

# Breaking the Cycle

Three foundations to boost  
British prosperity, drive up  
growth and escape the debt trap

By Gerard Lyons





## About the Centre for Policy Studies

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Founded in 1974 by Sir Keith Joseph and Margaret Thatcher, the CPS has a proud record of turning ideas into practical policy. As well as developing much of the Thatcher reform agenda, its research has inspired many more recent policy innovations, such as raising the personal allowance and National Insurance threshold, reintroducing free ports and adopting 'full expensing' for capital investment.

## About the Author

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In the City, he sits on two boards. He is the Senior Independent Director and a board member of Bank of China (UK) and is Chair of the Risk Committee and sits on the board of BGC Partners. He is a member of the Advisory Council of the Official Monetary and Financial Institutions Forum. Gerard is also Chief Economist at Netwealth Investments, which he helped establish in 2016.

From 1999-2012 he was Group Head of Global Research, Chief Economist and Advisor to the Board at Standard Chartered. He was credited as one of the few economists to predict the 2008 global financial crisis and his team was rated in 2010 and 2011 by Bloomberg as the most accurate forecaster globally. The bank emerged from the global financial crisis as one of the world's most capitalised. Prior to this he was Chief Economist of Japan's Dai-Ichi Kangyo Bank (DKB) International, then the biggest bank in the world, and was credited with foreseeing Japan's lost decade. This followed being Chief UK Economist at Swiss Bank and stockbroker Savory Milln.

On public policy he advised Boris Johnson when Mayor of London, was senior advisor to the Prime Minister's Business Council for Britain, was a candidate for Governor of the Bank of England in 2019, was an inaugural member of the EU Commission's Network of China Experts, and has sat on several Councils of the World Economic Forum. He has testified to committees of both US Houses of Congress, and to committees of both Houses of the UK Parliament. He was one of the external experts consulted for the 2025 five-yearly review of the OBR.

On the environment he has sat on the Advisory Board of the Grantham Research Institute on Climate Change and the Environment since 2008 and has been a member of the Washington-based Bretton Woods Committee's Climate and Energy Transition Finance (CEFT) project team since 2022.

In 2010 he was elected by the economic members to serve a five-year term on the Council of the Royal Economic Society, and he also joined the strategy group. In 2011 he was appointed a Fellow of the Society of Professional Economists. In 2025, he was re-appointed to serve another term as a member of the UK economy Honours Committee.



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# Executive Summary

The UK is in danger of sleepwalking into economic torpor. The issues we face are real, sizeable but – crucially – solvable. However, solutions have too often been evaded through short-term fixes and political timidity.

The UK is a low-growth, low-productivity, low-wage economy. The trend rate of growth has slowed sharply since the 2008 crisis. The economy is deeply imbalanced in terms of place and people. Twin deficits in the budget and current account reflect weak savings and low investment. There is a need to boost national savings and raise investment.

Above all, the economy is not competitive and, as a result, the country is living beyond its means. By the end of the decade, the ratio of debt to GDP is set to exceed 100%, and keep rising, with elevated debt-servicing costs and weak economic growth propelling the economy towards a debt trap – an inescapable cycle of rising debt.

**‘ Without immediate, credible action to rein in spending, contain debt and keep inflation under control, a fiscal crisis may be looming ’**

Of course, we should acknowledge the impact of the financial crisis and the pandemic. But the record is still stark. During their 14 years in office, the Conservatives presided over a sharp spike in the cost of living, a historic surge in public spending and a rise in the tax take to an all-time high. Net immigration was not brought under control. As health’s share of public spending rose, non-ring-fenced areas faced austerity. Opportunities to capitalise on record low borrowing rates to fund productive economic investment were missed.

And sadly, over the past year, hopes for a pro-business shift under a new Government have proved illusory. Despite welcome signals on public investment and planning reform, policy decisions look set to stifle risk-taking, overburden business with regulations and tax, hit jobs and fail to empower the private sector.

Financial markets are now signalling that without immediate, credible action to rein in spending, contain debt and keep inflation under control, a fiscal crisis may be looming.

The argument of this paper is that we need to chart a new policy course, anchored in principles while focused on outcomes.

The central aim of this strategy should be to grow GDP per capita. All policy decisions should be geared to this.

This paper argues that there are three central foundations needed to deliver this.



**Foundation one is fiscal discipline.** Fiscal credibility is essential. The status quo is unsustainable, locking the economy into a Groundhog Day of ever-rising taxes and weak growth. On current trends, public spending, taxes, borrowing and debt will all rise, pushing the country towards a debt trap. Economic reality must trump political intransigence. Debt must fall relative to GDP. An ageing population, higher defence spending and untenable public demands on government and the welfare state make spending restraint unavoidable. Central to this is controlling health spending and improving public sector efficiency.

The goal must be a smaller, more sustainable state with a lower ratio of spending to GDP. Alongside this, priority should be given to reversing the upward trend in the tax take and pursuing tax simplification – including removing the ‘Manhattan skyline’ of high marginal tax rates and indexing personal allowances. There is a case for immediate targeted cuts such as stamp duty, but broad-based tax reductions in the current fiscal climate may prove counterproductive and should follow improvements in the public finances. Fiscal policy’s effectiveness as a counter-cyclical tool necessitates spending and debt being contained. On the current path, corrective action is unavoidable – but it must not come through higher taxes, which would damage growth and erode confidence.

‘ The goal must be a smaller,  
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**Foundation two is a supply-side agenda to raise the potential growth rate.** A supply-side agenda is necessary to raise the economy’s potential growth rate. It is as important as credible fiscal policy. It is only through effective supply-side policies which raise potential growth that future fiscal policy can be used more meaningfully. Moreover, if successful, by raising potential growth, such supply-side policies would allow the neutral level for the Bank of England bank rate to be lower, as the economy could grow at a faster pace before hitting bottlenecks.

The importance of supply-side policies is even greater in an era of high debt and stubborn inflation. The notion that the economy can grow by focusing solely on fiscal policy or even cheap money policies is misguided.

In particular, this supply-side agenda must be built around four Is: investment, innovation, infrastructure and incentives. Public investment focused on research and development (R&D) must be higher and private investment and innovation encouraged. Planning reform must deliver infrastructure more quickly. We need to adopt incentives, driven by smart regulation and tax, that reward risk-taking and enterprise. Institutional reform is an aspiration but not an immediate aim, as it will use up too much bandwidth.

**Foundation three is low inflation, financial stability and a competitive City that serves domestic growth.** This requires credible and accountable monetary policy, with a clear break from previous cheap money policies. The Macmillan gap and the patient capital gap need to be narrowed, in order to help small and medium-sized enterprises (SMEs). More broadly, we need a new version of popular capitalism to help boost domestic savings and investment.

These foundations also suggest a range of other policies to help boost growth. We need to bring down energy bills while addressing the green agenda by energy addition, not energy substitution. Immigration must be tightly controlled, with the UK onshoring its skills base by investing more in domestic workers – while still being open to the best talent, particularly in our globally competitive sectors. We need



to build houses, to make life more affordable for younger people who wish to buy property and start a family. Young people must be helped if they want to start a family, given the declining fertility rate. There is a need to see off the bad ideas that are coming from the left, in particular the recent campaign for higher wealth taxes.

Above all, the UK economy must be competitive to break out of its current flatlining of low growth. Free markets are essential, but they must serve the national interest and deliver for the people who sustain them. The private sector has to be far larger, as it is what funds the public sector.

It is hard to quantify the exact relationship between the size of the state and the private sector, but a reasonable aim, and the ideal outcome of the policies suggested in this paper, would be a balance of two-thirds private, one-third public. We are far from this.

**‘ Instead of tax, spend and borrow, the  
UK must save, invest – and compete ’**

Meanwhile, the ambition to reduce debt-to-GDP levels must confront the reality that they are still rising, making stabilisation the immediate priority, and this should be by controlling public spending rather than raising taxes.

In the longer term, bringing debt down will require a significant reduction in the state's share of the economy. That demands stronger, sustainable growth, firm control of spending, and reform of the state – a process that will inevitably take time.

One might term this capitalism with British characteristics: the aim of a smaller, efficient state, with better targeted delivery of public services, alongside a competitive private sector, delivering much higher growth in GDP per capita. The current path of rising spending, higher taxes and mounting debt is unsustainable – a change in direction is inevitable

Politicians of all parties must recognise that resisting public spending control, planning reform and effective migration policy means opposing policies necessary to raise living standards.

In short, it is time for a sea change in economic management. Instead of tax, spend and borrow, the UK must save, invest – and compete.



# 1. The State of the Nation

Britain has many strengths. But it also has many severe problems – most of which have become significantly worse in the years since the 2008 financial crisis. If we are to put the economy back on the path to growth, we need to be honest about the scale of the challenge and we cannot repeat the group-think policies of the last decade or so.

- **GDP per capita has stalled.** The economic debate always focuses on GDP. But what matters is GDP *per capita* – because, as the Office for National Statistics (ONS) outlines clearly, ‘the volume of goods and services available to the average person is a proxy for a country’s living standards’.<sup>1</sup> In the 21<sup>st</sup> century, there has been a slower pace of GDP growth per head, particularly in recent years. And projections from the Office for Budget Responsibility (OBR) suggest the current picture has deteriorated further, because of sluggish growth and a continued rise in the population.

As the OBR noted in March, ‘real GDP per capita at the end of 2024 was 0.7% below’ what they had forecast as recently as October 2024 and was ‘1.1% lower than its level at the end of 2019’.<sup>2</sup> In other words, it has not recovered to its pre-Covid level. Partly because of that fall, the OBR has revised up its projections for GDP per capita growth from 2026 to 2029: after a fall in GDP per capita of 0.1% in 2024, the OBR expects a rise of 0.3% in 2025 and an average increase of 1.4% over the rest of the decade. Sadly, this may prove too optimistic.

Average annual % growth	Real GDP	Population	GDP per head
1970s	2.7	0.1	2.5
1980s	2.6	0.1	2.5
1990s	2.1	0.3	1.9
2000s	1.7	0.6	1.1
2010s	2.0	0.7	1.3
2020 - Q2 2024	1.1	0.7	0.3

Source: ONS

1 ONS, ‘Trends in UK real GDP per head: 2022 to 2024’ (October 2024). [Link](#)

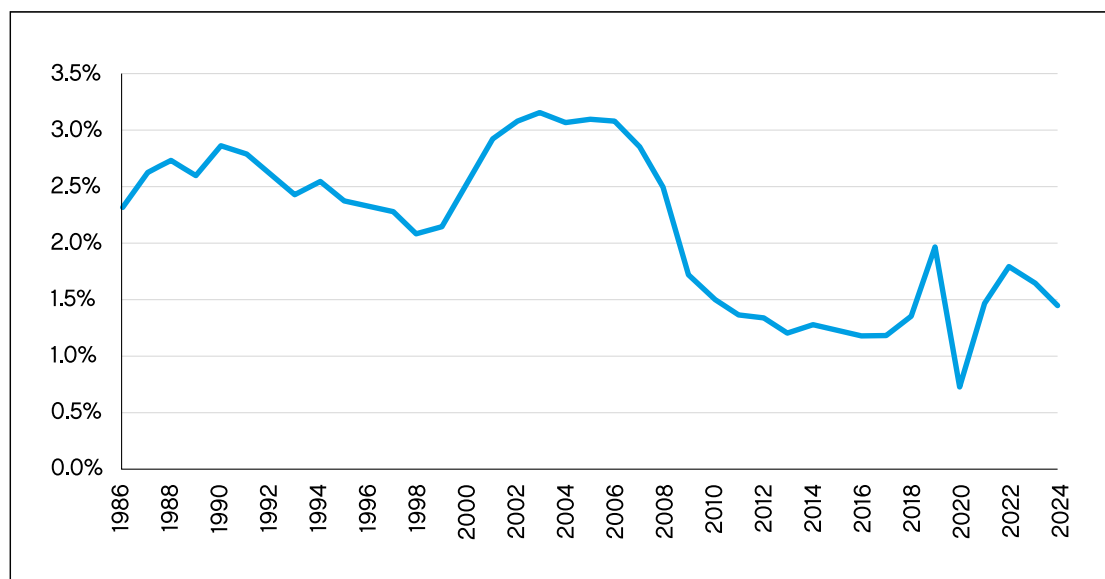
2 See: OBR, ‘Economic and fiscal outlook – March 2025’ (March 2025). For GDP per capita forecasts see tables A1 and A2 in Annex A. [Link](#)



- **Collapsing trend growth:** From 1987 to 2007, UK trend growth averaged 2.75%, doubling the size of the economy every 26 years. Since the 2008 crisis, growth has weakened significantly, despite attempts to prop it up with cheap money and rising debt. The OBR is forecasting that after 1% growth this year, growth will average 1.75% over the rest of the decade, which if it was sustained would mean a doubling every 41 years. Trend growth may, however, be closer to 1.25%, which would mean a doubling every 58 years.

To put it another way, at the pre-2008 trend rate, a 21-year-old would have seen the economy double in size by the time they were aged 47 and their living standards rise accordingly. Now they would have to wait until they are at least 64, if not much older. This is not just a human tragedy, but utterly incompatible with a rising debt burden and ever-increasing public spending expectations.

### Annual GDP growth, 10-year rolling average



Source: ONS

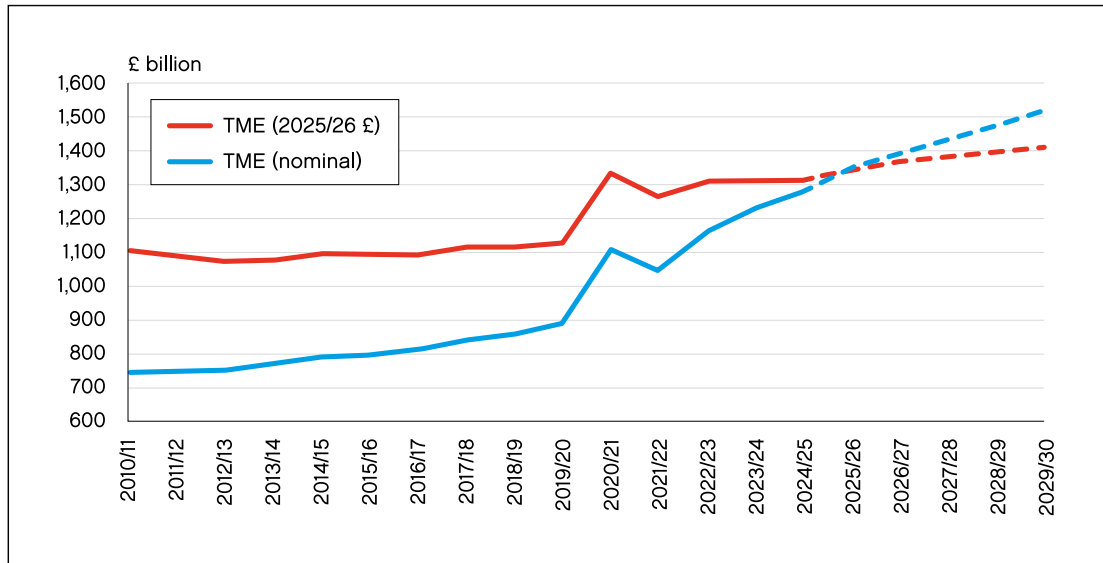
- **Uncontrolled public spending:** During their 14 years in office, the Conservatives failed to keep public spending under control. Total managed expenditure (TME) rose from £697 billion in 2010 to £1,335 billion in 2024 and is projected to surpass £1.5 trillion this decade. Health spending more than doubled, from £122 billion to £277 billion and spending on social protection rose almost as quickly, from £194 billion to £379 billion.

It is true that in real terms (after allowing for inflation), overall spending growth was more or less kept in check before the Covid pandemic, though not substantively reduced. But beneath the surface, the picture is more complex. The narrative of austerity took hold largely because the spending squeeze fell disproportionately on non-ringfenced departments, like justice and local government. The result was uncontrolled spending in politically expedient areas, austerity in others and a deeply unbalanced fiscal approach.





## Total government spending



Source: OBR

- **Tax system not fit for purpose:** The UK tax system has grown more complex and distortionary. Disincentivising marginal rates now impact those repaying student loans, those losing child benefits at incomes around £60,000 and those who have personal allowances withdrawn when their income goes over £100,000 – a ‘Manhattan skyline’ of high marginal tax rates.<sup>3</sup> The higher rate tax band now bites at a far from high level of income, because of fiscal drag and a failure to index the tax system.

There has also been little joined-up strategy behind tax policy. In 2023, the Treasury Select Committee identified 1,180 tax reliefs and yet noted that cost data existed for only 365 of them.<sup>4</sup> The Office of Tax Simplification, set up in 2010, was abolished in 2023 without delivering lasting reform. Despite promises made in the 2020 Budget, a tax system fit for the 21st century was never delivered. Budgets are now characterised by micro-management, with a total of 294 specific tax and spending decisions in just the last five fiscal events.<sup>5</sup>

- **A lack of transparency:** In 2021, the Public Accounts Committee reported that Arm’s Length Bodies – quangos – controlled £265 billion in annual spending and yet are created without serious cost-benefit analysis.<sup>6</sup> Although the Prime Minister announced plans earlier this year to get rid of the largest, NHS England, at least 27 more have been created since the general election.<sup>7</sup>
- **Regulatory overload and poor accountability:** Regulation remains excessive and poorly measured. In March 2025, the Government admitted that 17 regulators alone employed 36,000 full-time staff and spent £5.4 billion annually.<sup>8</sup> It also cited a 2005 estimate from a regulatory task force that red tape could be costing up to 3% to

3 ‘Manhattan skyline’ is how Warwick Lightfoot, advisor to a number of Chancellors, has described the profile of tax rates across different income levels. See for example: W. Lightfoot, ‘The criterion for judging a government’s budget’, Warwick Lightfoot’s Substack (28 October 2024). [Link](#)

4 House of Commons Treasury Committee, ‘Tax Reliefs’ (18 July 2023). [Link](#)

5 This includes 33 in the Spring Statement 2025, 70 and 40 in the two 2024 Budgets, 67 and 84 in the 2023 Budgets.

6 House of Commons Committee of Public Accounts, ‘Government’s delivery through arm’s-length bodies’ (16 September 2021). [Link](#)

7 D. Martin, ‘Labour axes one quango – after creating 27’, *The Telegraph* (11 March 2025). [Link](#)

8 HMT, ‘A new approach to ensure regulators and regulation support growth’ (17 March 2025). [Link](#)

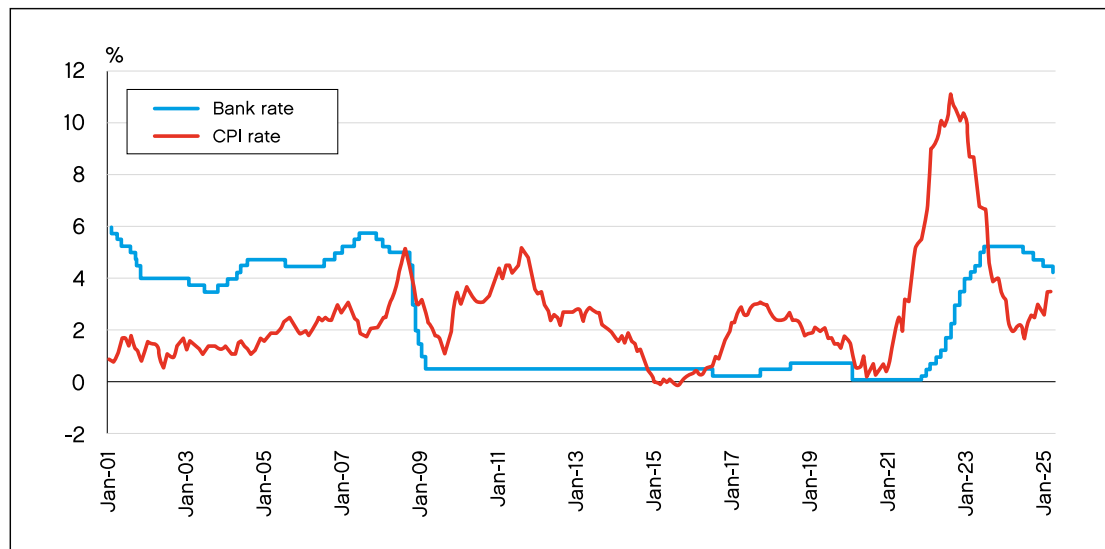


4% of GDP, roughly £70 billion.<sup>9</sup> That the Government cites such an outdated figure suggests the true cost of regulation remains poorly understood and that meaningful regulatory reform has been postponed for too long. For example, a CPS report from 2024, studying the impact assessments attached to 3,528 pieces of legislation between 2010 and 2019, found that costs to business increased by £6 billion a year – almost the equivalent of a 2p increase in corporation tax.<sup>10</sup> Moreover, the paper uncovered countless examples of how the regulatory system is not fit for purpose, including significant inaccuracies in regulatory impact assessments.

- **Inflation and monetary policy failure:** During the Tories' 14 years in office, the consumer price index rose by 49.8% – almost 18 percentage points higher than if it had tracked the 2% annual target. Monetary policy remained excessively loose for a prolonged time, with low interest rates and the printing of money under quantitative easing (QE) rising from £200 billion to £895 billion. In early 2021, despite clear signs of an impending post-pandemic rebound, the Bank maintained near-zero rates, advised the City to be prepared for negative rates and continued QE. By the time Russia invaded Ukraine in February 2022, inflation was already entrenched, with consumer price inflation more than three times the target and rising, at 6.2% and retail price inflation even higher at 8.2%.

Loose policy didn't just fuel inflation and the cost-of-living crisis. It boosted asset prices, including property prices; worsened intergenerational divides; and led markets to misprice risk, with zombie firms surviving and growth firms struggling to access capital. As usual, Westminster failed to hold the Bank of England to account.

### Inflation and interest rates



Sources: ONS, BoE

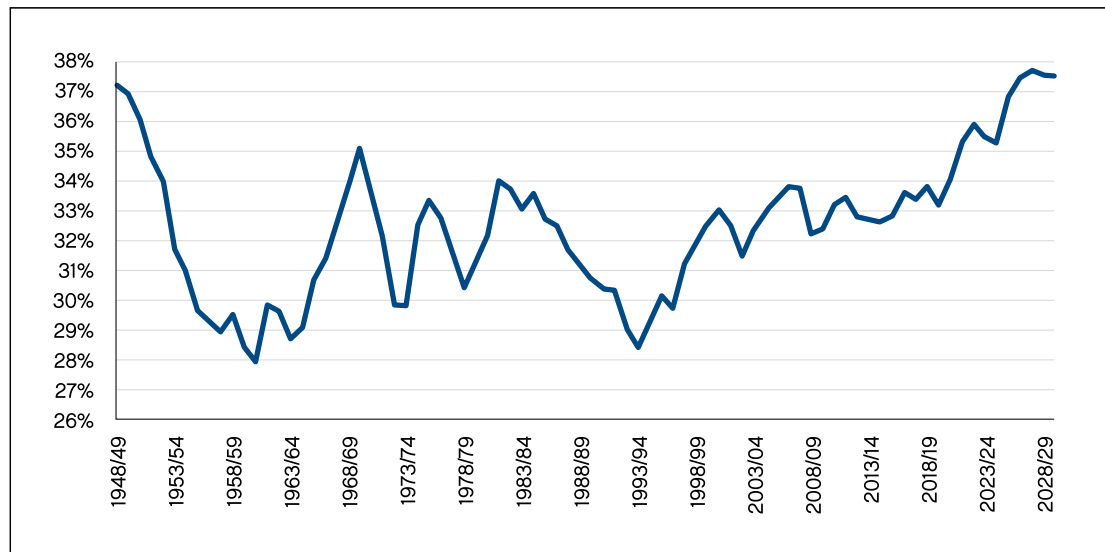
<sup>9</sup> BRTF, 'Regulation – Less is More: Reducing Burdens, Improving Outcomes' (March 2005). [Link](#). See also fn.2 of the House of Commons Treasury Committee 'Tax Reliefs' report: 'The £70bn figure is based on applying these percentages to 2023 GDP figures'.

<sup>10</sup> T. Clougherty & R. Colvile, 'The Future of Regulation', Centre for Policy Studies (April 2024). [Link](#)



- **Tax burden at a historic high:** The UK tax take has risen to a post-war high and is set to rise further. Although the average worker's tax rate fell to its lowest since 1975,<sup>11</sup> the freezing of tax thresholds and other measures have seen the system claim more from earners in the top half of the wage distribution, to the point where the top 10% of earners now pay around two-thirds of income tax. A progressive tax system is the right approach to take, but in a globally competitive economy, over-taxing mobile assets like skilled labour and multinational firms risks driving talent abroad and deterring investment. The abolition of non-dom status, set in motion by the previous government and adopted in a more aggressive form by this one, has contributed to a wealth drain and damaged the UK's ability to attract entrepreneurs. There is a danger that a tipping point has already been reached where it is now widely accepted that emigration for higher skilled or aspirational workers makes sense.

### Taxes as a share of GDP



Source: OBR

- **Surging immigration:** Over the 14 years in which the Conservatives were in government, immigration soared. Summing the annual flows, total immigration was around 11.5 million and net migration was around 4.5 million. At its peak, net migration reached 906,000 in the year to June 2023, with the gross inflow exceeding 1.3 million.<sup>12</sup> International migration has also become the main driver of a surge in the size of the UK population, given the fall in fertility rates among the UK-born population, which in turn is partly driven by the eye-watering costs of bringing up a family, including housing and childcare. As the Migration Observatory at the University of Oxford has noted, 'More than half (65%) of the increase in the UK population between 2004 and 2023 was due to the direct contribution of net migration.'<sup>13</sup> Since 2020, almost all of the growth in the population as come from net migration.' In fact, around 1 in every 25 people in resident Britain today arrived in just the last four years.

11 HMT, 'Spring Budget 2024: Personal Tax Factsheet' (6 March 2024), esp. fn.9. [Link](#)

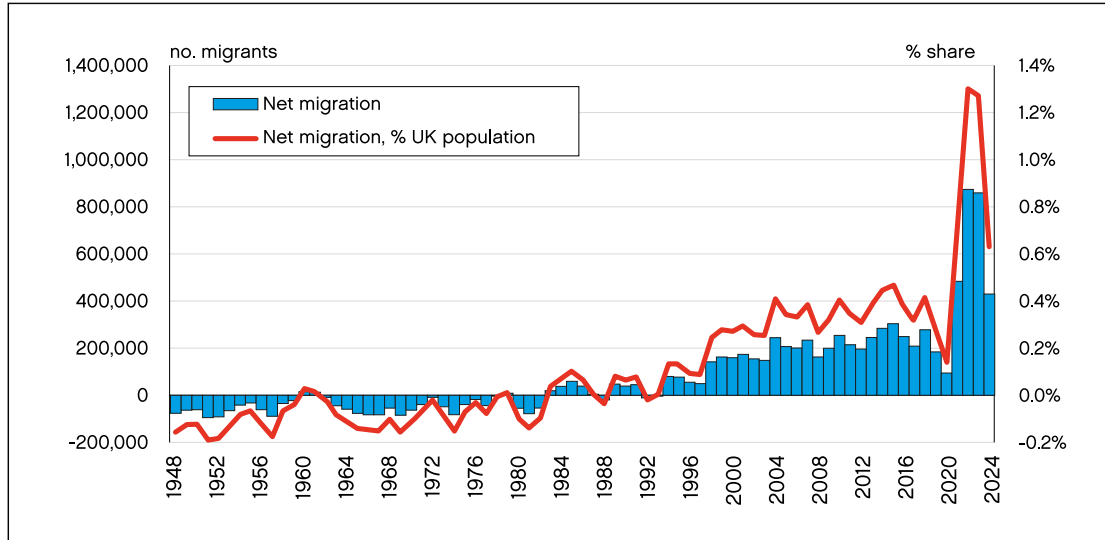
12 ONS, 'Long-term international migration, provisional: year ending December 2024' (22 May 2025). [Link](#)

13 A. Cangiano & B. Bridle, 'The Impact of Migration on UK Population Growth', The Migration Observatory (14 August 2025). [Link](#)



Migration was presented as an economic panacea, but our relatively indiscriminating system has seen population growth outpace infrastructure, housing and public service capacity. The CPS, for example, calculated in 2023 that net migration necessitated building an extra 1.19 million homes in England and accounted for 89% of the increase in the existing housing deficit against the government targets.<sup>14</sup>

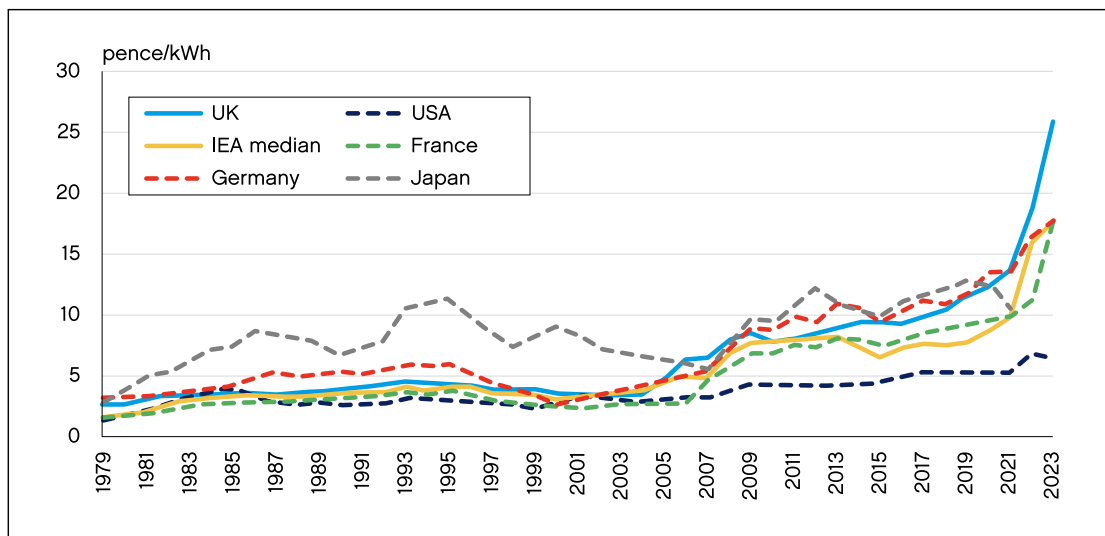
### UK net migration, 1948-2024



Sources: ONS, BoE, CPS analysis

- **Painfully expensive energy:** The UK's energy costs are among the highest in the world, with damaging consequences for the economy. Energy-intensive sectors, such as ceramics, chemicals or steel-making, have been particularly badly hit, but the cost of energy is also threatening our position in the industries of the future.

### Industrial electricity prices (including taxes)



Source: DESNZ

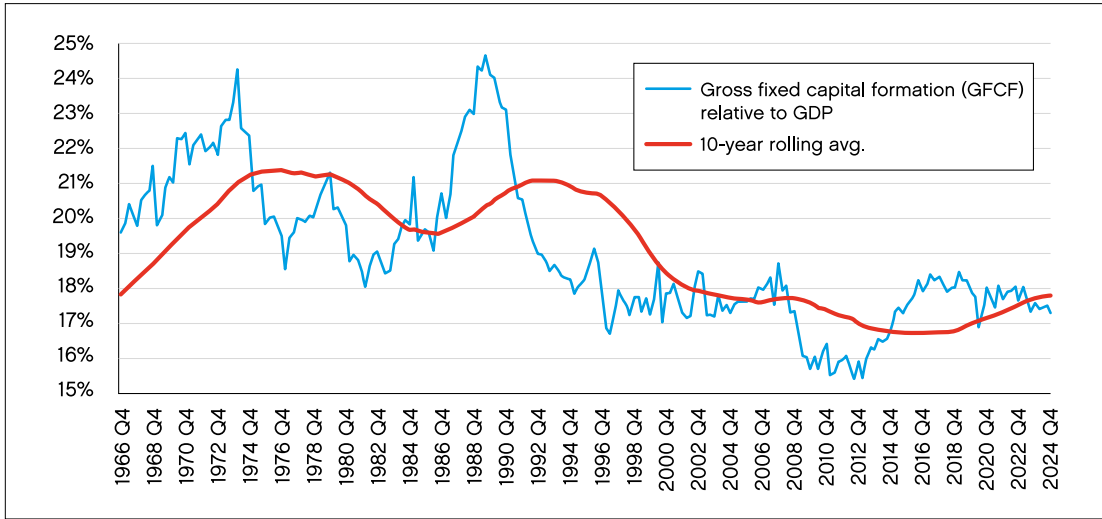
- **A record of low investment:** The UK has a historically low record of investment, both public and private. Spending on R&D has been a perennial area of concern. The latest ONS data shows expenditure on R&D was £70.7 billion in 2022, or 2.77%

14 K. Williams, 'Net Migration and Housing – A CPS Briefing', CPS (November 2025). [Link](#). See also: B. Hopkinson, 'How Many Homes Does the UK Need?', CPS (July 2025). [Link](#)



of GDP.<sup>15</sup> It comprises: the business sector, £49.9 billion; higher education, £16.3 billion; government, £3.6 billion; and private non-profit sector, £0.9 billion. That puts us above the OECD average (2021 data), but far below our most innovative and research-intensive competitors.<sup>16</sup>

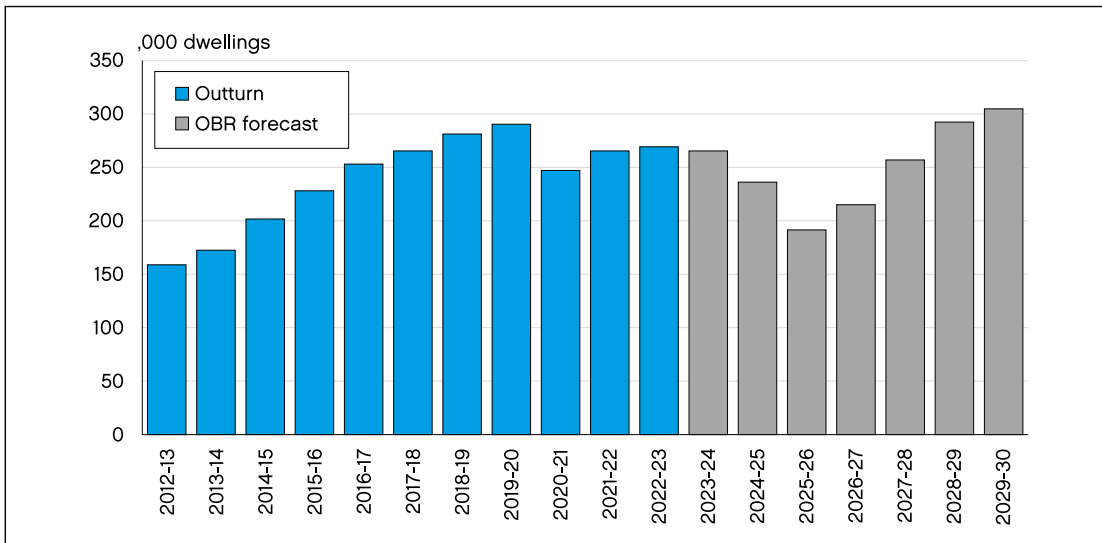
### Ratio of UK fixed investment to GDP



Source: ONS

- A 12-year low in housing starts:** Net additional housing starts are expected to be at a 12-year low of 192,000 in 2025-26, having fallen from 265,000 in 2023-24. According to the OBR, 'this is driven by the lagged impact of the recent fall in private housing starts. This fall was a result of higher interest rates and the higher cost of building homes due to building regulatory standards introduced in June 2022 and applied to housing starts after June 2023.<sup>17</sup> A recovery is expected, but it is unlikely to address the existing shortfall. The CPS recently estimated that compared to the European average, the UK is 6.5 million homes behind where it should be – with the house prices to match.

### UK net additional dwellings



Source: OBR

<sup>15</sup> ONS, 'Gross domestic expenditure on research and development, UK: 2022' (8 August 2024). [Link](#)

<sup>16</sup> OECD, 'Gross domestic spending on R&D' [accessed 25 June 2025]. [Link](#)

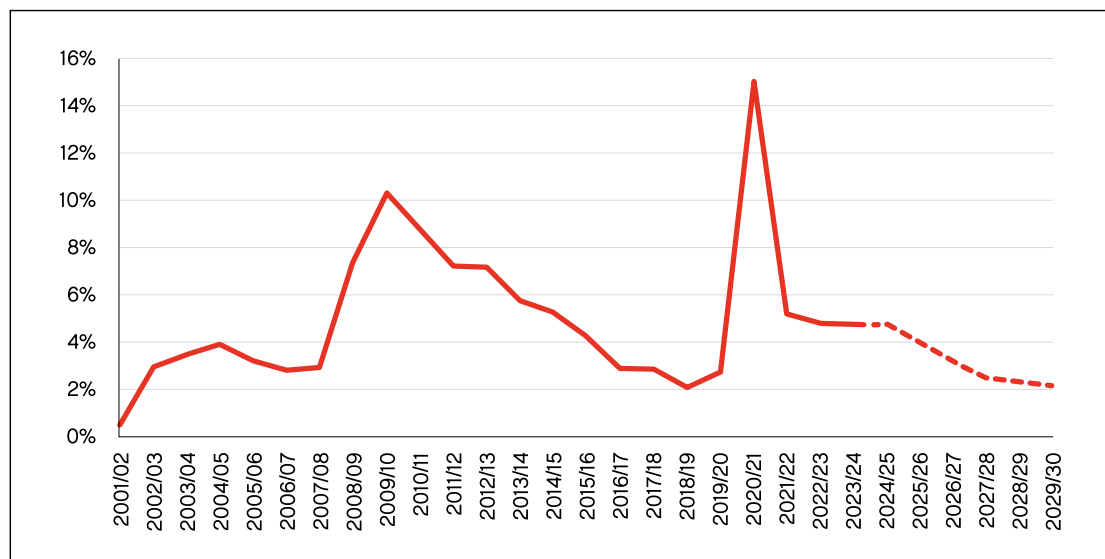
<sup>17</sup> OBR, 'Economic and fiscal outlook – March 2025' (26 March 2025). [Link](#)



- **A high spend, tax and borrow economy:** As the OBR stated in March 2025: 'Total public sector receipts are forecast to rise as a share of the economy from 39.9 per cent of GDP (£1.1 trillion) in 2023-24 to 41.7 per cent of GDP (£1.4 trillion) in 2028-29 and 2029-30. Within this, National Accounts taxes as a share of GDP (the 'tax take') are forecast to increase from 35.5 per cent in 2023-24 to 37.7 per cent of GDP in 2027-28, before stabilising at 37.5 per cent of GDP over the remainder of the forecast period. This peak would be a historic high and a 4.3 percentage point increase on the pre-pandemic level of 33.2 per cent of GDP in 2019-20.<sup>18</sup>

Yet despite a record tax burden, spending is still being allowed to outpace receipts, with borrowing taking up the slack. The UK has not run a budget surplus since 2000/01. And with interest rates higher, debt interest is expected by the OBR to be above £100 billion in every year of this Parliament – a huge additional burden on the public finances.

### Public sector net borrowing as a share of GDP



Source: OBR

- **Low productivity.** Over time, high-productivity economies have higher output and living standards. Low-productivity economies find it hard to keep up. To put it another way, if productivity is higher, we can work less, or pay ourselves more, or both. The failure of UK productivity to grow has led to the longest period of wage stagnation on record.

Ahead of the financial crisis, the UK was closing the productivity gap that existed with major competitors such as the US. But in the years since, productivity growth has averaged only a third of the pre-2008 long-run rate. Had trend growth resumed, productivity today would be about 27% higher than it currently is. The latest comparable international data shows annual output per hour worked to be £58.88 in the US, £55.83 in Germany, £55.50 in France, £46.92 in the UK, £45.33 in Italy, £42.92 in Canada and £33.57 in Japan.<sup>19</sup> The UK is far from the worst. But we are too far behind the best.

Not only that, but one of the most important forecast judgements made by the OBR is their forecast for medium-term productivity. In March 2025 they assumed it would average 1% over the medium-term, which is higher than most economists

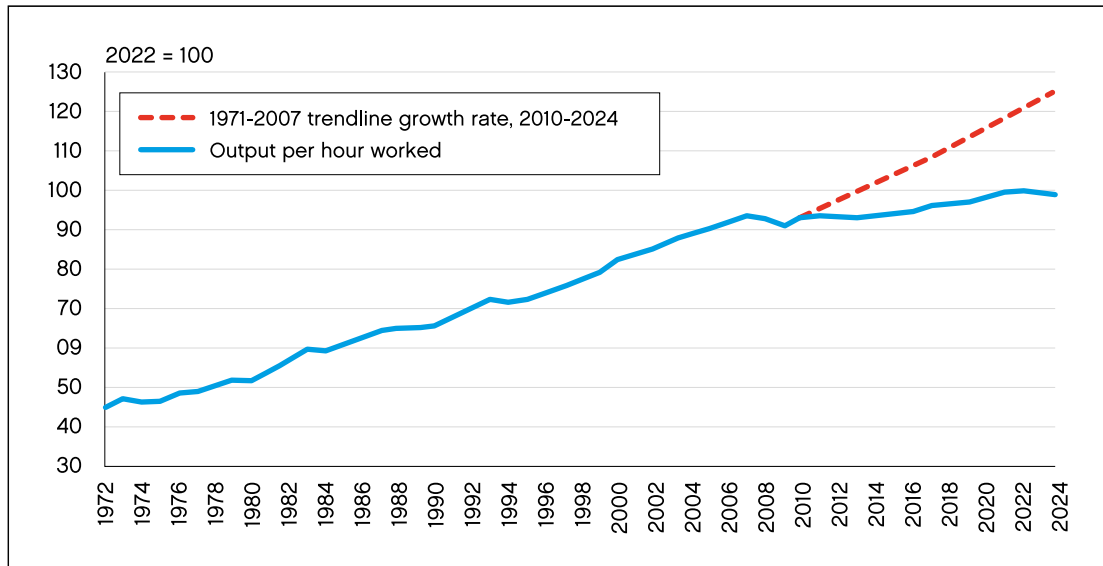
<sup>18</sup> Ibid.

<sup>19</sup> See 'Table 1' in ONS, 'International comparisons of UK productivity (ICP), final estimates: 2021' (11 January 2023). [Link](#)



assume. These projections are by their very nature highly uncertain, but because of our forecasting process, a downward revision to the OBR's productivity forecast would have major consequences, impacting growth projections and fiscal plans. As Charlie Bean said in a Bloomberg interview, the judgements he made in his four years at the fiscal watchdog were more consequential than any he did in his near-14 years at the Bank of England.<sup>20</sup> A downgrade of productivity projections is increasingly being anticipated in the report the OBR will prepare for the November 2025 Budget.<sup>21</sup>

### Productivity measured by output per hour worked



Source: ONS

- **Rising inactivity and a rising benefits bill.** The UK has a large number of people in work, although many are in low pay. In March there were 37.1 million people in workforce jobs. This was higher than in December and 304,000 more than a year ago. Our employment rate of 75.2% is also high by global standards, comparing with 70.9% in the EU, 73.1% across the G7, 77.4% in Germany and 71.7% in the US.

Yet the labour market is now turning down because of economic uncertainty and policy decisions such as the increase in National Insurance, higher minimum wage and new employment legislation: payrolled employees fell 25,000 in May and were down 135,000 on the year. Provisional data for June fell 41,000 and the numbers were down 178,000 from a year ago.<sup>22</sup>

But as widely reported, there has also been an alarming rise in inactivity, driven not by the health impacts of the pandemic (according to the IFS and others) but the design of the welfare system. There are now 101 parliamentary constituencies where 15-19.9% of the working-age population are not working and 30 where the figure is over 20%. The number of working age on sickness benefit, which had bottomed at 2.2 million in 2018/19, is projected to reach 4.1 million by 2028/29.<sup>23</sup>

20 Philip Aldrick & Tom Rees, 'How the UK's Fiscal Watchdog Holds Sway Over a £1.5 Trillion Budget', Bloomberg (31 March 2025). [Link](#)

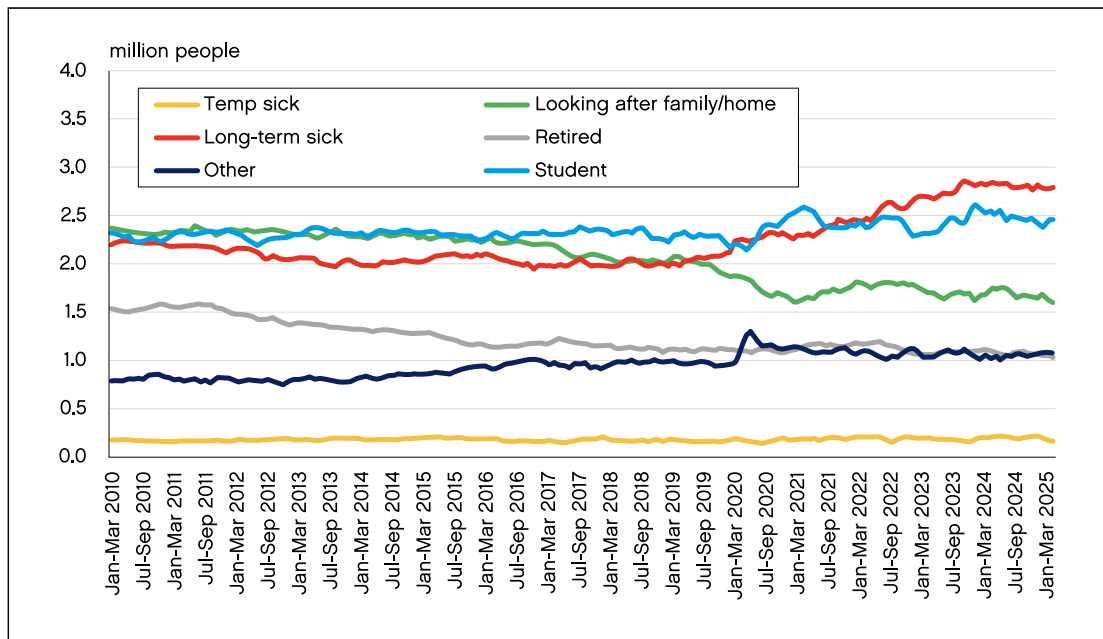
21 See for example: C. Angeloni, 'K Treasury eyes tax reforms as productivity downgrade looms – reports', *Investment Week* (18 August 2025). [Link](#)

22 ONS, 'Labour market overview, UK: June 2025' (10 June 2025). [Link](#)

23 See 'Sickness benefits heat map': F. Nelson, 'Britain's Benefits Scandal: The Rise and Rise of Sickness Benefit', Channel 4 (December 2024). [Link](#)



## Economically inactive individuals aged 16-64



Source: ONS

- **Wage problems – but not the ones you think.** The UK is traditionally regarded as a low-wage economy. However, there has been a sharp decline in those on low pay thanks to the rise in the national living wage (NLW).<sup>24</sup> In April 2024, the proportion of employees on low pay (less than two-thirds of median hourly earnings) was 3.4% – the lowest ratio since records began in 1997. In fact, the UK’s new problem is likely to be wage compression: combined with the National Insurance rise and the end of exemptions for younger workers, the higher minimum wage has caused problems for small firms, both in terms of higher costs and the impact on wage differentials within firms. CPS analysis shows that it will cost businesses £2,367 more to employ a full-time worker on the minimum wage this year and that the tax wedge – the combined amount of tax paid by employees and employers – for those on minimum wage will equate to a shocking 21.3% of salary.
- **Imbalances in people, place and productivity.** ‘Levelling up’ may have gone out of fashion but the UK still faces sharp internal divides. In terms of place, it’s London versus the rest, urban versus rural and coastal versus inland areas. For people, it’s old versus young and, because of the housing crisis, homeowners versus renters. (Divides which of course map on to each other.) Meanwhile, in terms of productivity it’s skilled versus unskilled and the employed versus the large numbers currently idle. The UK also faces macroeconomic imbalances, with a twin deficit problem in its budget and current account. The former points to the need for action to bring the fiscal numbers under control, while the latter leaves the UK dependent upon overseas money to fund itself.

Yet the labour market is now turning down because of economic uncertainty and policy decisions such as the increase in National Insurance, higher minimum wage and new employment legislation: payrolled employees have fallen by 74,000 since April and provisional data for July shows the numbers down 164,000 from July 2024.<sup>25</sup>

<sup>24</sup> HMG, ‘National Minimum Wage and National Living Wage rate’ (25 June 2025). [Link](#)

<sup>25</sup> ONS, ‘Labour market overview, UK: July 2025’ (12 August 2025). [Link](#)





But we do still have advantages. The UK is still the world's sixth-largest economy, although we are around 20<sup>th</sup> in terms of GDP per capita, with enduring institutional weight internationally and global soft power. It retains world-class capabilities in finance, law, life sciences, higher education, business and professional services, the creative industries and has leading global firms across many areas including energy, defence and pharmaceuticals, among others. It has one of world's leading financial centres. The UK is one of two major military powers in Western Europe, even though it still needs to increase defence spending considerably. It has a globally competitive creative sector and scores highly in most measures of soft power: in the Global Soft Power Index 2025 the UK slipped from second to third, behind the US and China, while on the IMF's new soft-power measure, the UK is eighth globally, although its score has again declined.<sup>26 27</sup>

Our policy challenges also have to be seen in the context of two once-in-a-century shocks: the 2008 global financial crisis and the pandemic. Structural change is also complicating the policy outlook. Globalisation has been replaced by fragmentation, free trade by protectionism and since the pandemic, national security decisions are indivisible from economic prosperity. Cyclically, as the UK is a large, open economy, a global slowdown would see weaker growth, trade, investment and confidence.

Structurally, the UK needs a more resilient economy, built to withstand global volatility and act with strategic autonomy. We need to retain our strength in high-end manufacturing – manufacturing is still a key contributor to growth, productivity and to high-end jobs – and, more particularly, across services and become more resilient in the face of policy shifts elsewhere.

But how is it possible to do any of this – or fix the problems outlined above? The argument of this paper is that we need an economic policy built on three core foundations: fiscal discipline, supply-side reform and a rational monetary environment. It is to outlining that agenda to which I now turn.

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26 Brand Finance, 'Brand Finance Global Soft Power Index 2025: China overtakes UK for the first time, US remains top-ranked nation brand' (20 February 2025). [Link](#). S. Cevik & T. Padilha, 'Measuring Soft Power: A New Global Index', IMF (October 2024). [Link](#)

27 I say around 20<sup>th</sup> as there are various measures of GDP per capita, with the UK ranking varying slightly by measure, and also some territories that are not countries that are also listed in these tables



## 2. Foundation I: Fiscal Credibility

The UK's long-term growth rests on three foundations. All are fragile today – but none more so than fiscal credibility.

At the core of the challenge is the debt burden. Financial markets have shifted in recent years from a focus on inflation, to growth and to debt. This should alarm all Western economies with a high level of debt. But it is of particular concern to the UK.

While our debt level may be less than five of the G7 countries, the UK is, like France, heavily dependent upon international investors to finance that debt.

If the public doesn't want to get debt under control, then the Government must – or the markets will eventually demand it. Even in the absence of a crisis, a shift in market confidence against the UK will always be a risk and our fiscal options will shrink. Warning signs have already been evident this summer, with government borrowing costs extremely high both by historic standards and in comparison with many similar countries.

**‘ The aim should be to run surpluses in normal or stable economic times, or occasional small budget deficits. Fiscal policy should be anchored in long-term economic conditions, not short-term political cycles ’**

The narrative needs to change and that requires a credible strategy – one built on reducing the debt-to-GDP ratio and controlling public spending. Achieving fiscal credibility is a necessity for future policy success.

This will, as is already clear, be an almighty challenge. It necessitates pushing back against the prevailing assumption that public spending will always rise, both in cash terms and as a proportion of GDP – indeed, that the ageing population means that there is no alternative but for spending and taxes to carry on rising.

Part of changing the narrative must therefore be about shifting our terms of reference away from Western Europe, to the faster-growing, lower-tax economies elsewhere which we have to compete with. It is necessary to shift both the economic and political debate.

Controlling spending is essential not only to reduce the ratio of debt but it is also important because it gives us the flexibility to manage shocks. Fiscal policy can be crucial for stabilising the economy, as we saw after the global financial crisis. The weaker the UK's fiscal position is, though, the worse its ability to respond to shocks. Indeed, the OBR has been crystal clear that our profligate fiscal management has led to 'a substantial erosion' of our ability to cope with another recession or pandemic.<sup>28</sup>

The aim should be to run surpluses in normal or stable economic times, or occasional small budget deficits. Fiscal policy should be anchored in long-term economic

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<sup>28</sup> OBR, 'Fiscal risks and sustainability – July 2025'. [Link](#)



conditions, not short-term political cycles. While fiscal rules may have been an attempt to achieve the latter, their frequent changes means that they lack credibility.

A credible policy to achieve fiscal solvency by reducing debt to GDP should be well received and rewarded by the markets. But explaining clearly to the electorate why spending must be curbed and debt controlled, and how this can be achieved, is the political challenge – and the principles set out here address it.

Another challenge, of course, is that the current fiscal rules do not work, as they lead to an overly short-term focus (in particular on reaching a narrow fiscal target three years out from 2026/27). But to abandon fiscal rules at a time when debt levels are high may be misinterpreted by the markets. Admittedly, the fiscal rules should provide the useful service of dampening political demands for more spending, although as we saw earlier this summer even this was not sufficient, with too many in the parliamentary Labour party appearing to believe that taxes might be hiked further instead.

If there is to be a rule, it should be focused on reducing debt to GDP, as a measure of fiscal solvency, underpinned by controlling spending. But there is a need to shift the focus of the policy debate, in a way that keeps financial markets onside and results in sensible and credible economic outcomes.

This requires changing the current back-to-front approach in which the OBR's forecasts drive the policy process, which leads to an obsessive focus on fiscal headroom – this was one of the main takeaways from the five-yearly external review of the OBR, which was released earlier this year.

If policy actions are not taken to address profligate spending and rising debt to GDP, then the financial markets will impose discipline on the UK. To not take fiscal action is not an option.

**‘ Most crises have unique features,  
but loss of confidence in policy  
is often the common thread ’**

## Will we repeat 1976?

The sharp rise in borrowing yields in recent months, together with fears of a 1976-style IMF bailout, shows that the issues highlighted in this paper are moving centre-stage.

In 1976, the UK faced severe pressures from high inflation, a large balance of payments deficit and rising public spending, leading to a loss of confidence in economic policy. Sterling fell sharply, and the pound remained fragile. The crisis peaked in September when Chancellor Denis Healey turned back from Heathrow amid fears of a currency collapse. In June, the UK secured a \$5.3 billion loan from a group of countries and the Bank for International Settlements, and in December agreed a further \$3.9 billion package from the IMF. The IMF programme required spending cuts and monetary discipline, but the UK did not default; the loan reassured markets and stabilised the situation. Yet economic challenges persisted, culminating in the 1978/79 Winter of Discontent.

Most crises have unique features, but loss of confidence in policy is often the common thread. In 1976 it was reflected in the pound's weakness; now it is visible in a risk premium on UK bond yields.



Although a repeat of 1976 is not inevitable, a fiscal crisis is a genuine risk.

The current focus is on the Budget in late November, but if the Government loses the confidence of international investors a crisis is possible at any time.

This is because the UK is suffering from two immediate problems. First, the persistence of UK inflation, which has made it an outlier relative to other G7 countries. Second, there has been a loss of confidence in our fiscal stance. This has fed a loss of confidence in the Government's economic policy and its direction of travel.

Sadly, the route the Government is apparently planning to take will not address the underlying problems of high public spending and weak growth. Ministers are planning tax hikes, but these will dampen growth prospects. If they opt to tax wealth, capital and property more, it will make the UK less economically attractive, risking a repeat of the same fiscal headroom problems in future years – particularly given the Government's incredibly tight spending projections for the back half of the Parliament.

The large sums required to meet the fiscal rules may mean that Labour will need to break their manifesto commitments (for instance, 1p on the basic rate of income tax raises £8.2 billion by 2028/29; 1p on the higher rate raises £2.1 billion; raising National Insurance by 1% raises £5.4 billion; and 1% on VAT gives you £9.6 billion). Yet the Budget needs to not only address the immediate fiscal problem but also outline a positive vision about future growth – which in turn requires a change in economic direction. Without this, talk of a repeat 1976 will persist.<sup>29</sup>

## Sustainable debt: reduce the ratio of debt to GDP

There is no fixed threshold for a 'sustainable' level of debt. What matters is future solvency and thus the direction of travel: debt must fall over time.

The UK has twice seen debt to GDP of around 250%, after the Napoleonic and Second World Wars. Today, the danger is not so much that debt is high – although debt interest costs of £120 billion a year are nothing to sniff at – but that it looks set to rise, with no credible plan to reverse course.

Weak growth and high interest costs threaten to push the UK into a debt trap. Once debt rises above 100% of GDP and the rate of interest paid on it exceeds the rate of economic growth, then for debt to fall the UK has to run a primary surplus – that is, a surplus excluding the payment of debt interest. That, or raise the rate of growth to exceed the rate of interest on our debts. Each would be a tall order – even if spending were not also growing at a rate that exceeds economic growth.

In its September 2024 'Fiscal risks and sustainability report', the OBR's baseline projection saw public spending rising from 45% to 60% of GDP over the next 50 years and the ratio of debt to GDP increasing from just below 100% to 274%.<sup>30</sup> In its July 2025 update to this, it noted that among 36 advanced economies, the UK's deficit was the fifth highest and debt sixth highest, although the US and France performed worse on both measures. Its borrowing costs were also the third highest, after New Zealand and Iceland. Although these could fall as rates decline, it is a precarious position.

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29 For more on the crisis of 1976, see: G. Lyons, 'The Lessons of 1976 and the Relevance for Now', Policy Exchange (December 2016). [Link](#)

30 OBR, 'Fiscal risks and sustainability – September 2024' (12 September 2024). [Link](#)



While the OBR's advice and input should be sought, as it performs a necessary task, there should be greater attention paid to these longer-term fiscal projections and their policy implications – not least because, as noted above, they are generally alarming. These projections should become the focus of policy, with the onus on government to outline steps to stabilise and then reduce spending and the debt-to-GDP ratio.

Because the OBR's warnings often concern a deterioration beyond the next general election, they are too easily ignored. This makes it even more important to place these projections at the centre of public debate; if so, the combined pressure of politics, markets and public opinion would prevent the can from being endlessly kicked down the road.

Yet instead of sitting back and accepting the inevitability of a deteriorating debt outlook, we should remind ourselves that by the late 1980s, the ratio of the national debt to GDP was at the lowest it had been since the start of the 18th century: 22% of GDP in 1990/1. At the time of the financial crisis, it was still a relatively low 34%. It has since been on a relentless upward march, because of the bail-out of the banks, the pandemic, poor economic growth, a rising population, the upward trend in spending – and a political failure to tackle the issue.

But what has been done can also be undone. Indeed, it must be. Because the public's demands of the government and the welfare state have now become untenable.

**‘ Because the OBR's warnings often concern a deterioration beyond the next general election, they are too easily ignored ’**

## What are the levers for debt reduction?

There are six options for reducing debt. One should be ruled out immediately and that is to inflate the debt away. This was partially attempted through the Bank of England's ill-judged QE programme, but with damaging and destabilising consequences. And in any event, much of our debt is now index-linked. Although it is far from clear that inflation will fall to the Bank's 2% target in coming years, as is generally assumed, the inflation outlook is far different to the 1970s, when it peaked at 26.9% in August 1975.

That leaves five options: growth, reform, spending control, taxation and borrowing.

Growth and reform are self-evidently the most attractive options. A stronger economy boosts the tax take and can broaden the tax base, reducing reliance on higher tax rates while sustaining revenues. Public sector reform allows spending to be more effective, especially given the size of its wage bill, around one-tenth of GDP.<sup>31</sup> (Public sector employment was 6.14 million in December 2024, of which the general government component, which attracts most attention, was 5.99 million.<sup>32</sup> Ahead of the pandemic, this latter figure was 5.42 million. There is therefore a strong case to use AI to help reform the state.<sup>33</sup>) Reform is critical to help improve service levels across the public sector and allow services to be provided in terms of better value for money.

31 On the enormous public sector wage bill, see Table 2.1 in: HMT, 'Public Expenditure Statistical Analyses 2024' (30 July 2024). [Link](#)

32 ONS, 'Dataset: public sector employment' (10 June 2025). [Link](#). The general government component comprises 4.0 million in central government and 1.99 million in local government. The NHS employed 2.05 million and education 1.67 million.

33 A. Iosad, D. Railton & T. Westgarth, 'Governing in the Age of AI: A New Model to Transform the State', TBI (20 May 2024). [Link](#)



But relying on growth and reform to deliver lower debt takes time. It also doesn't do much good if you are simultaneously ramping up spending. Also, as we have seen over the last year, higher taxes on employment can dampen growth.

Retaining financial market confidence as policy evolves is critical. And that means tackling spending.

## Public spending must be controlled

Since 1969, the UK has run a budget surplus only seven times. Surpluses build credibility, allow borrowing to be strategic rather than reactive and create headroom for future shocks.

This, indeed, was Keynes's original recipe for fiscal demand management: spend in the bad times, save in the good. Yet nowadays, we seem to take the opposite approach, with the Government being too relaxed over controlling spending when the economy is going well, and then failing to control overall spending when the economy is very weak, while occasionally tightening excessively in some sectors.

Instead, budget surpluses during periods of solid, or even modest, economic growth should be the aim and an important part of the economic narrative. Achieving this requires a fundamental shift in mindset and outcomes.

**‘ Keynes’s original recipe was to spend in the bad times and save in the good. Nowadays, we seem to take the opposite approach ’**

While the size and role of the state have long been contested, controlling public spending is a necessity. The alternative is rising borrowing costs and higher taxes that weaken competitiveness. Poorly targeted expenditure also distorts behaviour and risks long-term stagnation.

Of course, a healthy, educated population and strong infrastructure are essential to economic success. Research and development, whether publicly or privately funded, is also critical to innovation. Yet while public spending plays an important role in the economy, there is little doubt that for the vast bulk of outcomes, the private sector and market pricing delivers better results.

Moreover, we have reached the point – as plenty of CPS research shows – where the taxation and regulation that accompany a bigger state now act as a barrier to private sector growth. Meanwhile, in the regions, a rising public sector wage bill distorts labour markets and crowds out enterprise.

What is equally remarkable is that despite the sheer scale of public spending, areas that are in the country's longer-term interests – such as defence or its diplomatic service – have been poorly funded, including embassies being sold off, thus conveying a negative global image.

Equally, some parts of the public sector have been moved into private sector hands in a cackhanded way, without the appropriate powerful regulators in place, such as with water, or without focusing on the need for competition, as with rail. Despite the many benefits of privatisation, there is not much of a case for substitution of the public sector with poorly regulated, private sector monopolies.



## So how can we get a grip on spending?

In 2025/26, total managed expenditure is projected at £1,347 billion. This includes £379 billion on social protection, £277 billion on health, £146 billion on education, £126 billion on debt interest and £83 billion on defence.

Public spending typically falls into three categories: politically essential, ring-fenced areas such as defence, health and education; non-ringfenced areas such as criminal justice, prisons and local government; and cyclical areas such as unemployment benefits.

Since the financial crisis, two clear patterns have emerged. First, any spare resources have been allocated to health, with the non-ring-fenced areas getting squeezed. Second, whenever overall spending ratchets upward, as seen during the pandemic, it sets a new baseline, with no subsequent retrenchment.

This year's comprehensive spending review was indicative of the challenges, with health spending accounting for the bulk of the increase. But even so it is set to rise at a slower pace than its recent trend, and within the overall totals there was little scope for public sector pay to rise, despite pressure for higher wages.

### ‘Central to curbing public spending is the need to control health spending’

The priority must be to control spending growth over the economic cycle. But that means tough decisions are unavoidable. In the early 1980s one aspect of the monetarist debate centred on gradualism versus immediacy, in terms of the pace at which policy was tightened. A similar debate may be needed in terms of fiscal policy. Gradualism will not be enough.

Some increases are necessary: for instance, defence. A hypothecated tax, applied broadly, could be justified here. Health and social care will demand more, driven by demographic pressures. But the core issue with the NHS is delivery in the face of uncontrollable demand.<sup>34</sup> If something is free at the point of entry, the economic solution is to ration it. But if universal access remains, how can private innovation help raise efficiency?

Given the rising costs across the public sector, the emergence of public-private models seems inevitable, but learning the lessons of the period under Chancellor Brown is necessary, where on some estimates the total bill for £50 billion of capital investment under PFI will be as high as £278 billion.<sup>35</sup>

Central to curbing public spending is the need to control health spending.

In 2024, healthcare spending (public and private) of £317 billion was 11.1% of GDP, compared with 11.0% in 2023. Government-funded healthcare accounted for £258 billion of this or 9.0% of GDP. The share of health spending is off its Covid highs, but above the

<sup>34</sup> For instance, since the first Spending Review in 1998, day-to-day health spending has risen by an average of 3.5% per year, versus 1.5% for the overall day-to-day budget, meaning a severe squeeze on many other areas. Since the 2019 Spending Review, though, the health budget day-to-day spend has grown no faster than the overall departmental total. In the Comprehensive Spending Review, the rise for health was 2.8% per annum, higher than other areas but below its long-term trend

<sup>35</sup> See Bob Lyddon, 'Private Finance Initiative – the New Labour financial catastrophe', Lyddon Consulting (13 November 2024). [Link](#)



ratio of 9.7% to 10% of GDP seen between 2009 to 2019.<sup>36</sup> As the ONS noted, the state's share of health care spending 'has increased from 74.0% in 1997 to 81.3% in 2024'.

A decade ago the OBR projected that public spending on health would rise to 8.9% of GDP by 2030/31,<sup>37</sup> but it is already above that now. Success in reducing the ratio of public spending to GDP necessitates getting a grip on health spending. And given its likely trajectory, genuinely reducing the government's share, since the current direction of travel is not sustainable.

The public are strong supporters of the NHS's core principles, yet the public finances point to the need for a change in the operating model. This does not mean privatising the NHS (for example), but controlling the growth in health spending is essential.

The plethora of government reports in this area suggest no magic bullet, with many changes needed. In January 2025 the Public Accounts Committee warned of a lack of ambition among health officials when it comes to taking radical steps to execute the Government's three big shifts: from hospital-based to community care; from analogue to digital; and from treating ill health to prevention.<sup>38</sup>

**‘ The amount an individual receives in benefits may need to be benchmarked in a way to ensure that per capita benefit spending is contained ’**

Other areas that warrant attention include introducing financial reforms, expanding the use of health insurance via employment, which would likely encourage older people to remain in the workforce and encouraging people to use private health care, with this even receiving a tax relief as used to be the case. There is a need to encourage competition among health providers, as well as insurers.

Non-ringfenced areas must either be treated as priorities, if they are such, or delivered through alternative models involving the private sector. The current policy is to squeeze them.

There are other hard choices. The amount an individual receives in benefits may need to be benchmarked in a way to ensure that per capita benefit spending is contained. Given the growth in welfare recipients post-Covid, a radical approach could be to reset the base year for benefits to be 2019, immediately pre-Covid, implying real-term cuts now, as an incentive to encourage a return to work – naturally protecting those who have developed illnesses that preclude them from work. Effective policies to control public sector pay are also necessary, not only for this government but whoever wins the next general election. Perhaps public pension liabilities could be reduced by a switch to higher pay and lower pension contributions.<sup>39</sup>

36 ONS, 'Healthcare expenditure, UK Health Accounts 2023 and 2024' (30 April 2025). [Link](#)

37 Nuffield Trust, written evidence to parliamentary committee (6 October 2016). [Link](#)

38 Public Accounts Committee, 'NHS Financial Sustainability' (29 January 2025). [Link](#)

39 In March 2025 the OBR forecast overall employment growth of 0.6% per annum this decade. If public sector employment grows in line with this, so that the government's share of total employment is constant, and if the public sector pay bill were to grow by 1.2% each year in real terms, in line with overall budgets, then as the IFS notes, 'average pay awards would need to average 2.0% in cash terms each year', which would be both below expected private sector pay growth and 'below the pay awards recently announced for 2025-26' (which were around 4% on average) – thus risking recruitment and retention problems. Public sector pay growth has long exceeded private sector pay growth. See: B. Boileau, M. Warner & B. Zaranko, 'Four big decisions for the 2025 Spending Review', IFS (1 June 2025). [Link](#)





Labour's shift to viewing the public finances through a balance sheet lens does not alter the fundamentals. The exercise could be extended to include, for example, off-balance-sheet pension liabilities. In theory, such an approach might help government focus on where spending delivers most value and what can be cut. But the reality remains: creating an asset still means taking on a liability, and that liability must be financed.

## The share of the state

But whatever the specific decisions that are made, the lesson of the 1970s is clear. The state consumes resources. It must rely on the private sector to generate the wealth that finances it. The goal must therefore be a smaller, more efficient state.

After 1945, the UK adopted a mixed economy, with the state focused on public goods such as education, diplomacy and defence and the private sector as the engine of growth. By the mid-1970s, this balance had tipped too far towards the state. Chancellor Denis Healey acknowledged the need for restraint and the Thatcher government drove further change through privatisation, though public spending remained significant. Today, spending is almost 45% of GDP, and is rising.

In the 1980s, the state's share of GDP fell from 40 to 35 per cent. The circumstances are not identical and there is no fixed ideal size, but that range should serve as a guide to the direction of travel. These lower ratios are a long way away from where we are now, but if spending is controlled and if economic growth returns helped by the principles outlined here, then the ratio of public spending to GDP will fall.

**‘ It is not about deregulation or low taxes at all costs. Rather, we need a lean, effective and respected state – one that receives the investment it needs, when the economy can afford it ’**

The OBR has a relatively upbeat view of UK productivity growth, translating into projected average GDP growth of 1.8% in the second half of this decade. From 2023/24 to 2029/30 it sees a cumulative rise of 9.8% in GDP and 25.9% in nominal GDP. Inflation increases by 14.8% on the GDP deflator and 14.2% on the CPI. By 2029/30, nominal GDP is £3,464 billion, public spending £1,519 billion, and the state accounts for 43.9% of GDP.

Suppose in 2029 a new government set an ambition to reduce the state's share of public spending to 40% of GDP by 2034/35. If nominal GDP growth then continued at 3.7% per annum, in line with the OBR's assumed trend at the end of this decade, then this would allow public spending to rise to £1,661 billion. That equates to a 1.8% annual increase in nominal terms, or a small real-terms reduction of about 0.2% per annum.

If, however, nominal GDP grew at 4.5% per annum (with inflation nearer 3% and growth around 1.5%), public spending could grow by 2.6% annually in nominal terms, or 0.6% in real terms, reaching £1,727 billion. That would represent a £208 billion increase over the parliament.

These figures are illustrative, but they show that with moderate growth it is possible to reduce the state's share of GDP while still allowing sizeable increases in spending. By the early 2030s, AI might also be contributing to efficiency gains across public services, amplifying the benefits of discipline.



To reach a public sector share of 35% of GDP by the end of a subsequent parliamentary term, in 2039/40, with average nominal GDP growth of 4% per annum (which is a plausible base forecast), public spending would be £1,836 billion in an economy of £5,247 billion. That would entail a nominal spending increase of £109 billion across the parliament. But in real terms, spending would fall by around 1.1% per annum.

The consensus view is that achieving such a reduction would be extremely difficult, given demographic pressures, rising health and social care costs, and the likelihood of higher defence spending. The point, however, is that we are conditioned by our starting position. Since the pandemic, the state's share of GDP has ratcheted up and is widely assumed to be fixed at a permanently higher level. Yet this is not inevitable. Reducing welfare dependency, tightening eligibility for Indefinite Leave to Remain, and other structural reforms can ease the spending trajectory and help shift expectations.

**‘ With steady growth, reform, and ambition, it is possible to fund increases in spending while still reducing the state’s share of the economy. The challenge is whether structural pressures can be contained sufficiently ’**

The margin of error around such long-run projections is inevitably large, but the scale of the numbers illustrates the opportunity: with steady growth, reform, and ambition, it is possible to fund increases in spending while still reducing the state's share of the economy. The challenge is whether structural pressures can be contained sufficiently to make the more ambitious targets realistic. Above all, the priority should be to spend less and spend better, ensuring that resources are used more efficiently, and directed where they achieve the greatest impact

The analogy of ‘Singapore-on-Thames’ is often mentioned for this process of shrinking the state as a proportion of GDP. The analogy makes sense, but only if properly understood. It is not about deregulation or low taxes at all costs. Rather, it means a lean, effective and respected state – one that receives the investment it needs, when the economy can afford it. In Singapore, although small, the state is often seen as interventionist. The aim in the UK should be for it to be less intrusive, unless intervention is justified by the national interest. This would work alongside a dynamic, innovative and competitive private sector supported by the right incentives.

Smart regulation and simpler, competitive taxation are also desirable – but only if supported by fiscal credibility.

## Simplify taxes, don't raise them

Above, I said that there were five ways to deal with debt, excluding inflating it away. Growth and reform should obviously be a priority (indeed, supply-side reform is one of the other foundations of a prosperous economy, discussed below). Spending definitely needs to be brought under control. But what about the other options – taxation and borrowing?

Raising taxes is always tempting to politicians. But increasing them indefinitely is simply not credible, particularly when doing so harms jobs and investment and damages competitiveness. Indeed, the last few years have provided confirmation of the dangers of increasing National Insurance, a tax on jobs and increasing corporation tax, a tax on competitiveness.



It is understandable, given the historically high tax burden, that the debate often defaults to tax cuts. But as Thatcher argued, cutting taxes without controlling public spending is not credible. The fiscal sums must add up and the strategy must be clearly explained to financial markets. Fiscal policy also plays an important demand management role; tax cuts can help growth in the right circumstances, such as when demand is weak. But when trend growth is low, it requires a credible supply-side policy (as outlined here) to improve the effectiveness of fiscal policy. Tax policy has to be judged in the context of both the fiscal and economic environment.

Tax policy must rest on principles, not only to support the public finances but to help growth. The starting point, therefore, must be tax simplification alongside credible spending control. Only then will there be space for targeted tax reductions that support long-term growth.

Once simplification is achieved, tax rates should be kept as low as possible within the bounds of fiscal responsibility.

**‘ The UK’s tax system should be simple, fair, efficient and internationally competitive. It should not distort economic behaviour ’**

So, as with spending, let us start from first principles.

Across the OECD, it is significant how wide the distribution of tax revenues is: from 16.9% to 46.1% of GDP. The UK sits at 35.3%, just above the average of 34%.<sup>40</sup>

But tax isn’t just about totals. As the Tax Foundation have repeatedly pointed out, there are countries which collect relatively large amounts in taxes but with a tax code that is well designed to promote growth and vice versa. In other words, Adam Smith’s canons for taxation – equity, certainty, convenience and economy – still hold.

So how are we doing on that front? Across the OECD, income and social security account for half of tax revenues, VAT about one-quarter, other consumer taxes about 10%, corporation tax 10% and property around 6%. Again, the UK is relatively typical, although our VAT base is notably undersized. There has also been an evolution, in the UK and elsewhere, in the use of tax, used not just to raise revenues but to punish externalities like pollution; act as an incentive in impacting behaviour; or boost competitiveness in specific ways.

As Smith would tell you, the UK’s tax system should be simple, fair, efficient and internationally competitive. It should not distort economic behaviour.

Sadly, our tax system clearly falls foul of these principles. High marginal rates discourage work. Complex rules deter investment. The administrative burden frustrates small businesses.

Reform must begin with removing high marginal tax rates across the income spectrum. This Manhattan skyline of high marginal tax rates hits those repaying student loans, when child benefit is removed and when allowances are clawed back over £100,000. Tax-free allowances need to be reassessed and income tax bands

40 This is the latest data, which goes up to 2023. See: OECD, ‘Tax revenue’ [accessed 25 June 2025]. [Link](#)



indexed to inflation, to avoid fiscal drag. There also remains a strong case for income tax and National Insurance to be combined, but this is not a priority.<sup>41</sup>

A simple tax system, with few bands, should be retained, but the preference should be for tax not to be seen as for someone else, with a low starter rate of tax as opposed to very high tax-free allowances. (I am aware that it was the CPS that championed the policy of increasing the personal allowance, but respectfully disagree: lower rates and wider tax bases are more economically efficient.)<sup>42 43</sup>

The UK operates a progressive tax system, which remains a sound principle. But incentives matter: the top one per cent of earners contribute around 28% of income tax revenue and can probably not be squeezed much further. Taxes, like regulation, influence behaviour. And the prevailing assumption that taxes must rise to fund spending creates a self-defeating loop, since if spending keeps rising then higher taxes follow, damaging incentives and ultimately reducing the amount of tax paid.

**‘ The present Government has demonstrated a number of errors to be avoided: an obsessive focus on fiscal headroom; raising taxes in ways that have damaged the economy; a failure to retain flexibility; and an excessive emphasis on redistribution at the expense of productivity and growth ’**

Tax policy must also encourage work, investment and innovation. It must stay competitive when dealing with mobile assets such as capital and talent. Thus, one tax that warrants immediate attention is corporation tax.<sup>44</sup> Raising it from 19% to 25%, particularly on a widened base, has increased the cost of capital and reduced potential output. UK firms already invest too little. Management incentives that prioritise short-term share prices over long-term investment have made this situation worse. Low investment today means weaker growth tomorrow, so cutting corporation tax would help the investment outlook.

This paper cannot go through the pros and cons of every possible tax change. Suffice to say that some targeted tax cuts, such as stamp duty on shares and on housing, are justified immediately and can achieve wider goals. The present Government has demonstrated a number of errors to be avoided: an obsessive focus on fiscal headroom; raising taxes in ways that have damaged the economy rather than curbing spending; a failure to retain flexibility (in particular, needlessly boxing itself in with mistaken commitments, such as not to raise one of the major taxes); and an excessive emphasis on redistribution at the expense of productivity and growth. Plus, its inability to craft a credible narrative and to get on top of the problem.

As noted above, we need to be mindful of the fast-growing low-taxed economies. Increasingly we will have to compete with these in terms of retaining or attracting talent and in terms of economic output. I cannot reiterate enough that policy should

41 National Insurance and income tax both have a legally mandated destination account. Since 1866 income tax goes to the consolidated fund, while NI goes to the NI fund. Yet the entire wealth of the NIF is an accounting construct, internal to the Exchequer and there are explicit provisions for HMT to draw on the consolidated fund in support of the NIF's responsibilities. NIF surpluses are held in the debt management account whose primary function is offsetting daily flows between the Exchequer and the banking system.

42 M. Saatchi & P. Warburton, 'Poor People! Stop Paying Tax!', Centre for Policy Studies, 2001. [Link](#)

43 The challenge with tax changes, as Ken Clarke pointed out, is that losers make noise and those who gain keep quiet.

44 Andrew Smithers has written persuasively on the case for lower corporation tax as a boost to investment. See for example: A. Smithers, 'Corporation Tax', *World Economics Journal* 22 (2021). [Link](#)



be guided by the North Star of wanting to allow people to keep more of their own money, with low or lower taxes, but the starting position is the need to prevent taxes rising, simplify the tax system and to increase the potential output of the economy.

A perfect example of the challenges facing the current system was seen in the furore over cuts to winter fuel payments. The issue of whether benefits should be means-tested has been an ongoing debate, most notably since Barbara Castle introduced universal child benefit in the mid-70s. In times of fiscal difficulty, it is understandable that such payments should be targeted. Yet for the long-term credibility of the tax system, it is vital that those who contribute also feel they receive something in return. If taxpayers come to believe they are only ever paying in while others only ever benefit – for example, not being able to see their GP or not using state schools or hospitals and now losing access to universal benefits – support for the system will erode.

**‘ Devolution should foster competition, not uniformity. Regions must be encouraged to attract capital, talent and enterprise. Productivity improves when localities are free to differentiate rather than compelled to conform ’**

## Devolution must not be an excuse for more taxes

One area which has received widespread support in British policymaking is devolution. But there has been little attention paid to how this will work in fiscal terms, including what happens if things go wrong.

Given that so many counties and cities are in financial difficulty, it is worth stressing that devolution cannot be used as a way to sneakily increase the tax burden. Indeed, in terms of regional policy more broadly, the acronym FEED captures the four areas that are critical: finance, where local government must be subject to robust financial discipline; empowering, as long as the resulting decisions are transparent and accountable; enterprise, often overlooked but critical given that economic success ultimately depends upon the private sector; and diffusion, given that the greatest disparities in productivity are often found within regions, not between them.

Admittedly, the case is strong for skills budgets to be devolved. Even in areas where there are clear advantages to devolution, such as Cambridge, where housing and transport infrastructure have often been blocked, there will still be a need to work closely with central government.<sup>45</sup>

Yet while there are compelling reasons to decentralise power – local responsiveness, improved accountability, better-targeted policy, the potential for swifter and cheaper infrastructure delivery – this process must be approached with rigour. Devolution must not become a surrogate for bigger government, higher taxes, or expanded bureaucracy. Devolution should foster competition, not uniformity. Regions must be encouraged to attract capital, talent and enterprise. Productivity improves when localities are free to differentiate rather than compelled to conform. Without a sharp focus on private sector growth, devolution will drift toward state expansion rather than improved outcomes.

Fiscal accountability and clearly defined boundaries are imperative. Without offsetting reductions in central government grants, devolved tax powers risks simply

<sup>45</sup> As I saw from my role as a Commissioner on the London-Stansted-Cambridge Corridor Growth Commission, whose report was released in July 2016. See: LSCC Growth Commission, ‘Findings and Recommendations of the London Stansted Cambridge Corridor Growth Commission’ (July 2016). [Link](#)



increasing the overall burden. The London Finance Commission recognised this risk and recommended that any local tax increases be fiscally neutral.<sup>46</sup> That principle remains essential.

In particular, property taxes are often proposed for localisation, yet the UK already taxes property heavily but in an inefficient way. Stamp duty distorts housing decisions and discourages mobility. Delegating such taxes to local authorities, absent meaningful reform, might deepen these distortions rather than resolve them.

## Borrowing should be a policy tool not a default

Finally, we come to the last option for dealing with debt: borrowing.

Admittedly, it might seem lunatic to deal with a debt crisis by piling on more borrowing. Especially when gilt issuance this fiscal year is over £300 billion, including refinancing.

Yet borrowing is a legitimate policy instrument – but only when deployed with discipline and strategic intent. Borrowing can push up interest rates, crowd out private investment and inflate debt servicing costs. But it remains a vital tool for long-term investment. For example, the UK missed two clear opportunities, in 2012 and again during the pandemic, to lock in ultra-low rates for strategic infrastructure (and indeed to refinance its existing debts). These opportunities were clear at the time, not with hindsight, and I argued for them then. Both moments called for vision – and delivered hesitation.

Under the fiscal framework this paper proposes, borrowing should not be used for day-to-day spending, still less to mask structural deficits or cover the costs of debt servicing – the ultimate debt trap. Instead, it should be reserved for productivity-enhancing investment, counter-cyclical support in downturns and transformative national projects. As part of this, the boundary between capital and current spending must be upheld: yes, a hospital is of little use without the staff to run it, but that does not justify blurring categories to justify unchecked expenditure.

**‘ Borrowing should not be used for day-to-day spending, still less to mask structural deficits or cover the costs of debt servicing – the ultimate debt trap ’**

Not only is the context key, but language is important, too. Borrowing for tax cuts has – since Reagan’s days – been framed as ‘unfunded tax cuts’, whereas borrowing for higher spending is never referred to as ‘unfunded spending increases’. Higher borrowing for increased public spending is seen as normal. But for the UK now, with a budget deficit and high debt, there is even more reason for both spending and tax plans to make sense.

These points are central to heeding the lessons of the 2022 mini-Budget. Keeping markets onside is crucial. Given the febrile state of markets at the time, it was essential not to deliver shocks; and that was clear well before the event.

In future, every major fiscal event should be accompanied by OBR scrutiny to reassure markets the sums add up. But not with the OBR driving the process as now. As we saw in the pandemic, not all fiscal events given their speed or scale merit OBR involvement. In the autumn of 2022, there was a clear difference between what

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<sup>46</sup> I was an ex-officio member.



had been trailed over the summer, which did not merit OBR scrutiny, and what was ultimately delivered. By the time of the mini-Budget, the scale of the package and the inclusion of unexpected, costly measures made OBR involvement essential.

The Government also failed to prepare the ground by setting out its fiscal framework – and that, too, is a critical lesson. If markets are not on side or do not understand fully your policy ideas, then this means you have to go slowly and gain fiscal credibility.

**‘ Markets will tolerate borrowing when it is anchored in credible plans for growth. What they will not accept is drift, evasion or fiscal incoherence ’**

While some supply-side measures were well received, the absence of spending cuts, combined with unfunded tax cuts – and the stated intent, reiterated two days later, to go further – spooked markets. This loss of confidence was compounded by the Bank’s lack of anti-inflationary credibility and by the LDI crisis, itself the result of regulatory and policy failure and an accident waiting to happen. The overriding lesson is clear: control the controllables.

In short, markets will tolerate borrowing when it is anchored in credible plans for growth and long-term sustainability. What they will not accept is drift, evasion or fiscal incoherence.



## 3. Foundation II: A Supply-Side Agenda

The first foundation of a credible economic policy is fiscal credibility – which means, in the UK’s case, getting debt and hence public spending under control.

But as mentioned above, delivering fiscal credibility is an awful lot easier when your economy is growing. And as noted in the introduction, a supply-side agenda is necessary to raise the economy’s potential growth rate. That will not only ease the pressure on the public finances, but allow the neutral level for the Bank of England bank rate to be lower, as the economy could grow at a faster pace before facing inflation pressures.

It would also raise productivity, delivering stronger growth, higher real incomes and improved living standards. Although some sectors in the UK, notably financial services, are highly productive, overall performance is poor – and since the financial crisis, has been downright diabolical. The causes are structural: low investment, inadequate skills, an unfavourable business environment and policy unpredictability.

The second foundation, therefore, is a supply-side agenda focused on creating a competitive business environment. This must be built around the four ‘Is’: investment, innovation, infrastructure and incentives.

**‘ Low investment is a longstanding British weakness. Without addressing this, there can be no sustainable improvement in productivity or competitiveness ’**

### Investment and innovation must be national priorities

Low investment is a longstanding British weakness. A June 2024 report from the IPPR showed that the UK has not matched the G7 average for the ratio of investment to GDP since 1990. In fact, the problem dates back far longer: I drew attention to in a column in *The Times* in 1989,<sup>47</sup> pointing out that the UK had the lowest such ratio in the G7 from 1960-87.

The result has been an underlying underinvestment in capital and skills. Andy Haldane points out that the UK’s capital stock, on a per capita basis, is a third smaller than competitors.<sup>48</sup> Without addressing this shortfall, there can be no sustainable improvement in productivity or competitiveness.

The tragedy of this is that we know the criteria that need to be in place for higher investment: more finance and lending for firms; sound macroeconomic policies; a skilled workforce; a lack of bureaucracy; predictable, simple and low taxes; an expectation of future demand; and functioning and supportive infrastructure.

47 G. Lyons, ‘Underlying trends point to high-risk policy for sterling’, *The Times* (18 September 1989). [Link](#)

48 A. Haldane, ‘Voters know the real meaning of austerity and renewal’, *Financial Times* (20 June 2025). [Link](#)





But Governments of all parties have too often focused not on facilitating these vital enabling factors, but attempting to direct capital through politically driven strategies.

Yet there is also a need to think differently. Take skills, for instance. While improving education is key to this, so is the kind of education we provide. The evidence increasingly suggests that a more technical economy will demand more technical skills. It is also noticeable that in the calls for devolution, one area of unison is the desire for skills budgets to be devolved, thus allowing local areas to align training with employment needs.

Many of the same foundations are needed to boost innovation, which should be seen as an economy-wide imperative.

While the UK has a strong record of invention, its capacity to scale ideas and commercialise research remains limited. Understanding and addressing the lack of capital should be a focus of policy. Instead, as with investment, this problem is often talked about but never solved.

### ‘ The UK ranks fifth on the Global Innovation Index – but has only three science and technology clusters in the top 100 ’

Regulation, tax policy and the cost of doing business all need to reward risk-taking and support dynamic firms. Clustering around universities, leveraging regional strengths and ensuring a nationwide innovation strategy are critical.

The UK must also lead, not follow, in the application of new technologies. In the context of AI and digital disruption, the temptation to overregulate must be resisted. Excessive top-down intervention risks stifling the very process of creative destruction that fuels productivity gains. The goal should be to create a rules-based, transparent environment in which the private sector can adapt, compete and evolve.

Innovation helps drive growth and influence long-term performance. The UK ranks fifth on the Global Innovation Index – but has only three science and technology clusters in the top 100, with London 21st, Cambridge 66th and Oxford 78th.<sup>49</sup> Although by intensity – relative to population – Cambridge was first and Oxford fourth globally. Which is precisely why it is so urgent that we expand them.

A strong regional dimension is also evident in the innovation debate, linked with the low rate of R&D spend. As the then Government’s 2022 UK Levelling Up report noted, ‘Only seven of the UK’s 41 ITL2 subregions spend more than the OECD average of 2.4% of GVA on R&D’.<sup>50</sup> A report from Onward built upon this, revealing the location of ‘innovation deserts’ – areas where less than 1% of jobs are in research-intensive industries.<sup>51</sup> There is also a very noticeable regional productivity divide, with the latest ONS data for 2023 showing labour productivity, whether measured by output per hour worked or by output per job, is much higher in London and the South East than the UK average. In London, output per hour worked was 28.5% above the average and output per job 35.3% higher.<sup>52</sup>

49 The top five are Switzerland, Sweden, US, Singapore and then the UK. See: WIPO, ‘Global Innovation Index 2024’ (2025), esp. ‘London’, ‘Cambridge’ and ‘Oxford’. [Link](#). [Link](#). [Link](#). [Link](#)

50 HM Government, ‘Levelling Up the United Kingdom’ (February 2022), p.84. [Link](#)

51 F. Fraser, W. Holloway & J. Blagden, ‘Levelling Up Innovation’, Onward (February 2021), p.26. [Link](#)

52 ONS, ‘Regional and subregional labour productivity, UK: 2023’ (19 June 2025). [Link](#)



Innovation and a focused approach to regional development can also go hand-in-hand. As an independent commissioner on the London Stansted Cambridge Corridor Growth Commission, we noted the ‘striking finding’ that ‘all of our international competitor regions are promoting or have established comprehensive place-making strategies and cross-jurisdictional collaboration’.<sup>53</sup> Effective place-making is a ‘whole place’ approach to development, integrating economic development, skills, land use planning, infrastructure, transport and communities.

As we outlined in that report, regional development needs investment funds and attractive places that are well connected with vibrant communities, plus building a talent pool. In essence, being a good place to work, live and invest in. But in the region we studied, like so many in the UK, a ‘lack of workforce skills, housing and transport capacity was hindering further business investment and growth’.

When it comes to innovation, another critical area is AI, which will permeate all walks of life and all policy areas. It links into the skills agenda, into meaningful public sector reform and economic productivity.

The lesson of previous technological change is that you first get a substitution effect, where jobs are lost, followed by an income effect and creativity effect, in which new roles and jobs are created.<sup>54</sup> Of course, AI will be more profound. The 2021 National AI Strategy made the optimistic claim that ‘the UK has an opportunity over the next 10 years to position itself as the best place to live and work with AI; with clear rules, applied ethical principles and a pro-innovation regulatory environment’.<sup>55</sup> Yet in a discussion event in London, Brad Smith of Microsoft pointed out that every other country has been making the same claims. Skills and talent, R&D, international collaboration, access to data and access to finance are all key and obvious areas. But as ever, execution will be key.

‘AI will permeate all walks of life and all policy areas’

## Industrial policy is no substitute for supply-side reforms

In recent years, a consensus has grown among the political class that the way to deliver innovation and investment is not via supply-side reform, but direction from on high.

The Government announced a ‘Modern Industrial Strategy’ in June, with the release of a 160-page report. It followed multiple such plans for growth under the Conservatives and Coalition, including the 2017 Industrial Strategy, which morphed into the 2021 Plan for Growth.

The UK has a long history of industrial policy (although there was a temporary and blessed respite after 1979). The tone was set by the Special Areas Act 1934, amended in 1937, that sought ‘general economic development and social improvement in the special areas’, which were old industrial or mining areas.

The tendency of such strategies, however, was of propping up failures. Instead of picking winners, industrial strategies usually involved losers picking the government,

53 LSCC Growth Commission, ‘Findings and Recommendations of the London Stansted Cambridge Corridor Growth Commission’ (July 2016). [Link](#)

54 See my 2019 paper for the Centre for Social Justice: G. Lyons, ‘The future of work: technology and artificial intelligence. Part IV: The Fourth Industrial Revolution’, CSJ (April 2019). [Link](#)

55 HM Government, ‘National AI Strategy’ (September 2021). [Link](#)



through lobbying and political pressure. A Competition and Markets Authority (CMA) report earlier this year<sup>56</sup> found that past UK industrial policies delivered, at best, small short-term productivity gains, but had no lasting effect on employment, investment, or research and development.

This latest strategy has been titled 'modern', presumably to differentiate it from the past. But the green paper last year, which prepared the groundwork, seemed eerily familiar, arguing that 'there is a strong case for governments to more actively direct the structure of the economy'. While such forceful language was dropped in the new report, the thinking wasn't.

That said, it is certainly new in an important respect. The Government has picked sectors that are already winners, choosing eight of the most productive and competitive in the UK. These are referred to as the IS-8: advanced manufacturing, clean energy, creative industries, defence, digital and tech, financial services, life sciences and professional services.<sup>57</sup> They enjoy productivity 27.1% above the national average and average pay that is £7,900 higher.

**‘ While industrial policies are sometimes presented as a complement to supply-side reform, they more often become a substitute for it ’**

The IS-8 have also, crucially, seen lower investment than their international peers. But while the Government's industrial policy document mentions investment frequently, it is hardly going to address all of the enablers of investment discussed above. Prioritising sectors is not the same as fixing the fundamentals in areas requiring immediate action such as regulation, planning, skills and energy costs. This strategy is particularly light on the last two.

Indeed, behind the strategy's rhetoric of competitiveness and enterprise lay a corporatist, state-led agenda heavy on intervention and far lighter on genuine market freedom. The talk is of competitiveness, but the answer is intervention. For example, the document acknowledges that firms are concerned about high electricity prices and lengthy waits for grid connections, but its answer is that the current policy is right but can be tweaked.

Similarly, this new strategy explicitly mentions the role tax plays in incentivising investment, innovation and growth. It then argues our current approach is competitive. Really? In the 2024 International Tax Competitiveness Index, the UK ranked 30th out of 38 OECD countries and looks more likely to fall, than rise.<sup>58</sup> I am also deeply sceptical that the Government will deliver the deregulation promised in the strategy, though I am more optimistic regarding their proposed planning reforms.

At their core, industrial policies reflect scepticism about markets and an aversion to supply-side reform. Indeed, while they are sometimes presented as a complement to supply-side reform, they more often become a substitute for it.

Instead of removing hurdles to growth, as supply-side policies would, industrial policies often reflect the lethal combination of politicians driven by a belief that the state drives growth (when in fact the decisions of private businesses have a far greater impact on the economy, highlighted by the vast scale of their investment),

56 CMA, 'Industrial policies: new evidence for the UK (9 April 2025). [Link](#)

57 UK Government, 'VEST 2035: The UK's Modern Industrial Strategy' (November 2024). [Link](#)

58 Tax Foundation & Centre for Policy Studies, 'The UK's International Tax Competitiveness: 2024 Update'. [Link](#)



academics who think they know best and lobbyists. This new strategy is therefore unlikely to improve underlying business conditions.

There is also something amiss about these eight sectors in that they reinforce the imbalanced nature of the economy. The UK is a low-wage economy because half the population work in low paid jobs. Yet outside London and the South-East, the numbers employed in these eight sectors is very limited.<sup>59</sup>

In short, the UK needs to be wary of embracing industrial policies for anything other than strategic needs – and they should absolutely not be a substitute for supply-side reform.

**‘ It is investment that generates infrastructure,  
but it is infrastructure that attracts investment  
and makes innovation possible ’**

## Infrastructure: more, cheaper, quicker

Infrastructure is the third of our Is, but it is closely tied to the others. It is investment that generates infrastructure, but it is infrastructure that attracts investment and makes innovation possible. If you cannot build factories, create transport links and power lines to reach them and build houses for the workers, you will not have much of an economy to speak of.

But infrastructure must be understood in more than just the most obvious sense, of objects constructed (often of concrete and steel). It comes in three forms: hard, soft and institutional.

Hard infrastructure is the obvious type, which must be boosted: energy capacity, transport and digital connectivity and of course housing. Ideally this can be done via more investment from UK pension funds, a point addressed below. The UK must also learn from its past mistakes, including HS2 and prioritise reliable, cost-effective delivery. Connectivity improvements, especially outside London, are essential to attracting investment and enhancing productivity.

As the recent essay ‘Foundations’ noted,<sup>60</sup> Labour’s manifesto pointed to more state spending, but ignores the fact ‘that this investment would face the same barriers and high costs that existing infrastructure projects face and that deters private investment’. This was because, it argued, ‘Britain is now a place in which it is far too hard to build houses and infrastructure and where energy is too expensive.’ It highlighted a host of reasons why infrastructure is too expensive, including centralisation of delivery, feast and famine in procurement, judicial reviews and extra spending that does not enhance functionality.

A particularly notable culprit was the planning system. In the past, the authors noted, ‘This system was extraordinarily swift and inexpensive ... By contrast, today’s system is broken. For a whole range of infrastructure – railways, trams, nuclear power and more – building has become vastly more expensive than competitors across Europe and East Asia. The consenting of major projects usually takes years and sometimes decades.’

59 As Andy Haldane pointed out in a talk hosted by Policy Exchange, only around 15% of people employed in the East Midlands are employed in these eight sectors.

60 B. Southwood, S. Hughes & S. Bowman, ‘Foundations: Why Britain has stagnated’ (September 2024). [Link](#)



Much has been written on how to solve these problems, by the authors of Foundations and others. Rather than repeating their work, I would add my voice to the calls for Britain to take infrastructure seriously – but add that we also need to focus on the soft infrastructure of education, skills and workforce development,<sup>61</sup> all of which are widely recognised levers for growth.<sup>62</sup> Then there is institutional infrastructure, in the form of the quality and effectiveness of our economic governance, which is discussed later in this report.

### ‘ There is a strong case for a shift in the regulatory agenda ’

## Above all, incentives matter

A genuine supply-side agenda must be broad-based. Incentives matter. In particular, the importance of tax to the supply-side agenda, discussed above, reinforces the importance of joined-up thinking across the policy spectrum.

For example, for those out of work, benefit structures should be reassessed to strengthen the incentive to return to work. For those in work, tax simplification is essential, to reduce marginal rates and curb fiscal drag. Corporation tax should be cut to boost investment and competitiveness. These changes reinforce the need for coordination between tax, welfare and regulatory policy.

In particular, there is a strong case for a shift in the regulatory agenda. In May 2021, the Taskforce on Innovation, Growth and Regulatory Reform looked at this issue and made the point that ‘through setting clear, proportionate, long-term goals, frameworks and standards, UK regulation can be a significant driver of our international competitiveness’.<sup>63</sup>

There was a long list of proposals, many of which are worth revisiting, such as reimposing the ‘one in, two out’ regulatory duty on all government departments. Other proposals were to make the UK a leader in agile, adaptive regulation to increase productivity, competition and innovation. The report suggested aligning the political momentum behind this by creating a lead Cabinet Minister and Cabinet Committee responsible for the implementation of regulatory reform. Also noteworthy was a new ‘proportionality principle’ at the heart of all UK regulation.

Similarly, a CPS report by Tom Clougherty and Robert Colvile examined every regulatory impact assessment produced in the 2010s, finding not just that the burden of regulation had increased despite repeated promises to reduce it, but that the amount of attention paid to the cost of regulation and its cumulative impact, was utterly inadequate, to the point of basic errors appearing in the relevant reports. The MiFID II reforms to financial services, for example, were estimated to have a cost to business of £105.2 million per year – a vast underestimate by any standards. Yet as the report pointed out, the Government’s official position is that they will benefit the economy by £105.20 per year, since no one bothered to fill the form out properly.<sup>64</sup>

61 As noted by the IFS: ‘Since the early 2000s, the UK has seen a marked decline in participation in adult education and training. There has been a fall in both public and private investment in training.’ Although it did note that the starting position was important. For instance, training participation in the EU rose from 11% to 14% between 2010 and 2019, and while the UK’s fell from 25% to 20%, it was more a case of a narrowing gap. See: I. Tahir, ‘Investment in training and skills Green Budget 2023 - Chapter 9’, IFS (October 2023). [Link](#)

62 See for example: DfE, ‘Skills England: Sector evidence on the growth and skills offer’ (June 2025). [Link](#)

63 TIGRR, ‘Final TIGRR Report’ (May 2021). [Link](#)

64 T. Clougherty & R. Colvile, ‘The Future of Regulation’, Centre for Policy Studies (April 2024). [Link](#)



There has also been a renewed focus on the impact of regulation in the City in recent years, with financial regulators given secondary objectives to promote competition and Rachel Reeves promising to ease the burden on firms.

Reducing the regulatory burden should be seen as a facet of boosting innovation, another aspect of the supply-side agenda. Policymakers must accordingly recognise innovation as an economy-wide issue, not a sector-specific one.

**‘ SMEs account for 99.8 per cent of all businesses in the UK, over 16 million jobs and more than half of private sector turnover. Yet they remain under-supported ’**

## Empowering SMEs and unlocking risk capital

Our discussion of the four Is and their importance has, inevitably, been somewhat broad-brush. Let us bring them together to show how they apply to the backbone of the UK economy: small and medium-sized enterprises.

SMEs account for 99.8 per cent of all businesses in the UK, over 16 million jobs and more than half of private sector turnover. Yet they remain under-supported. The Federation of Small Businesses (FSB) has stated that ‘SMEs are vital to the UK’s prosperity, yet too often their potential is constrained by access to finance, regulatory burdens and economic uncertainty’. This hinders their ability to grow and compete.

Access to finance remains a persistent problem, with many SMEs struggling to secure funding from traditional banks, which often favour larger, lower-risk firms. The issue that comes to the fore is that risk capital is in short supply. British finance continues to favour large firms and property, over growth-oriented businesses. The shortage of access to finance that allows firms to scale up and a regulatory system geared towards risk aversion constrain the ability of SMEs to grow.

Too often, this has been viewed as a demand problem rather than a supply-side one. A reassessment is needed.

SMEs struggle for investment. This prevents them from doing all they can in terms of innovation. And they also bear the brunt of Britain’s longstanding failure to invest in infrastructure. A large company that needs to get things done can usually, eventually, persuade government to comply. It is smaller firms that are left to deal with the wider consequences of choked roads, crowded train lines and unbuilt houses. They also tend to lose out when the spoils are being shared out via the industrial policies discussed above, with funding and attention diverted to whatever shiny sector has captured ministers’ attention.

But above all, SMEs depend on incentives. And the current direction of travel under the Government is not good, with higher taxes and new employment legislation adding to costs and the burden for SMEs.

Wage policy also requires a more balanced approach. While minimum wages prevent exploitation, blanket increases create challenges for small firms with tight margins. Wage compression and job losses can follow. A voluntary, differentiated approach, such as that of the Living Wage Foundation, may offer a more practical path. Broader employment legislation must also be reassessed, with the aim of restoring flexibility and reducing compliance costs.



More broadly, there is the sense that Britain can be something of a hostile environment for SMEs and family firms – and in particular that it is relatively easy to start a business, but harder than it should be to grow them.

A CPS report in 2019 advocated easing the burden on small businesses by offering them the chance to pay a flat tax on turnover in place of existing taxes and administration.<sup>65</sup> It's a good idea, but likely requires the Treasury being convinced of the revenue neutrality of this, or that any short-term loss of revenue is more than offset by the future positive economic and tax impact.

**‘ Like larger firms, SMEs would benefit from policy predictability, but also from better policies – ones driven above all by an understanding of the incentives they face ’**

More pertinently, the report made a compelling case that regulatory burdens, tax complexity, employment law and business rates all weigh heavily on SMEs, with compliance costs disproportionately impacting them. The administrative burden of meeting these requirements diverts time and resources away from growth and profitability.

Like larger firms, SMEs would benefit from policy predictability, but also from better policies – ones driven above all by an understanding of the incentives they face. That, in a nutshell, is the case for supply-side reform: that it makes it easier for firms to grow and for the economy to grow with them.

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65 N. King, 'Think Small: A Blueprint for Supporting UK Small Businesses', Centre for Policy Studies (May 2019). [Link](#)



## 4. Foundation III: Low Inflation and Financial Stability

The third foundation of long-term growth is also the one which tends to get the least attention: a stable monetary and financial framework. This rests on three components: low inflation, financial stability and a globally competitive City that serves the domestic economy, via the provision of risk capital and funding to help firms scale, grow and remain in the UK.

### Holding the Bank of England to account

Ever since the Bank of England was given independence in 1997, politicians – and much of the media – have essentially stopped thinking about monetary policy. But it matters hugely. During their 14 years in office, the Conservatives presided over a rise of almost 50% in the consumer price index. More broadly, the recent era of cheap money, low rates, sizeable and unnecessary QE – pushed upon the economy by the Bank of England – alongside poor forecasting served to undermine confidence, distort the economy and fuel the cost-of-living crisis. It inflated asset prices, skewed risk allocation, kept zombie firms afloat and denied productive businesses the capital they needed to grow.

**‘ The Bank of England has a surprisingly dismal record in doing its core job ’**

In other words, the Bank of England has a surprisingly dismal record in doing its core job: curbing inflation. The future neutral interest rate – in which monetary policy is neither tight nor loose – is clearly higher than where the Bank believed it to be before the pandemic. In fact, the UK’s low rate of trend growth risks inflation bottlenecks being hit sooner and it requires supply-side policy to help in raising the trend rate of growth, as outlined above.

The Bank of England also became the largest holder of gilts and as a non-commercial buyer distorted the yield curve and shortened the maturity profile of UK debt. Its exit strategy now, of selling gilts into fragile markets through quantitative tightening (QT), has imposed significant taxpayer losses.

So what can be done?

Central bank independence is now an accepted fact. But we do need politicians to do more to hold the Bank to account, given how easy it is for it to fall into comfortable groupthink.

Price stability must be restored through disciplined, forward-looking monetary policy. Cheap money must be avoided at all costs. While I am not a monetarist, it is clear that within this approach the Bank needs to pay more attention to the monetary indicators – they should be on its radar screen in a way that they simply were not during the pandemic. Money does matter for monetary policy.





The 2024 Bernanke Review also exposed deep institutional failures at the Bank, in terms of governance, judgement and strategy. These must be addressed.

## Change policy over paying interest on reserves and QT

The Bank should abandon the damaging QT programme. I also support the idea of the Bank ceasing to pay full interest on commercial bank reserves and adopting a tiered system, reducing the fiscal burden while retaining monetary control. Although this would cost the banks money relative to persisting with the current situation, it is materially different to a levy on banks and is more a case of reducing what is in effect a subsidy from the taxpayer, bringing us into line with equivalent countries.<sup>66</sup> Such changes would also better align the Bank's operations with the public interest.

As this is such a key current issue, it warrants greater focus here.

### ‘ Often when the bank rate falls, media and political attention turns away from the Bank of England ’

In June, the Governor responded to criticism of the Bank's approach to paying interest on bank reserves and to its policy of selling gilts through QT. It is important that criticism of the present policy is not only linked to the current fiscal cost, but also to the operation of monetary policy and the decision-making process. That is because the markets expect the bank rate to fall over the next year or so (although currently service sector inflation is sticky). If so, this will contribute to a lower fiscal cost of this policy – and often when bank rate falls, media and political attention turns away from the Bank. It should be noted that before the pandemic, the mistaken view taken by central bankers was that  $r^*$  (or the neutral interest rate after allowing for inflation) was close to zero in many Western economies, including the UK. It is accepted now that this level is significantly higher, not only implying that the bank rate should settle well above zero, and at a higher level than pre-pandemic, but also reinforcing the future challenges on debt servicing and the dangers of a debt trap.

In particular, four issues come to mind with the present policy.

The first is the role of the indemnity from the Treasury to the Bank and how this impacts the decision-making process governing QT and the payment of reserves. The aim of the indemnity appears sensible: it is to allow the Bank to carry out monetary policy operations without regard to the fiscal consequences. The indemnity is always taken as a given in the policy debate. But this allows both the Governor and the Chancellor to avoid accountability regarding the fiscal consequences of decisions linked to QE and QT and to the payment of interest on reserves. Thus the fiscal cost borne by the taxpayer from the payment of reserves is not addressed.

Second, the Governor argues that payment of reserves is necessary for the operation of monetary policy. This is wrong. It is a policy choice. Under the current approach, the payment of reserves at bank rate allows the transmission of monetary policy to work smoothly. An alternative approach might mean more volatility, say, in overnight rates but the likelihood and the consequences of that should not be exaggerated.

66 Contrast the IPPR proposals for 'a QE reserves income levy on commercial banks, in a similar vein to Thatcher's 1981 deposit tax on banks', which markets have perceived – rightly – as a windfall tax on banks. See: IPPR, 'Thatcher-style tax on bank windfalls could raise billions for public services, says IPPR' (29 August 2025). [Link](#)



Before the current floor system was adopted, policy worked well previously when interest was not paid on reserves. The key being for the Bank to keep the market short of funds so that when it provided funds through open market operations it ensured that the marginal short-term rate in money markets was the same as the bank rate. An alternative approach was to have minimum reserve requirements to help the operation of monetary policy.

In practice, a tiered reserve system would achieve the same objective, as other central banks have demonstrated. Tiering would also counter the Governor's concern about volatility of rates, since the remunerated tier would continue to provide a floor. To allow for some flexibility, the Bank could move to a corridor around the policy rate, as in the US.

Third, the Governor states that a high level of reserves is both a consequence of QT and is necessary for financial stability. It is not. He accepts that interest must be paid on all these reserves at the bank rate. Commercial banks hold reserves as high-quality liquidity assets (HQLA). This helps meet regulatory requirements and is important for banks in the event of a call on funds or in a crisis. But this does not make the payment of bank rate on all reserves a necessity as the Governor implies. Regulatory requirements do not state that HQLA have to be held in bank reserves. Gilts could be held; so too could a raft of other assets. Thus, financial stability is not threatened if banks chose to move from reserves into other HQLA. It is their choice. A reduced demand for reserves is not in itself problematic; it may even be desirable.

### ‘ In the wake of QE, the Bank’s balance sheet is now a policy instrument ’

The holding by banks of reserves is a function of the interest rate that they receive on these reserves, which improves their attraction relative to alternatives. Thus, the Bank is not just meeting banks' demand for reserves – it is feeding that through the rate they are paying. If the rate paid was lower, then demand for reserves would undoubtedly fall.

This leads onto a critical point. If the Bank cuts the bank rate as a monetary policy decision, then on the Governor's logic in his June letter, is he saying that this threatens financial stability? Of course not. Yet to defend the status quo, he is prepared to say that keeping rates high and thus encouraging bank reserves boosts financial stability.

The key issue is that in a financial crisis there is a need for liquidity, which partially explains the focus on HQLA. As we have seen in previous crises, this liquidity can be provided quickly and cheaply by central banks, including the Bank of England. That does not mean having to make continuous payments to the banks now.

Finally, the approach to QT needs to be seen in broader policy terms. When I testified to the Treasury Select Committee on QE, I described it as the good, the unnecessary and the bad. It was a good policy in the immediate aftermath of the financial crisis. It was an unnecessary policy for much of the last decade, feeding a cheap money environment along with low policy rates, with damaging consequences. After the pandemic it was a bad policy, at the wrong time for the wrong reasons.

As a result of QE, the Bank's balance sheet is now sizeable. Reducing it should not be seen as a purely technical exercise, as the Bank does. Its balance sheet is now a policy instrument. Moreover, as a non-commercial player, first as a buyer of gilts



through QE (and of some corporate bonds, for which it should have been criticised) and now as a seller through QT, the Bank's operations can be impactful, moving the market and influencing expectations.

Even allowing for the indemnity, it is not clear that QT makes sense from a monetary policy perspective, especially at a time when the bank rate is falling. The policy implication is a steeper yield curve. QT also does not make sense from a wider economic or fiscal perspective. The Bank appears to treat holding gilts or selling them as functionally equivalent. This ignores the reality that selling gilts at a loss creates a real cash call on the Treasury, crystallising losses that would otherwise remain unrealised.

By selling gilts into a market already digesting heavy government issuance, the Bank's actions push yields higher, both directly and through the expectations they create.

No clear economic case has been made as to why active QT is superior to passive roll-off. Or, if based on the maturity profile, there is a case to sell, why not wait until a more appropriate time? A pause or slowdown in QT would not compromise monetary policy, but it would avoid locking in losses prematurely and reduce the fiscal burden.

While predictability of policy is important, it cannot be the only driver of policy actions. There needs to be a more mature approach, mindful of market conditions. Policy cannot be put on autopilot. A modern central bank, in touch with the market, should be able to adapt its operations to changing conditions.

**‘ Quantitative tightening on this scale does not make sense from an economic or fiscal perspective, or even arguably from a monetary one ’**

## The 2% target

A particular issue that warrants attention is whether to stick with the 2% inflation target. Given the urgency of the other issues facing the economy, this can be parked for future debate and is not an urgent option. The immediate priority is for the Bank to do its job better, curbing inflation. Any change to the target should not be a substitute for that.

In the longer term, the plus side is that the target is clear and understandable. But it has also lost its force: repeated misses result only in ritualised letters to the Chancellor. As a result, a shift to a nominal GDP target should be an area for future policy consideration – though the mention of it here should not divert attention from the immediate changes that are needed to restore credibility to monetary policy.<sup>67</sup>

A 4% target for nominal GDP, reflecting trend growth and moderate inflation, might face an initial challenge from the public before it could anchor expectations, but if it was achieved it should help restore discipline and ensure long-term stability.

Such a target would allow policy to act as a more effective economic stabiliser. This would help protect against higher inflation in an upturn and guard against weaker demand in a downturn. It would be consistent with reducing the debt to GDP ratio, steadily, over time. There has been some periodic debate as to whether central banks should set higher inflation targets. A four per cent nominal GDP target

<sup>67</sup> G. Lyons, 'Bank of England's remit needs a fundamental rethink', *Financial Times* (22 April 2022). [Link](#)



would help protect against inflation on the upside and against weak demand on the downside. A four per cent target would be accepted as credible by financial markets and seen as getting the balance right between inflation and growth. Also, the move towards more contemporaneous measures of economic activity – away from quarterly data released with a lag towards monthly snapshots of GDP – would remove one of the criticisms of money GDP targets, namely the data on GDP is available only with a lag.

Alongside monetary stability the Bank's remit should still focus on financial stability, including the use of macro-prudential powers, although there may be the case for revisiting their execution when it comes to mortgage lending, where to aid lending there is a case for greater flexibility.

**‘ Yes, we need to keep financial markets onside with credible policies. But we also need to get better at spotting problems that may disrupt them ’**

## A need for greater accountability and institutional reform

Too often in recent years, the UK's macroeconomic framework has failed – not just in execution, but in design. Stability depends on institutions that command trust. Markets cannot be relied upon as the sole check. Accordingly, demanding accountability is not an attack on independence: it is a challenge to underperformance.

So there is a need to re-examine the Bank's governance, as outlined above. But we also need to rethink how the Bank is held to account by Westminster – with a focus on not only the Monetary Policy Committee, but also the Bank's other policy committees on prudential regulation and financial stability and the interaction between their policies.<sup>68</sup>

The economy, after all, is significantly affected by the prudential controls placed upon on banks and people's ability to borrow has been impacted by macro-prudential regulations. (See for example the CPS's work on the 'Resentful Renters' locked out of the housing market after 2008.)<sup>69</sup>

Comprehensive reform of economic governance is therefore overdue. Alongside this, lessons from the past need to be heeded. In particular, the underlying causes of the LDI crisis in 2022 and the regulatory and policy gaps that prevented the authorities identifying that crisis in advance, need to be fully examined, as well as the inability of Westminster to interrogate the issue and understand it properly. Yes, we need to keep financial markets onside with credible policies. But we also need to get better at spotting problems that may disrupt them.

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68 Ibid.

69 G. Edwards, 'Resentful Renters', Centre for Policy Studies (December 2019). [Link](#)



## High national savings must be a strategic priority

At a time of economic stagnation, it may seem premature to mention the four major post-war boom-bust episodes under Chancellors Maudling, Barber, Lawson and Brown. The lessons, though, are relevant: all stemmed from ignoring macroeconomic imbalances.

From a fiscal policy perspective, perhaps the most relevant was Nigel Lawson's late-1980s boom and bust. At that time, there was a popular misconception that a healthy fiscal position was bound to mean economic stability. That promoted a relaxed attitude about what lay ahead, leading to a credit boom that was reflected in rising private-sector debt.

Despite healthy public finances, such private sector liabilities fed a boom that prompted interest rates to rise sharply, followed by a bust.

**‘When a country continues to run large trade deficits, which feed into a persistent current account deficit, it is a serious macroeconomic vulnerability’**

The lesson from is that economic stability cannot rely upon the government running a budget surplus – as rare as that is. This was a point I made when writing in *The Times* in the mid-1980s.<sup>70</sup> I pointed out that with rapid credit growth, the trade deficit mattered more than a budget surplus, providing an early warning sign that interest rates would need to rise sharply and the boom would become a bust.

When a country continues to run large trade deficits, which feed into a persistent current account deficit, it is a serious macroeconomic vulnerability. It also signals that domestic savings are too low.

The lesson for today, in different economic circumstances, is that we need both to get the public sector's finances in shape and ensure that the private sector maintains a sound balance sheet. This requires consistency across fiscal and monetary policy in the national interest and may require both prudent fiscal and monetary policies at the same time.

In short, economic stability requires more than sound public finances. It also depends on a coherent macroeconomic strategy, high savings and alignment between monetary and fiscal policy.

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<sup>70</sup> See: G. Lyons, 'External deficit matters more than a budget surplus', *The Times* (21 March 1998); G. Lyons, 'Outlook hinges on controlling domestic credit', *The Times* (27 June 1988).



## A competitive City can serve the national economy

Getting economic management right is not just about providing financial stability. It is about providing the right financial environment.

The Big Bang reforms of 1986 revolutionised London's financial markets, significantly enhancing the City's global competitiveness and attracting substantial international investment. Alongside this came the rise of popular capitalism, underpinned by a clear policy ambition to broaden share ownership – most notably through the public sale of state assets at attractive prices. This was reinforced by a strong economic backdrop that amplified the City's momentum.

Today, a modern-day revival of popular capitalism is needed – built on policies that both increase the City's competitiveness and improve how it services the wider economy. The latter includes helping raise national savings, directing those savings into UK-based firms and closing funding gaps to help serve the domestic economy.<sup>71</sup>

‘ Since the financial crisis, the regulatory pendulum has swung from light-touch oversight to excessive risk aversion ’

## Three pillars for a competitive City

The City's status as a leading international financial centre rests on three fundamental pillars – each of which requires renewed focus and reinforcement.

First, it must remain a place where global clients choose to do business, underpinned by deep, liquid and efficient markets.

Second, it must safeguard and strengthen its core attributes: the rule of law, robust infrastructure and institutional reliability. Even longstanding advantages such as the English language and the UK's strategic time zone should not be taken for granted, particularly in an era when AI may alter traditional dynamics. (Which only sharpens the imperative for the UK to be at the forefront of this transition.)

Third, the regulatory environment must strike the right balance: enabling enterprise and innovation while upholding the highest standards of governance and integrity. Unfortunately, since the 2008 financial crisis, the regulatory pendulum has swung from light-touch oversight to excessive risk aversion, resulting in a framework that too often stifles innovation. Brexit offered a pivotal opportunity to design a bespoke regulatory regime that enhanced the City's competitiveness and supported long-term growth. Yet the prevailing mindset remains overly cautious. I covered the issues linked to Brexit in a CPS paper in August 2024.<sup>72</sup>

While a bonfire of all red tape is not desirable, we must avoid using regulation as the immediate policy lever and challenge the mindset that any easing of regulation will result in an untold increase in risk. As part of this shift in mindset, regulation must be assessed not solely by its contribution to financial stability, but also by its support for innovation, investment and the UK's international standing. Compliance costs,

71 In 2021 I covered these issues in a strategy paper for Policy Exchange. See: G. Lyons, 'The City and UK Financial Services: A Strategy Paper', Policy Exchange (March 2021). [Link](#)

72 G. Lyons, 'Why the EU is Not the Answer to Britain's Growth Challenge', Centre for Policy Studies (August 2024). [Link](#)



also, must be kept proportionate. Equally, the tax regime should act as a magnet and not a deterrent for firms and individuals to operate and thrive in the UK. A good rule of thumb here would be to ask ourselves what activities can be done in London more easily, conveniently and affordably than in New York. At the moment, it is a depressingly short list.

Alongside smarter regulation, a new institutional framework is required, including: a specialist parliamentary committee to oversee financial regulation; an annual Chancellor's Statement on the City; and a quarterly 'Barriers to Business' report grounded in practitioner insight.

**‘ The Bank of England itself estimated the SME funding gap at £22 billion, then did nothing to address it ’**

## Closing the finance gaps

Businesses can only grow if they have the finance to do so. But one of Britain's eternal problems is a shortfall in finance that constrains growth. The Macmillan Gap, first identified nearly a century ago in 1931 as a structural weakness in SME lending, remains unresolved.<sup>73</sup> In 2019, the Bank of England itself estimated the SME finance gap at £22 billion,<sup>74</sup> then did nothing to help address it. The gaps in patient and scale-up capital are a serious concern.

Without action, there is a risk of a self-reinforcing cycle: if UK-based funds withhold investment from growth firms on the grounds of limited short-term profitability, those firms may be deprived of the capital they need to expand. As a result, they will either stagnate or seek overseas funding, raising the likelihood that they will ultimately list abroad, to the detriment of the UK's capital markets and long-term economic dynamism. That means we will struggle to build a stock exchange populated by our most innovative companies, which in turn means we will struggle to develop the kind of popular capitalism outlined below.

A broad-based approach is essential to improve long-term financing for UK growth. There has been a fixation with private equity in recent decades, leading to an over-reliance on debt-based finance without addressing the economy's underlying investment needs. Deals are often highly leveraged, raising concerns about short-termism and asset-stripping.

Nonetheless, private equity will continue to play an important role – providing access to capital to early-stage, high-growth companies that once would have listed and offering diversification benefits and, in some cases, improved governance through active ownership.

73 This is one of the most important issues in the UK economy and has been since being first identified nine decades ago. The Macmillan Gap refers to the shortage of finance provided to small and medium-sized firms. That 1931 report was largely responsible for the formation, in 1945, by the Bank of England of the Industrial and Commercial Finance Corporation to provide long-term finance to small and medium-sized firms. It has been an ongoing issue ever since. For instance, the 1980 Wilson Committee's investigation into the functioning of the financial system found no evidence of any shortage of funds based upon prevailing interest rates and levels of demand and upon the prevailing perception of the risks involved. Yet, the problem persists.

74 This was in its response to the 'Future of Finance' report that it had commissioned. See: H. van Steenis, 'The Future of Finance Report', BoE (June 2019). [Link](#)



The British Business Bank is now seen by some as part of the answer, and a more proactive role for it is welcome, particularly where it co-invests and crowds in private capital.

This should be seen alongside a wider set of measures, explored below – including incentivising UK pension funds to allocate more finance to domestic firms, reforming listing rules to encourage companies to go public in the UK and a renewed embrace of popular capitalism, using tax relief and ownership incentives to broaden participation and unlock new sources of investment.

Ultimately, closing the UK's funding gaps will require a system-wide alignment of incentives, institutions and regulation to ensure that domestic capital is mobilised more effectively in support of national growth. This must also include greater alignment with regional investment priorities, to address geographic disparities in access to finance.

A sovereign wealth fund is sometimes advocated, in response to the growing role of state capitalism elsewhere, but this is not a viable option for the UK. There is no obvious stream of surplus income to capitalise such a fund and it would not be prudent to fund it through higher taxation.

**‘ Not only has the number of listings fallen since 2008, but the composition of the London market resembles the old economy: industrials, banks and consumer staples ’**

## Make life easier for listed companies

The City is far more than just its stock market: it has broad-based strength in capital markets, derivatives, foreign exchange and international banking, among others. Yet the stock market is one area that is currently receiving much attention, in terms of its ability to both raise finance for UK firms and to boost retail ownership of shares.

Consider listings. All stock exchanges face challenges in terms of firms increasingly opting to stay private rather than go public, but London faces the additional challenges of a lack of liquidity and the increasing attraction of other centres not just in New York or but across the Middle East or Asia.

The debate has received much focus in recent years, most notably with Lord Hill's Listings Review in 2021.<sup>75</sup> As Hill highlighted, it is significant not only that the number of Initial Public Offerings has fallen since 2008, but also that the composition of the London market resembles the 'old economy': namely, industrials, banks and consumer staples. The London stock exchange needs to be reflective of the economy of the future.<sup>76</sup>

More than this, Hill noted the wider economic benefits of strong public markets for the economy, risk and savings, with firms finding it easier to raise funds to grow and invest, plus providing greater opportunities for investors from the UK and overseas. Both are critical and the latter helps to feed the former. The latter includes closing the patient capital and growth capital funding gaps and liberating the UK's deep pools of insurance and pension capital.

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75 HMT, 'UK Listing Review' (March 2021). [Link](#)

76 Paul Marshall has likened the UK stock market to Jurassic Park. See: P. Marshall, 'London is becoming the Jurassic Park of stock exchanges', *Financial Times* (1 December 2021). [Link](#)





Hill focused on reforming the rules governing how companies can raise finance on public markets in order to encourage more firms to list and grow here. This was followed by the 2022 Austin Review which outlined further ways to improve London's position, including making it easier, cheaper and speedier for firms to raise money on the stock market for their growth plans.<sup>77</sup> Both Hill and Austin had a strong focus on retail investing. Promoting savings – including ISAs, which are held by 22.3 million – and directing the money into UK stocks could be an extension of this.

The issues surrounding listings are not new. Writing in 2018 I noted that 'keeping as many global players in the FTSE 100 index as possible is important for London and should be a priority' and that 'as more of global growth comes from outside Europe, competition between big equity indices will intensify'.<sup>78</sup> At that time, the focus was on Unilever and its dual-listing, including unifying to enjoy the economies of scale from one listing.

Since then, the issue has become the focus of much attention, not least Rachel Reeves's latest proposals, which have been accompanied by a messy debate over the extent to which government should nudge, shove or simply compel investors to assign capital to particular asset classes. But at a bare minimum, the recommendations of both Hill and Austin should be implemented with all speed.

**‘ A new popular capitalism could and should  
involve boosting national savings ’**

## Popular capitalism 2.0

The previous section covered listings, but this is in fact a much broader agenda. As Robert Colvile argued in a CPS report in 2019, we need a wholesale restoration of the concept of popular capitalism, embraced by the Thatcher government in the late 1980s.<sup>79</sup>

A new popular capitalism could and should involve boosting national savings, directing more money into UK companies, seeing them grow and reducing the economy's vulnerability to its large current account deficit. Encouragingly, significant progress has already been made through the development of personal pensions and ISAs, which now provide a solid foundation on which to build.

The first aspect of popular capitalism 2.0 should ideally be for UK pensioners to see more of their pension assets invested in the UK equity market. But this should not be by compulsion but because of choice, based on an improvement in prospects for the UK.

The 2023 Mansion House Reforms<sup>80</sup> and the updated version in 2025, alongside the recent Leeds Reforms, are valid attempts to encourage more UK pension fund money to be invested in the stock market. While it is important that these reforms gain traction, the valid pushback is that they should not challenge the fiduciary responsibility of pension fund trustees.

77 HMT, 'UK Secondary Capital Raising Review – July 2022' (July 2022). [Link](#)

78 G. Lyons, 'Sense and flexibility could keep Unilever in the FTSE 100', *Financial Times* (20 September 2018). [Link](#)

79 R. Colvile, 'Popular Capitalism', Centre for Policy Studies (September 2019). [Link](#)

80 HMT, 'Chancellor's Mansion House Reforms to boost typical pension by over £1,000 a year' (10 July 2023). [Link](#)



One area that should be revisited is the tax and regulatory changes made by Gordon Brown. In the late 1990s, UK institutions held around half of UK-listed equities; today, that figure is around 4%.<sup>81</sup> The turning point was the removal of the dividend tax credit for pension funds in 1997, a change that amounted to a de facto tax raid.

The accompanying regulatory shift compounded the damage. Funds were steered away from equities – deemed too risky – and pushed towards gilts and fixed income, which were considered safer. This risk-averse framework was later entrenched through rules requiring funds to match assets and liabilities annually.<sup>82</sup> In practice, equities delivered superior long-term returns – which were denied to millions of British savers.

Another priority should be cutting or simply abolishing stamp duty on shares, to boost liquidity. Modelling by Oxera for the CPS in March 2024 outlined the boost to liquidity, equity valuations, pension pots, business investment and GDP, as well as the competitiveness of the London market, that would follow, noting: ‘The UK puts itself at a major competitive disadvantage by imposing a 0.5% transaction tax on a wide range of share purchases, in the form of stamp duty on shares. This is in contrast to our major international rivals who do not impose such a tax.’<sup>83</sup>

‘ We need not only to protect  
ISAs but to promote them ’

## Other aspects of popular capitalism

There are a number of features that could help enhance popular capitalism 2.0. First, it has to tie in with increased home ownership and addressing the housing crisis, which is covered below.

Second, encouraging individuals to take greater control of their finances should be a central goal, supported by policy reform when possible. This includes widening access to investment opportunities and removing unnecessary barriers to participation.

Today, 22.3 million people hold an ISA. The typical ISA holder earns between £20,000 and £29,999 per year, with an average ISA value of £31,014; equivalent to a year’s salary. This shows both the reach and importance of ISAs to middle income savers.

There is a growing narrative that views ISAs as a cost to the Exchequer. In 2022/23, HMRC estimated that £4.3 billion would have been collected if ISAs did not exist. But this framing presumes that government is automatically entitled to tax savings. It’s the person’s money, not the government’s. It also risks double taxation of savings, which acts as a disincentive to long-term saving. We need not only to protect ISAs but to promote them – and in particular to incentivise or persuade people to move more of their savings into stocks and shares, rather than keeping them locked up in cash.

81 H. McRae, ‘Time to fix Gordon Brown’s pension errors’, *Money Lowdown* (4 February 2024). [Link](#)

82 This contributed to the Liability-Driven Investment (LDI) crisis in 2022.

83 G.B. Lyons & R. Colville, ‘Sharing the Wealth’, Centre for Policy Studies (March 2024). [Link](#)



Simplifying the tax code, especially around savings and investment vehicles, could be another enabler of popular capitalism. The current system is too complex, deterring engagement and eroding trust. Greater clarity and stability would give savers the confidence to plan for the long term.

Reducing the costs associated with saving should be another priority. The pension and wealth management industries are too often opaque and expensive. High upfront fees deny people higher savings and cumulative returns. It should also be easy and quick for people to transfer their pensions. Greater openness on charges would allow people to make informed choices.

All of these reforms should consistently aim to foster a long-term savings culture, including through public education, national campaigns and behavioural nudges in policy design, such as the demonstrable success of auto-enrolment in workplace pensions. These efforts would help embed the discipline and expectation of saving across the population. Lessons should be drawn from countries where savings are higher or people seem more engaged with their pension plans, such as in the US.

**‘ Asset ownership remains heavily concentrated among older cohorts, while younger people face high housing costs, student debt and limited savings ’**

Improving financial literacy must also become a national imperative. Yet knowledge alone is not enough. According to the Financial Conduct Authority, around 12.9 million adults – one in four – have low financial resilience, meaning they have little or no savings and would struggle to absorb a financial shock. For them, the challenge is not only education, but income and stability.

Popular capitalism today must also address the intergenerational divide. Asset ownership remains heavily concentrated among older cohorts, while younger people face high housing costs, student debt and limited savings. That requires targeted interventions, encouraging the industry to develop products, or matched government contributions for those under 40, to build participation and ownership.

Additionally, crypto-assets, digital currencies, tokenised securities and fintech are reshaping how finance is organised, executed and who participates. The UK needs to continue to prepare for how this will impact popular capitalism, monetary and regulatory policy and the City’s competitiveness.

These measures, together with those broader reforms to revitalise the UK stock market – such as modernising listing rules, streamlining regulation and incentivising pension funds to invest more in UK equities – could form the basis of a new era of popular capitalism. Above all, success depends on creating a stronger economy, higher real wages and renewed public confidence.



## 5. Developing a Policy Agenda

There is no shortage of international examples of economies that have reversed their fortunes and achieved sustained growth. The Asian Tigers, notably Singapore and South Korea,<sup>84</sup> are cases in point. While these economies benefited from the momentum of catching-up and escaping low-income status, their continued success and the durability of their income per head underscores a critical truth: long-term competitiveness demands consistent investment, especially in human capital and innovation. (Of course, they may face different challenges, as South Korea's declining fertility highlights, but this is not to miss the point)

So, what should politicians' priorities be, as they try to plot the revival of the British economy?

The three foundations outlined above offer a set of core principles for economic management. But our leaders need to prioritise those measures that will make the most impact. In particular, at a time when the UK risks falling into a debt trap and when the prevailing economic consensus has demonstrably failed to deliver the competitiveness and per capita growth the country needs, there can be no room for 'everythingism'.<sup>85</sup> We must be ruthless in prioritising higher GDP per capita and accept that this inevitably involves trade-offs.

**‘ Few advanced economies have fully recovered from the aftershocks of the 2008 global financial crisis. Yet two notable exceptions stand out ’**

We can see the value of this approach elsewhere. Few advanced economies have fully recovered from the aftershocks of the 2008 global financial crisis. Yet two notable exceptions stand out: the US and Ireland. In the US, the dynamism of Silicon Valley and its broader ecosystem show the value of being at the frontier of technological change, removing regulatory obstacles and facilitating a pro-business environment. Ireland's success, meanwhile, highlights the role of a competitive corporate tax regime in attracting investment and the centrality of education in lifting national competitiveness.

These examples are not blueprints. But they illustrate the value of focused, strategic policy as opposed to the risks of fragmentation and drift.

Given that the strategic goal is to boost GDP per capita, this should guide all policies: will they drive growth now or in the future?

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84 Roger Bootle and James Vitali discussed a range of countries in: R. Bootle & J. Vitali, 'Economic Transformation: Lessons from History', Policy Exchange (March 2024). [Link](#)

85 J. Hill, 'Everythingism: an essay', Reform (March 2025). [Link](#)



This incorporates sustainability, as noted below. It is important, however, to be cognisant of the six capitals approach, which broadens the focus on how value is created, informs investment priorities and underpins an approach to measuring national wealth with a focus on physical assets, net financial capital, natural capital, intangible assets, human capital and social and institutional capital. Valuable as this wider perspective is – reinforcing the importance of stakeholders and sustainability – it must not distract from the central objective: restoring economic growth in order to raise living standards.

## Lessons from the 1980s

In crafting such a policy platform, some of the most relevant lessons come not from overseas, but from our own past. During the Thatcher period, leadership was central, but so too were clarity of purpose, a coherent set of principles and the careful sequencing of reform. Above all, there was a determination to confront the most pressing challenges of the time head-on.

In Thatcher's case, the twin challenges were inflation and trade union power – which were deeply interlinked. She entered office in the aftermath of the 1978–79 Winter of Discontent with a clear mandate to tackle both.

**‘ The most important point about the 1980s is that the government held its course ’**

A combination of factors led to an initial surge in inflation: a sharp rise in oil prices, large public sector pay settlements as she honoured the Clegg commission's awards and the near doubling of VAT in Geoffrey Howe's first Budget, which was also notable for the abolition of capital controls. Monetarism provided the theoretical framework, but came with a very high economic cost: the initial approach brought sharply higher interest rates and a stronger pound, which contributed to deindustrialisation, deep recession and rising unemployment.

The 1980s were a painful period of transition for the UK economy. Regional policy was missing, leading to lasting scars in some areas, both as a legacy of deindustrialisation and the 1984–85 miners' strike. Compared with that period, when the focus was on turning around loss-making industries, there is also now greater awareness of the case for protecting strategic industries if it may be in the national interest – though the boundaries of such protection must be tightly drawn.

But the most important point about the 1980s is that the government held its course. Years in opposition had been used to prepare for power, including through the CPS's *Stepping Stones* report. Thatcher and her Cabinet resisted mounting calls for a U-turn despite rising public anger and economic pain. What mattered was clarity of policy purpose, even in the face of adversity. Debt reduction and curbing the size of the state were integral to her medium-term financial strategy – but the success of her economic policy also rested on a wider supply-side reform agenda.

Another defining lesson from this period was the willingness to challenge consensus. Nowhere was this clearer than in 1981, when 364 economists wrote to *The Times* to condemn the Budget. Ironically, that Budget marked the economic turning point, aided by a subsequent loosening of monetary policy. Proactive leadership also meant shaping the intellectual terms of debate, rather than following the accepted consensus.

Nigel Lawson's 1984 Mais Lecture exemplified this, challenging orthodoxy with its assertion that 'it is the conquest of inflation and not the pursuit of growth and employment, which is or should be the objective of macroeconomic policy. And it is the



creation of conditions conducive to growth and employment and not the suppression of price rises, which is or should be the objective of microeconomic policy.<sup>86</sup>

Privatisation was referred to as the jewel in the crown of the Thatcher years and the popular perception is that it evolved by chance during her time in office. Yet, as Lawson makes clear, Thatcher had a 'fear of frightening the floating voter'. Indeed, in the minutes of the founding meetings of the Centre for Policy Studies there is a commitment to avoid discussion of 'denationalisation', as it was then called – not because those present did not believe in it, but because of the need to ruthlessly prioritise and to acknowledge the limits of the politically possible. That is something that needs to be borne in mind now when thinking about institutional reform, or policy on issues such as the NHS.

In short, turning an economy around is not without precedent. Leadership is essential, but so too is clarity of purpose, anchored in coherent principles. Success demands a willingness to confront the key issues directly, to sequence reforms intelligently and to pursue clearly defined policy objectives, even when that means challenging prevailing orthodoxies.

**‘ Turning an economy around is not without precedent. Leadership is essential, but so too is clarity of purpose, anchored in coherent principles ’**

## The Three Foundations and the Immediate Challenges

By the time of the next general election, the dominant issues are overwhelmingly likely to be debt and GDP per capita – which, of course, are again interlinked. I believe there are five policy priorities that politicians should address, informed by the three foundations outlined above:

- (a) Controlling immigration,
- (b) Reducing energy costs
- (c) Addressing the housing crisis
- (d) Rejecting harmful wealth taxes
- (e) Enhancing Britain's global resilience

### **a) Controlling immigration**

Immigration lies at the heart of the UK's economic and political debate. As we now see, scale and legality are the two key issues in the present debate. Immigration is good for an economy if it is targeted and controlled. For migration to be a net economic positive, the UK must control the numbers and ensure that it allows in those that the country needs, not just those that wish to be here. The current scale of legal migration is too high, while illegal immigration should be stopped. Of course, one cannot blame migrants for coming here if it is to work or join their family. Rather, it is the UK's policy that needs fixing.

A healthy economy needs a skills-focused, economically aligned migration policy. That means attracting skilled global talent in sectors such as academia and business and professional services, among many others. This might be because the UK wishes to remain a world leader in these areas, or to address skills shortages, while also investing more generally across the economy to reduce dependence on imports of labour.

<sup>86</sup> See pp.414-415 of Nigel Lawson's memoirs, which are required reading to understand the economic policy and context. N. Lawson, *The View from Number 11* (1992).



The scale of inflows has brought the costs into sharp focus. The CPS's recent report 'Taking Back Control' sets out the case clearly: high immigration strains public services, fuels housing demand, suppresses wage growth and disincentivises employers from upskilling their existing workforce or investing in automation. The impact on the domestic population has been significant. It is wrong to see immigration as the answer to the UK's growth challenge.

Immigration must be controlled. But low migration does not mean no migration. Increasing GDP per capita will still require some immigration, for if we are to be a fast-growing – or at least a faster-growing – economy then we must be open to the best talent, particularly in our globally competitive sectors.

At the same time, there is a need for the economy to onshore as much of its skills base as possible. That is, to invest in the domestic economic stock.

**‘ Successive governments have treated immigration as essential to filling skills gaps and sustaining growth. But why can we not fill more of these roles ourselves? ’**

Instead, successive governments have treated immigration as essential to filling skills gaps and sustaining growth, as reflected in OBR forecasts. Yes, targeted immigration can help address genuine skills shortages. But why can we not fill more of these roles ourselves? Recruiting doctors from emerging economies to meet rising domestic demand may be expedient, but we could also train more at home, as every other similar country does. Similarly, large employers favour migration because it fills immediate needs.

In their June strategy report, the Government noted a fall in new apprenticeships in engineering, while visa for engineering professionals continued to rise. Plus, it noted, in 6 of the 10 sectors seeing the 'highest change in payrolled employment of non-EU nationals have been correlated with declines in UK employment.'<sup>87</sup>

But the alternative would be to pay more or invest in domestic skills or productivity-enhancing machinery. Too often, the focus on migration allows us to overlook how little the UK invests. One of many examples is in terms of robot density.<sup>88</sup> The UK is in 23rd place among the leading nations, with 119 robots per 10,000 workers in manufacturing. South Korea leads the world with 1,012. Germany is fourth, with 429 industrial robots per 10,000 workers and Italy 14th with 228. Admittedly this is solely for manufacturing, but it makes the point. Per capita investment in the UK has been low for some time. In addition, the UK needs to upskill its domestic workforce.

The UK must avoid both extremes: uncontrolled migration that fuels instability and overly restrictive rules that choke off growth. For example, I would argue that there is a strong case for removing international students from immigration figures – they provide a clear economic benefit. But dependents must be restricted. The UK, by contrast, opts for a low-cost solution, based on cheap migrant labour – including high numbers of health and care worker visas.

The scale of migration impacts wider aspects of the economic debate, so as the population rises, joined-up policy thinking should ensure that housebuilding is boosted, too. Another good example of the issues at play here is social care. If

87 Home Office, 'Restoring control over the immigration system' (12 May 2025). [Link](#)

88 IFR, 'World Robotics - Industrial Robots', World Robotics 2024 (2024). [Link](#)



one looks at best international practice, Japan's Society 5.0, it shows a focus on investment and technology. The UK, by contrast, opts for a low-cost solution, based on cheap migrant labour.

One has to question the long-held view that migration is a fiscal positive. The OBR tended to find that skilled workers had a positive fiscal impact but more recently, concern has been raised about unskilled workers, in particular if one looks beyond the five-year timeframe that covers the OBR's forecast cycle. The speed and the scale of recent migration adds to this.

Given this, there is a need for a complete reassessment of the total fiscal benefits of immigration, especially when one takes into account family members, those who qualify for an Indefinite Leave to Remain (ILR) and then citizenship and who do not work – and to draw policy implications from these results, given the economic need to now raise GDP per capita. Given the scale of the debt problem, these issues can no longer be ignored. For example, the UK needs a full audit of net migration for clarity on whether high-skilled migrants have left and it is low-skilled migrants with dependents who have remained, or vice versa. We should also learn from places like Dubai, Singapore, and even the US, where work related visas are clearly separated from citizenship and welfare entitlements. There must be a fundamental shift in immigration policy so that Indefinite Leave to Remain should no longer be a backdoor to full citizenship and benefits. The focus must return to work permits – people come to do a job, are welcomed, then return home.

In short, immigration must serve the national interest, rather than being used to avoid difficult domestic reforms. The case for action is clear: reduce immigration significantly and cap overall numbers, prioritise high-skilled migration, ensure a positive net fiscal contribution and maintain public trust. A credible, enforceable and balanced immigration policy is essential to long-term economic success and social cohesion.

**‘ The focus should not be on energy substitution, but energy addition – as it is in many other countries that are also moving to renewables ’**

#### **b) Reducing energy prices, via energy addition rather than energy substitution**

The UK has a legal mandate to meet a Net Zero target by 2050. It has already reduced emissions to half of their 1990 level. Under the seventh Carbon Budget, they are set to fall over coming years to a quarter of today's total and thus end up 87% lower than in 1990.

In other words, by international standards, the UK has been a leader in reducing carbon emissions. But the pace of current plans represents a dramatic change. The challenge of the UK approach is that the cost of transition to Net Zero is not only very high energy prices now, but the likelihood that they will remain high.

Achieving strong economic growth is not possible if energy costs stay high. As one of the most important input costs across all sectors, energy must be at a competitive price. Not only that, but the longer energy costs stay high, the more it will deter future investment in energy-intensive and growth-important areas such as tech, AI, data centres and robotics.

Yes, we must protect the environment and ecology and not ignore the risks of not doing so. But our aim should be to align environmental goals with affordable and reliable energy. This needs to be achieved without damaging the economy, via high costs that it cannot bear.





The focus should therefore be on energy addition, not energy substitution, as it is in many other countries that are also moving to renewables. The economic theory is that as the cost of renewables falls and technology advances – notably storage – this allows their reliability to improve, and they will displace fossil fuels, eventually substituting for them. By contrast, the UK is moving towards substitution now, when renewables are unable to provide baseload and at the expense of high energy costs.

It takes considerable time, and may not be fully possible, to move from a fossil-fuel economy, while meeting domestic energy needs. Moreover, the cost of transition for the public can be high, if carried out over too short a time-period. We do not have sufficient storage and thus given our marginal cost pricing structure, the cost of nationwide energy is set by the marginal cost we pay for imported gas, at a time when demand for that is high globally. Even as gas prices have fallen recently, this has not been fully reflected in UK energy bills, in part due to high system costs because of intermittent renewables.<sup>89</sup>

There is a strong case for renewables and continuing to invest in them, but the energy mix needs to be diversified and thus we should add to our supply – certainly with nuclear. In October 1979, Mrs Thatcher’s first energy minister David (now Lord) Howell proposed a new generation of nuclear plants to prepare for the new energy future. In the event only one was built – at Sizewell B – and that took 15 years to start operating. If only we had proceeded then, as Howell himself now points out, the current energy scene would be both greener and less vulnerable to shocks.

**‘ Even as gas prices have fallen recently, this has not been fully reflected in UK energy bills, in part due to high system costs because of intermittent renewables ’**

Soon Sizewell B will be the only one of the old plants operating – to be then joined by the expensive Hinkley Point and then one further mega-plant, Sizewell C. We should instead add to our nuclear capability via smaller and faster-constructed nuclear reactor models. These can be factory-fabricated and – in theory – ready in around three years. These should go on existing sites, but also new sites, closer to urban areas.

While the focus should be on a diversified supply including renewables and nuclear, plus storage, there are other things we could do to deliver energy abundance and affordability. Investment in the North Sea has been subject to erratic tax policy and now to legal challenge. Trouble is, we can’t move from a fossil fuel economy overnight and thus the North Sea can’t be ignored. Given the current importance of gas, we should invest more in storage. We should focus on technology and lowering the cost of batteries and carbon capture and storage (CCS) technology.

At a global level, the UK alone cannot reduce carbon emissions, but we can exercise global influence, via policy fora and through making the City of London the centre for global green finance. That could help reduce the cost of capital for the green transition across emerging economies, while supporting our economy. Indeed, while US financial institutions appear to be adopting a more cautious approach, there is an increasing number of funds looking to invest in green assets. The City of London is in a strong position to establish itself as the default avenue for capital investment not just in the UK, but globally.

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89 See: D. Helm, ‘The price of energy and the system costs of renewables’ (26 August 2025). [Link](#)



### c) Building houses and help Generation Rent become Generation Buy

At this point, it hardly needs saying that Britain has a housing crisis. But this is not just a crisis of housing. It is a crisis of productivity, growth and family formation too. In other words, it makes all our other problems worse.

That may sound like an exaggeration. But the shortage of homes pushes up housing costs, reduces labour mobility and fuels intergenerational inequality. It is also hitting fertility. According to ONS data for England and Wales, the number of births is at its lowest since 1977. The fertility rate is 1.44, the lowest since records began in 1938 and far lower than the reproduction rate of 2.1. And people are having their first child much later than in the past, with the average age of first-time fathers hitting 33.8 and mothers 30.9.<sup>90</sup>

The housing crisis needs to be addressed both to help the economy and to ease pressures facing young people. The UK needs more homes, faster turnover in the market and reforms to planning, land use and housing finance. Politicians need to make life more affordable for younger people who wish to buy property and start a family: to help Generation Rent become Generation Buy.<sup>91</sup>

How can we do this? There are three issues: supply, finance and demand.

New supply is starting to be addressed, but there is a huge shortfall to make-up: the CPS recently showed that Britain is 6.5 million homes behind the European average in terms of homes per capita.<sup>92</sup>

#### ‘ The UK needs more homes, faster turnover in the market and reforms to planning, land use and housing finance ’

The easing of planning reforms needs to be embraced fully at local authority level. Crucially, housing policy must be aligned across planning, infrastructure and land use. These cannot operate in silos. The green belt cannot be protected at all costs – such an approach ignores economic and social realities. Local authorities cannot keep acting as NIMBYs, opposing housebuilding. Opposition by politicians in Westminster, too, on the basis that houses should be built on brownfield sites, ignores the scale of the challenge: there is a need for large-scale building where people want to live, often in London and the South-East. Home building needs to be where the jobs are and where people want to live.

Where development is necessary, however, it must be sequenced intelligently, with infrastructure – transport, schools, healthcare, utilities – planned and delivered alongside, or in advance of, new housing. (It is interesting to note that HM Treasury thought Canary Wharf would not succeed and so opposed public funds to extend the Jubilee Line, yet the lesson is that putting the infrastructure in place first acts as a magnet for private-sector interest.) The current approach of adding homes in locations where infrastructure is already overstretched is counterproductive. A joined-up policy framework is essential.

Addressing the supply problem is also about improving turnover in the housing market, through reducing or replacing stamp duty, which is an economically

90 ONS, ‘How is the fertility rate changing in England and Wales?’ (October 2024). [Link](#)

91 G. Lyons, ‘Helping Generation Rent become Generation Buy: Addressing housing market challenges’, Policy Exchange (February 2021). [Link](#)

92 B. Hopkinson, ‘How Many Homes Does the UK Need?’, Centre for Policy Studies (July 2024). [Link](#)



damaging tax on mobility including downsizing. As the Mirrlees Review made clear, it distorts the market and hinders efficient use of housing.<sup>93</sup> Council tax, still based on 1991 valuations, is outdated and regressive; reforming it would increase fairness and improve incentives to move. Overall, property should not be taxed more, but taxed better.

Linked to the supply problem are constraints in the construction sector, but these will take time to address. Expanding apprenticeships with some urgency should form part of a broader strategy to increase housing supply.

Finance is another major barrier, particularly for first-time buyers. We need to make it not only possible but mainstream for people with a reliable track record of paying rent to access 100% mortgage finance without deposits. Many renters can afford monthly mortgage payments but cannot save for a deposit, especially given that mortgage borrowing does not cover stamp duty. Prudential measures, too, should not penalise borrowers through stress tests that limit people's ability to borrow. Encouraging the development of longer-term fixed-rate mortgages would offer greater stability. Clearly, if measures to improve access to finance took place without more supply and improved turnover then prices might rise, reinforcing the need for joined-up policy addressing supply, demand and finance issues simultaneously.

Mortgage insurance, such as Canada's model of government-backed insurance for high loan-to-value mortgages, could also help lenders manage risk and support more flexible lending, although it is expensive. The UK's Mortgage Guarantee Scheme was a step forward but should evolve to encourage greater private-sector involvement and product innovation. Innovative financing models, such as blended mortgages and structured deposit alternatives, have been around for a while but often are knocked off track by policy interventions. Lifetime mortgages should also be expanded, offering flexibility for households over the life cycle.

**Many renters can afford monthly mortgage payments but cannot save for a deposit, especially given that mortgage borrowing does not cover stamp duty**

Although an immediate off-the-shelf policy option is not available, tax policies may be needed to help address the problems facing young people and make inroads into the fertility crisis, given that the cost of housing is almost certainly deterring some from starting a family. However, the Government should resist the temptation to pump up the market via demand-side interventions and subsidies such as the Help to Buy scheme.

On rent, the goal should similarly be to increase affordability through supply, not controls. Well-intentioned proposals like rent caps often have the unintended effect of reducing investment and restricting rental supply, ultimately hurting the very people they aim to help. And of course, we need to curb excessive demand by controlling immigration.

93 IFS, 'Mirrlees Review' (2010). [Link](#)



## d) Pushing back against new wealth taxes

Most of the proposals in this section, and this paper, are for things the Government should do. But it is worth spending some time on something it absolutely should not do, given the rumours swirling around the Autumn Budget – introduce new wealth taxes.

A wealth tax would be economically damaging, administratively burdensome and ultimately counterproductive. Although often framed as a response to rising fiscal pressures, such taxes consistently fail to deliver the revenues promised, distort behaviour and penalise saving, investment and growth. Worse, they divert attention from the deeper structural challenges in terms of public spending, economic inactivity and the need for long-term reform.

Few countries globally have a wealth tax, with the number in the OECD falling from 12 in 1990 to four now (including Colombia, who became an OECD member in 2020). Even in the other three – Norway, Spain and Switzerland – thresholds have risen and rates fallen.

This global retreat from wealth taxation reflects a hard-earned recognition that such taxes don't work. They fall disproportionately on those who are not internationally mobile – retired savers, small business owners, or households with illiquid assets – while the most mobile individuals and capital simply relocate. So the middle classes would be those with most to fear.

**‘Wealth taxes would result not just in lost revenue, but a damaging shift in the composition of the UK economy’**

Wealth taxes would also result not just in lost revenue, but a damaging shift in the composition of the UK economy. Britain would risk becoming a ‘domestic economy’: less open to international capital, talent and enterprise and more reliant on taxed domestic wealth and consumption. That is a path to stagnation, not renewal.

It would also send a negative signal about our outlook, disincentivising entrepreneurs and wealth creators, discouraging them from investing or creating jobs here. An efficient tax is one which does not impact behaviour. A wealth tax would precisely do just that.

This is not a defence of billionaires, but a focus on economic reality as to how policy would work. Interestingly, recent research for the Wealth Tax Commission, endorsed by Gus O'Donnell, which is often cited in favour of a wealth tax, contains many reasons to oppose the very tax it is advocating.<sup>94</sup>

For a start, it accepts that it would be more effective to make existing taxes on wealth, such as capital gains tax, work better, as opposed to introducing a new one. It also acknowledges that even at a very low rate of wealth tax, one in six of those impacted could leave. As the report puts it, ‘at a tax rate of 1%, between 7% and 17% of the initial tax base would be lost to behavioural response. This is not a trivial amount.’

That research also found that for individuals with taxable wealth over £5 million, 87% is tied up in ‘business assets’. It acknowledged that ‘another problem category could be start-ups that are potentially profitable but loss-making in the early years’.

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94 A. Advani, E. Chamberlain & A. Summers, ‘A wealth tax for the UK: Wealth Tax Commission Final Report’, Wealth Tax Commission (December 2020). [Link](#)



A wealth tax would clearly act as a deterrent to those with the potential to create jobs, growth and future tax revenues. It would be both anti-business and anti-growth.

Another concern is double taxation. Indeed, the double taxation involved in the combination of capital gains tax, inheritance tax and wealth taxes would, over time, tend to limit domestic savings, investment and capital accumulation. The long-term result would be to reduce the UK's productive capacity, undermine financial resilience and discourage long-term planning.

There are also deep issues of liquidity and fairness associated with wealth taxes. An old argument against is that they would hit people who are asset rich but cash poor. Even its advocates accept that it 'may require acceptance of the need to force some additional borrowing and/or asset sales'.

Yet the economic reality is that imperfect capital markets mean it is often difficult for people to raise the cash value of their fixed assets, such as houses or precious items. Borrowing, or deferring tax liabilities, would be cumbersome and could depress asset prices – undermining property markets and, in turn, inheritance tax receipts.

The Treasury has always argued in favour of taxes where there is a clearly identified income stream, making them easier to collect and harder to avoid. That is clearly not the case with a wealth tax.

**‘ The truly wealthy can manage their estates through long-term planning. Middle-income families typically cannot ’**

The administrative burden would also be significant. Unlike income, which is transparent and traceable, wealth is often hard to value and easy to shift. Implementing a wealth tax would require annual valuations of illiquid assets and create strong incentives for avoidance, reclassification and emigration. Worse still, if applied at a rate high enough to raise material revenue, it would amount over time to a slow expropriation. A recurring wealth tax of 2% would see the state appropriate the full value of a person's assets in under 50 years.

Alternatively, if imposed at a lower rate – one that households might realistically be able to pay – the revenue raised would likely be minimal, raising the question of whether the disruption would ever justify the return. As history shows, wealth taxes often underperform fiscally while damaging the credibility and predictability of the wider tax system.

These concerns are mirrored elsewhere. Inheritance tax, for example, often penalises those who are not wealthy enough to avoid it. The truly wealthy can manage their estates through long-term planning; middle-income families typically cannot. Raising IHT thresholds would reduce the burden on ordinary households and restore some basic fairness. Likewise, high stamp duty on property discourages mobility and distorts the housing market. Recent changes to non-dom taxation have also sent a poor signal to international investors, reinforcing the perception of a system that punishes mobility and discourages wealth creation.

A wealth tax would reinforce this perception. It would increase the complexity and volatility of the UK tax system at precisely the moment when clarity, stability and competitiveness are needed most. Yes, a progressive tax system is the right approach to take. But in a globally competitive economy, over-taxing mobile assets like skilled labour and multinational firms risks driving talent abroad and deterring



investment. Even Denis Healey acknowledged, looking back on his time as Labour Chancellor in the 1970s, that ‘we had committed ourselves to a wealth tax, but in five years I found it impossible to draft one which would yield enough revenue to be worth the administrative cost and political hassle.’ Perhaps just as well. Ireland, which did impose a wealth tax in 1975, abolished it in 1978.

It is clear to everyone that the Government is planning to raise taxes in the autumn, not least in the wake of its recent U-turns on Winter Fuel Payments and curbing the growth in welfare spending. But the talk about wealth taxes – and more taxes in general – risks a repeat of the second half of last year, when confidence was sapped as households and businesses braced for a Budget focused more on tax increases than growth.

Rather than confronting the root causes of fiscal strain – weak growth, the need for a comprehensive reform agenda and a failure to curb rising public expenditure – there is a drift toward new taxes as a short-sighted and misdirected response.

The UK’s future prosperity will be secured not by taxing wealth more, but by creating the conditions for more people to generate it.

‘ In an uncertain world, an increased focus on resilience and risk assessment is necessary at the heart of Whitehall ’

#### **e) Enhancing Britain’s resilience in an uncertain world**

The bulk of this paper has focused on economic management. But an economy cannot be managed in isolation. An open economy such as Britain’s will always be influenced, for good or ill, by what is happening elsewhere.

In particular, to boost GDP per capita – one of the core tasks outlined above – the UK needs to reposition itself in the changing and growing global economy, so that it is more competitive. There are many facets to this.

Having a good working relationship with the EU is sensible, but should not come at the cost of policy freedom. Thus, remaining outside the single market and customs union is critical. This is all the more important given the need to pivot our trade and investment strategy decisively toward the growth economies of the future. There is a shift in the balance of economic power towards the Indo-Pacific, where the bulk of future economic growth will emanate. We are already moving to a G3 world, with one group being the US and its allies, another China and its partners, and a third the global South, sometimes called middle-ground powers, including many Commonwealth countries with whom the UK should work on deepening economic ties.

Obviously, when it comes to the US, we should seek to maintain close economic ties; the Government is to be congratulated for navigating President Trump’s tariffs with relative aplomb (thanks, in large part, to the freedoms granted by Brexit).

When it comes to China, the Government’s approach is to cooperate, compete and challenge. But the unsaid ‘C’ is consistency – which would provide the clarity that businesses need. Just as critics of deeper engagement must acknowledge the economic upside of trading with China, so too must advocates recognise the national security concerns. The future relationship may require a clear and explicit red line. This would help firms plan ahead and reflect the complex task of calibrating the tension between economic and strategic imperatives. In my view, on one side of



the line should sit sensitive sectors where the UK aligns firmly with the US, such as defence, security and intelligence. On the other side should be areas to encourage relations, such as trade, business and finance.

**‘ Just as there are regular strategic defence reviews, so there is a need for a rigorous and institutionalised process of cross-government economic risk assessment ’**

More broadly, in an uncertain world, an increased focus on resilience and risk assessment is necessary at the heart of Whitehall policymaking. This calls for a step-change in strategic thinking. Strategic resilience must become a central organising principle of national policy – identifying where risks could emerge and the narrative and the policies that are needed to pre-empt this.

The UK therefore needs to embed strategic foresight across government. Just as there are regular strategic defence reviews, so there is a need for a rigorous and institutionalised process of cross-government economic risk assessment. That insight should inform both domestic decision-making and the UK’s role in international fora.

## 6. Longer-Term Priorities

There are four additional areas that warrant attention. I have left them outside the scope of this paper, as unlike all the issues outlined above, they may not be immediately deliverable but they are important and the process for addressing each of them needs to be started at some stage:

- **Bismarck versus Beveridge:** First, there is a need for a comprehensive overhaul of the current benefits system. In particular, the pros and cons of the Beveridge system need to be contrasted with alternatives, one of which is the Bismarckian system. The system needs to be affordable as well as send the right incentives. A Bismarckian system, based on contributions and also insurance-driven, would appear to work better – and might also act as a deterrent to excessive immigration. This may best be addressed through a Royal Commission.
- **Institutional capture:** Second, we need to address the issue of institutional capture and institutional reform. This is one of those issues for which it never seems to be the right time: institutional change can absorb much political capital, while reforming the political architecture when the country is about to face a debt crisis may not be the best way to keep the markets inside. The collapse of the Truss government has also tainted many of the arguments in favour of institutional change.

‘ Reform of the Treasury is needed – and indeed has been raised repeatedly, by figures ranging from John Maynard Keynes to Harold Wilson and Gordon Brown ’

Yet while any changes need to be handled with deftness, in particular in ensuring the financial markets have no reason to doubt the independence or effectiveness of our institutions, they still need to be made. The fundamental problem is that things do not work as well as they should. We need to address the groupthink, in-built bias and inertia that make it hard to pursue reforms. And we need more effective horizontal integration across Whitehall, so as to properly address the biggest challenges, like national security, AI or the green agenda.

What should these changes look like? Reform of the Treasury is needed – and indeed has been raised repeatedly, by figures ranging from Maynard Keynes in the 1930s to Harold Wilson and Gordon Brown. The Treasury is a super-ministry whose powers in other countries are split between different departments. There is a strong case for it to be split in two, with one department focused on budgetary control and one on economic strategy.

Similarly, sometimes it seems as if the Bank of England has become effectively an offshoot of the Treasury, which oversees and chairs every selection committee to choose the Court of the Bank, the governor, the deputy governors and members of every policy committee. There is as a result a revolving door from the Treasury to Threadneedle Street and further groupthink.





As part of the same reset, there is a strong case for the current opaque set-up to be replaced by a new Council of Economic Advisers, reporting into and advising both No 10 and No 11.<sup>95</sup> This group should focus on strategic policy, publishing an annual ‘State of the Nation’ report, with the aim of complementing rather than duplicating the work of the Treasury, Bank and the OBR.

- **University funding:** Third, we need to rethink the funding of universities. There have been a number of recent reviews of this area, but many issues remain. On the face of it, the UK is in great shape. In the June 2025 QS ranking of top universities, the UK had 17 in the top 100, with four in the top 10 (Imperial, Oxford, Cambridge and UCL).<sup>96</sup> This was up from the previous year and second only to the US. The UK also has a strong showing in the rankings of business schools. But the reality is that leading universities in other countries are now seeing significantly higher funding.

Yet in the UK, there has been deep reluctance to raise tuition fees, squeezing universities’ funding and/or making them more reliant on foreign money. The outcome of the 2022 Augar Review of student finance has not addressed the student debt problem. Debt is high by international standards, many students face high marginal tax rates early in their careers to repay loans at exorbitant interest rates and the new 40-year period over which loans are to be repaid seems excessive. There is also a widespread recognition that there is a long tail of courses and institutions that are not providing students with anything like the education they have been promised.

‘ Many students face high marginal tax rates early in their careers to repay loans at exorbitant interest rates ’

On top of this, there is the traditional problem that Britain struggles to scale up, and invest in, ideas coming out of its universities – a problem that is often as much cultural as financial.

At the heart of this debate are questions such as whether there should be fewer universities, given too many are offering the same generic degrees; and whether there is a need for greater excellence, which in turn may help to attract private sector funding. My position is that it should be possible to have centres of academic excellence for even the most obscure career or degree: as long as they are among the best globally, then they will likely attract funding. We also need to increase the numbers in vocational training and apprenticeships – and a sea-change in our thinking on AI (a repeated theme of this paper).

- **Position ourselves in AI:** Earlier, when discussing innovation, it was stressed how we should position ourselves in AI. The UK has a strong track record of early digital innovation – from computing to internet adoption – but has lagged in areas like full-fibre and gigabit infrastructure. We cannot afford to lag in AI. But this requires policies being aligned: lower energy costs, avoiding damaging tax policies, improving education and embracing a smart deregulation agenda. There needs to be clarity about how tax and labour regulation may be holding back this sector, and to address this. Business is already focused on this and the supply-side agenda outlined would reinforce this directly. Policy needs to be fully cognisant of how AI will impact different sectors.

95 The author has written a note on this, not yet published

96 QS World University Rankings, ‘QS World University Rankings 2026: Top global universities’ (June 2025). [Link](#)



On global benchmarks – including Stanford University’s and the Australian Strategic Policy Institute’s (ASPI) rankings<sup>97</sup> – the UK is often seen as third or fourth globally on AI, behind only the US and China and alongside India.<sup>98</sup> But we will not sustain that position if no one can afford to build data centres here, or indeed get planning permission for them.

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97 See the visual representation of 64 technologies in ASPI, ‘Top 5 countries visual snapshot (2019–2023)’ (28 August 2024). [Link](#)

98 ASPI, ‘ASPI’s two-decade Critical Technology Tracker: The rewards of long-term research investment’ (28 August 2024). [Link](#)



# Conclusion

The UK economy requires a fundamental reset. The priority has to be raising the rate of growth of GDP per capita.

This paper has set out a path to do that, based on three essential foundations: fiscal credibility, supply-side reform and a policy mix that delivers low inflation and financial stability.

In terms of Foundation One, debt must fall relative to GDP. Public spending must be controlled and better targeted. The tax system must be simplified and reformed to support long-term growth. Addressing the looming debt trap is essential.

Foundation Two focuses on the supply-side agenda of investment, innovation, infrastructure and incentives. We save too little, we invest too little. Supply-side policies are essential to raise the economy's potential growth rate. Moreover, if successful, such supply-side policies would also allow the neutral level for the future Bank of England bank rate to be lower, as the economy could grow at a faster pace before hitting inflation bottlenecks.

Foundation Three is the need for low inflation and financial stability and for the City to serve domestic growth. Popular capitalism could be part of this approach.

**‘ It’s not easy to share prosperity if it isn’t being created in the first place ’**

Free markets are essential, but they must deliver for the people who sustain them. A progressive income tax system remains important, but the real challenge and opportunity is to shift the economic and political narrative away from redistribution towards expanding the economy itself. It's not easy to share prosperity if it isn't being created in the first place. The immediate imperative on that front is to reward those in work, enabling them to keep more of what they earn and access affordable housing to rent or buy.

Adam Smith's *Wealth of Nations* highlighted the power of markets and the 'invisible hand'. His *Theory of Moral Sentiments* reminded us that values, institutions, morals and ethics matter too. We should speak of both hands: the visible one that provides confidence, stability and sound governance, helping to provide a sense of national and individual purpose; and the invisible one that drives growth through competition, innovation and reward.

To summarise the argument: the UK approach in recent years has been to tax, spend and borrow. Instead, we must save, invest and compete.



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