

Macmillan Lecture, Tory Reform Group, 30 January 2012

My old friend, Richard Benyon, came up to me in the division lobby last week and said, "I thought the Macmillan Lecture was something they got elder statesmen to do. You've gone straight from 'new kid' to 'old git' in only eighteen months." I was a little crestfallen. But then I looked to see who delivered the lecture in the last few years. And I thought to myself, "Well, Richard, if you want to call David Davis an old git, you're a braver man than me."

Since the New Year, politics has been dominated by a discussion of the extraordinary gains made by the richest people in Britain at a time when most people's disposable incomes have been caught in a vice. According to the OECD, the richest 1 per cent have seen their share of total UK income double from 7.1 per cent in 1970 to 14.3 per cent in 2005. The richest 0.1% have done even better, seeing their share go from under 2% to over 5% in the same period.

In the last few days, attention has focused on the pay of senior bankers. My colleagues Jesse Norman, Matt Hancock and Nadhim Zahawi have blazed a trail for the government through their analysis of the recklessness and greed that laid Britain's financial sector low.

Last week Vince Cable responded and brought forward measures to increase the transparency of senior executive pay packages and make it easier for shareholders to constrain them. I welcome this.

But I fear that this obsession with the incomes of the wealthiest is blinding us to the biggest economic challenge that our country faces.

It's not that I don't share the widespread dismay about vast bonus payments being awarded to those who take minimal personal risk and preside over companies with falling share prices. I too wish that senior executives could rediscover the idea that money is not the only currency of value: that the challenge, the prestige, the respect of one's peers, and the satisfaction of doing a difficult and important job well should count for more than another seven figure sum.

But we must be careful not to delude ourselves or dupe those who put us here: making a few bankers and company bosses a bit less rich is not going to make most people in Britain any better off.

From the moment it was set up by Peter Walker, the Tory Reform Group has understood that the Conservative Party can only prosper when it is serving the interests of the whole country. And Harold Macmillan knew that a government can only call itself 'modern and progressive' if it is actively helping everyone in society secure a better life for themselves and their families. So it should worry everyone in

this room that growth in the British economy has been steadily decelerating for 30 years.

According to a recent CBI report, the average rate of per capita GDP growth in Britain fell in successive periods between 1970 and 2009. It was 2.3% between 1970 and 1979. It slowed to 2% between 1979 and 1997, and to 1.5% between 1997 and 2009. This is decline by any definition.

Not surprisingly, this has hit most people's pay. According to the Resolution Foundation, while average wages rose by an annual 1.9% in real terms between 1980 and 2002, they only rose by an annual 0.1% in real terms between 2002 and 2008.

As much as we all enjoy the thrill of the chase when our prey is a feather-bedded banker, we in the political pack must not duck the really hard economic question. Which is why have people in low- and middle-ranking jobs not been able to secure a real increase in their pay for nearly a decade? And we must not dodge the really hard answer. Which is that the productivity of people in those jobs is falling behind that of their competitors.

According to the Office of National Statistics, the average output for every hour worked in Britain in 2010 was 23% lower than in the US, 18% less than in Germany and 16% less than in France. The Office of Budget Responsibility reports that productivity in the UK is still nearly 7% below its pre-crisis trend and is growing much more slowly than after previous recessions in the UK and than it is in other countries.

While this has had the beneficial side effect of limiting the increase in unemployment during the recession, lower productivity constrains the wages that people can demand. The only way that the real wages of workers can rise in the long term is if the productivity of each hour they work rises too.

That the productivity of British workers lags behind that of their European and American counterparts is not new. What is new is the undercutting of wages in all Western countries by the entry into an increasingly global labour market of a vast number of educated and ambitious young women and men who are willing to work much longer hours for much less money. And the fact that the competitive threat that they pose is no longer restricted to relatively low skilled jobs in factories producing low value consumer goods - like the paintbrushes that my business used to produce so profitably in Belfast before the Chinese pulled the rug out from under us.

China now turns out over half a million qualified engineering graduates every year. Although there is evidence that many of them are much less well prepared for real-

life problem-solving than their British or American counterparts, China is becoming more competitive in the manufacture of highly engineered products. Meanwhile, as Thomas Friedman and Michael Mandelbaum observed in their recent book, *It Used To Be Us*, the combination of the IT revolution and globalisation means that Indian graduates are now able to compete with us in the delivery of high value services like research and programming and graphic design. Ten years ago these things weren't tradable at all.

By bringing customers into immediate and direct contact with suppliers, who speak English as well as we do, and by making it possible for any amount of data to be sent quickly and cheaply around the world, the internet and broadband have allowed global competition to penetrate areas that were previously cosy domestic markets.

This process can only continue - and gather pace. Even as some Chinese and Indian graduates begin to demand higher wages, they will be replaced by a limitless army of ambitious new recruits to the global rat-race. In China, from its vast rural hinterland. In India and Brazil, from the huge number of young. And, around the world, from the next wave of rapidly growing countries like Malaysia, Indonesia, Vietnam, Columbia, Mexico, Turkey, Nigeria and South Africa.

This intensification of competition is entrenching a divide between a global superclass of the hyper-educated and well connected - and the rest. Those who have the skills and networks to gain and hold positions of power in globally integrated markets will receive rapidly rising rewards. While everyone else will face a daily battle to hold on to their job and maintain their current level of pay.

This is the greatest challenge to social justice in Britain over the next 20 years. Not the Coalition's cuts to public services and benefits, painful though many of them are. Not the upward spiral in the wealth and income of the top 1%, unjustifiable though much of it is. What really threatens the general wellbeing of the British people is the stalling of productivity growth and the certainty that the next 20 years will expose them to competition that is vastly more intense than anything we have ever seen. If we Conservatives want to show that we are truly progressive, improving the productivity of average British workers and the competitiveness of our economy should be our focus. For this is the only way in which most people's living standards will improve.

Fortunately, Britain is well placed to prosper in the next 20 years if we are clear-sighted and quick-witted.

Hoary cliché it may be, but it is still true to say that we start with huge inherited advantages: our mastery of English (the language of global communication and trade), our timezone (placed between the Americas and Asia and easily able to serve both in the same day) and our long history of international investment and trade.

Recent developments in our industrial base and employment patterns have also served us well. It is fashionable to decry the decline in the share of British employment and output accounted for by manufacturing. And it is certainly true that we need advanced manufacturing, fuelled by research, design and innovation, to make an important contribution to our future prosperity. Whether through global pharmaceutical giants like GlaxoSmithKline. Or local, family owned engineering firms like BGB Innovation in Grantham, which manufactures the control equipment for offshore wind turbines and sells it around the world, including to India and China.

But, much more than manufacturing, it is Britain's relative strength in tradable service sectors and in creative content production that puts us in a good position to exploit the ambitions and insecurities of Asia and Latin America's vast new middle classes.

OECD research by Homi Kharas in 2010 projected an increase in the global middle class (defined as people earning between \$10 and \$100 a day) from 1.8 billion today to 3.2 billion by 2020 and 4.9 billion by 2030. He forecasts middle class purchasing power to rise from \$21 trillion today to \$56 trillion by 2030 and expects 80% of this growth to come from Asia. If we can entrench our position as the people to turn to if you want to invest your savings, insure your property and educate your children, to hedge your risks, sue your business associates or be entertained, then the next 20 years will offer Britain opportunities unsurpassed since Francis Drake fell upon the Spanish Main.

Just because we start off in a strong position to capitalise on this burgeoning global middle class doesn't mean that we will end up bringing home the booty. The very same people that we want to sell to, will also be quick to take these markets away from us, if we fail to improve the speed of our ships and the sharpness of our cutlasses.

In their attempt to chart a course for the United States through the fiercely competitive currents that both our countries face, Thomas Friedman and Michael Mandelbaum provide a compelling, if slightly frothy, account of the dynamism that will be required for relatively well-paid workers from mature economies like ours to hold their own.

Whereas skills were once just one of a number of important factors underpinning the competitive position of an individual, a company or a country, they will for us in future be its most critical determinant.

But this doesn't just mean functional or technical skills like accountancy, law, engineering and computer science (which, though essential, will not be sufficient to make well paid Americans or Brits competitive against similarly qualified Indians and Chinese.) The key source of long term competitive advantage will lie in the overlaying onto those technical skills of what Tony Wagner from Harvard calls 'the three Cs': "critical thinking, effective oral and written communication, and collaboration." Because they are the key to creativity and innovation.

Nor should we neglect a fourth C, which appears to be more powerful today than ever: Michael Porter's concept of clusters. In a high wage economy like ours, competitive advantage cannot survive for long without constant innovation. And there is lots of evidence that this is much more likely to happen if the people working in a particular sector are also part of physically connected community, in which they, and the organisations they work for, can spark off each other, as rivals, partners, suppliers, customers and friends. With co-authors Mercedes Delgado and Scott Stern, Michael Porter recently established that in an increasingly globalised marketplace industries participating in a strong local cluster create new patents and jobs more quickly, and boost wages.

If these are the things that deliver rising productivity and sustained competitive advantage in the modern world, are we doing enough to put them in place?

We have made a strong start.

Without a sustained increase in business investment, Britain can kiss goodbye to any increase in labour productivity. So nothing is more important than the low long term interest rates won by George Osborne's plan to cut the Government's deficit and stabilise its debt.

Business investment is also deterred by the bureaucratic rigidity of our outdated planning regime. So it is essential that we press on with our planning reforms and do not allow the hysterical scare-mongering of latterday Luddites like Simon Jenkins to strangle developments that will boost living standards.

As the most important source of future competitive advantage will be the skills of our young people, everyone should welcome the government's commitment to education reform: the liberation of good teachers and good heads through the academy programme, the unleashing of educational innovation through free schools and University Technical Colleges, the focus on rigorous subjects through the English Baccalaureate and the investment of more money in the education of the least well off through the Pupil Premium. But students will in future need more time in school to acquire the mental and emotional equipment to compete. So it is good news that both Michael Gove and his Labour shadow, Stephen Twigg, think that we must increase the amount of total teaching time by extending the school day.

A modern economic infrastructure will also be vital if we are to make it possible for British businesses to compete. The Government has published well-targeted plans for massive investment in superfast broadband, in our energy networks and in new transport links like Crossrail and high speed rail. I fervently hope that, in 2012, David Cameron is able to persuade Nick Clegg of the case for expanding London's airport capacity. Because people who cannot get here easily will place their orders and make their investments elsewhere - and the resulting CO2 will still make its way into the atmosphere we all share.

These are the essentials. They should stop the slow decline of our economic performance, and maybe even reverse it. But we need to do more if we are to overtake our competitors. I will now sketch out three ideas to build on these foundations - and hope to develop a longer list of policy proposals in the months to come.

We need to do what we can to strengthen our existing industry clusters and facilitate the creation of new ones to catalyse innovation and cross-fertilisation. The Government's support for Tech City in East London is far-sighted but this emerging cluster of web technology businesses remains fairly small in scale. It is time to increase our ambition. In Oxford and Cambridge, Britain has two of the world's top seven universities, according to Times Higher Education's 2011 rankings. Each of them offers a deep seam of ideas, intellect and research for British businesses to mine. But, though 75 miles apart, they might as well be on separate islands. The old Varsity Line railway closed in 1967 and it now takes nearly 3 hours to drive from one to the other.

The Government should back Simon Wolfson's idea for a new motorway, following the existing routes connecting Oxford, Bicester, Milton Keynes, Bedford and Cambridge. It could be financed by a Docklands-style development corporation, that would build a new garden city somewhere along the way and create much-needed housing close to the best jobs. Silicon Valley is still the most productive industry cluster on the planet. Building the Oxbridge Brain Belt would be Britain's best shot at giving the Californians a run for their money.

With the country facing sluggish growth and widening inequality, we need a tax system that rewards the honest labours of working people and raises revenue in ways that supports economic development. Our Liberal Democrat allies want the Chancellor to use the revenues from a mansion tax to take more people on low pay out of income tax. While I endorse the broad objective of raising a tax on immobile forms of wealth to fund a tax cut that benefits the majority, the Liberal Democrat proposals would miss the target. We should instead introduce a Land Value Tax, which exempts farmland (that does not have planning permission) and people's main homes (except those with a land value of over £1 million) and from which business rates would be fully deductible.

New South Wales' Land Tax raises roughly 2 billion Australian dollars a year so a UK Land Tax could raise over £5 billion a year - and it would encourage productive use of under-utilised development land.

Instead of using the proceeds to increase the personal allowance, which would benefit those in work but not do anything to create jobs, we should cut employers' National Insurance - what the Chancellor rightly calls Britain's jobs tax. This would be the best way to boost employment and the living standards of working people.

A government's first duty is to its own people - and the Migration Advisory Committee recently found that immigration from outside the EU displaced 160,000 British-born workers' jobs between 1995 and 2010.

That's why I have always been a strong supporter of the government's move to reduce immigration. But, as I made clear in my book, *Which Way's Up*, we must not allow necessary action to root out widespread abuse of the student visa system to harm one of Britain's most important sources of future export earnings - our university sector.

There is now some evidence that this is happening - and I believe that the solution is straightforward.

Instead of counting all new students coming to the UK as immigrants for the purpose of our measure of net immigration, we should only count those students staying on to work here after their studies are complete. Student visa numbers should be removed from the immigration cap - and instead we should require incoming students to buy a £5,000 immigration bond, that would be repayable only after they have left the country at the end of their studies. In this way we can reassure British workers that their interests are being protected, while allowing our universities to do what they can to help the country pay its way in the world.

Policies matter. The ideas I have outlined would help boost our competitive position and I am sure that, between us, we could think of several more. But we will only be able to meet Britain's competitiveness challenge if everyone in the country does their bit.

For this to happen, we must articulate a clear and consistent vision of what a more competitive Britain would look like and instill in everyone a common understanding of what will be required of them if we are to achieve it.

Sometimes we sound a bit like a hospital consultant from the 1950s, the sort of character who would be played by James Robertson Justice. "You're fat," we say. "We're putting you on a diet." And we give the British people the dispiriting impression that there's nothing they can do - that they should just grin and bear it while we get on with unpleasant business of cutting their rations.

But Britain doesn't need to get thin, it needs to get fit. And, as any personal trainer will tell you, nobody can do that for you. The motivation, the discipline, the perseverance must all come from within. If we want our economy to grow again, if we want our national income to be honestly earned and fairly shared, if we want to take home more in wages than millions of equally qualified people around the world, if we want to hang onto paid maternity and paternity leave and protect our rights to an annual 28 days' holiday, if we want to benefit from healthcare that is high quality and free, if we want to live comfortably in retirement, if we want all these things, we need to ensure that we are a lot more productive than our competitors. And right now we are not.

Children will need to be in school a bit longer, and do more homework.

Students will need to go to more lectures and get better grades. We all need to work a bit harder and go the extra mile for the customers we serve. And the Government needs to do more to make sure that all of its policies are contributing to this new, national mission. To make Britain - and the British people - competitive once again.

In the year in which the world's best athletes will descend on London for the Olympics, people are asking whether Team GB has what it takes to win lots of medals. As foreign leaders fly here to attend the Opening Ceremony, they will also be asking if the British government and the British people are doing enough to help our country get fit for the economic competition that will shape the next two decades. No question is more important.

Let's make sure that we, the Tory progressives, can confidently answer, "Just you watch. Britain is on it's way back".