

Long-Run Growth: The Role of Government

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Getting government intervention right:

Keynes on Burke:

“We cannot therefore settle on abstract grounds, but must handle on its merits in detail what Burke termed ‘one of the finest problems in legislation, namely, to determine what the State ought to take upon itself to direct by the public wisdom, and what it ought to leave, with as little interference as possible, to individual exertion’”

(J.M.Keynes, *The End of Laissez Faire*, p. 288-91)

Four phases of policy thinking

- Phase 1: The normative
- Phase 2: Confronting government failure
- Phase 3: Institutions matter
- Phase 4: The importance of state capacity

Phase 1: The normative

- It is very easy to dream up reasons why market fails
 - Indeed if you look at economics of the past 50 years, you might worry why we have markets at all
 - Market fundamentalists are actually a minority among economists
- Some tools for normative analysis are well-developed
 - E.g. cost-benefit analysis for public investment
 - Design of tax policy
 - Analysis of benefits from competition
- Others less so
 - Industrial strategy
 - Banking regulation

Phase 2: The challenge of government failure

- Influential thinking of the Public Choice School
 - Refined in more mainstream recent political economy
- Three elements
 - Ignorance
 - Incentives
 - Incompetence
- Sometimes find it hard to diagnose which is at work

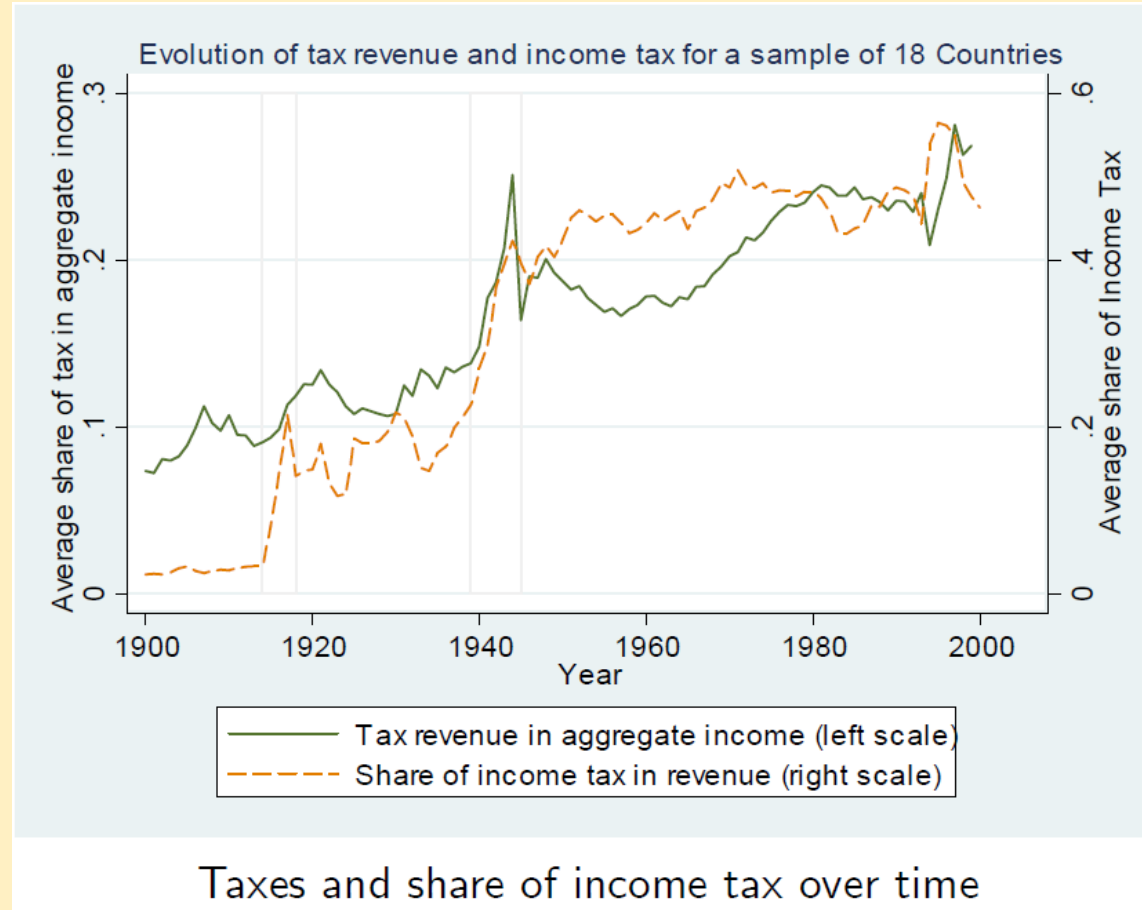
Phase 3: Institutions matter

- Increasingly the mantra of policy economics
 - Builds on the legacy of economic historians such as Douglass North
 - Aim is to get the state focused on common-interest policies
- Making democracy work
 - Two dimensions of democratic decision making
 - Sensible constraints on executive authority
 - Rules for the allocation power
 - Important role of expert opinion and independent authority
 - Courts, regulators, central banks etc
 - Also role of civil society
 - Including the media
 - Think tanks and universities

Phase 4: The role of state capacities

- Overtime, the state builds the expertise that it needs to carry out key functions
 - These are important investments which increase the ability of the state to:
 - Support markets
 - Augment markets
 - Finance the needs of government
- The right institutional framework is needed for state capacity to flourish
 - UK is patchy in some areas

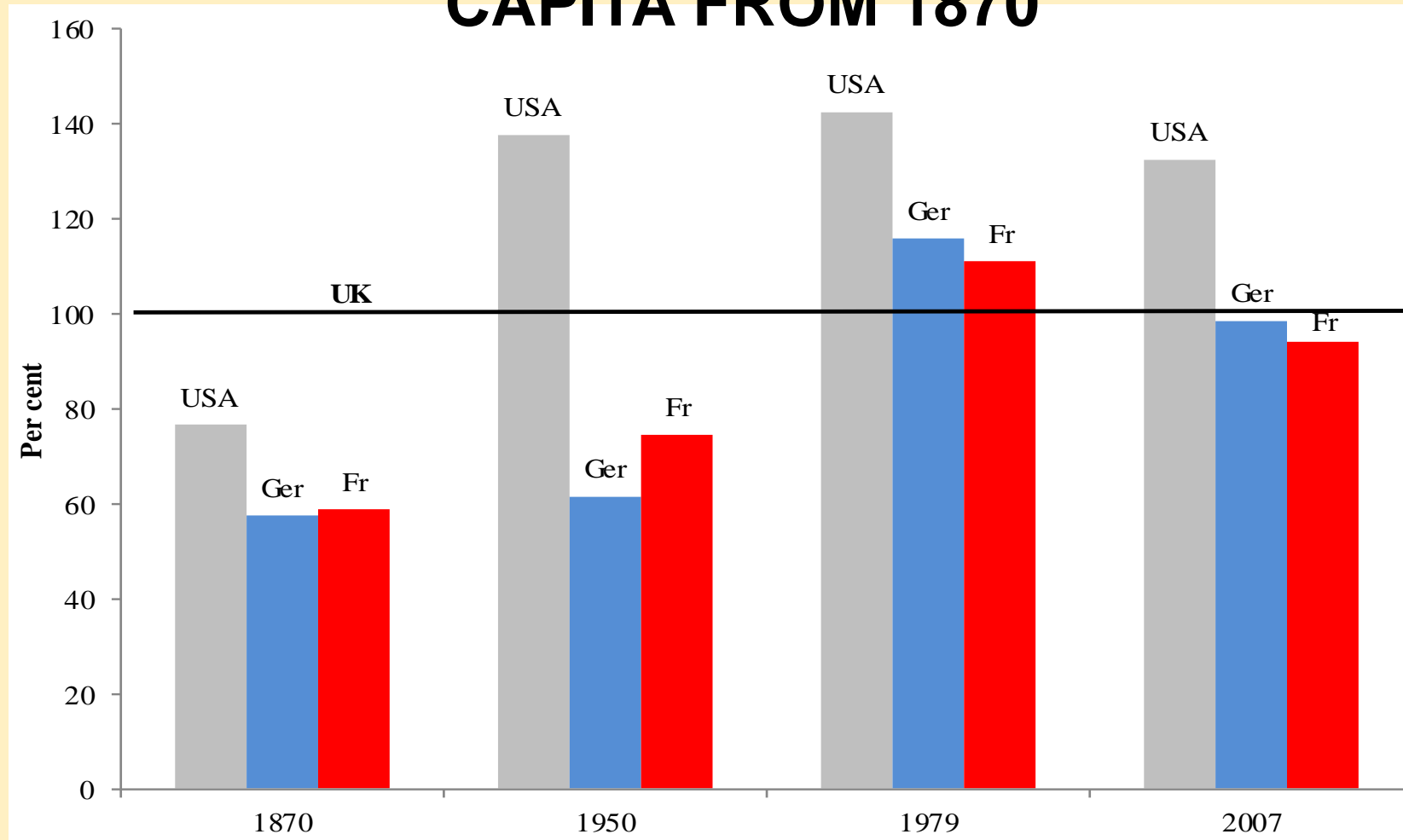
A Remarkable Transformation



A UK Story

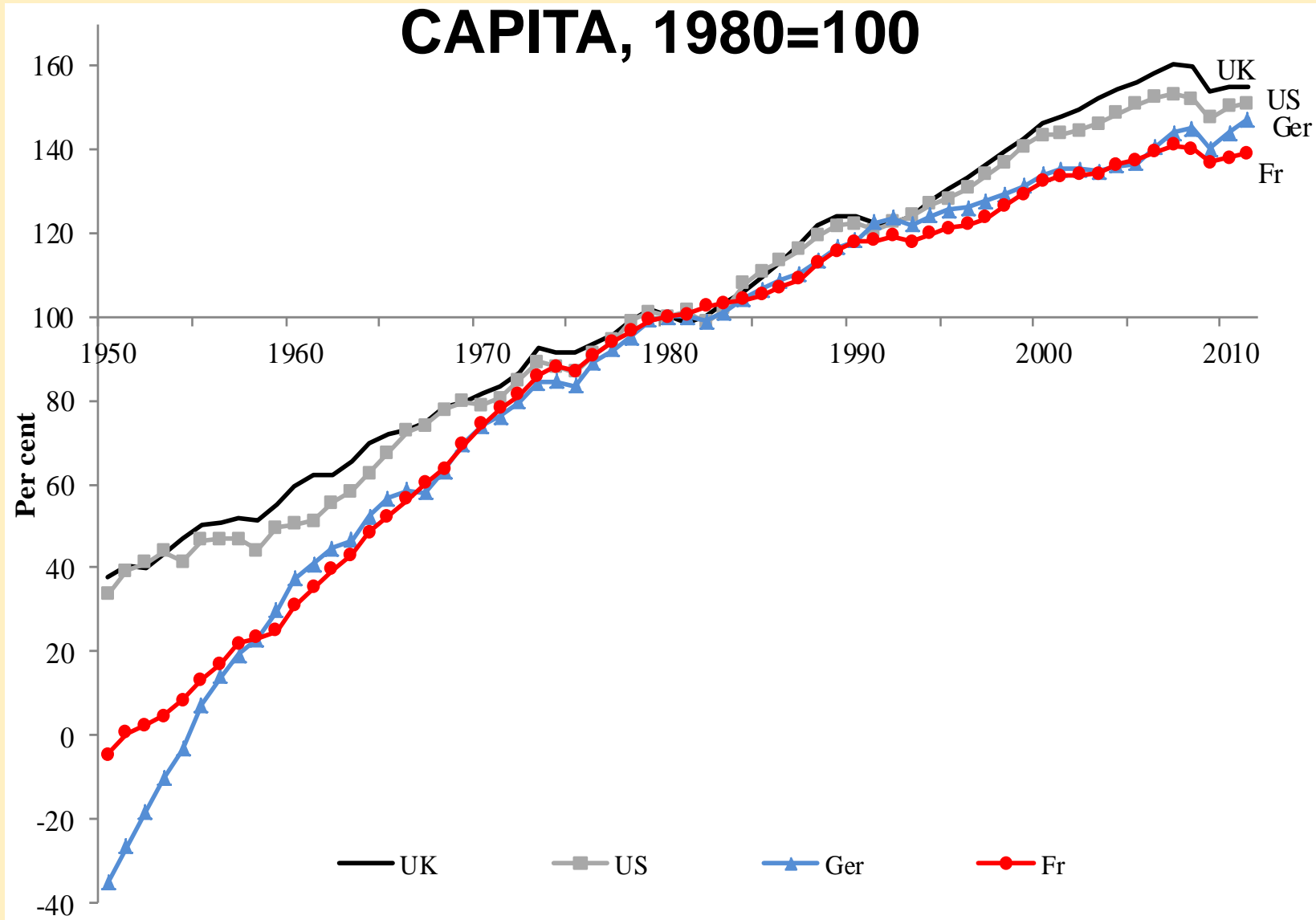
- 1945-1980
 - Successfully built state capacity in some areas
 - E.g. building NHS
 - Extending educational attainment
 - Failures in other areas
 - The macro-economic mess of the 70s
 - (Most) nationalized industries
- 1980-2008
 - Privatization
 - Liberalization based on openness and competitiveness
 - BUT issues of inclusion
 - Regional
 - Household
 - Limited government activism

DECLINE AND REBOUND: RELATIVE GDP PER CAPITA FROM 1870



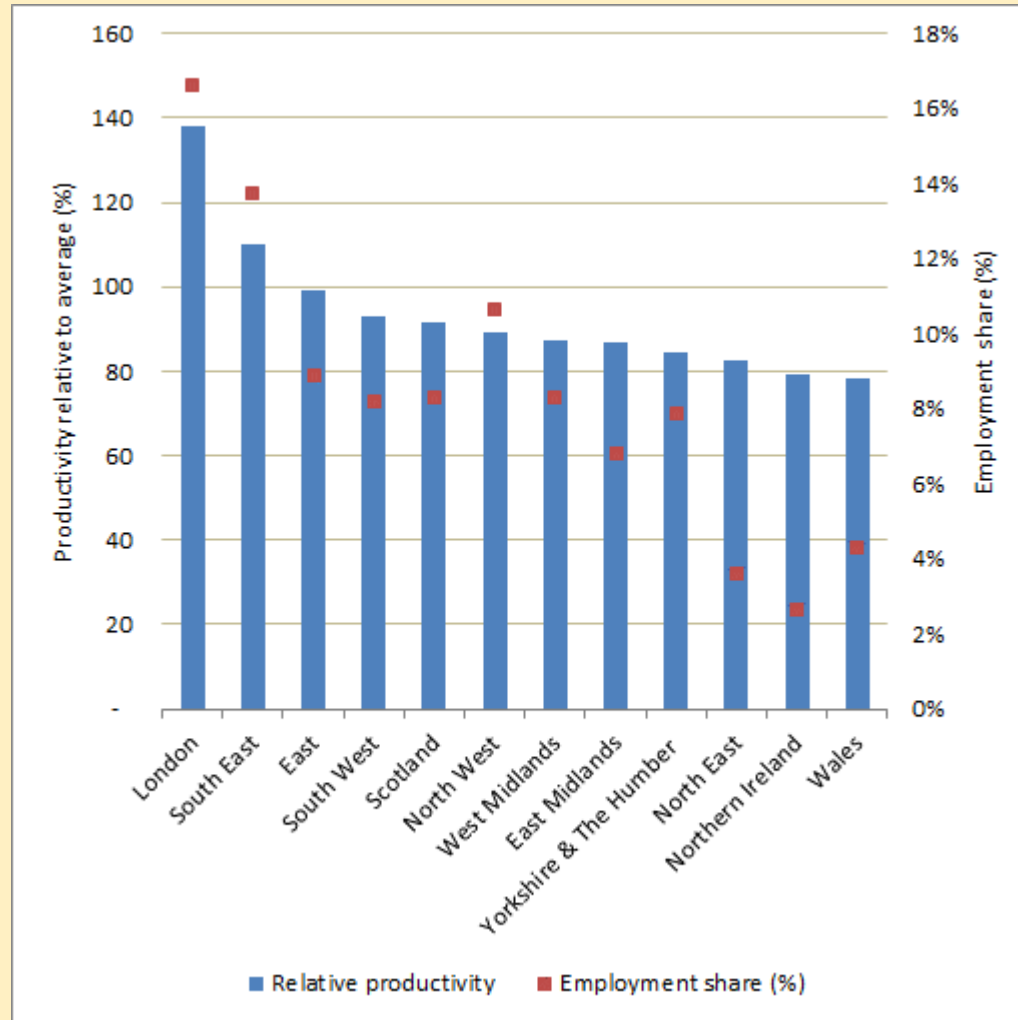
Source: LSE Growth Commission

A REVERSAL OF MISFORTUNE? GDP PER CAPITA, 1980=100



Source: LSE Growth Commission

Regional Productivity Differences

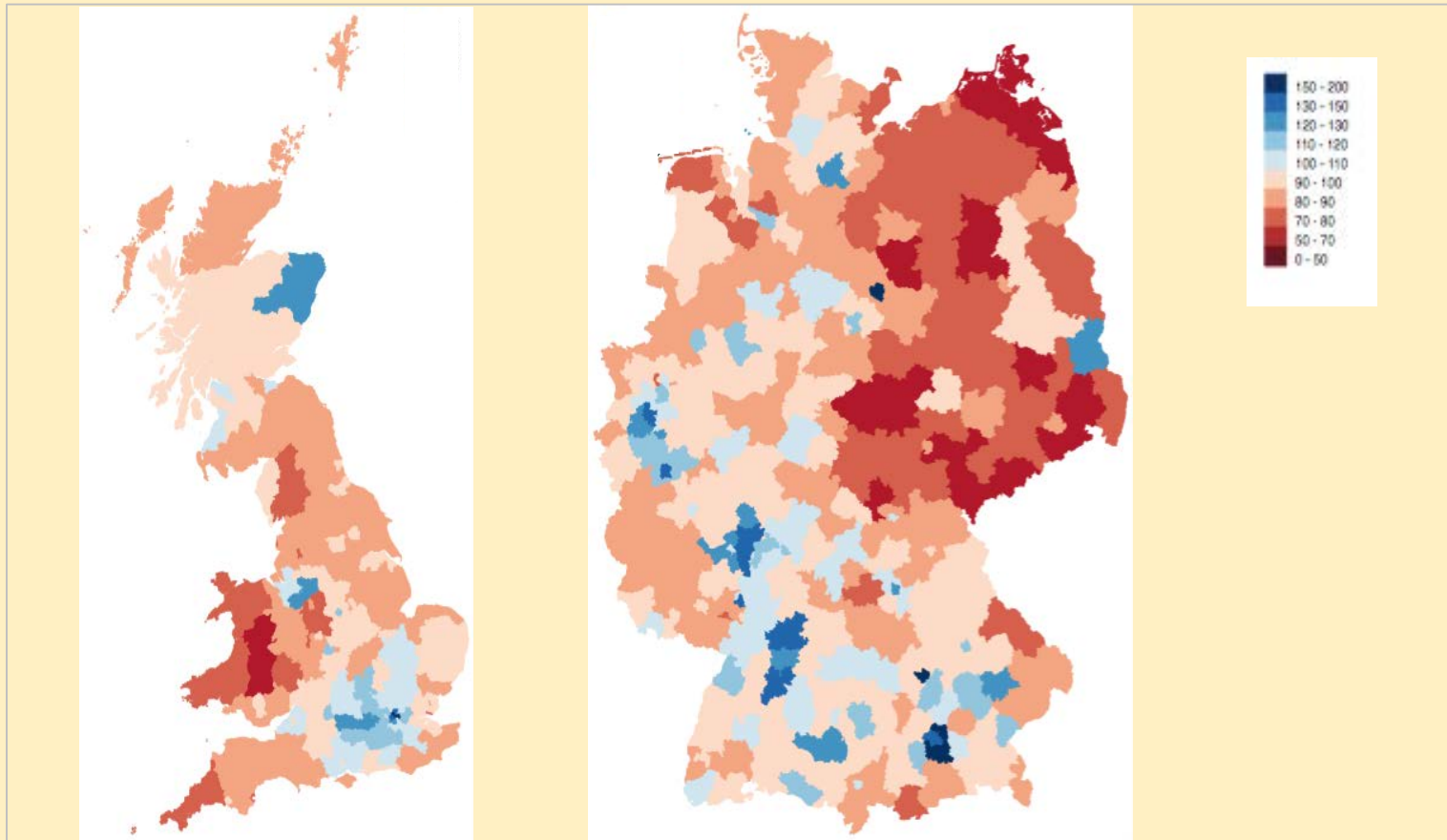


Notes: GVA/employment relative to average=100, data for 2015. Excludes mining as extra region activity is not apportioned across regions. Source: ONS.

- London and SE account for 40% total GVA, 33% of firms but 27% population.
- London and SE also most productive.
- Differences between regions are not driven by different sectoral mix, but by firms being less productive even in same sector (ONS, 2017)

Regional Productivity Differences

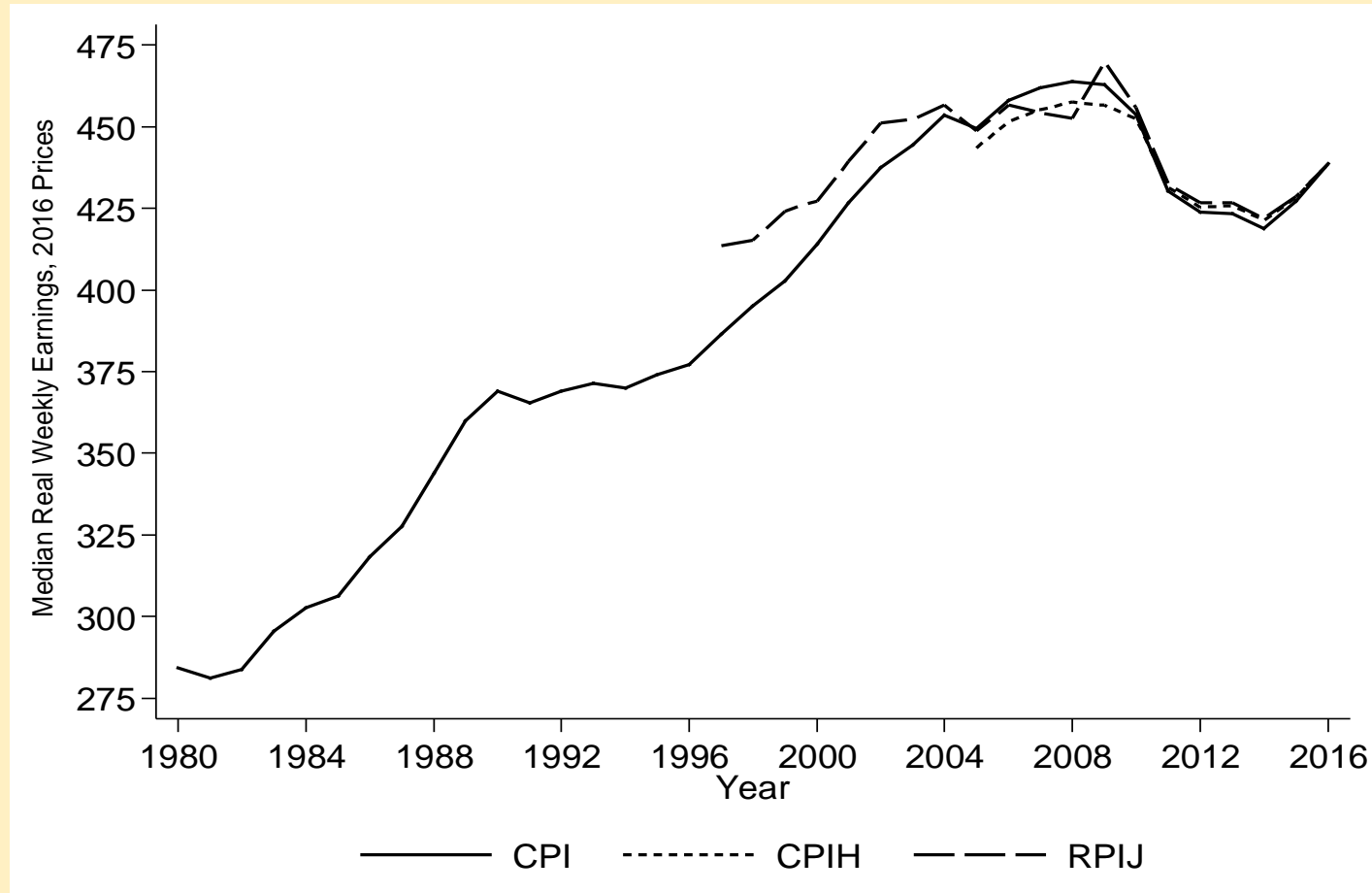
GVA per hour, regions in the UK and Germany compared to national average (NUTS3)



- High productivity regions more spread in West Germany
- Disparities in Germany narrowing over time
- UK developing a thicker tail of poorly performing regions

Note: These two maps show GVA per hour at NUTS3 level in 2014, with the overall country's level set to 100 (index).
Source: UK data from ONS release (January 2017), German data from the federal states national accounts (VGRdL).

Falling real wages since 2008



Notes: Weekly earnings deflated by CPI, CPIH and RPIJ.
Source: Annual Survey of Hours and Earnings (ASHE).

The Politics

- Increasing political consensus from 1980 onwards on broad contours of policy:
 - Tougher competition through privatization; independent regulators; competition policy
 - Enhanced by EU State Aids Policy
 - Flexible labour markets through reforms to employment services, benefits & union law
 - Increases in university education (5% had degree in 1980 compared to 31% in 2011)
 - Openness to FDI & immigration
 - State raising about 36-37.5% of GDP in taxation
 - Aiming off strategic economic policy-making
- Increased use of Independent bodies – experts & political resilience
 - Competition Commission & OFT
 - NICE
 - Bank of England MPC
 - OBR and NIC since 2008

Independent Bodies

	Monetary Policy	Fiscal Policy	Competition Policy
Policy tool	<ul style="list-style-type: none"> • Bank Rate • Asset Purchases 	<ul style="list-style-type: none"> • Tax and spending 	<ul style="list-style-type: none"> • Merger clearance and remedies • Market investigations, • Penalties for anti-competitive behaviour
Legal framework	<ul style="list-style-type: none"> • Bank of England Act 1998 • Bank of England and Financial Services Act 2016 	<ul style="list-style-type: none"> • Budget Responsibility & National Audit Act 2011 • Charter for Budget Responsibility 	<ul style="list-style-type: none"> • Competition Act 1998 • Enterprise Act 2002 • Enterprise and Regulatory Reform Act 2013
Independent decision maker or oversight	<ul style="list-style-type: none"> • Bank of England's Monetary Policy Committee (MPC): external members 	<ul style="list-style-type: none"> • Office for Budget Responsibility (OBR) 	<ul style="list-style-type: none"> • Competition and Markets Authority (CMA) Board independent panel members
Mandate or guidelines	<ul style="list-style-type: none"> • Inflation target 	<ul style="list-style-type: none"> • Fiscal rules 	<ul style="list-style-type: none"> • Duty to promote competition for the benefit of consumers.
Transparent publication	<ul style="list-style-type: none"> • Inflation Report 	<ul style="list-style-type: none"> • Budgets • EFO 	<ul style="list-style-type: none"> • Merger inquiry findings • Market investigation findings

Charter for the National Infrastructure Commission

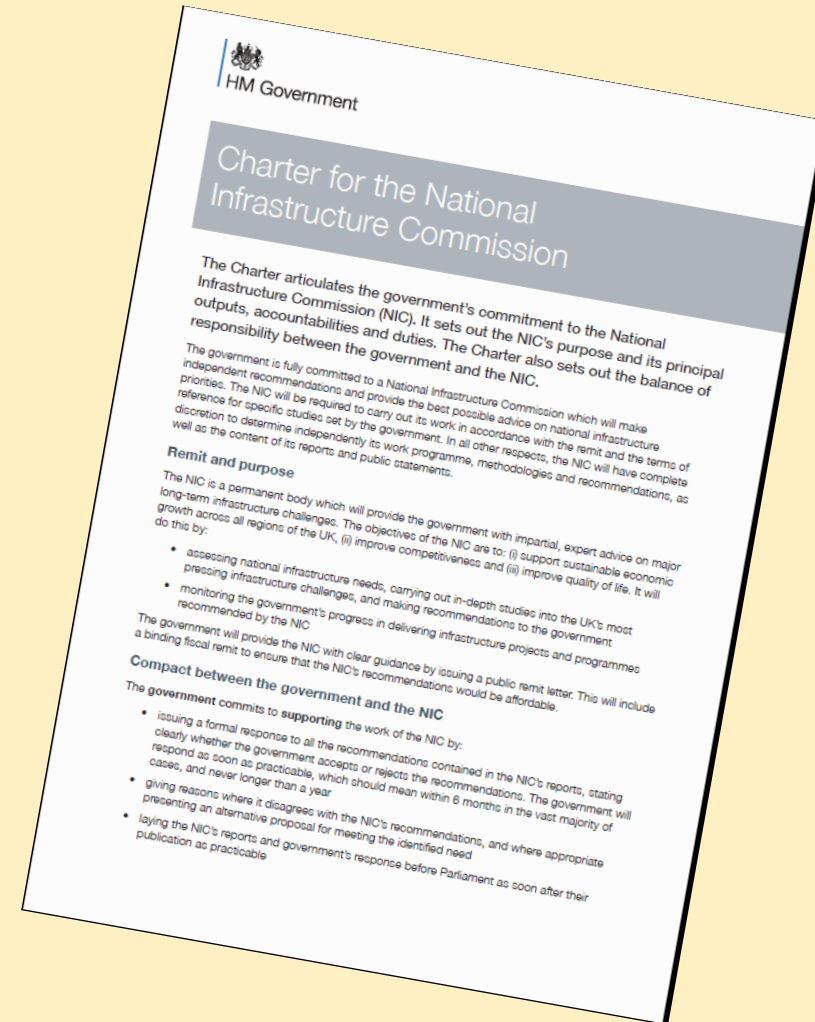
“The NIC is a permanent body which will provide the government with impartial, expert advice on major long-term infrastructure challenges. The objectives of the NIC are to: (i) support sustainable economic growth across all regions of the UK; (ii) improve competitiveness and (iii) improve quality of life. It will do this by:

- Assessing national infrastructure needs, carrying out in-depth studies into the UK’s most pressing infrastructure challenges, and making recommendations to the government
- Monitoring the government’s progress in delivering infrastructure projects and programmes recommended by the NIC

...

“The NIC commits to delivering the following products and services:

- A National Infrastructure Assessment once in every Parliament, setting out the NIC’s assessment of long-term infrastructure needs with recommendations to the government”



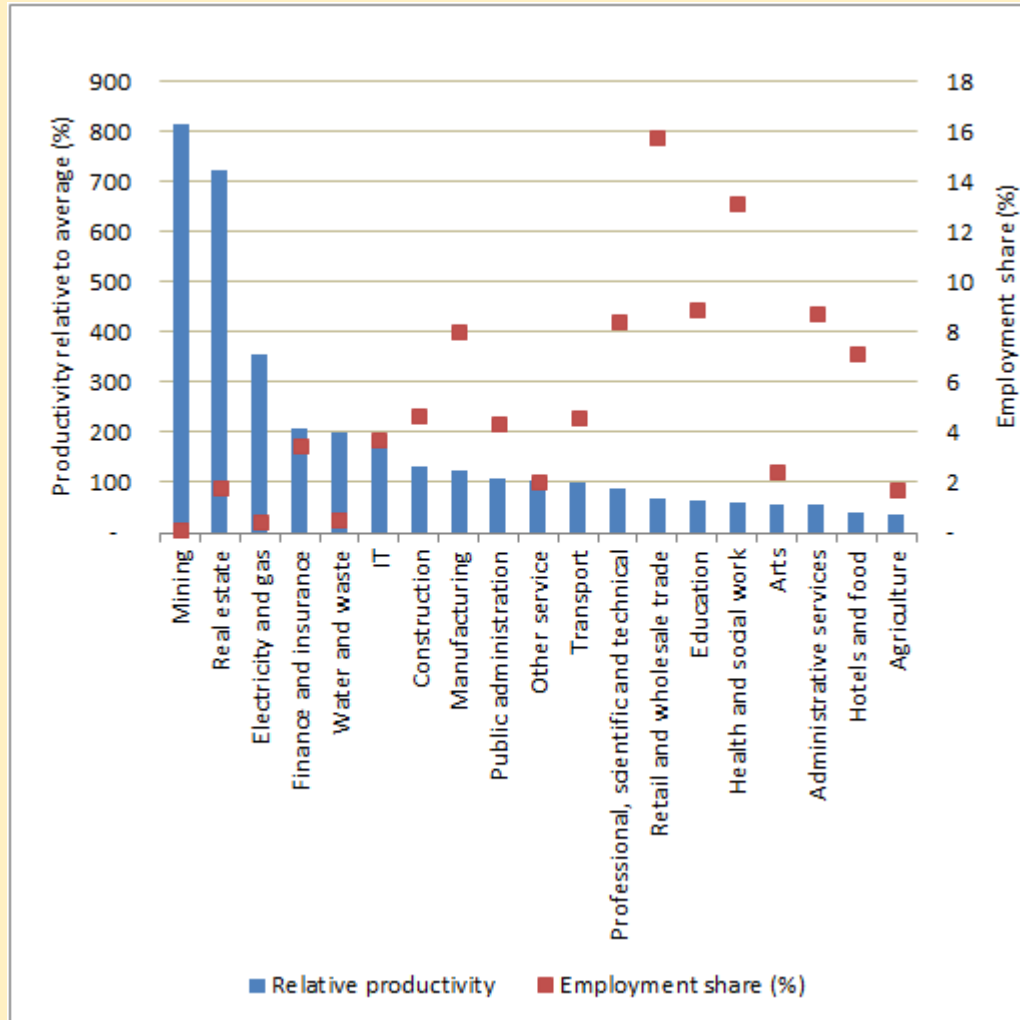
A New Direction?

- Industrial strategy now back on the agenda
 - But without any kind of well-defined policy framework
 - At least two aims
 - Addressing regional imbalances
 - Dealing with problems of low-productivity growth/stagnant wages
 - Three aspects of policy
 - Conceptual
 - Forensic
 - Institutional
- Challenging the 38% ceiling
 - But 27% of tax paid by top 1% and 59% by top 10%
 - And who bears the corporation tax burden?

An institutional framework for industrial strategy?

- Conceptual
 - What is the objective?
- Forensic
 - Can we have an empirically and analytically based policy framework?
- Institutional
 - Where we decision making, transparency and accountability lie?
 - Role for a new policy framework with independent expertise
- Big issue
 - Do we have the state capacity needed to deliver or will repeat the mistakes of the past?

Where to focus?



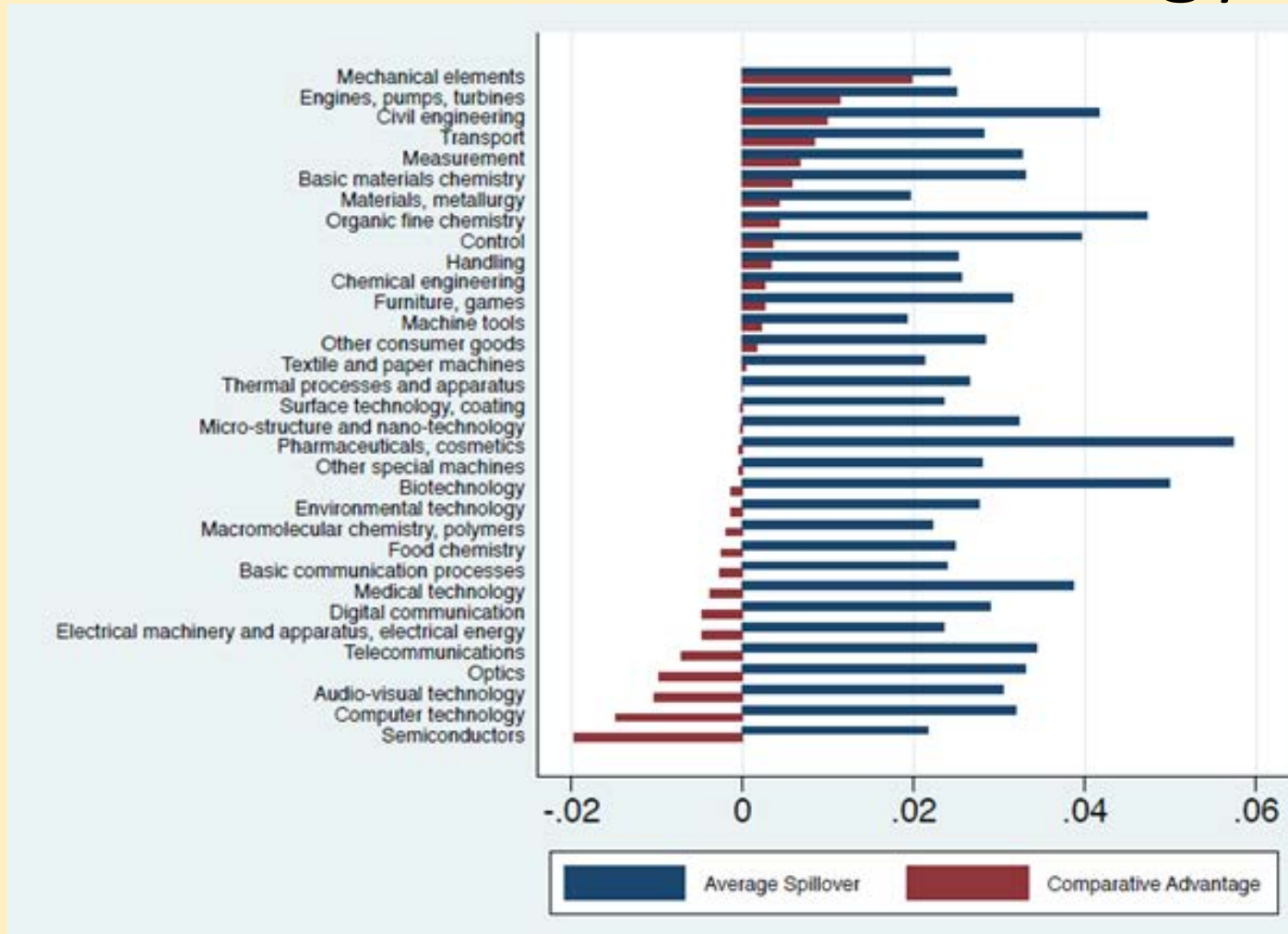
Notes: GVA/employment relative to average=100, data for 2015.

Source: ONS.

- Most highly productive sectors tend to have lower employment share
- “Low productivity” sectors like retail have a high employment share
- Different policy prescriptions for sector based policies
- But there is a long tail of unproductive firms in all sectors and size bands (strong need for economy wide policies)

Where to focus? Technology spillovers

- Support should be focused on areas where market failures most likely to prevent efficient allocation of resources
- Patent analysis: Areas of current comparative advantage vs areas of highest spillovers in UK



Note: Calculations based on global patent data (1950-2005). Comparative advantage is based on relative innovation share of the UK in area X compared to the 10 most innovative countries globally. Average spillover is an estimate of the average knowledge spillover a patent in area X generates within the UK. Source: Dechezleprêtre et al (2017).

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Thank You!

