Having focused on austerity, we now need a Plan A-star for growth

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Comment

> One good way to reduce future budget liabilities is to raise the retirement age

CONFIDENCE is more important than gold and money". So said Chinese premier Wen Jiabao in March 2009, as the financial crisis was hitting hard. Now, moving into another stage of the crisis, his words may prove important for us to bear in mind.

As the Chancellor pointed out last Thursday, the UK still retains the confidence of international investors. Not only do we need to retain this, but we also need to boost confidence at home, encouraging more domestic spending. Increasingly the key issue around the world is where growth is going to come from.

Having focused on austerity for the last year, a pro-growth agenda is now necessary. I would call this Plan A-star, building on the credibility of the Chancellor's Plan A of reducing the budget deficit, which has worked. The aim is not to abandon what we have achieved, but to start thinking about investment in the UK's longer-term potential, and to use this as a spur to encourage firms to invest and people to spend.

After all, despite worries about global debt, UK borrowing rates are incredibly low. This allows the government to borrow for the economy's longer-term potential. Perhaps this can be funded by spending cuts, although at a time when international investors are in search of longer-term growth opportunities it may make more sense to seize the moment and invest now. Borrowing for targeted, longer-term infrastructure spending would also have the benefit of creating jobs, and would probably act as a magnet to attract more private investment into the regions.

The challenge otherwise is not only a sluggish recovery, but that when growth does return it is funded, once again, by consumer borrowing. Take, for instance, the independent forecasts from the Office for Budget Responsibility. While they see growth rising in coming years, an important part of this is a return to bad old ways, with UK household debt rising from £1.6 trillion to £2.1 trillion by 2015. That would be a rise from 160pc to 175pc of disposable income. Instead we need to see more investment-led growth.

Thankfully, UK monetary policy has proved to be an effective shock absorber for the economy. Last week's quarterly Bank of England inflation report pointed to interest rates staying low for some time. That is the right decision. As the Governor pointed out, some of the biggest challenges facing the UK now are external. Yet, at the same time, there is a strong domestic case to keep interest rates low. There is excess capacity, sluggish wage growth and broad money is falling on an annual basis. Inflation is set to fall. Not only that, but given the fragile state of demand another round of quantitative easing may prove necessary.

One area where policy may need to change eventually is sterling. A weak currency has been a positive policy development, but it has come at a price, as import costs rise. At some future stage we need to think differently. The UK cannot compete with emerging economies on cost, so we should think less about the benefits of a weak currency. Instead we need to focus on quality exports. We need to think global and focus on selling more into the high growth markets in Asia.

This will also reinforce the need for the economy to move up the value curve. The UK has many strengths such as its science base, high level skills, openness to international competition, effectiveness of regulation and competition regimes and expertise in many growth sectors such as nanotechnologies, life sciences, low carbon and advanced manufacturing. We have many successful and world-class industries such as financial services, creative industries, textiles, pharmaceuticals and aerospace. Imagine how much better we could do if we encouraged investment? Research and development spending, for instance, is only 1.9pc of GDP, far less than our major competitors.

Of course, there still needs to be reform. One way to reduce future budget liabilities is by raising the retirement age. Indeed, last week there was speculation that France would be downgraded. That is not going to happen. Neither is it justified. Moreover the rating agencies alluded to France's decision to raise the retirement age by two years to 62 as an important factor in their decision. Even though our retirement age is higher, one wonders whether it is not high enough.

When Bismarck introduced pensions in Germany at the end of the nineteenth century the retirement age was set at 70, at a time when life expectancy was 59. Germany's retirement age was subsequently lowered to 65, and it was that age that the US copied when they introduced pensions in the 1930s. But even then, it was still way above US life expectancy of 62. Now, at the beginning of the 21st century, pensions are more generous, life expectancy is far higher and yet the retirement age has barely moved. Raising the retirement age shows that there are ways to make credible, longer-term inroads into future government commitments.

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