



Perspectives by Ruth Lea

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Britain needs a radical pro-growth strategy

Introduction

Speculation about the contents of the next Budget (23 March 2011) is already beginning. However a package of measures for stimulating growth in the private sector as fiscal retrenchment begins to bite looks a racing certainty. As we have discussed in previous Perspectives, if the OBR's GDP forecasts are to be met, then the private sector will have to grow by around 5-6% per annum for the next 4 years.¹⁻³ Such growth rates are not without precedent. Private sector growth in the mid-1990s, after the pound's eviction from the ERM, was very buoyant. But circumstances were more favourable then. There was buoyant growth in Britain's export markets, the banks were stronger and the economy was almost certainly more competitive than it is today.

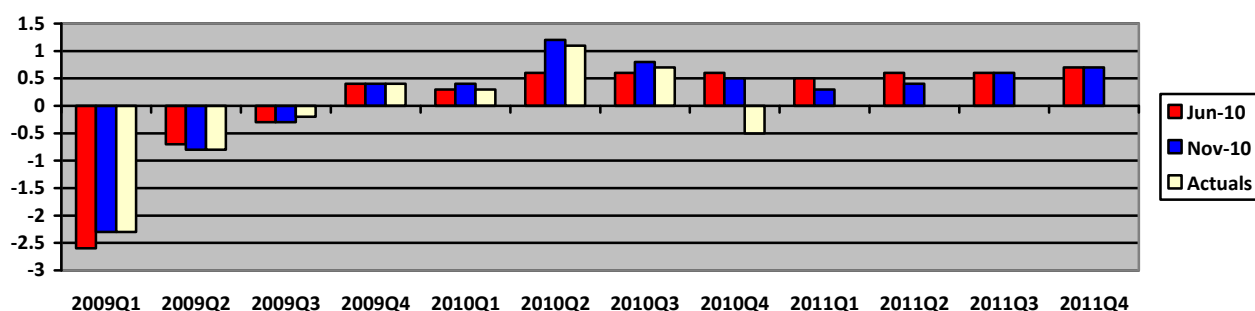
There have to be significant risks that the private sector will not meet these implied growth forecasts and the OBR's GDP forecasts will be missed – with potentially serious implications for the public finances. These implications were raised recently by the IFS. One suggestion being that, if the public finance targets were missed, then the chancellor would have raise taxes and/or cut spending further.⁵ Whilst it could be argued that such speculation was somewhat premature, the chancellor should nevertheless be prepared to be flexible about his deficit-cutting plan given the undoubted economic uncertainties ahead. We have been, and are, very supportive of his "Plan A", which has the strategic objective of making the sustainability of the fiscal position credible, with the cyclically-adjusted current budget in balance by FY2014.⁶ But it would help the policy debate if the chancellor could explain the possible circumstances which could give rise to policy changes – whether it be "Plan B", "Plan C" or any other type of plan.⁷ This approach would be more credible than ruling out any change in fiscal strategy however adverse the economic circumstances.

But, putting on one side fiscal issues, the Government is right to start placing the emphasis on growth. Britain needs a radical pro-growth strategy to sharpen up the country's competitiveness, revitalise the private sector and lessen the regulatory and tax costs on business. And it is all the more necessary given concerns that the economic recovery may be faltering.

Recent economic developments

The preliminary GDP data for 2010Q4 were very disappointing, showing a 0.5% fall in the quarter, and considerably worse than expected. They were, of course, badly affected by the arctic weather in November and December. The ONS estimated that the bad weather could explain a 0.5% fall in GDP, suggesting that if the weather had been "normal", GDP would have been flattish in the quarter,⁸ which is still disappointing especially as there may have been a pre-VAT hike boost to consumption. A flat figure compares very unfavourably with the OBR's November forecast for a 0.5% increase in the quarter, as shown in table 1, underlying the need to be very cautious about the OBR's forecasts.

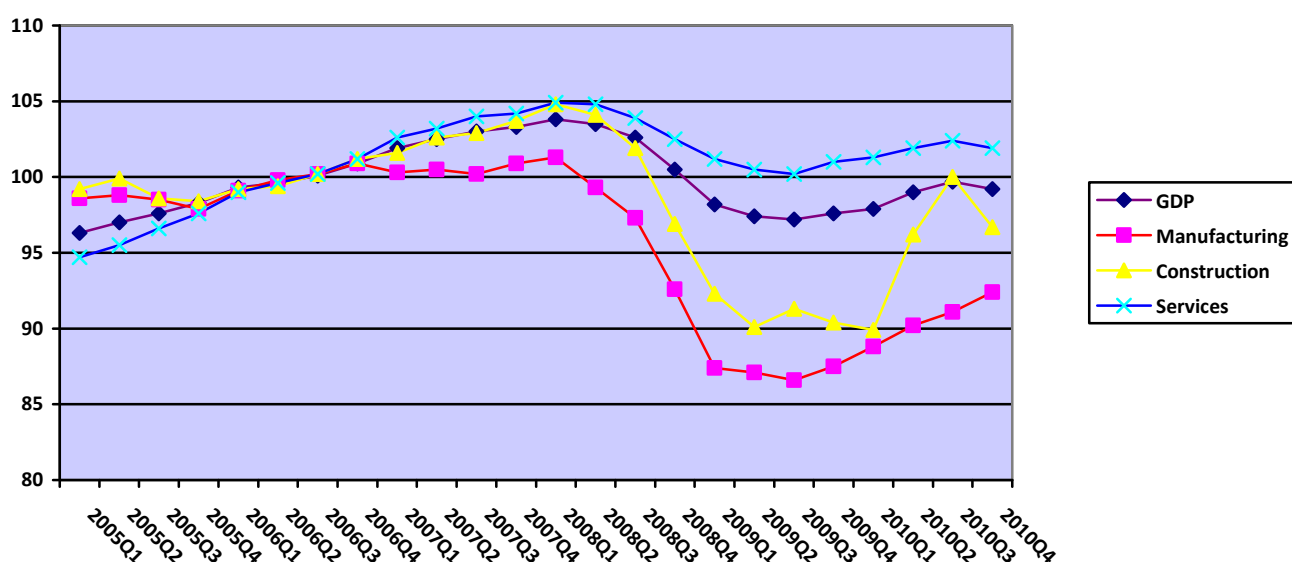
Chart 1 OBR June and November forecasts, ONS actuals: quarterly GDP growth profile (%)



Source: OBR, *Economic and fiscal outlook*, November 2010; ONS, "Gross domestic product: preliminary estimate, 2010Q4", 25 January 2011.

Within GDP, manufacturing industry (nearly 13% of GDP) is making a good recovery, having fallen by nearly 15% from peak to trough in the recession, but note that manufacturing output is still 9% down on its 2008Q1 peak (chart 2). Adjusting for bad weather, the recovery in construction (over 6% of GDP) also looks well-established whilst services (nearly 76% of GDP) have shown some growth.

Chart 2 Sectoral split for GDP: volume indices, 2006=100



Source: OBR, *Economic and fiscal outlook*, November 2010; ONS, "Gross domestic product: preliminary estimate, 2010Q4", 25 January 2011.

The weak 2010Q4 data do not, in themselves, indicate a "double-dip" and, weather apart, there is always the possibility of upward ONS revisions. Moreover recent (January) Markit/CIPS purchasing managers surveys have been quite upbeat for services, upbeat for construction and very upbeat for manufacturing.⁹ Whilst survey material can be misleading, there are grounds for cautious optimism that growth has returned in the first quarter of 2011.

Digression: February's Monetary Policy Committee meeting

The Bank of England's Monetary Policy Committee will announce the outcome of its next meeting on 10 February. We still take the view it is too early to increase interest rates, despite prices inflation being well above the Bank's 2% target, but still expect an increase sometime in 2011Q2.¹⁰

One of the key factors for the MPC is whether pay settlements are rising in response to the higher prices inflation. There are some signs that this may be starting to happen. But we

expect that the MPC will wait for more solid information about the real economy before raising rates. By the May meeting, the key GDP figure for 2011Q1 will be available and, assuming some growth, there is a fair-strong possibility the MPC will increase rates (to 0.75%) at that meeting.

The need to improve UK competitiveness

We have already suggested that the Government should embark on a radical pro-growth strategy to sharpen up the country's competitiveness. Economic purists argue that to talk of a nation's competitiveness is absurd on the grounds that nations do not compete in the same way as companies. When two companies compete it is arguably a "zero sum game". But this is not the case for two countries when they trade together as there can be benefits to both. But the term "competitiveness" is useful shorthand for a country's ability to trade successfully, to attract capital, to grow and to prosper.

The World Economic Forum (WEF) defines "competitiveness" as "the set of institutions, policies, and factors that determine the level of productivity of a country" and that "the level of productivity, in turn, sets the sustainable level of prosperity that can be earned by an economy". In other words, the WEF sees competitiveness as the ability of a country to achieve "sustained levels of GDP per head" rather than more specifically about growth. The WEF compiles an index of competitiveness which is a weighted average of a large variety of social and economic indicators, mainly taken from its extensive Executive Opinion Survey. The annex describes the methodology in more detail.

The WEF's *The Global Competitiveness Report for 2010-2011* showed the UK in 12th position, after Switzerland, Sweden, Singapore, the USA, Germany, Japan, Finland, the Netherlands, Denmark, Canada and the Hong Kong SAR (see the annex for more details).¹¹

John Major's Government picked up on the competitiveness theme energetically, publishing three Competitiveness White Papers in the mid-1990s.¹² A shift in emphasis from competitiveness to increasing social/employment regulations on business, as part of a social agenda, characterised much of business policy under the Blair-Brown Governments.^{13,14}

The Coalition Government has come to the issue of competitiveness as part of its growth agenda. In place of the expected Growth White Paper, a paper entitled *The path to strong, sustainable and balanced growth* was released last November which launched the Government's Growth Review. The Growth Review has a strong emphasis on the need to improve competitiveness. The paper stated:¹⁵

- "That is why today we are launching the Growth Review, a rolling programme to last the whole Parliament, with a first report by Budget 2011. This will be a fundamental assessment of what each part of Government is doing to provide the conditions for private sector success and address the barriers faced by industry."
- "Action needs to be taken to restore UK competitiveness. The World Economic Forum's Global Competitiveness Index showed the UK's ranking falling from 7th to 13th place between 1997 and 2009-10". (Though note the ranking was 12th in 2010-11.)

Specific issues

The challenges facing the Government's Growth Review will be many. The WEF's *The Global Competitiveness Report* suggested that, for the respondents to their Executive Opinion Survey, the most problematic factors for doing business in the UK related to taxation, finance, employment regulations, educational standards and infrastructure (mainly concerning transport but Britain's increasingly expensive electricity price should be added). These are also the main problematic factors that are quoted in related surveys by the business organisations, including the CBI, the IoD and the BCC. We will be looking at some of the most pressing issues to run alongside the developments in the Government's Growth Review in future Perspectives.

WEF: The most problematic factors for doing business in the UK

	% of responses
Tax rates	18.0
Access to financing	16.4
Tax regulations	15.7
Inefficient government bureaucracy	12.8
Policy instability	8.9
Restrictive labour regulations	6.4
Inadequately educated workforce	5.4
Inadequate supply of infrastructure	4.8
Poor work ethic in national labour force	3.8
Inflation	3.4
Government instability/coups	1.8
Foreign currency regulations	1.0
Crime and theft	0.6
Corruption	0.6
Poor public health	0.3

Source: WEF, *The Global Competitiveness Report 2010-2011*, 2010

Note: from a list of 15 factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5 (least problematic).

References

1. Ruth Lea, "The OBR's November forecast: so far, so good", Arbuthnot Banking Group, 6 December 2010.
2. OBR, *Economic and fiscal outlook*, Cm7979, November 2010.
3. Ruth Lea, "The British economy: tough times ahead but no double dip", Arbuthnot Banking Group, 20 October 2010.
4. Brewer et al (eds), *The IFS Green Budget*, February 2011.
5. *FT*, "Osborne warned he needs more tax rises", 3 February 2011
6. HM Treasury, *Budget 2010*, HC61, June 2010
7. *FT leader*, "The chancellor and the case for plan B", 4 February 2011.
8. ONS, *Gross domestic product: preliminary estimate, 2010Q4*, 25 January 2011, estimated that the estimated bad weather impact of -0.5% in the quarter was roughly split across the sectors as follows: Construction -0.1%; Services -0.4%. Within services, the main areas affected are hotels and restaurants, the various transport industries (particularly land transport and air transport) and recreation.
9. The Chartered Institute of Purchasing and Supply's website is www.cips.org.
10. Ruth Lea, "Memo to the MPC: it is too soon to raise interest rates", Arbuthnot Banking Group, 10 January 2011.
11. WEF, *The Global Competitiveness Report 2010-2011*, 2010.
12. The DTI's three Competitiveness White Papers under the Major Government were published in 1994, 1995 and 1996.
13. Though the DTI published *Our competitive future: building the knowledge-driven economy*, the "Government's Competitiveness White Paper" in 1998. This was the last competitiveness white paper.
14. HM Government, BERR, *New Industry, New Jobs, Building Britain's Future*, April 2009, did discuss competitiveness, though the emphasis was on the "new activism".
15. HM Treasury and BIS, *The path to strong, sustainable and balanced growth*, November 2010.

Annex: the WEF's Global Competitiveness Report

Methodology

The World Economic Forum (WEF) releases a *Global Competitiveness Report* annually. The WEF defines "competitiveness" as "the set of institutions, policies, and factors that determine the level of productivity of a country". The level of productivity, in turn, sets the sustainable level of prosperity that can be earned by an economy.

In the 2010 the WEF measured Global Competitiveness Indicators (GCIs) for 139 separate countries, which were principally calculated from information from the WEF's extensive Executive Opinion Survey, though additional information was used where this was considered relevant. Survey questions asked for responses on a scale of 1 to 7, where an answer of 1 or 7 always corresponds to the worst or best possible outcome, respectively. The answers were ultimately weighted for each country to give an overall score (GCI) for that country's "competitiveness", with the top countries in the resulting league table achieving the highest scores and the bottom countries achieving the lowest.

The WEF identified 12 pillars of competitiveness, which they grouped into 3 sub-indexes of the overall GCI (see table 1):

- The competitiveness of the "basic requirements" sub-index is regarded by the WEF as the key for "factor-driven" economies.
- The competitiveness of the "efficiency enhancers" sub-index is regarded as the key for "efficiency-driven" economies.
- The competitiveness of the "innovation and sophistication factors" sub-index is regarded as the key for "innovation-driven" economies.

The WEF used income thresholds (GDP per capita (in US\$)) for establishing stages of development, thus:

- Stage 1: factor-driven < \$2,000, including India and Nigeria.
- Transition from stage 1 to stage 2: \$2,000-3,000, including Indonesia and Saudi Arabia.
- Stage 2: efficiency-driven \$3,000-9,000, including Brazil, China, Malaysia, South Africa, Thailand and Turkey.
- Transition from stage 2 to stage 3: \$9,000-17,000, including Poland and Taiwan
- Stage 3: innovation-driven > \$17,000, including G7, Western Europe, Israel, Hong Kong, Japan, Australia and New Zealand.

Table 1: The WEF's Global Competitiveness Indicators: components

GCI sub-indexes	Pillars	Explanations of the pillars
Basic requirements	Institutions	The institutional environment is determined by the legal and administrative framework within which individuals, firms, and governments interact to generate income and wealth in the economy.
	Infrastructure	Extensive and efficient infrastructure is critical for ensuring the effective functioning of the economy, as it is an important factor determining the location of economic activity and the kinds of activities or sectors that can develop in a particular economy.
	Macroeconomic environment	The stability of the macroeconomic environment is important for business and, therefore, is important for the overall competitiveness of a country.
Efficiency enhancers	Health and primary education	A healthy workforce is vital to a country's competitiveness and productivity.
	Higher education and training	Quality higher education and training is crucial for economies that want to move up the value chain beyond

		simple production processes and products.
	Goods market efficiency	Countries with efficient goods markets are well positioned to produce the right mix of products and services given their particular supply-and-demand conditions, as well as to ensure that these goods can be most effectively traded in the economy.
	Labour market efficiency	The efficiency and flexibility of the labour market are critical for ensuring that workers are allocated to their most efficient use in the economy and provided with incentives to give their best effort in their jobs.
	Financial market development	The recent financial crisis has highlighted the central role of a sound and well-functioning financial sector for economic activities.
	Technological readiness	In today's globalized world, technology has increasingly become an important element for firms to compete and prosper. The technological readiness pillar measures the agility with which an economy adopts existing technologies to enhance the productivity of its industries.
	Market size	The size of the market affects productivity since large markets allow firms to exploit economies of scale.
Innovation & sophistication factors	Business sophistication	Business sophistication is conducive to higher efficiency in the production of goods and services.
	Innovation (technological)	Although substantial gains can be obtained by improving institutions, building infrastructure, reducing macroeconomic instability, or improving human capital, all these factors eventually seem to run into diminishing returns. The same is true for the efficiency of the labour, financial, and goods markets. In the long run, standards of living can be enhanced only by technological innovation.

Source: WEF, *The Global Competitiveness Report 2010-2011*, 2010

Results

Some key results are shown in table 2. According to the WEF, Switzerland is the most competitive country followed by Sweden, Singapore, the USA and Germany. The UK is in 12th position (compared with 13th in 2009) and France in 15th. The BRICs are well down the list according to the WEF, but note that these are currently much less prosperous countries than the top economies and have much catching up to do in terms of prosperity.

Table 2: Global Competitiveness Index 2010-11 rankings and 2009-2010 comparisons

	2010-2011 rank								2009-2010 rank
	Overall		Basic requirements		Efficiency enhancers		Innovation & sophistication factors		
Country	Rank	Score	Rank	Score	Rank	Score	Rank	Score	
Switzerland	1	5.63	2	6.05	4	5.41	2	5.71	1
Sweden	2	5.56	4	5.98	5	5.32	3	5.67	4
Singapore	3	5.48	3	6.05	1	5.49	10	5.07	3
USA	4	5.43	32	5.21	3	5.46	4	5.53	2

Germany	5	5.39	6	5.89	13	5.11	5	5.51	7
Japan	6	5.37	26	5.35	11	5.17	1	5.72	8
Finland	7	5.37	5	5.97	14	5.09	6	5.43	6
Netherlands	8	5.33	9	5.82	8	5.24	8	5.16	10
Denmark	9	5.32	7	5.86	9	5.20	9	5.15	5
Canada	10	5.30	11	5.77	6	5.32	14	4.95	9
Hong Kong SAR	11	5.30	1	6.12	2	5.48	24	4.46	11
UK	12	5.25	18	5.58	7	5.28	12	4.98	13
China, PRC	27	4.84	30	5.27	29	4.63	31	4.13	29
India	51	4.33	81	4.30	38	4.42	42	3.96	49
South Africa	54	4.32	79	4.35	42	4.37	43	3.93	45
Brazil	58	4.28	86	4.26	44	4.35	38	4.03	56
Russia	63	4.24	65	4.52	53	4.19	80	3.36	63

Source: WEF, *The Global Competitiveness Report 2010-2011*, 2010

The detailed results for the UK are shown in table 3. According to the WEF the UK benefited from clear strengths, such as the efficiency of its labour market (8th), standing in contrast to the rigidity of many other European countries. The country also continued to have sophisticated and innovative businesses that were highly adept at harnessing the latest technologies for productivity improvements and operating in a very large market (ranked 6th for market size). However, the macroeconomic environment, especially the size of the fiscal deficit, remained the greatest competitive weakness. The state of the banks was also regarded as a major weakness.

Table 3 United Kingdom: Global Competitiveness Index (GCI) in detail

	Rank (out of 139)	Score (1-7)
GCI 2010–2011	12	5.3
GCI 2009–2010 (out of 133)	13	5.2
GCI 2008–2009 (out of 134)	12	5.3
Basic requirements	18	5.6
1 st pillar: Institutions	17	5.3
1.01 Property rights	17	
1.02 Intellectual property protection	17	
1.03 Diversion of public funds	11	
1.04 Public trust of politicians	55	
1.05 Irregular payments and bribes	21	
1.06 Judicial independence	8	
1.07 Favouritism in decisions of government officials	23	
1.08 Wastefulness of government spending	72	
1.09 Burden of government regulation	89	
1.10 Efficiency of legal framework in settling disputes	8	
1.11 Efficiency of legal framework in challenging regulations	16	
1.12 Transparency of government policymaking	34	
1.13 Business costs of terrorism	99	
1.14 Business costs of crime and violence	55	
1.15 Organized crime	39	
1.16 Reliability of police services	31	

1.17 Ethical behaviour of firms	14	
1.18 Strength of auditing and reporting standards	22	
1.19 Efficacy of corporate boards	16	
1.20 Protection of minority shareholders' interests	17	
1.21 Strength of investor protection*	10	
2 nd pillar: Infrastructure	8	5.9
2.01 Quality of overall infrastructure	33	
2.02 Quality of roads	35	
2.03 Quality of railroad infrastructure	19	
2.04 Quality of port infrastructure	23	
2.05 Quality of air transport infrastructure	34	
2.06 Available airline seat kilometres*	3	
2.07 Quality of electricity supply	15	
2.08 Fixed telephone lines*	11	
2.09 Mobile telephone subscriptions*	24	
3 rd pillar: Macroeconomic environment	56	4.8
3.01 Government budget balance*	117	
3.02 National savings rate*	107	
3.03 Inflation*	54	
3.04 Interest rate spread*	2	
3.05 Government debt*	108	
3.06 Country credit rating*	18	
4 th pillar: Health and primary education	19	6.4
4.01 Business impact of malaria	1	
4.02 Malaria incidence*	1	
4.03 Business impact of tuberculosis	36	
4.04 Tuberculosis incidence*	32	
4.05 Business impact of HIV/AIDS	54	
4.06 HIV prevalence*	55	
4.07 Infant mortality*	28	
4.08 Life expectancy*	21	
4.09 Quality of primary education	27	
4.10 Primary education enrolment rate*	8	
Efficiency enhancers	7	5.3
5 th pillar: Higher education and training	18	5.3
5.01 Secondary education enrolment rate*	28	
5.02 Tertiary education enrolment rate*	35	
5.03 Quality of the educational system	28	
5.04 Quality of maths and science education	55	
5.05 Quality of management schools	10	
5.06 Internet access in schools	28	
5.07 Local availability of research and training services	12	
5.08 Extent of staff training	28	
6 th pillar: Goods market efficiency	22	5.0
6.01 Intensity of local competition	8	
6.02 Extent of market dominance	10	
6.03 Effectiveness of anti-monopoly policy	8	
6.04 Extent and effect of taxation	95	
6.05 Total tax rate*	54	

6.06 Number of procedures required to start a business*	34	
6.07 Time required to start a business*	45	
6.08 Agricultural policy costs	53	
6.09 Prevalence of trade barriers	21	
6.10 Trade tariffs*	4	
6.11 Prevalence of foreign ownership	7	
6.12 Business impact of rules on FDI	14	
6.13 Burden of customs procedures	31	
6.14 Degree of customer orientation	44	
6.15 Buyer sophistication	8	
7 th pillar: Labour market efficiency	8	5.3
7.01 Cooperation in labour-employer relations	26	
7.02 Flexibility of wage determination	20	
7.03 Rigidity of employment*	18	
7.04 Hiring and firing practices	49	
7.05 Redundancy costs*	40	
7.06 Pay and productivity	25	
7.07 Reliance on professional management	7	
7.08 Brain drain	10	
7.09 Female participation in labour force*	47	
8 th pillar: Financial market development	25	4.7
8.01 Availability of financial services	5	
8.02 Affordability of financial services	10	
8.03 Financing through local equity market	32	
8.04 Ease of access to loans	74	
8.05 Venture capital availability	38	
8.06 Restriction on capital flows	10	
8.07 Soundness of banks	133	
8.08 Regulation of securities exchanges	42	
8.09 Legal rights index*	6	
9 th pillar: Technological readiness	8	5.6
9.01 Availability of latest technologies	15	
9.02 Firm-level technology absorption	21	
9.03 FDI and technology transfer	17	
9.04 Internet users*	9	
9.05 Broadband Internet subscriptions*	11	
9.06 Internet bandwidth*	6	
10 th pillar: Market size	6	5.8
10.01 Domestic market size index*	6	
10.02 Foreign market size index*	6	
Innovation and sophistication factors	12	5.0
11 th pillar: Business sophistication	9	5.3
11.01 Local supplier quantity	23	
11.02 Local supplier quality	30	
11.03 State of cluster development	10	
11.04 Nature of competitive advantage	9	
11.05 Value chain breadth	11	
11.06 Control of international distribution	19	
11.07 Production process sophistication	17	

11.08 Extent of marketing	4	
11.09 Willingness to delegate authority	16	
12 th pillar: Innovation	14	4.6
12.01 Capacity for innovation	15	
12.02 Quality of scientific research institutions	3	
12.03 Company spending on R&D	14	
12.04 University-industry collaboration in R&D	4	
12.05 Gov't procurement of advanced tech products	53	
12.06 Availability of scientists and engineers	29	
12.07 Utility patents per million population*	20	

Source: WEF, *The Global Competitiveness Report 2010-2011*, 2010

Note: the ranks of notable competitive advantages are **highlighted in bold**. An asterisk (*) indicates that data are from sources other than the WEF. The scores are only available for the overall GCI, the 3 driving factors and the 12 constituent pillars.

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