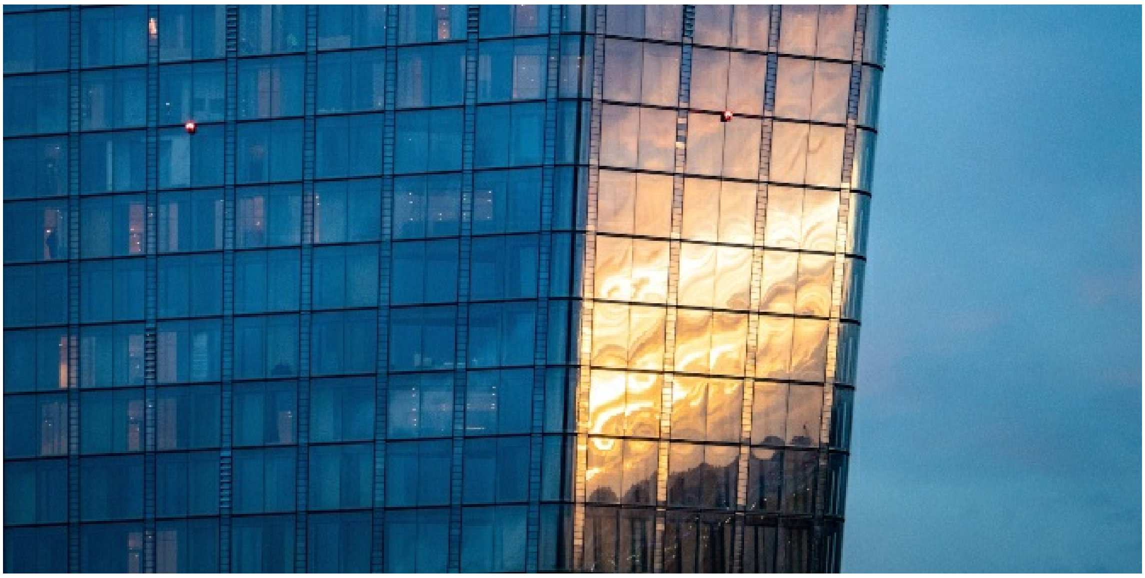
Building back better: policies for a strong and sustainable recovery



The Covid-19 crisis is already inflicting serious damage on both the UK and the global economy. This raises questions on the appropriate policies for a strong and sustainable recovery, contributing to global efforts to avoid a depression, and delivering on overarching governmental objectives, including reaching net-zero emissions and reducing inequalities across and within regions. On 14 May 2020, the Royal Economic Society hosted a webinar on policies for a strong and sustainable recovery, the second in a series of three. Here we discuss some of the issues raised by the speakers, drawing on our ongoing work.

Unprecedented economic crisis

The economic crisis caused by Covid-19 is unprecedented in modern times. In the Bank of England's illustrative scenario, UK GDP is expected to be around 30% lower in the second quarter of 2020 than it was at the end of 2019. In annual terms such a contraction has not been seen in over 300 years. As a result of this economic shock and the necessary rescue packages put in place by the government, borrowing will increase dramatically. In its early assessment of the possible impact of Covid-19 on public finances, the OBR estimated that HM Treasury could borrow £273bn, or 14% of GDP through 2020-21 – the largest single year deficit since the second world war. Given the severity of the ongoing crisis, it is likely that these estimates will prove optimistic.

Building back better

Into the recovery phase, further borrowing for productive investment in long term assets should be distinguished analytically from immediate and highly necessary spending on frontline services and general packages of support for businesses, which will continue to be required for some time.

There is now the opportunity to form a new implicit social contract which recognises the need for higher public debt and equitable taxation – including increases in taxation for those able to pay more (Hughes et al., 2020). It must be emphasised that the finance raised through these means will provide material benefits to citizens in relation to the critical social issues highlighted most acutely during the crisis, such as deep and widening inequalities. Investments in productive, sustainable assets will generate large multipliers in the short and long term, enabling the UK to service its increased debts via the tax revenues associated with economic growth, and improving connectivity, air quality and living standards across the UK.

Tackling inequalities

The economic shock caused by Covid-19 has hit the young and lowest paid the hardest and is expected to deepen labour market inequalities. The impacts of ongoing disruptions to education will also be uneven with school closures exacerbating pre-existing gaps for students from disadvantaged backgrounds. The unprecedented downturn that we face appears likely to create long term scarring where businesses become insolvent, individuals suffer periods of unemployment, and learning losses are likely to damage future educational trajectories. Greater income and education inequalities as a result of the uneven impacts of the crisis will further reduce social mobility into the future.

Moreover, Covid-19 is likely to intensify automation in some sectors. An extremely low cost of capital combined with falling labour productivity and rising labour costs due to necessary social distancing measures could tip the balance in favour of investment in capital over labour. At the same time, jobs in labour intensive services (e.g. hospitality) are at risk due to social distancing. Therefore, beyond the need for government to provide adequate social security, there must be a well-planned transition for those displaced by the current crisis due to changing economic conditions on the demand and supply side. Transition can be enabled via programmes of government investment in projects with high job creation potential – as is the case in many areas associated with the zero-carbon transition (for example insulating homes, low carbon heating, tree planting and peatland restoration – see CCC, 2020); together with continued focus on skills and lifelong learning. Such programmes will also generate wider co-benefits for society, and build the foundations for long-run sustainable growth.

Part-time work and short-term measures, together with job guarantees in sustainable projects should play a role. New approaches for adult skilling and lifelong learning should be sought, including exploring the potential for human capital tax credits to incentivise employers to train their workers. A national tutoring service could help close widening education gaps for disadvantaged children due to school closures, and measures at the local level to address mismatch between skill supply and demand will be required.

Innovation must be centre stage

Innovation is crucial for enabling the global community to both deal with the Covid-19 crisis and find its way out of it. Digital technologies, including AI, are already working alongside innovation in medicine and medical equipment to provide solutions to the challenges presented by the pandemic. More broadly, innovation is required for achieving sustainable long-run growth in advanced economies such as the UK (LSE Growth Commission, 2013, 2017), for transitioning to net zero greenhouse gas emissions and for addressing other societal challenges. It follows that innovation policy needs to go beyond fixing specific market failures to be 'mission-driven', generating and directing demand for innovation.

The UK can continue to build on its clean innovation strengths via consistent policies and incentives on both the demand and supply side, and benefit from growing global demand into the future (Rydge et al, 2018; Unsworth et al., 2020). The existence of spillovers is a key justification for public support for research and development (R&D), and analysis of patents shows that spillovers from clean innovations in the energy production and transport sectors are over 40 per cent greater than in conventional technologies.

The research and innovation system faces a number of new risks – from the impacts on university finances, to difficulties faced by innovative start-ups or scale-ups accessing finance. The drive to 2.4% R&D as a share of GDP can be accelerated via incentives in the tax system (including effective carbon pricing and R&D tax credits), appropriate regulation and demand side mechanisms that create growing markets for new technologies and direct technological change (Acemoglu et al., 2012). Current low oil prices create an opportunity for introducing a robust carbon price, essential for ensuring that innovation continues to be directed towards zero carbon. Without this there is a risk that progress will stall.

The diffusion of innovation into the "long tail" of smaller firms is also important from a productivity perspective – while the crisis has forced many firms to accelerate their adoption of digital technologies, it will be important to understand better the barriers to doing so, the extent to which any positive changes persist (e.g. increased remote working and flexibility) and how policies into recovery can help.

A long-term industrial strategy which is coherent from national to local level

Given the response to Covid-19 and the extent of government support to industry it entails, there is now a chance to build a strong partnership between the private and public sector accelerating investments towards a low-carbon, sustainable and inclusive economy. Over the years, the UK's industrial policy has lacked the consistency, scale and longevity required to effectively direct investment (LSE Growth Commission, 2017). The formulation of coherent policies for investment should be shaped by the UK's industrial strategy, re-emphasised nationally and locally, updated and relaunched as a central pillar of recovery. All investments must be driven not only by productivity defined in a narrow sense, but also by broader measures of health and wellbeing. Consideration of this long run outlook, combined with the proper valuation of different forms of capital – particularly human, social and natural – can inform policies to crowd in investments in innovation, infrastructure and skills, garnering popular support at the national and local levels.

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Notes:

- *This blog post is based on discussions at the RES Policy Webinar:* ***Policy for a strong and sustainable recovery****. Chair: Nick Stern. Speakers: Tera Allas, Diane Coyle, Stephen Machin, Rain Newton-Smith, Adair Turner, Andres Velasco.*
- *LSE's Centre for Economic Performance and Grantham Research Institute will be working together in the coming weeks and months to deliver a series of reports examining the different aspects of the UK's recovery from Covid-19, including strategy, policies and finance for sustainable and inclusive investment.*
- *The post expresses the views of its author(s), not the position of LSE Business Review or the London School of Economics.*
- *Featured image by Fred Moon on Unsplash*
- *When you leave a comment, you're agreeing to our Comment Policy*

Sam Unsworth is a policy analyst at LSE's Grantham Research Institute, focusing on climate policy, finance and diplomacy. He was previously a manager in PwC's sustainability and climate change practice. Sam managed projects in the UK, Sub-Saharan Africa, South America and South Asia. He also spent two years as part of the Climate and Development Knowledge Network, focusing on climate diplomacy in the lead-up to and aftermath of COP21 in 2015. Prior to this, Sam worked at the NGO Renewable World, which installed off-grid energy projects. He holds a Masters in Conflict, Governance and Development from the University of York.

Anna Valero is an ESRC innovation fellow at the CEP. She received her PhD in economics at the LSE in 2018. Her research is focused on the drivers of productivity and innovation, and in particular the role of skills and universities in explaining differences in economic performance between firms and regions. Anna has also been working on UK productivity and industrial strategy more broadly, and in 2017 was a research director for the LSE Growth Commission. Previously, Anna was a manager at Deloitte's Economic Consulting practice.