rates of mental illness, addiction, obesity, teenage births, homicides and imprisonment, and better levels of life expectancy, educational performance and social mobility.[73]

If the social investment state needs to expand, this will be on top of other drivers pushing costs up, especially in the welfare state. It is critical we understand these pressures and possible cost saving measures.

The major long-term cost drivers are the ageing population, the Baumol 'cost disease' (productivity gains are much more difficult to find in human services but public sector workers' earnings on average rise with the private sector, thus driving up costs per unit output) and rising expectations for better services. The Office for Budget Responsibility (OBR) estimates that the first two will push up expenditure by 3.6 percentage points of GDP within two decades, mainly on pensions and the NHS. Of course these drivers also affect private providers and insurers, thus there are no social savings to be made there; indeed they carry other large cost inefficiencies.

Adding in other desirable goals (reducing child poverty to Scandinavian levels, free and improved long-term care, improved early years provision) would add another 4 percentage points.[74] This would be on top of the social investments discussed above. Are there any potential savings? Yes, there are two major ones, which are linked: upstream prevention and regulation.

Much of the existing welfare state remains curative and repairing rather than preventive and preparing. This is harmful to citizens, the economy and the planet. Take just one example – policies to reduce obesity. Shifting transport from driving to walking and cycling would bring about significant reductions in heart disease, stroke, breast cancer, dementia and depression;[75] similarly, a 30% reduction in livestock production and consumption would reduce heart disease by 15%.[76] These improvements would achieve a triple return: improve well-being, reduce emissions and save money. If the incidence of obesity in all social classes had been the same as for social class 1, the cost to the NHS of treating obesity would have been £2.2 billion in 2009 compared with the actual figure of £4.8 billion, a reduction of 54%. This does not include the costs of a programme to achieve such reductions, but they would be only a fraction of that.

Second, social policy is not just spending and taxing: it encompasses regulation and policies to sponsor behaviour change. The private and social costs of regulating corporate sector activity that harms health are small in many areas. Regulations over smoking have achieved remarkable savings and improvements to health. It is time to move against some food corporations which encourage bad eating and have consistently lobbied to protect their profits, for example by blocking the introduction of 'traffic light labelling' of foods in supermarkets. An investment state would act to prevent corporate stimulation of harmful and wasteful activities rather than pick up casualties downstream.

The idea of the social investment state provides a powerful counterweight to the ideology that the markets know best. We need to understand better how to recognise, value and account for its economic, social and environmental returns. Nowhere is this more important than for two things we value most: time and family life.

F Time and the core economy

The demands of global market competition and the austerity measures of Plan A are combining to put intolerable pressures of individuals and families, especially the poorest. The challenge is to transform the welfare system for the 21st century, so that it is able to reduce inequalities and improve well-being for all, without relying on endless economic growth. We want human resources and relationships to be brought into the centre of policy-making, strengthened and enabled to flourish. We want to move from an economy based on scarcity of economic resources to one based on an abundance of human resources. We also want to move beyond a deficit model of need, where we simply pay attention to problems that require fixing, to a more rounded and positive approach, where we consider how we can all lead a good and satisfying life. We can do this in two ways: by growing the core economy and by redistributing time.

By the 'core economy' we mean the human resources that comprise and sustain social life.[77] They are embedded in the everyday lives of every individual (time, wisdom, experience, energy, knowledge and skills) and in the relationships among them (love, empathy, responsibility, care, reciprocity, teaching and learning). They are 'core' because they are central and essential to society. They make it possible for the market economy to function by raising children, caring for people who are ill, frail and disabled, feeding families, maintaining households, and building and sustaining intimacies, friendships, social networks and civil society. They are largely uncommodified and routinely overlooked and undervalued.

This core economy can flourish and expand, or weaken and decline, depending on the circumstances and conditions within which it operates. It can 'grow' if it is recognised, valued, nurtured and supported. It is not a natural phenomenon that floats above politics, but is profoundly influenced by the rules, protocols and power relations that emanate from the state and the market. It not only shapes and sustains social and economic life, but also reflects and reproduces divisions and inequalities. For example, most of its transactions involve women working without wages – a pattern that generates lasting inequalities in job opportunities, income and power between women and men. These are often compounded by age, race, ethnicity and disability. So it matters a great deal *how* the core economy grows.

It will be essential to build capacity for equal participation. This means putting measures in place that encourage, enable and support individuals and groups – especially those who are disadvantaged and disempowered – by building knowledge and experience, by distributing material resources that make participation possible, and by opening up access to decision-making at all levels. It also means tackling inequalities in income and wealth and making sure everyone has a fair living income.

Time is a key resource in the core economy. Everyone has the same amount, of course, but some people have much more control over their time than others, especially those with low-paid jobs as well as caring responsibilities. We propose there should be a slow but steady move towards much shorter and more flexible paid working hours. That way, people who currently have jobs that demand long hours will get more time for leisure activities and unpaid activities as parents, carers, friends, neighbours and citizens. It will help to address practical and cultural barriers to equal participation and iron out inequalities between women and men.

When the economy is not growing and resources are scarce, it will help to spread employment across the population, with more people earning and paying taxes and fewer claiming benefits. A shorter working week could help to change our values about work, money and things. Too many of us are caught on a treadmill of living to work, working to earn, earning to consume, and consuming without regard to the limits of the natural environment. This could help us to get off the treadmill and live more sustainably. Business could benefit from more women entering the workforce; from men leading more rounded, balanced lives; from greater hour-for-hour productivity; and from reductions in workplace stress and absenteeism. It would be easier for older people to choose deferred retirement without damaging their health or needing to claim a pension.

How to get there? We can start to shift expectations about what is 'normal', by building on current trends, where many employers have managed the recession by only offering part-time new jobs. An obvious objection is that shorter hours would reduce earnings and hit low-income groups the hardest. But a gradual transition should allow time to put compensating measures in place. These would include trading wage increments for shorter hours year-on-year, giving employers incentives to take on more staff, limiting paid overtime, training to fill skills gaps, raising the minimum wage, and introducing more progressive taxation and arrangements for flexible working to suit the different needs of employees – such as job sharing, school term shifts, care leave and learning sabbaticals.

John Maynard Keynes imagined there would be a 15-hour week by the beginning of the 21st century. He thought rising productivity would stop us having to work long hours to satisfy our material needs. Instead, productivity increased, a 40-hour week became routine and consumption has soared as we set about wrecking the planet on which all our lives depend. Moving to much shorter 'normal' paid work time could help to address a range of urgent, interlinked problems: overwork, unemployment, over-consumption, high carbon emissions, an impoverished welfare system, low well-being, entrenched inequalities, and lack of time to live sustainably, to care for each other, and to enjoy life.

But however much more time we get to enjoy outside employment, work is and will remain central to our lives; to learn, earn, be creative, forge relationships and identities. It is the nature of work that we tackle next.

G A new bargain at work

The traditional adage is that if you work hard and play by the rules you can get on. But work isn't working for millions of us. Jobs have become more insecure, pay has stagnated, the quality of the work we do has declined and no one listens to us. A good economy for a good society cannot and need not be like this.

Unsqueezing the workers

Since the end of the 1970s, earnings for the bulk of the workforce have been falling behind increases in wider prosperity. As a result, the share of national output taken by wages has shrunk from around 60% in 1980 to 53% in 2008. Moreover, this squeeze has been felt most heavily by middle and low earners. While the real output of the economy more than doubled in the three decades to 2008, middle earners enjoyed a rise of just over a half while those at the edge of the bottom tenth rose by little more than a quarter. Some unskilled and semi-skilled jobs now pay little more in real terms – and in some cases less – than they did in the late 1970s. As a result, the proportion of people working on low pay has doubled over the period to more than one in five.[78]

In the two immediate post-war decades, the proceeds of growth were much more evenly shared. Since the late 1970s, they have gone increasingly to big business and a small financial and corporate elite. This accounts for the rise in the fortunes of the super-rich and the surge of inequality to levels last seen before the Second World War. As the High Pay Commission has shown, the share of take home pay going to the top 0.1% of earners fell by two-thirds between 1949 and 1979. Since then it has returned to its 1949 level.[79]

The sustained shrinking of earnings as a share of national output has been, in part, the result of the rise in the supply of global labour and a decline in the relative pay of the unskilled. But it has also been driven in the UK by the shift in the balance of bargaining power from the workforce to big business and the adoption of a more market model of capitalism, one that has made the pursuit of shareholder value – the chase of short-term profits whatever the impact on others – the primary goal of the big corporations. Since the end of the 1970s, union powers have been eroded, while the length of the dole queue has soared. The proportion of workers who are members of a union has halved over the last 30 years, while only one in seven private sector workers is unionised. The average level of unemployment since 1979 – of 7.9% – is more than three times the average level recorded in the two post-war decades.

One of the principal consequences of this change in the power balance has been that trends in pay began to fall behind the output of the economy. This pay–output gap began to emerge from the late 1980s and accelerated from the mid-1990s. This decoupling of wages and output has had important negative consequences for the way economies function – squeezing the purchasing power needed to buy the extra output being produced, while boosting corporate profits and personal fortunes.

Real wages for most have been stagnant since the mid-2000s, are now falling, and are set to continue to do so for at least the next two to three years. According to the Chartered Institute of Personnel and Development, in the first six months of 2011, three-fifths of the workforce had their pay frozen. A further one in five had them cut.[80] Real living standards in 2013 are likely to be no higher in 2013 than they were a decade ago.

In contrast, the aggregate of top personal fortunes – which initially took something of a hit at the height of the recession – has largely been restored, while many of the UK's largest companies are sitting on record pools of cash, in part the product of frozen wages and cost-cutting during the recession.[81]

A successful economic strategy requires tackling the growing pay–output gap, which is now one of the fundamental structural faults in the British economy. There should be a fairer distribution of the national cake, with the proceeds of growth more evenly shared between wage-earners and big business. This is what happened in the immediate post-war decades, an era when growth and productivity grew much more quickly than during the post-1980 era of 'market capitalism'. Without this switch in strategy, advanced economies will continue to have a built-in tendency towards stagnation and inequality.

Rebalancing the economy requires a five- to ten-year programme of economic reforms aimed at raising the earnings floor, lowering its ceiling, and restoring the share of output taken by wages back to around 60% – the level achieved in the immediate post-war era. Plan B would therefore implement the following reforms:

- Elevate to one of the key economic targets, alongside the control of inflation, the goal of ensuring that the workforce shares proportionately from growth because of its central significance to economic success.
- Raise the level of the minimum wage at a slightly faster rate than median earnings while guaranteeing all public sector (and contracted) staff a minimum of the living wage.
- Reverse the long-term decline in the role of trade unions, moving the UK's labour laws closer to those of a number of European states where collective bargaining takes a

more central role in economic and business decision-making.

- Tackle excessive pay at the top by, for example, introducing new powers for shareholder groups to be able to vote to block excessive executive remuneration packages. This problem is especially acute in finance, where remuneration significantly exceeds the sector's contribution, while greatly damaging the wider economy by distorting incentives. This is best tackled by ending the 'supernormal' profits enjoyed in Britain's oligopolistic banking system by capping the size of bank assets at a fixed proportion of GDP and introducing much tougher banking taxes.
- Introduce much tougher rules to prevent financial engineering of existing companies (one of the main mechanisms used for the upward transfer of existing wealth) whereby the motive is largely huge private gain. To prevent the way financiers are able to make big money by playing with other people's money with no risk to themselves, bank and finance directors should hold a minimum proportion of capital in their companies, so they end up taking responsibility for their own financial bets.
- Drop the dominant 'shareholder first' doctrine, which has ruled business for 25 years – a business model that has fuelled short-termism while allowing executives to line their own pockets – with big business accepting a wider responsibility to staff, taxpayers, the environment, the local community and shareholders. As Paul Polman, the boss of Unilever, has argued publicly, that concept 'has passed its sell-by date'. To ensure a better balance between the public interest and market freedom, workforces should be treated as integral to success and rewards should be linked more closely to real performance.
- Recast the tax system so that the richest pay proportionately more than those on middle and low incomes. There should be tougher measures to end tax avoidance, while the tax base should be linked more closely to wealth and capital, both of which are undertaxed, with higher taxes on the ownership of property, inherited wealth and windfall capital gains.
- Co-operatives and mutuals can also enhance efficiency in the private and public sectors by improving work motivation and promoting collaborative forms of entrepreneurship.[82] Profit-sharing can be used more widely and specifically in ways that support saving.[83] This form of business organisation also helps promote wider asset ownership.

Having a voice at work

At the heart of our economy is the energy and capacities of our workforce. Developing and mobilising the productivity of the millions of people who go to work every day will be fundamental to our future prosperity.

Moreover, this 'human factor' is becoming increasingly important in the 21st century – whether we are talking about the cutting edge of the high-tech 'knowledge economy', where innovation is driven by free experimentation and collaboration, or the private and public service sectors, where quality depends on the day-to-day care and commitment of its frontline workers.

In this context, employee 'engagement' – a sense of identification and ownership with one's role and the organisational goals to which one is contributing – is the all-important variable.[84] One study has suggested that organisations whose employees are fully engaged can be 43% more productive as a result.[85] Other studies shows that those with the most engaged employees experience a range of benefits from higher customer advocacy to lower employee turnover, all resulting in stronger financial performance.[86]

It's fairly obvious that organisations that earn their employees' loyalty and commitment are those that treat them with respect, value their perspectives and give them genuine opportunities to play a part in developing their roles and designing their working environment, and there is an abundance of empirical evidence to back this up empirically. As David Coates of the Work Foundation says, 'The best research suggests that genuinely giving employees control generates higher levels of job satisfaction and higher productivity.'[87]

For example, Lynda Gratton shows in her studies of high-performing companies such as Sony and McKinsey & Co that 'working relationships based on free choice and shared purpose – where autonomy, choice and trust breed speed, flexibility and commitment' are fundamental to building 'strong, agile enterprises powered by employee engagement and collaboration'.[88]

Sandra Black and Lisa Lynch have presented evidence that much of the improvement in US productivity habitually ascribed to the diffusion of information and communication technology has in fact been the result of innovations in workplace organisation – including the use of self-managed teams, profit-sharing and employee voice.[89]

And analysis of international data by the Organisation for Economic Co-operation and Development (OECD) shows that 'high performance work practices' – such as more team-working, downward delegation of responsibility, and clear internal communications – are clearly linked with effective institutions of 'collective voice' such as works councils or recognised trade unions.[90]

But the UK as a whole is not following best practice. Less than half of UK employees feel the organisation they work for deserves their loyalty.[91] Only one in three are satisfied with their involvement in workplace decision-making. Less than a fifth report they are frequently consulted about workplace change.[92]

This is obviously a major problem for our day-to-day well-being, and the wide range of domestic, health-related and social problems that can be the consequence of a negative and stressful working life. It also represents an immense waste and cost to our economy. One estimate puts the minimum economic cost of workplace disengagement at £36 billion a year.[93] Widespread employee disengagement has also been cited as a key factor behind the UK's continued lag in international productivity tables.[94]

Even more worryingly, there are signs that things may be moving in the wrong direction, partly exacerbated by the pressures of the recession – one survey showed the number of employees who felt their managers were encouraging them to develop their own ideas fell from 51% to 43% between 2008 and 2009.[95]

Reform that reviewed and strengthened current information and consultation regulations would be a good starting point for supporting the development of more participative and productive workplaces.[96] Granting employee representatives a role on remuneration committees would be another. More ambitiously, we should take a serious look at extending the role of works councils, which have worked so effectively on the continent.

Facilitating the work of trade unions could be another way of encouraging more participative workplaces. More could be done to support and extend the work of union workplace reps in identifying problems, resolving disputes, encouraging learning and facilitating change, which independent analysis has estimated already adds £4–12 billion of value to the economy every year[97] – a consideration that applies just as much to our public services as the broader economy.[98]

Finding ways of extending the opportunity to join a recognised union to the millions of British workers who say they would like to join a union if they could would further promote productive workplaces.[99] International comparisons suggest that, although the relationship is not mechanical, countries with higher trade union density tend to score higher on measures for employees' autonomy, creativity and ability to influence their environment at work.[100]

In addition to encouraging high-involvement management and empowering employees and their representatives, more could be done to encourage employee ownership – from the promotion of employee trusts to the encouragement of full cooperative models. Companies in which employees own a significant stake now account for an annual turnover of £25 billion and a growing share of GDP. There is evidence that employee-ownership is associated with improved employee morale and greater willingness and ability to contribute innovative ideas, and that combined with employee involvement in decision-making, employee ownership can boost productivity by 52%.[101] Cooperative businesses, wholly owned by their employees, now account for annual turnover of £33.5 billion, and sustain almost a quarter of a million jobs. They have provided opportunities for empowering and fulfilling work and driven the creation of social as well as economic value across a range of sectors, from the creative industries to village pubs.

If people are the source of productivity increases in companies then the same applies to the state and public services. The essence of Plan B is that the state can and must play a proactive role in enabling not just recovery but long-term prosperity. But to do that it can't just be the state of old. Instead it must be open, democratic and accountable – so that it can be more efficient and innovative. So finally, we focus on how the state itself can perform more effectively.

H A new state that spends better

Public spending cuts are the main deficit reduction tool under Plan A. But in fact shrinking the state has been an ideological cornerstone of free market fundamentalism for decades.[102] In essence it holds that private investment is always more efficient than public and the latter tends to crowd out the former. The correct role of government given this free market world view is to reduce public spending as far as possible, open as much of the state as possible up to market forces and in the rest of the economy unfetter the market of social, labour and environmental standards.

Neoliberals and others argue that factors like the demographics of ageing mean rising state indebtedness is unsustainable.[103] But it is equally arguable that the demographics of aging and the need to invest around 2% of global GDP ($1.2 trillion) in ways to reduce global warming suggest that state spending should, and will, continue to rise over the long term.[104] Similarly, as societies become richer the demand for public goods like education, health and pensions seems to rise faster than demand for other goods.[105] In this context, attempts to reduce the deficit with short-term spending cuts alone will fail, as long-term pressures push spending back up. The neoliberal response is to cut faster and harder. A thoroughgoing Plan B requires a more radical and positive approach to the long-term transformation of public services – approaches like co-production, which seeks to transform the nature of public service provision, in order to permanently control costs and increase productivity while making services more responsive and democratic at the same time.

Rather than treating people as passive recipients, co-production seeks an active input from those who are the intended beneficiaries of services alongside front-line staff.[106] The object is an equal and reciprocal partnership with (variously) professionals and other service workers, family members, neighbours and carers. In this kind of partnership, people work together, pooling different kinds of knowledge and skill, to decide what would improve people's lives, to design activities to help achieve those improvements and – where possible – to participate in and contribute to those activities. For example, in direct payment schemes now being rolled out across social services departments, individuals negotiate the use of budgets assigned to them to buy the services they need. Co-production approaches can bring individual budget holders together so they can avoid isolation, combine their purchasing power, share and exchange uncommodified activities, build social networks and make better use of all their resources.

Co-production can make better use of public resources, by drawing on a largely unrecognised and underused set of assets – the skills and engagement of service users and providers. Evaluations of local authority co-produced care schemes indicate this can bring an overall saving of some 15%, as well as high levels of user satisfaction.

So far, co-production has been tried and tested in social care for disabled people, frail older people and those with mental health problems and learning difficulties. It has considerable potential in other areas: well-informed patients can play a role in choosing and contributing to their own treatment. Individual choices lie behind life-style factors (diet, exercise, alcohol consumption) that often affect health outcomes. School students can be engaged in directing their education into the areas they value. Tenants can manage social housing. Community banking can be incorporated into social security. Extending co-production throughout the public sector will not deliver rapid spending reductions; more importantly, it can help reduce the inexorable upward pressure on public spending for the long term.

Hospitals that involve their staff more have been most effective in improving patient outcomes, from shorter waiting times to lower mortality rates;[107] and councils whose staff say they are informed and consulted are more likely to be rated 'excellent'.[108] In places like Newcastle, local government services have been transformed by 'insourcing' contracts via worker and management collaboration. In the process they have improved the quality of provision and saved money that can be reinvested elsewhere.[109]

Conclusion

A call to action

A new paradigm for a political economy doesn't just emerge with one document or report, no matter how timely or good that document is. But the country can and must take large steps and as quickly as possible. This is necessary not only to avoid a longer recession, and make use of the opportunity the current crisis creates for shifting economic thinking in a progressive direction, but also because of the danger that the failure of Plan A could lead to a shift to the authoritarian nationalistic right as people become increasingly desperate for solutions. So the stakes are incredibly high.

Plan B builds on work being undertaken by myriad progressive thinkers and campaigners and pulls them together into the start of a coherent and systematic alternative economic future for Britain. There is still a huge amount of work to be done – ideas to be fleshed out and joined up. New policies need to be developed. There are paradoxes and tensions to be thought through – not least relating to the need for growth in some areas of the economy, contractions in others and therefore the survival of the planet. There are priorities to set and therefore things to be sacrificed. We cannot have it all. Democratically, openly and tolerantly we need to work our way through all these challenges and issues.

So the quality of our thinking and the precision of our ideas matter – but just as important if not more so is our ability to turn ideas and polices into a political movement for change. It is the mix between theory and practice that creates political change. We must interpret the world, but the point, of course, is to change it.

Not everyone will agree with every dot and comma in Plan B. But if you and/or your organisation agree with general thrust – that Plan A isn't just not working but is making things worse, that the state has to play an active social and economic investment role to ensure prosperity and sustainability, and that there must be no return to business as usual, but rather a transition to a different political economy that works for people and the planet – then join us and create that alternative.

The country doesn't just need a Plan B on paper – but a Plan B put into practice as soon as possible, as fully as possible.

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