

# Executive summary

## LONG-TERM PROSPERITY DEMANDS A MORE PRODUCTIVE, BROAD-BASED AND RESILIENT ECONOMY

A successful, dynamic economy must be productive, broad-based, and resilient. In these respects, the United Kingdom's recent economic record has been mixed.

Over the last 15 years the UK's productivity growth has been encouraging, matching the strong performance of the United States and closing the productivity gap with the EU-15. Overall productivity levels, however, are still 17 percent below the US and 10 percent lower than those of Germany.

The UK enjoys relatively high rates of labour participation (nearly five percentage points higher than the OECD average) and relatively low unemployment. But regional imbalances remain a concern—around half of economic growth over the past decade was concentrated in Greater London and its neighbouring regions—and too much recent employment growth has been in the public sector (from 1999 to 2009, the public sector workforce grew by 800,000).

The UK, meanwhile, is well-placed to survive and thrive in a modern global economy and should be able to benefit from growing demand from consumers in rising markets like India and Eastern Europe. However, there is a need to build resilience by managing down high public deficits and private debt levels, and taking practical steps to offset the economic effects of our ageing population.

## THERE ARE SEVEN PRIORITIES TO DRIVE LONG-TERM GROWTH

Small changes to the long-term growth rate will have a far larger impact over the next two decades than anything that changes the short-term outlook. Specifically, a downward shift in long-term GDP growth from 2.5 percent per annum down to 1.5 percent per annum would reduce aggregated growth in GDP between now and 2030 by nearly 30 percentage points. This could reduce output by as much as £400bn in 2030.

Beyond the downturn, we believe there are seven priority areas that if tackled will allow the UK to achieve sustained growth over the next two decades:

1. **Focus on raising productivity sector by sector to drive overall growth.** To drive overall growth it is “within sector” productivity that matters, not sector mix. Public policy often focuses on innovative niches (e.g., semiconductors) rather than on the largest sectors whose productivity is low by comparison with global best practice. Service sectors (e.g., retail trade, business services) represent around 65 percent of private sector output and account for much of the productivity gap with countries such as the US and Germany. Government can lead efforts to improve productivity by working with sector participants and new entrants to remove barriers to growth (such as regulatory burdens, land use restrictions) and support improvements in managerial quality and employee skills.

2. **Secure the UK's position as the location of choice for multinationals.** Multinationals may account for less than two percent of UK businesses, but they drive overall economic growth and large-scale innovation, accounting for 80 percent of UK R&D, and growing productivity eight times as fast as smaller firms. Government should work with leading multinationals on a ten-year plan to make the UK the most attractive European location for multinationals, addressing skills, immigration, infrastructure, and tax.
3. **Unlock infrastructure investment.** The UK will need to spend more than £350 billion over the next 20 years merely to maintain its existing transport infrastructure and a further £120 billion – £170 billion to support its energy infrastructure. This level of investment will require greater regulatory certainty and improved economic returns to attract private capital. In energy, for example, agreement is necessary on how the UK's decarbonisation targets will be met. In transport, a priority is to create additional funding streams to fund road investment via, for example, higher fuel duties.
4. **Innovate at scale.** Government efforts to stimulate the growth of clusters have often ended in failure. Past McKinsey research has shown that only half of clusters have grown faster than the overall economy. Achieving success requires concentration of investments in research into large and connected centres, access to global best practice through the recruitment of top talent, and cluster-specific support that builds on existing competitive advantages (e.g., in biosciences).
5. **Unleash the growth potential of education and health.** Education is a huge market—the OECD estimated that in 1980 just over a million students were enrolled at universities and colleges outside their country of origin; that number has now tripled to 3.3 million. This is a significant growth opportunity. For example, educating international students is Australia's third largest export industry. Meanwhile, UK health care could be a £200 billion industry by 2030. The UK needs to think about these sectors as international growth opportunities rather than public sector cost centres. This will require new and existing universities to add capacity and capability to attract international students. In addition, NHS organisations need to be able to restructure and compete for private patients without restrictions, while additional private capital will be needed to meet rising health care demand in the UK.
6. **Pilot devolution to dynamic cities.** Cities have been responsible for 78 percent of the UK's economic growth over the last ten years. Given the urgency of supporting growth across the UK, now is the time to experiment with options and give cities much greater city-wide coordination roles and financial responsibility, including, for example, the flexibility to negotiate regional as opposed to nationally agreed public sector pay and the freedom to strike local financial deals with investors.
7. **Address generational imbalances.** Demographic trends pose two challenges for major developed economies such as the UK. The first is how to maintain growth in the face of a declining working population (estimated to be a 0.3 percent annual drag on GDP growth). The second is how to fund long-term health and social care, where demand is set to rise by more than 70 percent in the next 20 years. The UK needs a radical increase in older working, leveraging the practices of innovative firms and ensuring these are spread more widely. Unlocking the £1 trillion of unmortgaged housing wealth owned by those over 60 through equity release would also enable older generations to make a greater contribution to paying for the public services they need.