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***Going for growth: building Britain's future
economy***

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The Work Foundation**

This week not only marks the beginning of an election year in Britain. It also marks the start of a new decade in which we know the economy will come under fiercer competitive challenge than ever before, as the world tilts further east towards China and the other emerging economies.

But we do not have to resign ourselves to relative economic decline. On the contrary.

In Britain we still have one of the best environments in the world for starting and growing a new business.

We are emerging from the financial crisis and the downturn with our key industrial strengths intact, unlike our experience in previous recessions.

The competitive value of the pound is helping exports and increasing the sourcing of manufactured goods in the UK. And the Government will maintain its support for the economy through existing public spending and investment until the recovery is firmly locked in.

But that's not the end of the story. The recovery is only the beginning of how we are going to pay our way in the global economy and create the jobs of the future.

As the Government will explain in the strategy for economic growth we are publishing tomorrow, how we create future jobs won't be the same as in the past. We will turn new technologies into jobs, like those in digital and biotechnologies. We will commercialise the output of our hugely successful science and research base. We will turn low carbon into business and employment opportunities.

None of this is going to happen with government simply standing on the sidelines. Other governments are actively investing in their industrial strength. We have to do the same.

And it won't happen if we take the wrong turn in sorting out the national finances in the coming months.

David Cameron argues that the priority here is quick and far-reaching retrenchment: that eliminating the government's financial deficit by slashing government spending, and investment, and presumably hiking taxes, will create economic growth. This is potentially dangerous nonsense. I want to explain why.

I quite understand why people who worry about getting into debt themselves are naturally concerned by the current scale of the deficit the government is running.

But managing a family's household budget is not the same as managing the public finances prudently.

At a time of low private sector activity, government spending provides vital demand.

Pull away that prop for the economy and you reduce the tax take, push up spending on unemployment and make the deficit worse. This is the paradox of government thrift. We learnt it in the 1930s. It seems to be totally lost on the present day Conservative party.

The Tory argument that we are not cutting the deficit enough, when in fact we have set out tough plans to do just that during the next four years, can only mean they would cut spending more, put up taxation more and do all of this more quickly.

And my point is this: this would only stall the recovery, stymie growth, put unemployment up and the costs it imposes on us, reduce the tax take and make the deficit worse, not better.

Nor is it credible just to argue as the Tories have that cutting the deficit will produce lower interest rates which will drive growth. First those deficit reduction plans have to be credible, and the scale of the unfunded and uncOSTed Tory tax and spending commitments suggest their rhetoric has to be treated with caution.

Second, low interest rates in themselves are no guarantee of economic growth, as the Japanese experience shows. You also have to have policies that build capabilities and incentives that mobilise investment and create business and employment opportunities. Otherwise, cutting the cost of money is, famously, like pushing on a piece of string.

Of course consolidation is vital. But we have to show more sense and more caution than simply adopting a one club policy of cutting spending. Unfortunately, my friend George seems resolutely determined to duck the lessons of history and be the Montagu Norman of the 21st century.

Two plans

So a credible Deficit Reduction Plan has to be accompanied by an equally credible Growth Plan. Deficit reduction is a three-sided

triangle: spending reductions, tax increases and economic growth, and, of the three, growth is the best antidote to debt both in short term and the long term.

December's PBR is far more credible in all these respects than some of the British press and our political opponents like to pretend.

It has a clear objective – to halve the deficit by 2013-14. It is bold and tough: the equivalent of something approaching an £80 billion turnaround in the public finances. This is the sharpest reduction in the budget deficit for any G7 country. This is vital for credibility, vital for attracting inward investment.

Our social priorities in health, schools and policing are protected. But, as the Prime Minister and the Chancellor have both made clear, the impact on other services cannot be painless.

Our plans do not at this stage fix rigid limits for each department, for the good reason that future uncertainties remain. But the commitment to real reductions is clear.

I believe that we have provided a much clearer and more coherent commitment here than the Opposition. But we have also gone far further in defining the other critical ground for the politics of the next decade, which is the question of how we achieve growth in a globalised economy.

The politics of growth

You can see the last thirty years as a series of steps and mis-steps towards this economic goal; shaped sometimes by ideology, sometimes by pragmatism, increasingly by the realities of globalization.

The 1980s saw the timely privatization of industries that were long overdue for return to the commercial sector. Industrial relations underwent a seachange. The quality of management in our best firms improved, and with it, corporate profitability.

But, there was also soaring unemployment and social divisions. And other long-standing weaknesses in UK economic performance were becoming chronic: an indifference to manufacturing; neglect of science, engineering, technology and skills; lack of a long-termist business culture; and an education system that paid scant attention to the needs of employment.

In 1997 New Labour fully accepted that there was no question of going back to the past, but sought to remedy Thatcherism's supply side deficiencies, in particular the serious lack of investment in infrastructure, science and skills, and in the regions. We also worked to bring greater fairness and security in the workplace.

A decade later the most serious of these problems have been eradicated or sharply reduced. But prosperity isn't owned, it is earned - and it still has to be earned.

British business still suffers from too large a tail of poor management and low productivity and the financial crisis demonstrated that the long-termist business culture needs to be more firmly established. There is a debate within business on business models, especially the reliance on debt over equity.

Reality demands that the centre left cannot and must not confine itself to the politics of distribution. We need a new and renewed politics of production. And New Labour above all has to articulate this new politics that will allow Britain to earn its way in the world and support our public services and welfare system.

We need a politics of long termism over short termism.

Of a smarter, more effective and affordable state.

Of a return to the values of hard work, enterprise, corporate stewardship and mutual commitment over those of dodging responsibility, making a fast buck, and putting self before others.

Of working together as a nation to address the shared challenges of the future, not social divisiveness or outdated ideological obsessions about the State or doing away with government.

We need a dynamic economy and society, but we also need to understand that while people want opportunity, they also want security for themselves and their families in a fast changing world.

There are significant strengths for Britain which give us a base that makes the new challenges easier to address.

The UK research base has benefited from a doubling of the Government's investment in science.

Our universities are now fully part of the way we earn our living in the world: attracting 230,000 fee-paying overseas students and generating £59billion a year for the UK economy – more than 2% of GDP.

There has been a renaissance of major UK cities – a genuine end to the psychological cycle of decline that blighted the late eighties. This has been led by public-private investment in which the Regional Development Agencies, a brainchild of the present Government, have played a major role.

And although our opponents constantly but falsely allege that the UK was profligate in the years before 2007, at the start of the banking crisis, our debt to GDP ratio was amongst the lowest of the G7 economies.

Although employment in manufacturing continued to fall sharply, productivity has risen by close to 50% since 1997 as a result of the competitive pressure of open markets and globalization.

Although it has not grown at the rate of the rest of the economy, the British manufacturing sector did not in fact contract in absolute terms in the decade before the recession – its output in both value and volume has remained stable despite the fiercest imaginable competition.

The resilience and reinvention has been helped by flexible labour markets which in this period became culturally embedded in the private sector.

It is this factor, together with the scale of the fight-back mounted by the government and the strength of our welfare-to-work system, that has helped keep people in jobs and limit the effects of the global recession.

But it is also clear – and I want to be honest about this - that the global economic crisis has exposed structural problems in all developed economies, including the British economy that we did not entirely foresee or deal with in the years of uninterrupted growth.

No-one fully understood the risks in the model that destroyed Lehman Bros and crashed the banking system.

And let me say this quite bluntly. For the past decade we allowed ourselves to become over-dependent on the City and financial services for growth and our tax revenues. That is why, without wishing the financial sector to be smaller, we need other industrial strengths and sources of revenue to grow faster.

And finance will have to change – the insurance bill for saving the economy from the status quo was far too steep and it can never happen again. While putting the City in an iron cage of regulation is undesirable, just relying on a bit of nudge here and there will not suffice.

The document we will be releasing tomorrow sets out the Government's plans for growth. It sets out what we have done since I launched the New Industry New Jobs agenda last spring and described the Government's further work programme for the coming months. It is work in progress. We are in a marathon, not a sprint. But it defines an agenda for a very challenging future, and a new approach to investing in our basic capacities for growth.

Today I want to highlight some of the key themes of that work programme and say something about where we need to go with each.

Enterprise

First and foremost we need to foster a new climate for enterprise in Britain. There is no substitute for this - no substitute for the drive and ambition that it brings. It can sometimes be a touch ruthless and raw. But it is the single most important engine of economic progress. The recovery cannot be driven by consumer debt or public spending. It will be driven by private sector investment and private enterprise.

Enterprise and reward go hand in hand. Much as it shocked many of my friends when I said I was comfortable with people making themselves “filthy rich”, in the context I was speaking I was simply stating a simple truth: that enterprise and effort should be rewarded. It sets goals to spur people and brings gains to us all. And it is often forgotten that I added the important rider “as long as people pay their fair share of taxes”.

I would also add now that pay and performance must go together. That means long term sustainable performance. In this case, there is no need for government to intervene. We are not interested in capping salaries for the genuinely successful.

Where pay and performance do not correlate, the whole notion of value breaks down. And if remuneration is actively driving systemic risk, and that risk cannot be confined to a single institution, then we have a real problem.

Of course given the tax rises on the better off imposed in the past year, tax is inevitably once again a hot topic of debate in the business

community. Setting tax rates for me has always been a matter of striking the right balance, not of ideology. In a difficult fiscal environment no credible government can rule out the need to raise taxes. And we haven't shirked from taking those tough decisions over the past year.

But there is never a case for punitive taxation. There is never a case for rates of tax that remove the incentive to self-improvement or to build a business. Britain retains one of the most favourable tax regimes in the world for entrepreneurs who start a successful business and eventually sell part of their stake.

Our 18% capital gains tax rate is among the lowest in the world and our corporation tax rate among the lowest in the G7. A competitive tax environment is something we must preserve.

On this subject incidentally the Tories' promise of corporation tax reductions turns out to be paid for by the abolition of the annual investment allowance and cuts in the vital business capital allowances, which shows a real tin ear for what business actually needs.

As for the new top income tax rate, I believe that is justified in the quite exceptional circumstances we face.

It is right that in taking the tough decisions on tax needed to combat the deficit those with the broadest shoulders will bear the greatest burden. I believe we have got this balance right.

But as a Government we will always be vigilant that this burden does not become so great that it damages our long-term competitiveness or inhibits those whose efforts will help us build sustainable growth.

At the same time we need to accept that the current structure of most public companies is better at rewarding enterprise in senior management or owners than it is at giving the bulk of the workforce an incentive to innovate or commit to the business. The evidence is that companies that share rewards with their employees, like the John Lewis Partnership, are also very good at pursuing long term growth strategies.

Innovation

Second, we need to renew our focus on what makes us successful innovators. A decade of sustained investment by this government has rescued British science from its desperate straits in the 90s and secured its position of global excellence, second only to the United States. Our challenge is to transform more of that knowledge into economic gain. To get more D out of our R and D.

In productivity terms we spent the late twentieth century trying to catch up with the US. Now Asia is racing to catch up with us. We did

well in the American century. We can take little for granted in the Asian century.

Our 21st century economic growth needs to be built on innovation at the knowledge frontier, addressing new challenges such as climate change and decarbonisation and exploiting new digital and materials technologies.

For this reason, it is vitally important to preserve our research capabilities even through a period of increased constraint on investment. Our universities must focus on research that offers the greatest economic potential, prioritise excellence, develop partnerships with industry, specialise around their core strengths and not be afraid to develop distinctive missions.

For each region of the country, I am asking the Chair of the Regional Development Agency to present me with a report by mid- March, prepared in conjunction with their Vice Chancellors, on how their universities, supported by RDAs, can drive economic growth in their area.

In the PBR, to boost innovation, the Government supported the concept of a “Patent Box” that ring fences commercial revenues from patents and secures favourable tax treatment for them. This complements the incentives we have for research in the UK through the R&D tax credit.

Since I launched our policy framework New Industry New Jobs, we have earmarked almost a billion pounds in the last year for investment in British capabilities in cutting edge technologies like plastic electronics, composites, wave energy and industrial biotechnology. We will be publishing the next stage of our plans for the further development of key sectors – including construction, business services and homeland security - by the end of March.

Over recent years we have built up the basic skeleton of an industrial innovation system in the UK. We have the rapidly growing outreach of our universities into business, RDA investment in innovation centres, the setting up and expansion of the Technology Strategy Board, and the recent decisions to establish industrial centres of excellence in a range of technologies including civil nuclear engineering and industrial biotechnology in Yorkshire, and plastic electronics in County Durham.

Our challenge now is to build and consolidate that innovation landscape into something like the Fraunhofer network in Germany which actively connects industry and the German research base. With this objective in mind I have asked technology entrepreneur Hermann Hauser to undertake an urgent but systematic evaluation of the UK's existing Innovation network to see how Britain can best emulate the outcomes of the Fraunhofer model.

Finally, innovation depends on skilled people. We have set out plans for the creation of a new British technician class, in part through a

dramatic expansion of Advanced Apprenticeships. This will fill a longstanding gap in the British skills market.

These proposals have been well received but we need to focus on implementation. I have asked Lord Sainsbury to report to me by the end of March on the development of the registration system for engineers and proposals to introduce a parallel scheme for science technicians that will make this new technician status a reality.

Finance for growth

My third theme concerns the way we finance this enterprise and innovation. Enterprising and innovative companies need investment to grow, but there is strong evidence that UK financial markets have for some time not served some growing British companies well. The credit crisis has exacerbated this problem by dramatically reducing the banking system's appetite for risk. We need to keep up pressure on banks to lend, but we also need to look for wider solutions, both at the British and the European level.

For a decade we have tentatively been experimenting with public-private solutions to the growth capital problem. It is clear that Britain needs coherent solutions at a different scale. We need a new range of public-private financial instruments to step into the historical equity gap and the breach created by the banking system's reduced appetite for commercial risk.

That is what the Innovation Investment Fund launched last year will in part do – it has already more than doubled its initial £150 million public investment with private funds and its professional independent fund managers will make their first investments this year.

At the same time the Rowlands Review has explored the issue of growth capital for business and the feasibility of re-creating a successful fund like the old ICFC or 3i. So we are working with banks to establish a new growth capital fund which will invest in established UK SMEs who are seeking between £2 and £10 million to develop their business.

In parallel the RDAs are establishing a number of new public private financial vehicles with the help of European funding and the EIB, which will invest in businesses seeking less than £2m.

These will sit alongside existing smaller venture capital funds established over the last 10 years.

I am therefore now asking Mervyn Davies to report to me urgently on what might be done to give this network maximum coherence and reach. My aim is to create an industrial investment network with a strong regional capacity.

Infrastructure

Fourth, over the next ten years Britain will need a transformative wave of private investment in digital, energy, transport and low carbon infrastructure, totalling hundreds of billions of pounds.

We have two challenges here. First, how we get these high cost, long term investments made. The public purse isn't going to be able to fund them, so we need to get the conditions and incentives right for private sector investors. Second, we need to make sure that these massive programmes create opportunities for British-based industry. Britain's supply chain only too often has a habit of missing these opportunities. This time has to be different.

We are implementing plans to stimulate investment in the infrastructure for digital communications. They will extend broadband access to every home and business in Britain in just a few years and extend next generation broadband beyond where the market alone will build it to serve 90% of the population.

And are developing strategies on renewable energy, rail electrification, low carbon vehicles and the charging infrastructure for electric cars, putting in place what only Government can – clear frameworks of policy within which the private sector can take commercial decisions

We have begun a shift in the basic remit of the regulatory agencies so that they focus on the need to renew our infrastructure and adapt it to a low carbon future.

In the transition to low carbon energy and transport, emissions trading and a carbon price potentially provide strong stable investment incentives. Initial experience though has been disappointing. The need now is to look urgently at the options for ensuring we have a carbon price that is more stable and truly reflects the environmental costs.

And we need to examine how the role of pension funds to be major investors in the long term infrastructure projects of the future.

Infrastructure UK has been tasked with producing a full assessment of the scale of the challenge, and to produce creative ideas for how to meet it. Getting this right will be one of the most important ways of securing the country's future prosperity. We all need to engage with Paul Skinner as he draws up his report in the coming months.

We need equal vigour in tackling the parallel challenge of making sure that British-based firms are ready for the opportunities this wave of investment will create.

Government bodies like the Office for Nuclear Development and the Office for Renewable Energy Deployment need to work intensively with British-based companies to anticipate and compete for the supply chain opportunities from huge shifts to alternative energy or transport infrastructure.

By the time the call for tender arrives, these firms should understand the opportunities, understand the capacities they will require, and understand the help Government can provide in helping them develop those strengths.

That's exactly what we are doing now for example in the civil nuclear sector through the Nuclear Advanced Manufacturing Centre and our work to develop the nuclear supply chain to serve the growing nuclear industry in the UK.

Long termism vs short-termism

Finally, we need to start a debate about how we build a stronger culture of long term commitment to sustainable company growth in this country, based on a strong compact between institutional shareholders and the corporate sector.

On one hand we need a system that enables shareholders to discipline poor management. But we also need to give management some scope to plan and build without the excessive demands for quick returns that characterise too much modern public company ownership.

I don't have any easy answers. Our reforms of company law made clear the importance of directors taking a long term view. At the same time we have empowered shareholders. We are now evaluating

whether this has changed behaviour in the board room – and among investors.

Chris Hogg has played a key role in this debate with his review of corporate governance, and it is time for Britain to take a long hard look at the questions he and others have raised. I attach the highest importance to the new Investor Code and will be meeting investors and companies next week in the run up to the further consultation by the Financial Reporting Council.

Takeovers provide a very clear test here - for all involved. Companies making acquisitions should set out transparently and publicly their long term plans for the assets they propose to acquire, including company headquarters, R&D sites and main plants. Although these remain commercial decisions, firms or investors should expect to brave the court of public opinion if they are motivated only by short term profit.

Surely investment managers should be judged on their long term growth and profitability, not their short term performance – and the same goes for CEOs. How many strategic and effective managers are being hobbled with the quarterly race to please the beauty contest of the markets?

Conclusion

This Government stands for a new politics of production and growth, not only one of fairness and redistribution. These are two sides of the same coin. Only by growing our economy can decent jobs be created, living standards protected, and the winners' circle expanded outward to those on low and middle incomes.

We have learnt the right lessons from the downturn and will sustain the recovery. But the key question is how we can achieve a step-change in the growth rate of the British economy in the decade ahead.

There is a real dividing line between Labour and the Conservatives on the economy. The Conservatives have no clear plan for the future. They would return Britain to an era of stop/go economics and resurrect all the tired old arguments about the role of government in the economy.

Their politics of production remains rooted in a laissez faire ideology that does not acknowledge the role of strategic government and public investment in our collective strength. They remain conservatives in every sense.

I believe it falls to New Labour again to build the new synthesis. When we in our party talk about aspiration, we offer the policies to back it up.

This remains the basis of my firm belief – that New Labour remains the only credible Party of aspiration in British society and that's what we will go out and argue for.