Resolution Foundation
BRIEFING

The growth mindset

Sizing up the Government's growth agenda

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Summary

The Chancellor has made economic growth a priority for the new Government, promising to make the UK the fastest growing country in the G7. This is much-needed ambition. Since the financial crisis, although overall GDP has been propped up by migration and increases in the employment rate, productivity growth – the key to improving living standards – has lagged behind our G7 peers. By June 2024, the level of UK productivity (output per hour worked) was 5 per cent lower than if it had kept pace with average growth seen in the rest of the G7, leaving average annual wages £1,700 short of where they might have been. The Government sees tackling these issues as key both to boosting household incomes and easing the constraints on our stretched public finances.

Since the election, the Government has moved quickly to announce new supply-side policies on infrastructure, housing and trade. In this briefing note, we size up these plans, identify key channels through which they would impact productivity, and estimate their likely impact on growth and contribution towards the Government achieving its ambitious aim of delivering the fastest growth in the G7, while also acknowledging the huge uncertainties involved in such an exercise. Finally, we outline what might be necessary to close the remaining gap.

Topping the G7 growth league requires a boost to annual GDP growth of 0.5 percentage points each year of this Parliament

The IMF forecasts that UK GDP per person will grow by 1 per cent per year from 2024 to 2029, in the middle of the G7 pack but well behind the US, which is forecast to grow by 1.5 per cent. So, being the fastest growing G7 country over this Parliament means boosting the growth rate of GDP per person by 0.5 percentage points, on average, each year.

Annual growth of 1.5 per cent per person would be the fastest five-year growth rate since 2018 and a rapid turnaround from the recent past. Indeed, GDP per person is actually estimated to have fallen by a cumulative 0.6 per cent over the past five years. But it would still leave the UK a long way short of the 2.2 per cent annual growth in GDP per person attained in the 10 years to 2007.

Nonetheless, such growth would boost Government revenues by around £30 billion (in today's prices) by the end of this Parliament. So the OBR faces an important decision about how such policies should affect its fiscal forecasts. For tax measures with good evidence behind them, the case is strong – fiscal rules might otherwise constrain growth policy. For indirect, uncertain and non-fiscal measures like a relaxation of planning rules, the case for upgrading forecasts is much weaker.

Whether or not the growth impacts of policies feed through into official forecasts, GDP per capita is a key determinant of living standards, so increasing such growth will also boost prosperity. If, as history suggests, nominal earnings growth was similarly boosted by 0.5 percentage points in each year (an annual average of 3.6 per cent instead of 3.1 per cent), real median household income would be £500 higher in 2029-30 (in 2023-24 prices).

With little economic slack at present, achieving faster growth requires improvements on the supply side of the economy

According to both the Bank of England and the OBR, the economy is currently operating with limited 'spare' capacity. So any lasting increase in GDP growth must come from boosting the productive capacity – or the 'supply side' – of the economy. Raising demand without increasing supply would only lead to a reacceleration in inflation, ultimately harming growth rather than boosting it. Growth in our economic capacity can come from a number of sources, including increased participation in the workforce, or higher skill levels (for example, through better workforce health or investments in training or education); more investment in physical or intangible capital (infrastructure, equipment and ideas); or greater efficiency (known as total factor productivity).

The new Government wants to build more infrastructure: if it succeeds, this could add significantly to growth

The UK economy has major infrastructure needs: the National Infrastructure Commission estimates that spending in this area needs to rise by between 25 and 45 per cent over the next decade. Boosting infrastructure investment, in either the private or public sector, paves the way for economic growth by connecting firms to workers, consumers and each other through roads, railways and telecommunications, and providing essential resources such as energy and water.

Recent Government measures aim to increase infrastructure investment by making it easier to build and to attract private finance. The Government's initial actions have included repealing the onshore wind ban, reforming planning to accelerate infrastructure projects, establishing Great British Energy and a Green Prosperity Plan and leveraging private finance through the creation of the National Wealth Fund, a vehicle for combining public and private finance for infrastructure. These initiatives provide a direct boost to infrastructure spending and making that spending go further, so that more infrastructure can be built for the same cost. We estimate that these measures could boost annual growth by up to 0.2 percentage points over the next decade.

Building more houses would boost GDP directly, but not necessarily tax receipts

One area the new Government argues will boost growth is increasing the number of new homes that are built. Here the key commitment is to deliver 1.5 million homes in England over the course of this Parliament. This would entail growing the housing stock at the fastest rate in almost 40 years (since 1987), and represent a 28 per cent rise in net additions compared with 2022-23.

If – a big if – these homes can be built, what would they do to GDP? There are two key ways that housebuilding can add to GDP. First, directly, through increases in industrial output and final expenditure. Second, indirectly, by fostering long-term growth in total-factor productivity. This happens when workers can relocate to areas with higher productivity jobs, and when cities expand, taking advantage of their larger scale – known as 'agglomeration' – to drive economic growth.

A key component of consumption and hence GDP is housing services: the service of keeping shelter over your head. Building an additional 60,000 homes translates into an annual boost to growth of around 0.03 percentage points, a small but worthwhile boost to the economy which, if sustained over the life of this Parliament, would mean the overall size of the economy rises by £3.5 billion (in current prices). This will provide a small but welcome boost to living standards, but it will do little to help public finances: for owner occupiers, this extra 'rental income' is not liable for tax. The Government would only receive income tax on the extra private rentals, additional Council Tax revenues and with one-off tax receipts from Stamp Duty upon sale.

But building houses can also boost GDP by allowing more people to relocate to places with more productive – and ultimately higher-paying – jobs. The new Government's housing targets focus on building in England's least affordable areas – as defined by the ratio of local house prices to wages. Unfortunately, the least affordable areas are not always the most productive. Places like London, Slough, and Guildford are both productive and have expensive housing. But others, such as Sheringham and Cromer in Norfolk, combine low productivity with high unaffordability. Under the new Government's housing targets, housebuilding will increase only slightly more in the most productive travel-to-work areas as it will in the least productive (the top half of the productivity distribution would see a 1.5 per cent increase in the stock on average compared to a 1.3 per cent increase for the bottom half).

So, the new housing targets are not tailored to maximise economic growth. But they are still an improvement on building patterns over the past 10 years. We estimate that the implied allocation of workers into areas with higher productivity and higher employment rates under new targets could add another 0.03 percentage points to GDP growth each year by allowing workers to access housing in areas with higher-productivity jobs.

Finally, housing policy can boost growth if it allows our cities to grow. England's cities have untapped potential for agglomeration. However, the new housing targets also miss this opportunity to boost productivity through agglomeration outside London. London's housing stock is set to grow by 2.1 per cent if all 48 local authorities in its commuter area meet their goals. But, outside of London, ambition is much more limited. In fact, by category of settlement, the next largest boost goes to villages and smaller areas, at 1.5 per cent. Birmingham and Manchester, England's largest job markets outside London, have housing targets of just 1.2 per cent of the existing housing stock.

So, the contribution to growth from housing once peak housebuilding is reached under the Governments' targets is 0.06 percentage points per year. But if the Government wanted to prioritise growth, it could reconsider its housing targets, shifting construction towards more productive areas, or towards cities. Our estimates suggest that tilting building towards more productive areas would boost GDP growth by a total of 0.13 percentage points each year. Alternatively, prioritising cities to take advantage of the agglomeration effects would boost GDP growth by 0.14 percentage points each year.

A trade reset with the EU could ease some of the damage evident from Brexit, but the scope for gains are limited by political red lines

Brexit has weighed on Britain's economic growth in recent years, with the OBR estimating that it has reduced long-run productivity by 4 per cent. The damage from Brexit is clearly visible in the trade data: in the year to Q2 2024, goods trade was 10.7 per cent below its 2019 levels, compared to 4.6 per cent higher on average for the rest of the G7.

So, from the point of view of growth, it is encouraging that the new Government is prioritising improved relations with the EU. But its current proposals – a Sanitary and Phytosanitary agreement, secure mutual recognition of professional qualifications (MRPQ), and ease access for touring artists with the EU – will do very little to address post-Brexit trade barriers. If the Government succeeds in delivering agreements with the EU that achieve all of these aims, we estimate that this would boost goods trade by just £3.5 billion (just 0.4 per cent), and services trade by just £0.4 billion (just 0.1 per cent), which would have a very limited impact on GDP. Even then, much of this is unlikely to happen during the current Parliament: the EU-Canada MRPQ negotiation took six years and only covered architects.

The most significant steps to reduce trade barriers (such as re-joining the Customs Union or single market) would cross the Government's red lines, so the main option left to bring economic benefits from the UK's trade relationships is to align goods regulation. The UK has already begun to unilaterally adopt certain EU rules, such as by allowing continued use of the EU's CE mark for product safety in the UK. Further alignment is

likely unavoidable, but the current patchwork approach, where influential sectors secure regulatory alignment while less powerful ones are left behind, leaves much to be desired. Given that UK firms will seek to trade with our large neighbouring market, there is a case for making regulatory alignment the default, only diverging when there is a strong domestic case for different regulation. Alternatively, the Government could assess which sectors and products are most exposed to regulatory divergence and align these rules with the EU. Under either of these arrangements, a formal institution, such as that created by New Zealand and Australia, could help coordinate this process between the EU and UK.

We estimate that, if the UK were to negotiate an ambitious regulatory alignment, it could add 0.6 per cent to GDP by 2035, a small but meaningful boost to annual growth. This estimate carries significant uncertainty (both on the upside and downside), but it highlights that the impact could be significant should the Government negotiate an expansive deal (although not as large as revisiting the Government's red lines, such as a Customs Union which works in tandem with regulatory barriers).

The Government has made a good start with some policies, but needs to consider the growth consequences of others to form a comprehensive economic strategy

Stepping back, the Government has announced a laudable and ambitious growth mission. Less than three months into its mandate it has set out pro-growth policies on infrastructure and housing. Although there is huge amount of uncertainty, our best guess is that these policies could do around half of what is necessary, based on IMF forecasts, to close the growth gap with the US and make the UK the fastest-growing economy in the G7.

Of course, there are many more policies that could – and should – advance the Government's growth mission. This includes other parts of the Government's announced policy agenda – especially labour market reforms – which will affect growth, as will major tax and spending decisions in the upcoming Budget. And key policies including skills, competition and industrial policy will too, but these are not as yet well developed. It is crucial that these other policy areas are joined up with the growth mission.

More fundamentally, we are yet to see the Government articulate a clear growth strategy. Such a strategy is essential to help the Government to understand the scale of the task it faces, and to resolve the trade-offs that exist between its full set of policy instruments and policy objectives. For example, when deciding where to build extra houses, the Government could legitimately choose to prioritise affordability or productivity. But the first step to choosing well is to know that the trade-off exists, and this is one thing that a strategy can clarify.

A strategy is necessary even with the knowledge that economic growth in the UK will depend to a large extent on global and technological factors over which the Government has little control. Even the baseline growth acceleration to 1 per cent that the IMF predicts is far from certain, and would require a sharp turnaround from recent performance. While the Government places some emphasis on policy stability as a driver of growth, we judge that, although it is an important prerequisite, it alone will not deliver the scale of benefits required.

The opportunity therefore lies in building the Government's initial set of policies into a strategy. This is a big task: implementing the initial growth measures, complementing them in other key areas, and underpinning them by a strategic framework which manages the major trade-offs and interdependencies. But the prize would be worth it - a better chance to escape the economic stagnation of the past 17 years.

The new Government has made growth a priority

Growth is at the heart of the new Government's agenda. From its prominent position in Labour's election manifesto, to the Chancellor's post-election pledge to 'fix the foundations' of the UK's economy, growth is the new Government's answer to Britain's twin economic challenges of stagnating living standards and tight public finances.[1] At the heart of this approach is a pledge to make the UK the fastest-growing country in the G7.[2]

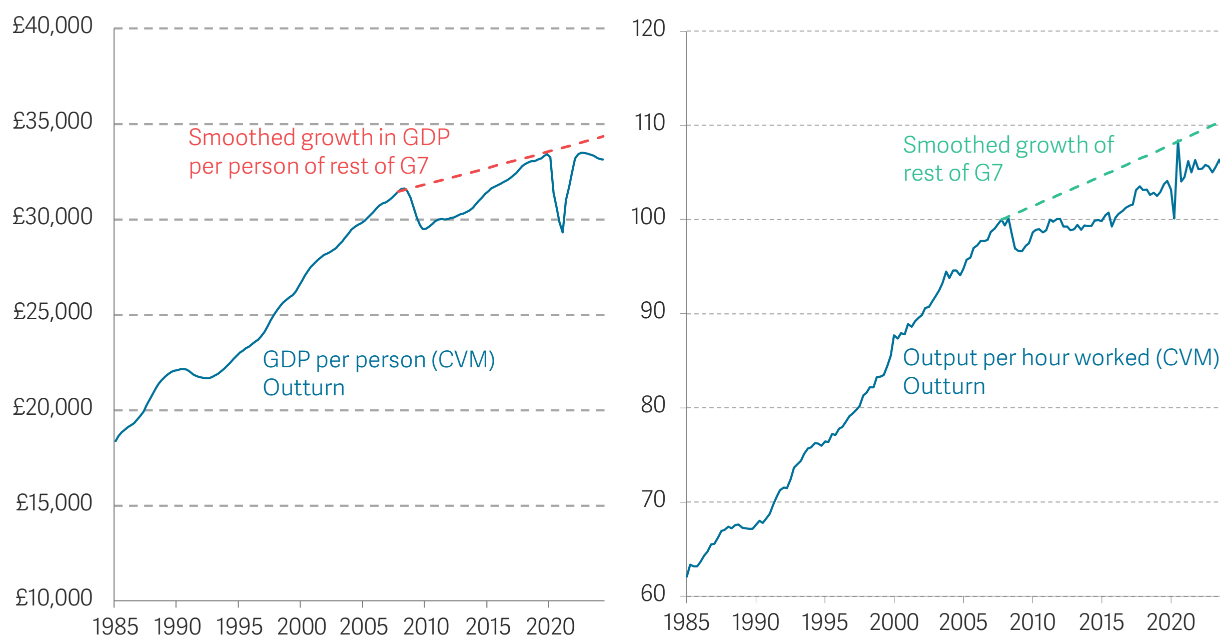
But achieving this will not be easy given the UK's recent record of stagnation.[3] While the UK's headline GDP growth has slowed sharply since the financial crisis (from 2.8 per cent from 1998 to 2007 to 1.1 per cent from 2008 to 2023), this has also happened elsewhere, such that Britain has been the third fastest growing G7 country since 2008.[4] But this headline GDP performance has been flattered by both a growing population – increasing by the fastest rate in a century – and a rising employment rate, where hours worked per person grew by almost 8 per cent in the 2010s.[5] In GDP per person terms, which is what matters for living standards, the UK grew at the second slowest rate in the G7, slower than Canada, France, Germany, Japan and the US since 2007. Concerningly, the UK's sluggish productivity growth – how much output is generated per hour worked – left Britain fifth in the G7 since 2007, growing at just half the rate of the average G7 country between 2007 and 2023.[6] Indeed, if the UK had matched the average productivity growth of other G7 nations since 2007, UK productivity would be 5 per cent higher than it was in Q2 2024 (see Figure 1). This gap leaves average wages £1,700 lower in Q2 2024 than they would have been had productivity grown in line with the G7 average.

Fixing this dire macroeconomic performance is the Government's solution to both stagnating living standards and constrained public finances. The first objective acknowledges that productivity growth is not just a number – it is the driver of wage growth over the long term. Although real wages have increased in 2024, these gains are unsustainable in the long run without productivity picking up.[7] The Government has also emphasised that it will face 'tough decisions' in the Autumn Budget 2024 in the face of a tight fiscal position. Confronted with crumbling public services, stubbornly high NHS waiting lists, and rising dissatisfaction with the public realm, the Government argues that growth is the essential condition to boost tax revenues and alleviate these pressures.

1 Labour Party, Labour Party Manifesto 2024, June 2024; HM Treasury, Chancellor Rachel Reeves is taking immediate action to fix the foundations of our economy, July 2024.
2 In this note, we interpret this ambition in terms of GDP per capita.
3 Resolution Foundation & Centre for Economic Performance, Ending Stagnation, December 2023.
4 RF analysis of OECD; ONS; BLS; StatCan; Eurostat; JIL; and IMF WEO.
5 E Fry, S Pittaway & G Thwaites, Life in the Slow Lane, Resolution Foundation, June 2024.
6 E Fry, S Pittaway & G Thwaites, Life in the Slow Lane, Resolution Foundation, June 2024.
7 The recent rise in wages has been linked to improving terms of trade, and companies' balance sheets alleviated from pension contributions, as opposed to rising productivity. For more, see: G Thwaites, The Macroeconomic Policy Outlook Q2 2024, Resolution Foundation, May 2024.

FIGURE 1: **The UK has underperformed productivity growth in the rest of the G7**

Quarterly GDP per person (left panel) and index of GDP per hour worked (right panel, 2008 =100): UK and average of the rest of G7



NOTES: Chained volume measures (CVM) of GVA per hour worked and of GDP per person. Smoothed simple average of annualised growth rates of G7 countries excluding UK between 2007 and 2023. Four quarter rolling sum of GDP per person.
SOURCE: RF analysis of ONS, Gross domestic product (Average) per head, CVM market price & Quarterly Output per hour worked Whole economy, Chained volume measure (CVM); OECD; BLS; StatCan; Eurostat; JIL; IMF WEO.

Rachel Reeves isn't the first Chancellor to talk about how our growth record declined after the global financial crisis, but results have, so far, not matched the rhetoric. Previous Chancellor Jeremy Hunt's 2023 Autumn Statement included 110 growth measures, many of which had the stated aim of increasing business investment – a key barrier to growth.[8] The new Government, drawing inspiration from the other side of the Atlantic, has zeroed in on a number of supply-side policies as part of a renewed focus on growth – namely in infrastructure, energy, housing, and trade.

So, in this briefing note, we explore the extent to which these supply-side reforms can shift the dial on Britain's growth prospects and consider whether what we have heard so far adds up to a growth strategy. In doing so, it is important both to acknowledge the huge uncertainties involved in such an exercise, and also that much of the UK's eventual record on growth will be subject to global economic factors outside the control of UK policy makers.

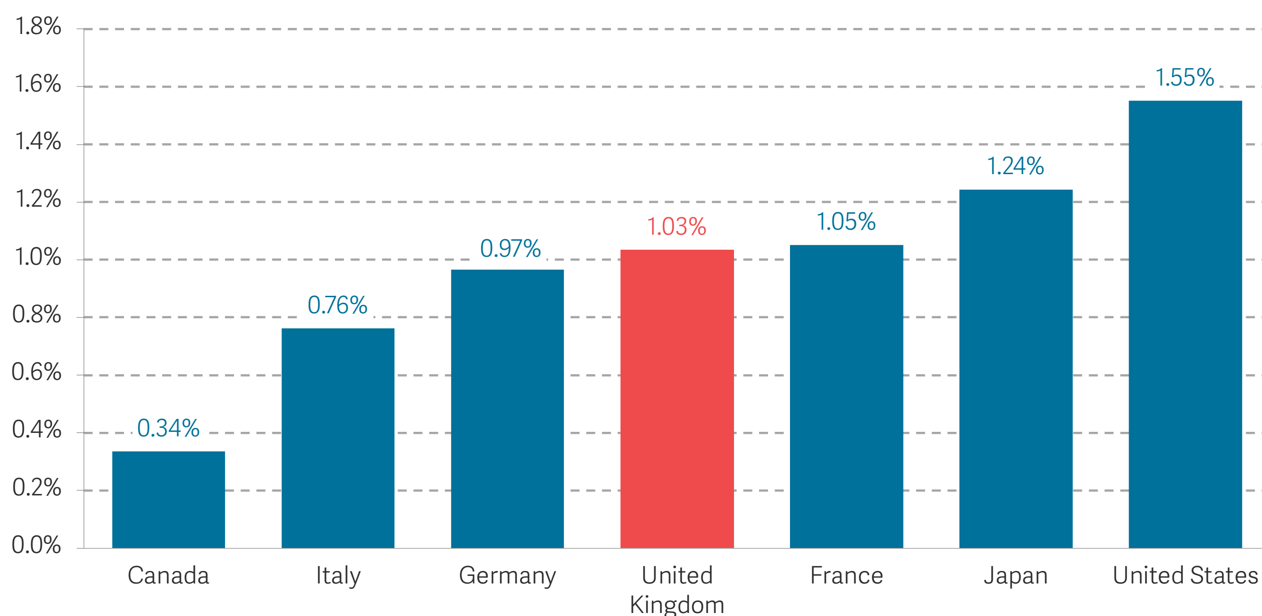
8 J Oliveira-Cunha et al., Business Time: How ready are UK firms for the decisive decade?, Resolution Foundation, November 2021.

The UK is forecast to grow 0.5 per cent per year slower than the fastest-growing G7 country

What would success look like for the new Government? Figure 2 shows that the IMF forecasts that UK GDP per person will grow at around 1 per cent per year over the 2024-29 period. This would put the UK in the middle of the G7 pack, and 0.5 percentage points behind the US, the fastest-growing country, which is expected to grow by 1.5 per cent per year in per-person terms. So getting to the top of the G7 on these forecasts means boosting the growth rate of GDP per person by 0.5 percentage points on average each year.

FIGURE 2: **The UK is expected to grow more slowly than the US over the next five years**

Average annual forecast growth rate of GDP per person, G7 countries, 2024-29



Source: RF analysis of IMF World Economic Outlook Database April 2024.

The resulting annual growth rate of 1.5 per cent per person would be the fastest five-year growth rate since 2018 and a rapid turnaround from the recent past – GDP per person actually fell by a cumulative 0.6 per cent over the past five years. But it would still leave the UK a long way short of the 2.2 per cent annual per-person growth of the decade leading up to the financial crisis.

Of course, it is worth remembering that the forecasts shown in Figure 2 are extremely uncertain. The average error of 5-year ahead GDP growth in IMF forecasts of is around

2 percentage points, and forecasts are generally biased upwards.[9] Recent economic history – the 2008 global financial crisis, the global slowdown in growth that followed it, the pandemic and the 2022 energy price shock – shows that the UK economy is heavily exposed to global events. It may be that US growth ends up being even higher, meaning the UK would need to do more to be the best in the G7. Equally, it may be that the Government introduces measures that add 0.5 per cent to annual growth in GDP per person, but our baseline growth rate ends up being much smaller than 1 per cent.

Achieving this goal would boost tax revenues and living standards

An extra 0.5 percentage point of growth each year could, other things equal, boost Government revenues by £30 billion, in today's prices, by the end of this Parliament.[10] This would be transformational to the fiscal outlook given that there was just £9 billion of 'headroom' against the fiscal rules at the time of the Budget in March 2024.[11]

Whether the Government reaps the benefits of its growth policies in terms of near-term fiscal space, however, depends in part on how much the OBR adjusts its growth forecasts. There are three key considerations here. First, how likely is it that the promised measures will be delivered? In this context, the OBR has a recent record of attempting to quantify the longer-term growth implications of policy announcements.[12] This is more straightforward for frequently-used fiscal measures such as changes in personal taxes. But this is more difficult for policies such as housebuilding, or infrastructure improvements. Second, how confident can we be that the measures will have a significant effect on the economy? This in turn depends on how big the effects will be in the central case, and our level of uncertainty about this. Third, can the reforms announced by the Government be thought of as part of the ordinary business of Government, and therefore one of the many unspecified factors that is driving growth in the baseline forecast?

This decision is especially important when fiscal rules would otherwise prevent policies from happening, which will be the case when the rules are binding and when new policies cost money. Where tax and spending growth measures can at least partially pay for themselves with higher revenues, the OBR should let such measures affect their growth forecasts. But for a relaxation of planning law, which is hard to execute, hard to assess and not primarily fiscal, the case for changing a forecast is much weaker.

Whatever the OBR decides, faster GDP growth will, in general, result in higher income growth. If nominal earnings growth was similarly boosted by 0.5 percentage points in

9 'Average error' here means root mean square error, the square root of the average squared forecast error, which takes into account both bias and variance. See Celasun, O., Lee, J., Mrkaic, M. and Timmerman, A., An Evaluation of World Economic Outlook Growth Forecasts – 2004-17, IMF Working Paper 21/216

10 This assumes that revenues of £1,322 billion in 2028-29 increase by 2.5 per cent, and that cumulative inflation is 10 per cent.

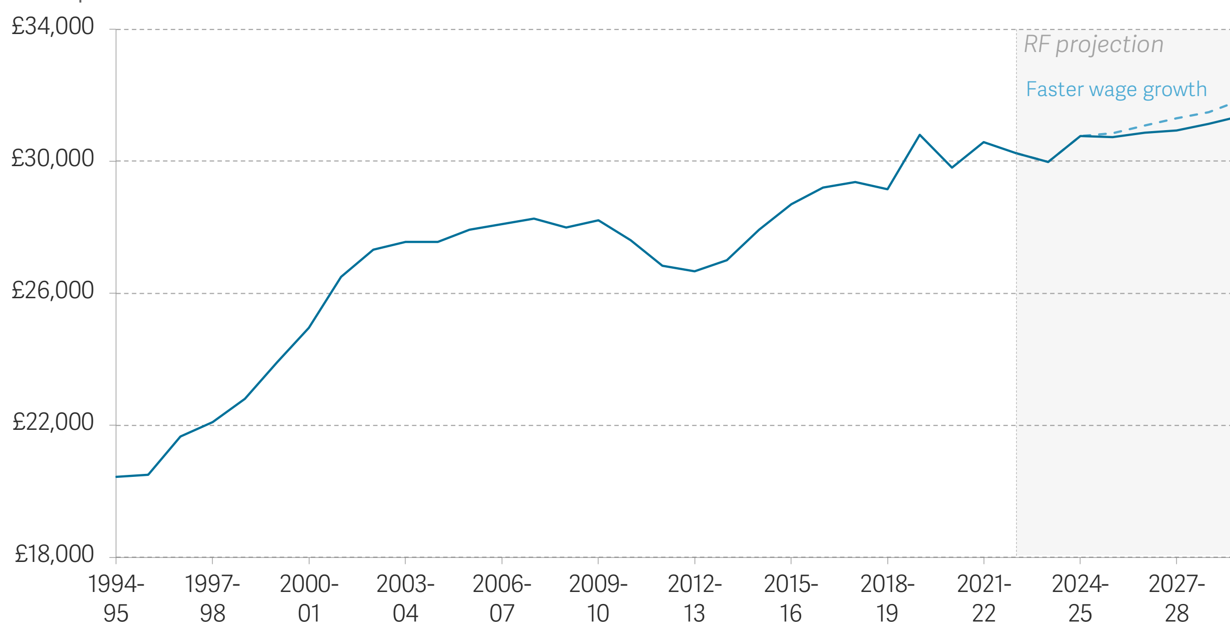
11 C McCurdy, C Pacitti & J. Smith, Debt dramas: Putting the public finances in context ahead of General Election 2024, Resolution Foundation, June 2024.

12 Office for Budget Responsibility, Dynamic scoring of policy measures in OBR forecasts, November 2023.

each year between 2025-26 and 2029-30 (an annual average of 3.6 per cent instead of 3.1 per cent), real median incomes would be £500 higher in 2028-29 than they would have been as shown in Figure 3.[13]

FIGURE 3: **Faster growth in earnings would improve the outlook for incomes**

Real median equivalised household disposable income after housing costs for non-pensioners: GB/UK



NOTES: GB before 2002-03. 'Faster wage growth' represents wage growth at 0.5 percentage point above our adjustment of the Bank of England and OBR forecasts in each year from 2025-26. In 2023-24 prices, deflated using our after housing costs deflator, based on CPI.
SOURCE: RF analysis of DWP, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model; Bank of England, Monetary Policy Report, August 2024; and OBR, Economic and Fiscal Outlook, March 2024.

Boosting growth in the longer term means improving the supply side of the economy

Both the OBR and the Bank of England judge that there is currently little spare capacity in the UK economy.14 In other words, the productive resources available are currently being used at an approximately normal rate. This implies that stimulus measures to increase demand would generate inflation, undermining growth in the longer term. This means any sustained acceleration in GDP growth will have to be driven by an expansion in the productive capacity of the economy.

In other words, when there is no spare capacity it is therefore wrong to say that an increase in, say, investment of £10 billion will 'boost the economy by £10 billion'. If there is

13 For the modelling underpinning these calculations, see the annex of: A Corlett & A Clegg, The Living Standards Outlook 2024, Resolution Foundation, August 2024.
14 Bank of England, Monetary Policy Report, August 2024 and OBR, Economic and Fiscal Outlook, March 2024.

no spare capacity then, in the long run, the only ways this extra £10 billion of demand can be met are by reallocating workers from elsewhere or importing the extra goods. In either case, domestic production and GDP do not rise.

With this in mind, the Government is focused on supply-side measures. It has set out that it will be undertaking measures that increase the capacity of the economy to supply goods and services in the long run. We can think of growth in productive capacity being accounted for by three factors: labour supply (including the skills of the workforce), the stock of productive physical capital, and the efficiency with which these inputs to production are combined (so-called 'total-factor productivity' or TFP). It is through this lens that we will assess the growth measures put forward by the Government.

For example, policies can boost GDP per person if they increase the amount of labour each person supplies (for example by improving population health or extending the retirement age), if they improve the skills of the workforce, if they add to the structures and equipment that workers use to make them productive at work, or through higher TFP. TFP is also the source of growth most likely to increase welfare (see Box 1). It reflects innovation, reallocation and technical progress and is the fundamental driver of most per-person growth in the economy. Experimental ONS data suggest that TFP accounted for around half the growth in market sector output per hour in the past three decades, with the remainder split equally between labour composition (which is mostly skills and qualifications) and more capital per worker.[15]

BOX 1: **Economic welfare and the sources of growth**

Not all sources of growth are equal from a welfare perspective. This box explains why TFP is best.

Domestic spending comprises consumption and investment. Consumption is the 'fun part' of GDP, and the point of investment is to facilitate future production and hence consumption. In an economic sense, investment is a cost. An increase in investment requires either a cut in consumption today, in return for higher consumption in the future, or an increase in imports which must be paid for out of future investment returns. This is true for investment in human or physical capital. So when we are considering strategies to raise growth, and the sources of growth, not all sources are created equal.

Moreover, investment tends to generate less tax revenue than consumption in the short run, because investment is tax deductible and hence leads to lower corporation tax revenues, and receipts of VAT, largely a consumption tax, will

15 ONS, Annual multi-factor productivity, market sector, UK: 2023, 2023

also suffer. This is important when thinking through the fiscal implications of different growth strategies.

The main driver of per-capita GDP growth in the 2010s was increasing labour supply rather than labour productivity.[16] This raised welfare to the extent that the extra workers preferred the extra money to the foregone time. But, for those of us who wouldn't work for free, growth achieved this way is inferior to growth in labour productivity, and the higher hourly wages this affords.

While increasing investment means postponing consumption, and work uses time that could be spent on other activities, TFP is the source of growth which comes without these downsides. Some of what is measured as TFP is, in reality, compensation for unmeasured or extremely productive investment.[17] But reallocating resources to their most productive use through, for example, spatial or trade policies can boost TFP and GDP without requiring extra work or investment in the aggregate.

The growth policies the new Government has announced to date are notable for their emphasis on investment. Higher investment would be welcome, because the UK starts from a position of low investment and a relatively small capital stock.[18] Well-targeted investments will also increase TFP and more than pay for themselves in the long run. The UK cannot grow sustainably without an acceleration in TFP growth, and it is boosting this that a long-run growth strategy must also deliver.

In the rest of this note, we assess the impact of Government announcements on infrastructure investment (planning reforms, the Green Prosperity Plan, Great British Energy and the National Wealth Fund), housebuilding, and trade policy through these channels.

Announcements on infrastructure will boost growth modestly

The UK economy has major infrastructure needs, with the Second National Infrastructure Assessment by the National Infrastructure Commission calculating that the UK's infrastructure spending needs will rise 25-45 per cent over the next decade.[19]

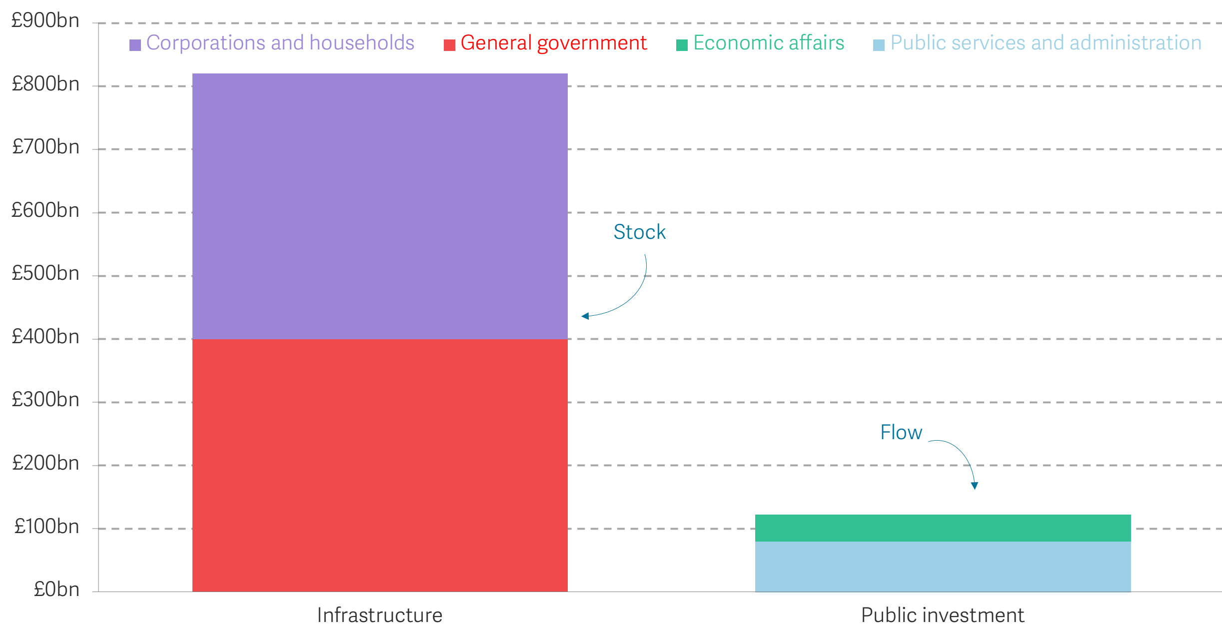
The UK's stock of infrastructure is valued at £824 billion, with roughly half owned through regulated private companies and the rest by Government (Figure 4).[20] Economic

16 E Fry, S Pittaway & G Thwaites, Life in the Slow Lane, Resolution Foundation, June 2024.
17 Using a broader concept of investment that categorises more business expenditure as intangible investment typically results in more growth being measured as investment-led.
18 Resolution Foundation & Centre for Economic Performance, Ending Stagnation, December 2023.
19 National Infrastructure Commission, Second National Infrastructure Assessment, 2024
20 ONS, Capital stocks and fixed capital consumption time series, 2024. Figures are for net capital stock of general government and the rest of the economy.

infrastructure produces final goods in its own right (for example, household consumption of utilities), and also produces important inputs for other industries (such as roads used for distribution services). So boosting infrastructure investment is an important driver of growth in the wider economy, as better access to transport, communications and power make it easier for workers and firms to produce and ship goods and services.

FIGURE 4: **In the UK, most infrastructure capital is not public, and most public investment is not in infrastructure**

Composition of infrastructure capital stock and public investment flow, £ billion 2023 and 2023-24



NOTES: Infrastructure is the net capital stock of 'Other Structures' in 2023. A small fraction of the capital stock of corporations includes public corporations. Public investment is total public sector capital investment on services. 'Economic affairs' is the PESA classification which includes 'enterprise and economic development'; science and technology; employment; agriculture and transport, which we consider infrastructure in this paper.
SOURCE: ONS capital stock HMT PESA tables and RF calculations

The Government has made several announcements that will boost the volume of infrastructure investment in the UK. In particular, it has introduced planning reforms to repeal the ban on onshore wind and facilitate other infrastructure projects, and it has announced the establishment of a Green Prosperity Plan (£4.7 billion per annum), Great British Energy (capitalised at £8.3 billion) and the National Wealth Fund (capitalised at £7.3 billion).[21] Other than this, we have little information ahead of the upcoming Autumn Budget about direct government investment in capital for research, public services and government infrastructure.

21 Green Finance Institute, National Wealth Fund Taskforce: Report prepared for the Labour Party, July 2024.

Cuts to public investment could include cuts to investment in infrastructure, and could harm growth.[22] But the overlap between public investment and infrastructure investment is low in the UK (see Figure 4 again). Most public investment is for public services (see Box 2). When this boosts productivity, it does so either directly in the public sector, or indirectly through the effects of better public services on the workforce (such as through better health or education). So it is possible to boost infrastructure without boosting public investment, and vice versa.

BOX 2: **The relationship between infrastructure and public investment**

Public investment is sometimes discussed as if it were the same as investment in infrastructure. But the overlap between the two in the UK today is far from total. To start with, around half of infrastructure capital is not public (see Figure 4): the utilities are largely privatised in the UK, leaving road and rail infrastructure as the main item still largely in the public sector.

Conversely, most public investment is not in infrastructure: HMT data suggest that only 34.5 per cent of the public-sector investment budget goes on 'economic affairs' (the right-hand bars of Figure 4), while the ONS categorises 34.1 per cent of total general government investment as infrastructure. What remains is for the production of public services – schools, hospitals, prisons, the military and so on. This extra capital for public services may economise on public-sector labour, releasing it for the private sector. Or it may increase the output of public services, adding to GDP both directly, through a higher volume of, say, healthcare, or indirectly, for example by improving the health status or skills of the UK workforce.

These announcements may boost the volume of infrastructure in two distinct ways:

1. Lower costs of producing infrastructure, through the repeal of the effective ban on onshore wind farms and the broader announced changes in the approach to infrastructure and large projects in the planning system. Cheaper infrastructure would have a double effect on GDP – representing a rise in the productivity of infrastructure-producing sectors, and meaning that a given amount of spending will go further in adding to the stock of infrastructure; and,

2. A rise in national spending on infrastructure through the establishment of the National Wealth Fund, Great British Energy and the Green Prosperity Plan.

22 OBR, Public investment and potential output, August 2024.

Starting with the first, it is difficult to quantify by how much the cost of building infrastructure might fall thanks to the Government's measures. But UK infrastructure is about 10 per cent more expensive than the global 'cost frontier'.[23] So success here would be for reforms to take the UK to the efficiency frontier, reducing the costs of new investment by 10 per cent.

How much such an improvement might boost the productivity of infrastructure investment depends on the scale of any new investment. In this context, the flow of infrastructure investment is roughly £41 billion per year. Reducing the cost of building this amount of infrastructure would have two effects. First, assuming that the price cuts flow from lower costs, they would represent a rise in the productivity of the infrastructure-producing sectors, adding £4 billion to annual GDP. And second, holding expenditure on infrastructure fixed in cash terms, lower prices will make the stock of infrastructure assets grow about 0.5 percentage points faster each year, boosting annual growth about one-tenth as much.[24]

The Government's reforms should also increase the total amount of investment. The National Wealth Fund, for example, is set to be capitalised with £7.3 billion in public funds. The aim is to crowd in three times as much private capital, and to use this to finance infrastructure investments that would not otherwise take place.[25] If these were realised, the UK's stock of infrastructure would eventually increase by £29 billion, a 3.5 per cent increase. Again, this would raise GDP by a proportion about one-tenth as large. If, in line with OBR assumptions, it takes 10 years for this infrastructure to come fully on stream, the average effect on annual GDP growth would be one-tenth as large again. We can apply similar logic to the Green Prosperity Plan and Great British Energy, assuming the latter spends a sum equal to its capitalisation over five years.

If we put these together, it suggests that the measures announced to increase infrastructure investment and make it cheaper could raise annual GDP growth by around 0.2 percentage points once they take full effect, which could be in 10 years' time.[26]

Building more houses could boost GDP...

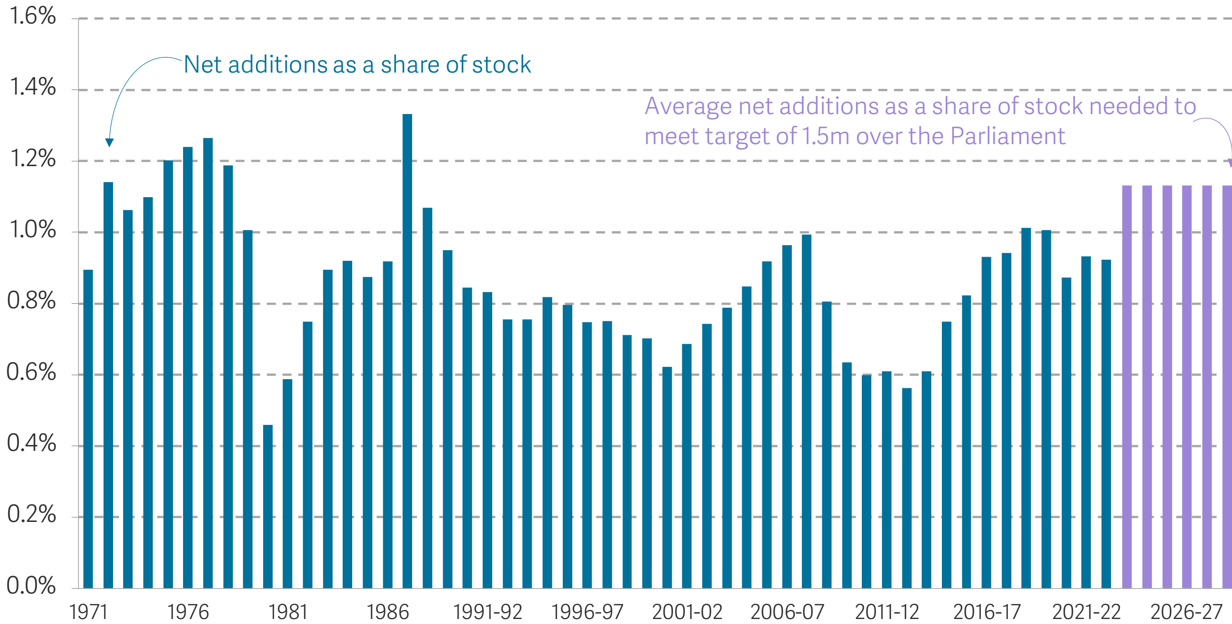
One of the new Government's first commitments was to deliver 1.5 million homes in England over the course of this Parliament. The resulting goal to build 300,000 new homes a year is mainly about increasing affordability and tackling the housing crisis. But the Government is also optimistic that more housing is a route to boosting growth.[27]

23 R Hughes et al., Euston, we have a problem: Is Britain ready for an infrastructure revolution?, Resolution Foundation, March 2020.
24 OBR, Public investment and potential output, August 2024. We need to say somewhere how we are dealing with depreciation.
25 Evidence from the EIB suggests that this is feasible: European Investment Bank, EIB EFSI Multiplier Methodology Calculation, Update of July 2018, October 2018.
26 OBR, Public investment and potential output, August 2024 suggests that investment can take 10 years to become fully productive.
27 Labour Party, Labour Party Manifesto 2024: Kickstart economic growth, June 2024.

Achieving the Government's housing target would entail net housing additions as a share of housing stock increasing to 1.15 per cent annually between 2024 to 2029, from an average of 0.85 per cent per year between 1971 and 2023 (see Figure 5).[28] The last time that we built at these rates in England was almost 40 years ago, in 1987.

FIGURE 5: **England must ramp up building to meet new Government targets**

Net additional dwellings as a share of stock, actual and target: England, 1971 to 2029



NOTES: Data on net addition dwellings is in calendar years until 1991-92. Data on completions is in fiscal years throughout. 1990-91 data not included since this does not exist for net additional dwellings.
SOURCE: RF analysis of MHCLG, Live table 104.

The new Government's housing targets simplify the previous system. They have replaced the 2014 local housing projections, the 35 per cent urban uplift for city centres and the cap of 40 per cent above a local authority last published 'local plan'.[29] Instead, housing growth is set at a flat 0.8 per cent increase in housing stock across all local authorities. The affordability adjustment is now 0.6 per cent for each percentage point that the local authority house price-to-earnings ratio exceeds 4, which is 0.35 percentage points higher than the previous Government's targets.

28 Net additions include the overall changes to the size of dwelling stock due to: new builds; conversions (for example, a house to a number of flats); changes of use (for example, a residential house to an office); and demolitions.

29 For more discussion on calculating housing targets, see: C Aref-Adib, J Marshall & C Pacitti, Building blocks, Assessing the role of planning reform in meeting the Government's housing targets, Resolution Foundation, September 2024.

So, assuming that the Government meets its target to build 1.5 million homes over the next five years, how would this contribute to growth?[30] There are three ways that we explore: by increasing the flow of housing services, by increasing labour mobility, and by facilitating agglomeration – the productivity advantages that firms gain when they co-locate with other businesses and workers.

A key component of consumption, and GDP, is housing services. In 2023, this amounted to 12 per cent of UK GDP. Most of this comes in the form of so-called 'imputed rents' which is the way in which we estimate the housing services consumed by owner-occupiers. Building more homes, then, will increase such estimates of 'housing services'. The housing services of an additional 60,000 occupied homes in England would add about 0.03 percentage points to GDP growth each year the extra homes are built.[31]

These new homes raise living standards by improving the size of the housing stock, but the fact that there are more houses to go around has a limited direct impact on the public finances: imputed rents are counted in GDP, but for owner-occupiers there is no 'rental income' to tax. The fiscal boosts from higher housing services will be from tax on extra private-rental income, council tax revenues and from the stamp duty paid when homes are bought.[32]

...but the growth impact would be larger if new homes mean workers can move to more productive jobs

But the more important consideration of whether houses will be occupied comes down to: location, location, location. Build a bridge to an uninhabited island, and few will use it; connect previously disconnected parts of a thriving city, and it becomes an indispensable artery of activity. The economic impact, in the latter case, is far greater. Similarly, when building homes, it is this geographic dimension – the relationship between housing location and demand – which we turn to next.

30 Much of the strategy to achieve this target is centred on reforming the planning system. This focus is not without merit: England's planning system has long been seen as a barrier to housebuilding, particularly due to its highly discretionary nature, where local councils make planning decisions on a case-by-case basis, and the extensive land protections, especially within the Green Belt. But planning is not the only constraint: even when planning permission is given, just two thirds (64 per cent) are actually started, and there is a lack of commercial incentives for private developers to build at pace. Therefore, building (and the impacts on GDP) would likely ramp up over the course of the Parliament, to accommodate the time taken from approving a development and the point when people actually move in. For more discussion on the housing targets, the planning system and their feasibility see: C Aref-Adib, J Marshall & C Pacitti, Building blocks, Assessing the role of planning reform in meeting the Government's housing targets, Resolution Foundation, September 2024; MHCLG and HM Treasury, Independent review of build out: final report, October 2018.

31 This estimate might be at the higher end of housing services' contribution to GDP. One reason is that the investment in housing would have been spent elsewhere. For example, had the funds from this housing investment been reallocated from infrastructure, then some of the GDP gains attributed to housing might not be additional. Another factor pushing this estimate to the upper end is the assumption that all newly built homes will be occupied. However, we judge that this is plausible given population projections: England will still be delivering around 40 per cent fewer net additional dwellings than France and Germany delivered relative to population growth since 2015. It is also worth noting that 5.4 per cent of homes were vacant at the time of the 2021 census. This is one of the lowest rates of vacant homes in the OECD, with London reporting a lower rate of vacant homes than England average. Source: C Aref-Adib, J Marshall & C Pacitti, Building blocks, Assessing the role of planning reform in meeting the Government's housing targets , Resolution Foundation, September 2024 & Census, Number of vacant and second homes, England and Wales: Census 2021.

32 For a discussion on the inefficiencies of Stamp Duty, and the need to reform Council Tax, see: A Corlett, Revenue and Reform: What tax changes could – and should – we see in Autumn Budget 2024?, September 2024.

The key to unlocking productivity growth from housing is to build in areas connected to lots of jobs. There are currently large variations in the employment rates and wages in different parts of the country (Figure 6). The raw differences are stark: the employment rate of the lowest-employment area is 66 per cent; the most is 90 per cent. And average hourly wages ranged from £13 to £21 in 2019.[33] Of course, not all of these differences can be explained by area alone – variation in the individual characteristics, such as skills and age, of people living in different areas is important. But it is clear that local labour-market conditions vary considerably. Indeed, recent research found that between 46 per cent and 80 per cent of the variation in employment differential is accounted for by area effects, and between 10 per cent and 36 per cent of the wage differential.[34]

FIGURE 6: **Employment and wage disparities endure across the UK**

Employment rates (left chart) and average wages (right chart) in 1998 (x axis) and 2019 (y axis) by TTWA: England

NOTES: Average hourly wages among working-age (16–64) employees in 2019 and 1998.
SOURCE: Recreated from supplementary data by H Overman & X Xu, Spatial disparities across labour markets, Oxford Open Economics, Volume 3, Issue Supplement 1, 2024.

A programme of house building can help boost GDP if it makes it easier for individuals to move to higher-wage areas with better employment opportunities. So what do the Government's plans imply?

In this context, there is evidence that house prices influence labour mobility within countries. An OECD 'gravity' model of England and Wales found that inter-regional

33 RF analysis of H Overman & X Xu, Spatial disparities across labour markets, Oxford Open Economics, Volume 3, Issue Supplement_1, 2024, Pages i585–i610, https://doi.org/10.1093/ooec/odae005 July 2024.

34 H Overman & X Xu, Spatial disparities across labour markets, Oxford Open Economics, Volume 3, Issue Supplement_1, 2024, Pages i585–i610, https://doi.org/10.1093/ooec/odae005 July 2024.

migration flows are highly responsive to regional income and house prices, and only marginally to local employment conditions.[35] For example, a 10 per cent increase in house prices in the destination region is associated with a reduced population inflow by 3 per cent. Meanwhile, a 10 per cent increase in house prices in the origin region is associated with an increase in population outflows of 4 per cent.[36] An analogous model also finds that migration is sensitive to housing supply. So, whether or not construction moves house prices, it is likely to move workers. [37]

The previous Government's record on housebuilding was not particularly focused on England's most productive labour markets. Although Government housing targets are set at local authority level, we analyse the impacts of the Government's targets through travel to work areas (TTWAs) [38] which better reflect the flow of economic activity in the UK.[39] Under the previous Government, the rate of house building (relative to the size of the local housing stock) was relatively even across high and low productivity areas, with only a slightly higher rate of building in TTWAs in the top productivity decile, as shown in the blue bars in Figure 7. This is despite the previous Government's housing targets targeting a much higher rate of house building in TTWAs in the most productive decile, as shown in the red bars in Figure 7. The targets were particularly ambitious in London which aimed for an annual building rate amounting to 2.5 per cent of existing housing stock.

35 A gravity model in economics is typically used to predict bilateral trade flows between two countries based on their economic size and distance. The trade flow is a function of the size of the economies trading, the distance between the economies as well as other factors such as shared language. Gravity models can be applied to the movement of people too – predicting migration of people within or between countries based on population, economic opportunities, and bilateral distance.

36 M Chiara Cavalleri, N Luu & O Causa, Migration, housing and regional disparities: A gravity model of inter-regional migration with an application to selected OECD countries, OECD Working Paper, 2018.

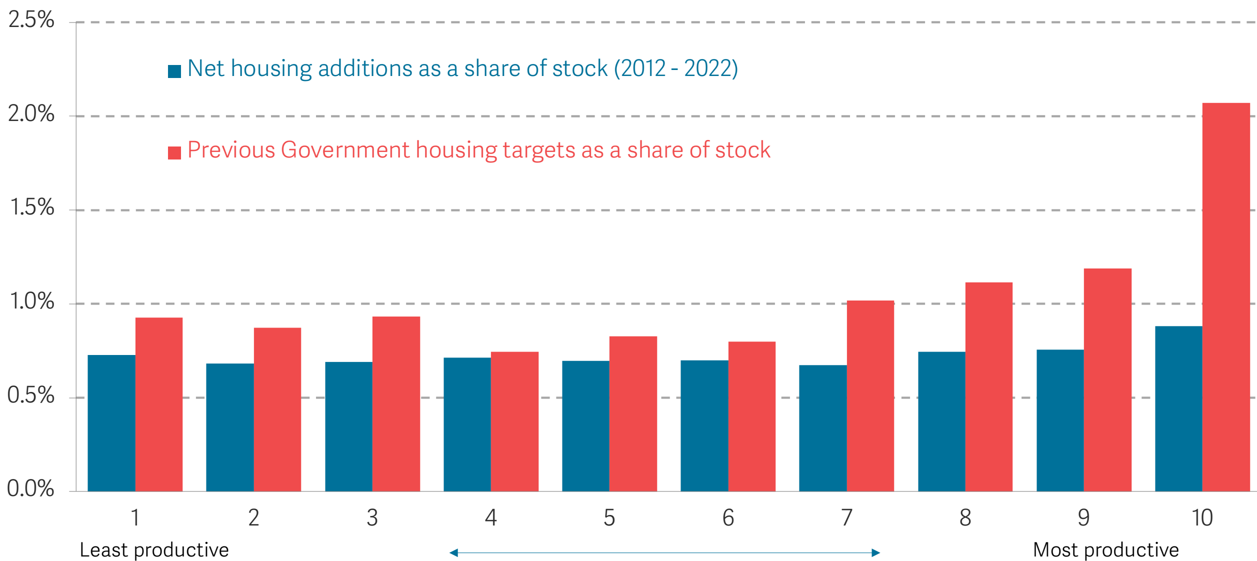
37 For the relationship between housing supply and house prices, see, for example: V Been, I Gould Ellen & K O'Regan Supply Skepticism: Housing Supply and Affordability https://www.tandfonline.com/doi/full/10.1080/10511482.2018.1476899?src=recsys

38 The current criteria for defining TTWAs are that at least 75 per cent of the area's resident workforce work in the area and at least 75 per cent of the people who work in the area also live in the area. Source: ONS, Travel to work area analysis in Great Britain: 2016, September 2016.

39 When thinking about productivity, local authorities are too small a unit of economic analysis for the simple reason that their boundaries largely fail to reflect the actual flow of economic activity. Although planning decisions are made by local authorities, people regularly live in one local authority and commute to another for work. A person living in the Stockport or Bury local authorities are more likely to be commuting into Manchester for work rather than staying in their local authority. Indeed, Manchester has ten local authorities which are part of its travel to work areas (TTWA). The new Government's English Devolution Bill acknowledges the need for transboundary spatial plans targeting economic growth, For more, see: HM Government, Kings Speech 2024, Background briefing, July 2024.

FIGURE 7: **With the exception of London, housebuilding during the previous Government wasn't particularly targeted by productivity**

Average annual housing completions and previous Government targets as a share of housing by TTWA productivity deciles: England, 2012-2022



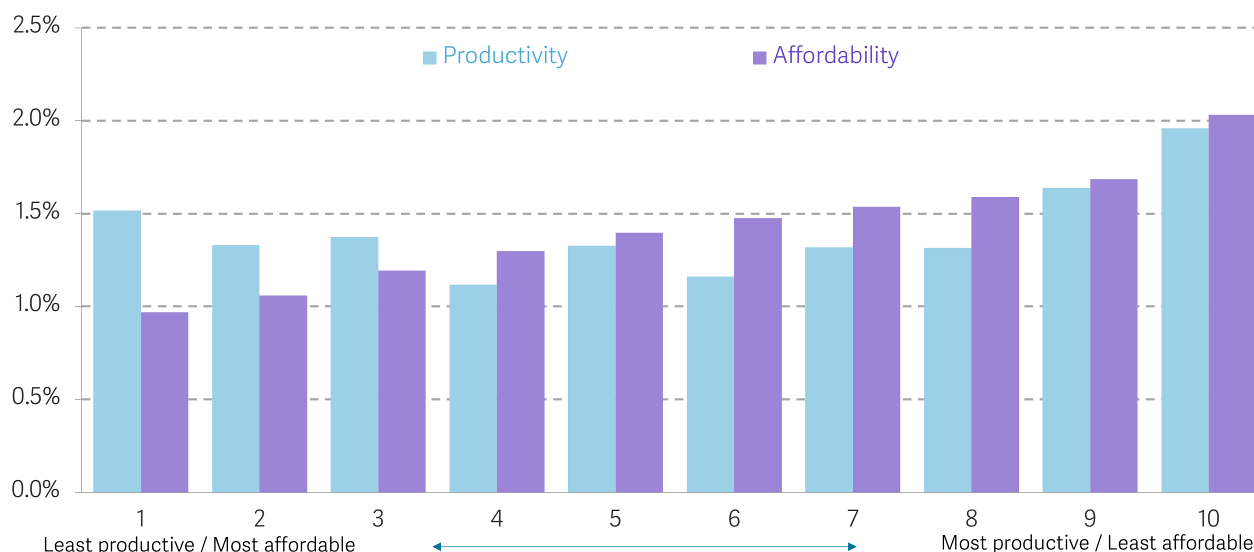
NOTES: This includes 2012 to 2015 which was a lower than average period of housebuilding for the UK.
SOURCE: RF analysis of live tables on housing supply from Ministry of Housing, Communities and Local Government, ONS UK GVA and productivity estimates for other geographic areas, ONS Housing affordability in England and Wales, and the formulas for the previous Government and new Government's housing targets.

The Government's new mandatory housing targets aim to build in the least affordable areas, where affordability is a function of local house prices and local earnings. But the least affordable areas are not always the most productive ones. As shown in Figure 8, the new targets are not well calibrated to deliver housing the most productive areas: the top half of the productivity distribution would see a 1.5 per cent increase in the stock on average compared to a 1.3 per cent for the bottom half. While some areas, such as London, Slough, and Guildford, are both highly productive and some of the least affordable areas of England, this is not always the case. Kingsbridge and Dartmouth in Devon, along with Cromer and Sheringham in Norfolk, are some of the most unaffordable but rank in the lowest productivity decile.[40] So, targeting unaffordable areas for development is likely to reduce prices in those places where they are highest relative to earnings, but isn't the most effective way to use a housebuilding programme to boost economic growth.

40 This is due to a combination of a higher proportion of retirees and second homes in these areas. For example, Cromer has twice as many people aged 65 and older as the England average (35.8 per cent vs 18.5 per cent). In addition, North Norfolk also has 5.8 per cent of all dwellings being second homes with no usual residents, compared with just 1 per cent for England. Source: ONS, Number of vacant dwellings and second homes (with no usual residents), 2021 Census.

FIGURE 8: **The new housing targets are more linked to affordability than productivity**

Annual targets as a share of existing housing stock by TTWA affordability and productivity deciles: England, 2022



SOURCE: RF analysis of live tables on housing supply from Ministry of Housing, Communities and Local Government, ONS UK GVA and productivity estimates for other geographic areas, ONS Housing affordability in England and Wales, and the formulas for the previous Government and new Government's housing targets.

There is significant potential for agglomeration effects

Relying on productivity figures from 2022 to assess potential productivity presents a rather static view of the British economy. It could be beneficial to build housing in areas that are currently less productive, if they might be more productive in the future. What stands out here is the potential for cities to increase in size, exploiting the potential for agglomeration effects.[41] Such effects reflect improved worker-employer matching, 'thick' markets for business services, and innovation fostered through knowledge sharing.[42] So, housing policy that targets high-potential cities may yield more substantial economic dividends than focusing on those areas that are productive in 2022.

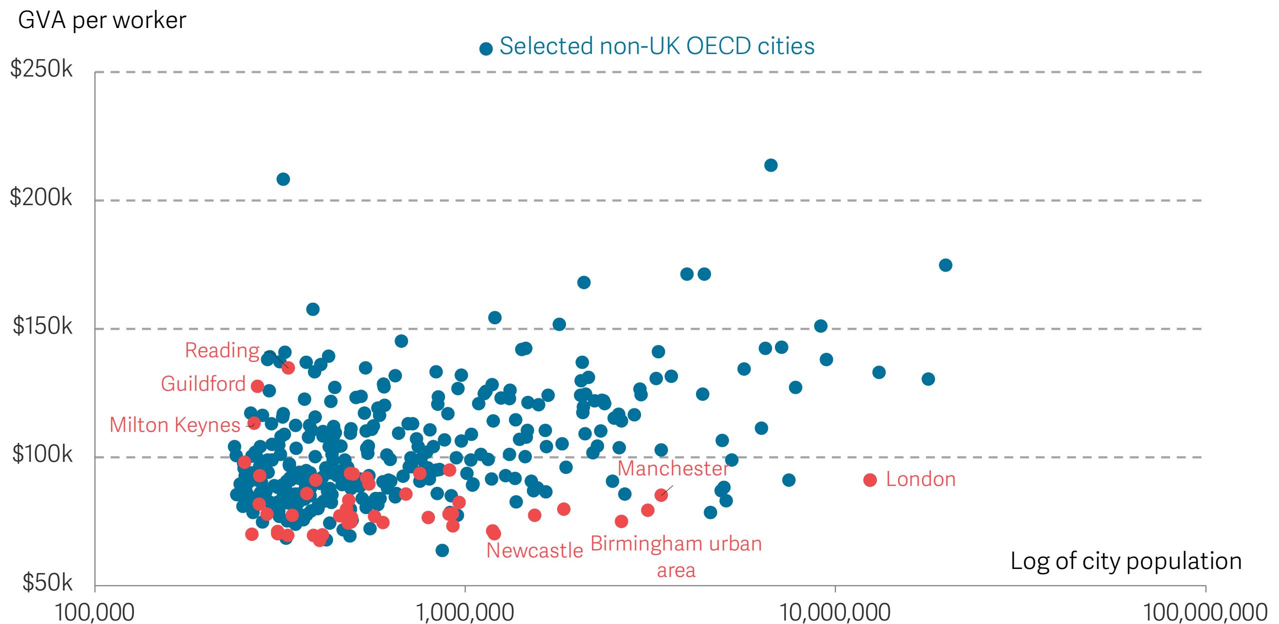
This is particularly important in the UK context given city size doesn't yet guarantee higher productivity. In other advanced economies, larger cities tend to benefit from economies of scale and increased productivity. In the UK, however, the relationship between city size and productivity is much weaker, as shown in Figure 9. Given this, some

41 G Duranton & D Puga, Micro-foundations of urban agglomeration economies, Handbook of Regional and Urban Economics, 2004.
42 T Papageorgiou, Occupational Matching and Cities, American Economic Journal: Macroeconomics, 2022. A Stoyanov & N Zubanov, Productivity Spillovers across Firms through Worker Mobility, American Economic Journal: Applied Economics, 2021; E Berkes & R Gaetani, The Geography of Unconventional Innovation, The Economic Journal, 2021.

have argued that the potential for productivity growth is particularly strong in the UK's major cities outside of London, given the lack of agglomeration to date.[43]

FIGURE 9: **Unlike other OECD countries, as British cities grow they don't get more productive**

GVA per worker (USD constant prices) and city population (log): selected OECD countries, 2019



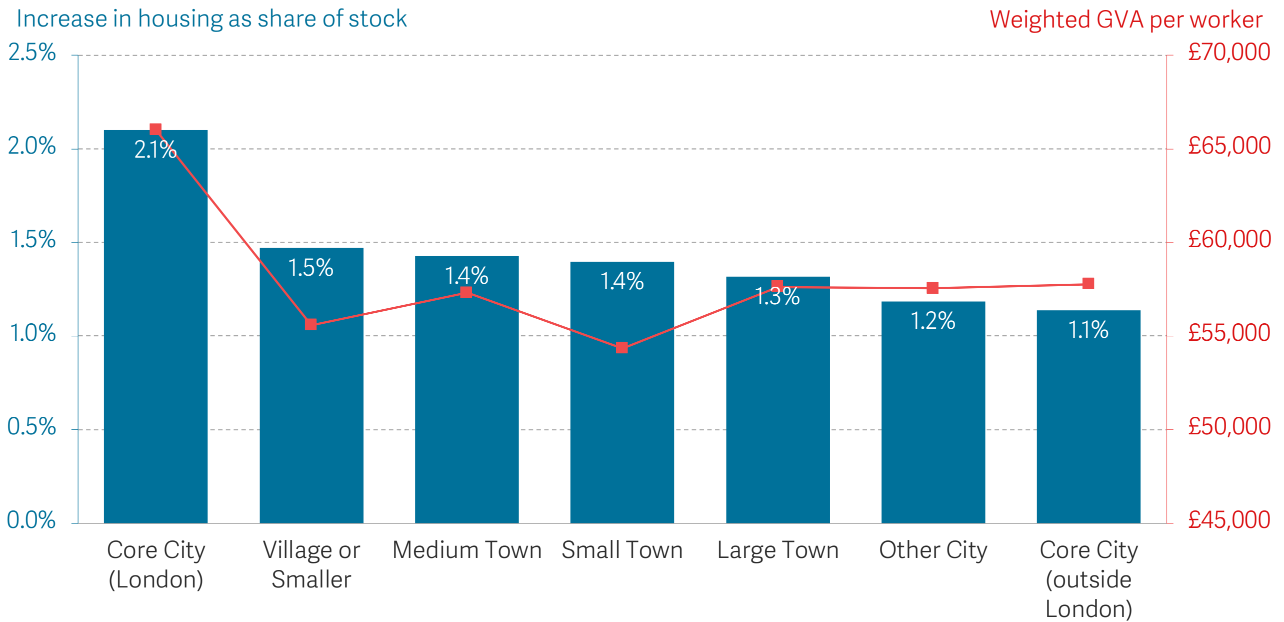
NOTES: GDP per worker measured in in US dollars, constant prices, constant PPP. Cities from countries include Australia, Canada, Belgium, Germany, France, Ireland, the Netherlands, Sweden, and the USA. Based on a chart from G Rodrigues & A Breach, Measuring Up: Comparing public transport in the UK and Europe's biggest cities, Centre for Cities, November 2021.
SOURCE: Analysis of OECD GDP per worker and OECD population datasets, accessed through OECD.stat.

But the Government's housing targets also miss this potential opportunity. London's housing stock stands to increase by 2.1 per cent (down from 2.5 per cent under the old Government's target) if the 48 local authorities which comprise the London TTWA meet their targets. But the next biggest boost goes to 'villages and smaller areas' (where the targets represent a 1.5 per cent increase in the housing stock), and small and medium towns (where targets represent a 1.4 per cent increase in the housing stock) as shown in Figure 10.

43 G Rodrigues & A Breach, Measuring Up: Comparing public transport in the UK and Europe's biggest cities, Centre for Cities, November 2021.

FIGURE 10: **New housing targets are ambitious in London and villages while leaving other cities behind**

Annual housing targets as a share of existing housing stock and weighted GVA per worker, by area type: England, 2021/2022

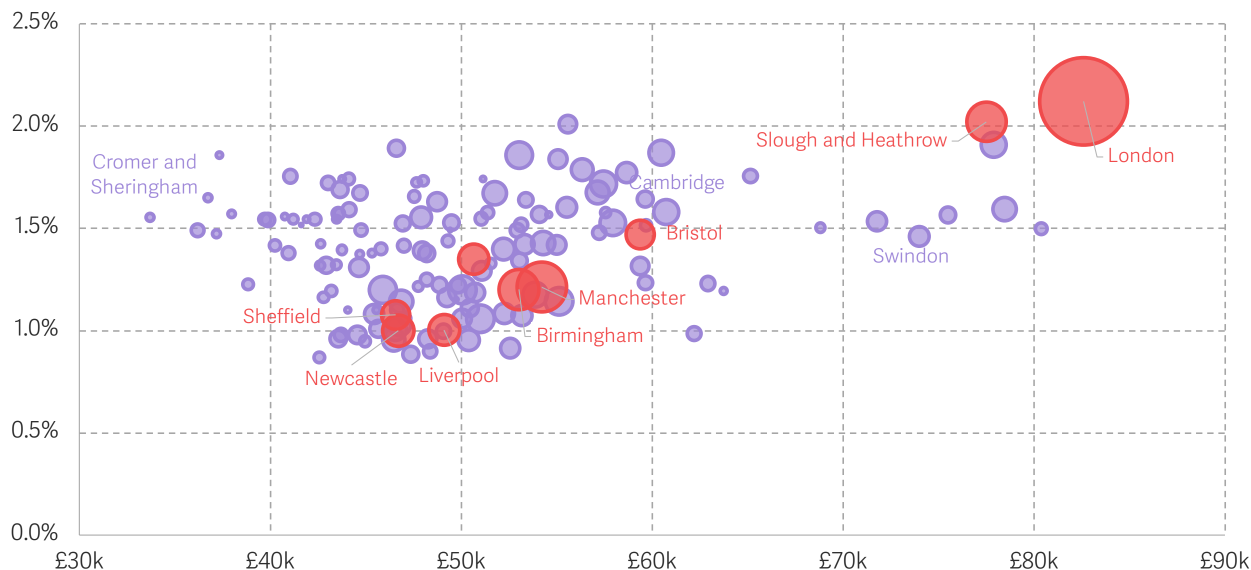


NOTES: Core cities In England include Birmingham, Bristol, Leeds, Liverpool, Manchester, Newcastle, Nottingham and Sheffield. SOURCE: RF analysis of live tables on housing supply from Ministry of Housing, Communities and Local Government, ONS UK GVA and productivity estimates for other geographic areas, ONS Housing affordability in England and Wales, and the formulas for the previous Government and new Government's housing targets.

Figure 11 illustrates this in more detail. Under the new Government's targets, 'core' cities – such as Manchester, Bristol and Birmingham – along with other cities like Leicester and Cambridge would have slower growth in housing as a share of stock than both London and small TTWA's, with an increase as a share of stock of just 1.1 per cent on average. For example, Birmingham and Manchester, the two largest job markets in England outside of London, rank in the 7th and 8th productivity deciles but remain relatively affordable, in the 3rd most affordable decile. This leaves the new housing targets in these cities at just 1.2 per cent each – half of London's – despite their agglomeration potential.

FIGURE 11: **The Government's new housing targets miss the opportunity to boost growth in England's biggest cities outside of London**

Annual housing targets as a share of existing housing stock and productivity, by travel to work area: England, 2021/2022



SOURCE: RF analysis of live tables on housing supply from Ministry of Housing, Communities and Local Government, ONS UK GVA and productivity estimates for other geographic areas, ONS Housing affordability in England and Wales, and the formulas for the previous Government and new Government's housing targets.

There is the potential for new housing targets to add more to GDP if they consider these spatial factors

As currently designed, the new Government's housing targets are not well suited to exploiting the potential for spatial productivity gains. Using the method described in Box 3, we describe how we calculate the effects of housebuilding on the distribution of workers, agglomeration, and therefore GDP, combined with the impacts from housing services. The new Government's targets would lead to a more productive distribution of housing and workers, holding the number of workers constant, than if houses were built in the same distribution as they have for the past decade, adding 0.06 percentage points in total to annual GDP growth.

So how could the Government use its housing targets to boost growth? One option would be to increase targets in more productive areas and shrink them in the least productive areas. Our scenarios suggest this would boost GDP growth by 0.13 percentage points in each year these houses are built (three times as much as the existing targets). A second option would be to increase targets in cities. Exploiting agglomeration effects could add an additional 0.14 percentage points to GDP each year (see Figure 12).

BOX 3: Calculating the effect of labour mobility and agglomeration on GDP

Housebuilding's effect on both labour mobility and agglomeration can add to GDP through a more efficient allocation of resources in the UK. This would show up as higher TFP growth. To calculate these impacts on GDP, we use a simple framework. We adjust the distribution of England's housing depending on the scenario, holding the number of overall workers constant but varying the employment rate by area, to calculate each areas contribution to GDP. Data includes live tables on housing supply from Ministry of Housing, Communities and Local Government, ONS UK GVA and productivity estimates for other geographic areas, ONS Housing affordability in England and Wales, and the formulas for the previous Government and new Government's housing targets.

Using this dataset, we explore four scenarios of the impact of new targets on productivity, holding the number of workers constant, and reporting the results in Figure 12:

3. Baseline – the 2012-2022 distribution of net additions to housebuilding across the UK;
4. 'New targets' – the impacts of the Government's new targets on the distribution of workers in the UK;
5. 'Tilt towards more productive TTWAs' – the impact of the Government's new targets plus a building boost of 50 per cent in highly productive regions, and a reduction in building by 50 per cent in lower productivity areas of the UK;
6. 'Tilt towards Cities' – the impact of increasing housebuilding in TTWAs with populations greater than 500,000 people by 50 per cent,[44] and including an agglomeration impact of 4.6 per cent, offset by a reduction in house-building in villages and smaller areas.[45]

The final scenario includes an estimate of agglomeration's boost to productivity through clustering of worker in cities. In order to capture the full benefits of agglomeration, the Government would need to pursue complementary polices of building sufficient transport infrastructure, increase firm clustering in city centres, as well as ensuring that these TTWAs attract skilled workers.[46]

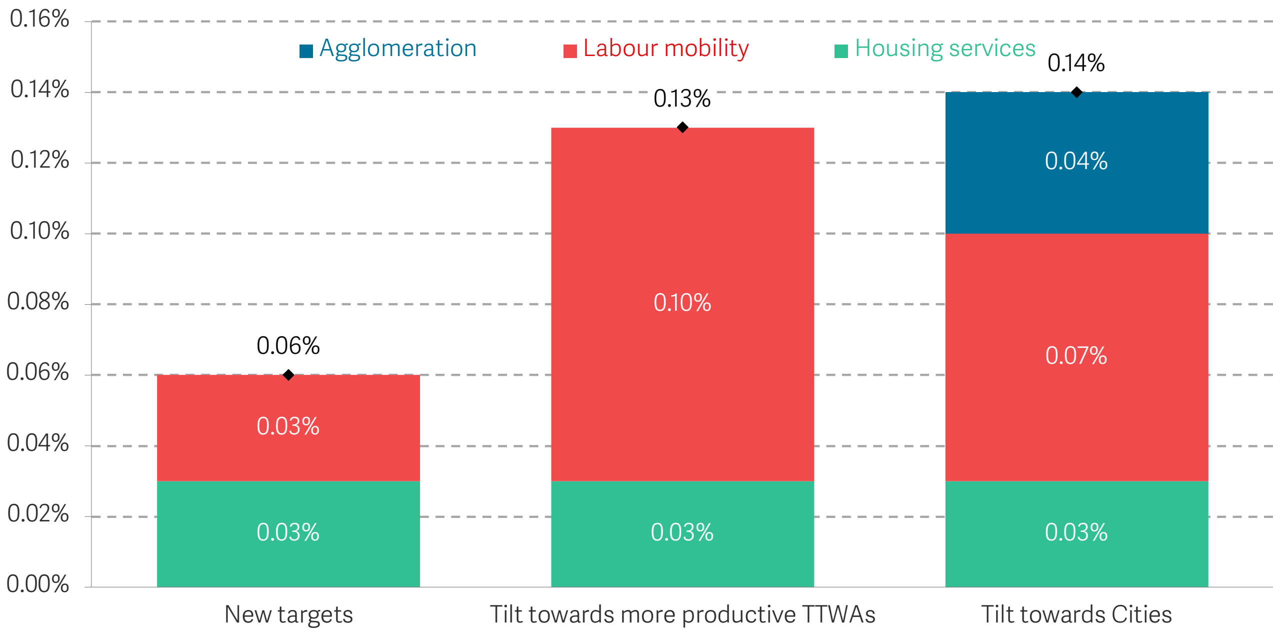
44 The previous Government target included a 35 per cent urban uplift on the biggest cities, this was narrowly defined to the central local authority as opposed to the entire commuting zone. This 50 per cent uplift to cities applies to the full travel to work area, which better takes economic activity into account.

45 We use the unweighted mean agglomeration elasticity (which is typically measured by city size by population or workers) across 47 international empirical studies reported in: D Graham & S Gibbons, Quantifying Wider Economic Impacts of agglomeration for transport appraisal: Existing evidence and future directions, September 2019. While the empirical evidence supports agglomeration effects, the magnitude of agglomeration can vary substantially across sectors and countries.

46 P Brandily et al., A tale of two cities (part 1): A plausible strategy for productivity growth in Birmingham and beyond, September 2023; P Brandily et al., A tale of two cities (part 2): A plausible strategy for productivity growth in Manchester and beyond, September 2023.

FIGURE 12: **New targets can boost growth, but the prize is in tilting housebuilding towards more productive TTWAs**

Annual impacts on GDP of housing targets across housing services, labour mobility and agglomeration compared to the baseline: UK



NOTES: Baseline is building in the historic distribution between 2012-2022 of net additions to housebuilding across the UK.
SOURCE: RF analysis of live tables on housing supply from Ministry of Housing, Communities and Local Government, ONS UK GVA and productivity estimates for other geographic areas, ONS Housing affordability in England and Wales, and the formulas for the previous Government and new Government's housing targets.

Taking the new Government targets' boost to growth from labour mobility and agglomeration together with the contribution from housing services, the total impact to growth for each of the next five years would be 0.06 percentage points. Should the Government adjust these policies to be more oriented towards growth – whether by boosting building in productive areas, or by boosting building in cities – this could rise to as much as 0.14 percentage points.

Lower trade costs would boost GDP, but current proposals unlikely to significantly shift the dial on growth

There is a broad consensus that Brexit has harmed the UK economy, with estimates of the drag on long-term growth ranging from 3 to 5 per cent and the OBR's central forecast pegging the loss at 4 per cent.[47] This impact is due to a combination of higher barriers to trade, reduced investment, heightened uncertainty post-referendum, and altered migration patterns. Among these, the trade repercussions have become particularly pronounced since the implementation of the Trade and Cooperation Agreement (TCA),

47 OBR, Brexit analysis, March 2024 Economic and fiscal outlook.

the new, post-Brexit trading arrangement. The decline in goods trade of 10.7 per cent in the year to Q2 2024 since 2019, compared to 4.6 per cent higher on average for the rest of the G7, highlights the tangible economic costs of leaving the Customs Union and the single market.[48]

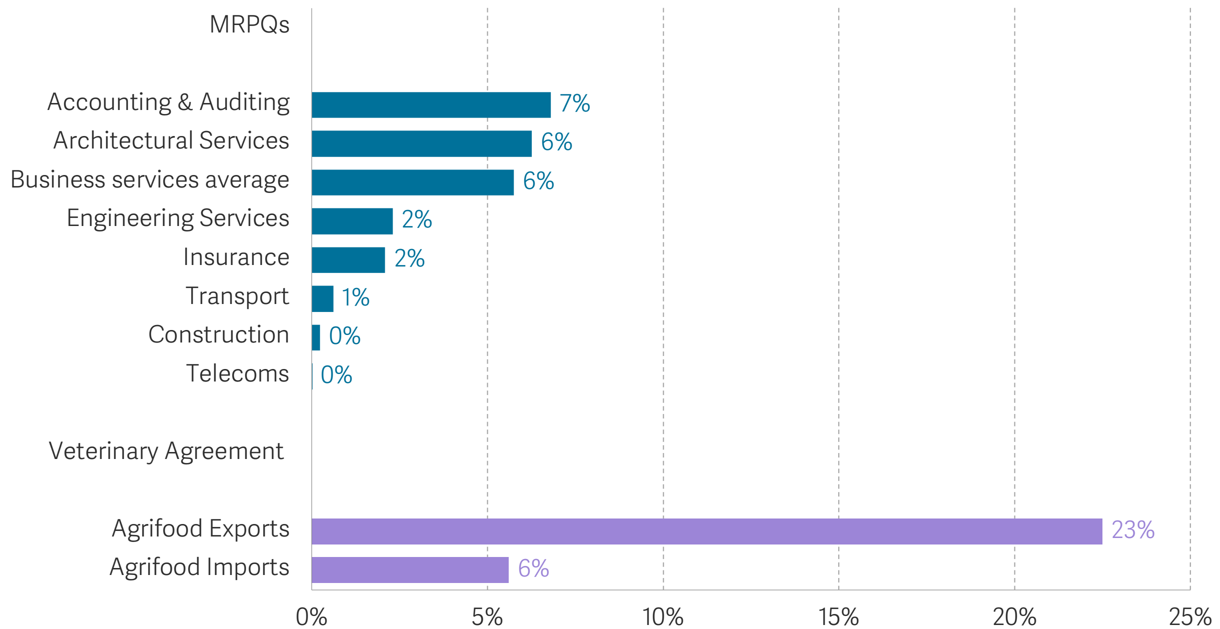
In contrast to the previous Government's focus on non-EU trade agreements, Labour's manifesto outlined a series of targeted commitments aimed at enhancing trade with the EU. Notably, it proposed negotiating a Sanitary and Phytosanitary (SPS) agreement, securing mutual recognition of professional qualifications (MRPQs), and facilitating access for touring artists. If delivered, these measures could potentially boost services trade by just £0.4 billion, with certain regulated sectors – such as accounting and legal services – benefitting from MRPQs in particular, as shown in Figure 13, and goods trade by £3.5 billion.[49] However, this is a tiny sum overall – achieving the veterinary agreement could increase goods trade by 0.4 per cent, just one twenty-fifth of the decline since 2019.[50]

And even these small gains would take time to be negotiated and implemented. It took six years of negotiations under the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union to secure their first Mutual Recognition of Professional Qualifications (MRPQ) for a single professional service sector – architects – in 2023. So, it seems highly unlikely that the Government's ambitions will make a material impact in the current Parliament.

48 S Bhalotia et al., Trading Up: The role of the post-Brexit trade approach in the UK's economic strategy, June 2023.
49 MRPQ estimates from RF analysis of DIT, Services trade modelling, DIT Analysis Working Paper; OECD STRI, ONS, quarterly services trade data Q4 2023; ONS, UK Trade July 2024; Agri-food estimates based on J Du, G Messenger, & O Shepotylo, Enhancing the Brexit Deal: Exploring the Impact of a UK–EU Veterinary Agreement on Agri-food Trade, Centre for Business Prosperity, April 2024.
50 UK trade was £1,740 billion in 2023. For more see: ONS, UK trade: December 2023, February 2024.

FIGURE 13: **Negotiated agreements take time but could increase trade for targeted sectors**

Partial trade effects of veterinary agreement and export effects of MRPQs on selected sectors: UK



NOTES: Agri-food estimates based on J Du, G Messenger, & O Shepotylo, Enhancing the Brexit Deal: Exploring the Impact of a UK–EU Veterinary Agreement on Agri-food Trade, Centre for Business Prosperity, April 2024. Matching of STRI sectors to trade data uses the mapping set out in the DIT, Services trade modelling. The impact of removing measures related to the categories above are applied to the elasticities (the increase in trade for a given change in the STRI) estimated in the paper. Estimates are based on the difference between intra-EEA STRI and applied STRI scores across EU partners. MRPQs would have greater impact on increasing trade with non-EU countries such as Australia and the US.
SOURCE: RF Analysis of DIT, Services trade modelling, DIT Analysis Working Paper; OECD STRI, ONS, quarterly services trade data Q4 2023; ONS, UK Trade July 2024.

To deliver a significant boost to growth, the Government would need to go further

So although it is encouraging that the new Government is prioritising improved relations with our largest trading partner, the current proposals do very little to address the trade barriers hitting businesses.[51] Firms have faced both regulatory and customs barriers from day one, and under current proposals these trade frictions will worsen as UK and EU regulations diverge. Often, this is 'passive', happening when the UK's domestic regulations are not updated in line with changes made by trade partners. For example, since the TCA was signed, the EU has tightened its REACH regulations (which aim to protect human health and the environment from risks of chemicals) to restrict more chemicals, while the UK's REACH rules are still being developed. But divergence can also be 'active', with countries choosing to separate their rules from others.

51 E Fry, Britain needs to acknowledge rather than deny its weaknesses in goods trade, and leverage its strength in services , Resolution Foundation, May 2024.

Even where regulations are aligned, businesses can still face compliance costs. After Brexit, the UK created its own conformity assessments for products but decided in May 2024 to accept EU conformity assessments indefinitely.[52] This means manufacturers don't need to demonstrate product safety with both CE marking for the EU and UKCA marking for the UK.[53] However, British companies still face trade barriers because they can't conduct CE product tests in the UK and must use testers in the EU unless a new bilateral agreement is reached.

It is inevitable that the UK will align with some EU rules. Indeed, the new Government has already signalled that they will pursue a pragmatic approach to resolving regulatory frictions with the EU through the 'Product Safety and Metrology Bill', introduced in the July 2024 Kings Speech. The bill aims to "recognise new or updated EU product regulations, including the CE marking, where appropriate to prevent additional costs for businesses and provide regulatory stability", as well as provide options for UK product safety regulation to diverge from the EU if appropriate. [54] While narrowly focussed on product safety, and particularly issues at the Northern Ireland border, this indicates this Government's fresh approach to regulation. Indeed, it is a starkly different approach from the previous Government's Retained EU Law (Revocation and Reform) Act which aimed (but failed) to revoke much EU-origin law by the end of 2023.[55]

But this approach is still a patchwork where influential sectors secure regulatory alignment while less powerful ones are left behind. To maximise the growth impact, the new Government should be far more ambitious. Given the economic costs of divergence, which raises barriers for UK producers to trade with a huge neighbouring market, there is a case for making alignment the default, except where there is a reason to diverge. Alternatively, the Government could assess which sectors and products are most exposed to regulatory divergence and align these rules with the EU. Under either of these arrangements, a formal institution, such as that created by New Zealand and Australia, could help coordinate this process between the EU and UK.[56]

Depending on the extent of this alignment across sectors, alignment – whether unilateral or dynamic – would provide a meaningful boost UK GDP. Research from the Resolution Foundation and the LSE suggests that almost half of the trade-related impact of Brexit on the UK's GDP, or 0.6 percentage points by 2035, is from the foregone ongoing alignment within the EU (which can be interpreted as both passive and active regulatory

52 J Reland, UK-EU Divergence Tracker Q1 2024, April 2024 ; Department for Business and Trade, UKCA marking: conformity assessment and documentation, May 2024. (with the exception of medical devices and construction products)
53 EU CE mark "Conformite Europeenne" certifies that a product has met EU health, safety, and environmental requirements. Similarly, the UKCA (UK Conformity Assessed) is a product market indicating that it meets UK regulations and is compliant.
54 Prime Minister's Office, King's Speech 2024: background briefing notes, July 2024.
55 G Cowie, Retained EU Law (Revocation and Reform) Act 2023, House of Commons Library, July 2023.
56 S Bhalotia et al., Trading Up: The role of the post-Brexit trade approach in the UK's economic strategy, June 2023.

divergence).[57] Although this estimate carries significant uncertainty it does provide a reasonable central case for the scale of gains that could be on the table.[58]

Even with this deep regulatory alignment, other barriers to trade will remain under the TCA. Should the Government seek to tackle these ongoing frictions, the Prime Minister would need to reconsider his Brexit red lines on the customs union and the single market. Here the impact could be very large – a 'UK Protocol' (combining joining the EU's customs territory with the single market for goods) could reverse much of the hit to the level of GDP from Brexit, restoring 2 percent of GDP which over, say, a decade, by around 0.2 percentage points – enough on its own to achieve two-fifths of the growth needed to reach the top of the G7 growth league.[59]

Policy stability is pro-growth, but easier to promise than to achieve

In addition to specific announcements on infrastructure, housing and trade, the Government has emphasised a more general commitment to economic stability, contrasting this with what it claims was a time of relatively unstable economic policy under the previous government.[60] And such stability has certainly been something that UK business has repeatedly asked for.[61] This is not a surprise: uncertainty makes it more difficult for firms to judge which investment projects are likely to be productive, leading to postponement, at least in the short run.[62] There are several mechanisms: investment is costly to reverse, leading firms to wait for the resolution of uncertainty; it can increase firms' discount rates; and it can tilt what investment remains towards things that pay off in the short term.[63]

Measures of policy uncertainty have been elevated at certain times during 2010-24, including around the Brexit referendum, crunch points in the subsequent negotiations and around the so-called mini-budget in September 2022 (see Figure 14).[64] It remains to be seen, however, whether the Government will be successful in reintroducing stability to economic policy, given that policy must sometimes respond to events, and that it has ambitions to make changes to trade policy, tax policy, employment relations and workers' rights.

57 S Dhingra, E Fry, S Hale & N Jia, The Big Brexit: An assessment of the scale of change to come from Brexit, Resolution Foundation, June 2022.

58 It may understate the potential benefits of regulatory alignment, as it fails to account for gains from increased investment or migration. Conversely, it could also overstate the potential benefits, as some of the regulatory alignment lost post-Brexit may prove difficult to restore – for example businesses facing additional compliance costs and unavoidable regulatory divergence – even with a comprehensive bilateral process.

59 Analysis of HM Government, EU Exit: Long term economic analysis, November 2018; and S Dhingra & T Sampson., Brexit Economics, November 2019.

60 HM Treasury, Chancellor Rachel Reeves is taking immediate action to fix the foundations of our economy, July 2024.

61 CBI, CBI responds to Rachel Reeves' first speech as Chancellor, July 2024

62 Dixit, A. and Pindyck, R., Investment under Uncertainty, Princeton University Press, 1994

63 N Bloom, Fluctuations in Uncertainty, Journal of Economic Perspectives 28/2, Spring 2014

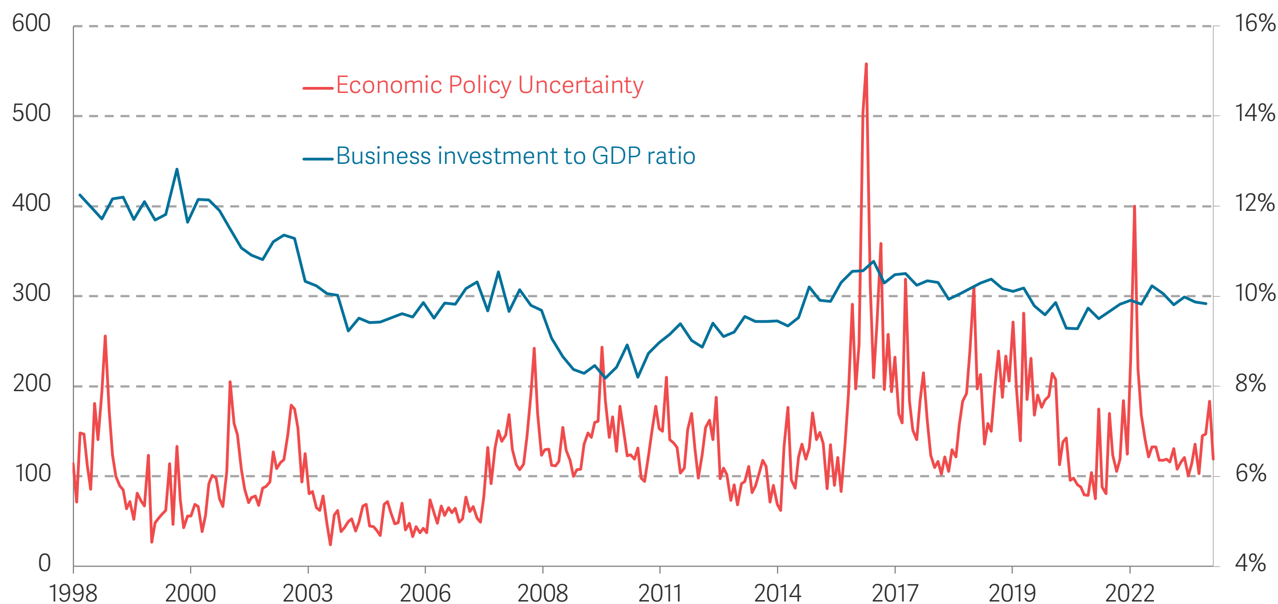
64 S Baker, N Bloom & S Davis, Measuring Economic Policy Uncertainty, The Quarterly Journal of Economics, Volume 131, Issue 4, November 2016, Pages 1593–1636, https://doi.org/10.1093/qje/qjw024

On the other hand, we should not overstate the role of domestic policy uncertainty. A large part of the volatility to which UK firms are exposed arises from economic or geopolitical causes elsewhere in the world, such as Russia's war in Ukraine, or the attitude of the US and China to free trade. Moreover, the UK's investment rate started to fall during the relatively stable mid-2000s, suggesting that, while greater stability may be helpful, it is just one among many factors.[65]

Robust, causal evidence on the long-run effect of reduced policy uncertainty is hard to come by. And it is hard to know how much policy uncertainty is really in the Government's control. But a reasonable aspiration would be to avoid the policy uncertainty from the Brexit and mini-Budget period. The multipliers in the literature suggests that this could increase the growth rate of the capital stock by around 0.3 percentage points, enough to boost the growth rate of potential GDP by a small amount for several years.[66] The effects could be much larger or smaller than this in practice.[67] But it would be unwise to bank on much of a growth boost from lower policy uncertainty alone.

FIGURE 14: **Economic policy uncertainty spiked due to Brexit and the mini-Budget, reducing business investment**

Economic Policy Uncertainty Index for the UK and UK ratio of nominal business investment to GDP



NOTES: Business investment to GDP ratio is in nominal terms
SOURCE: www.PolicyUncertainty.com and ONS.

65 J Oliveira-Cunha et al., Business Time: How ready are UK firms for the decisive decade?, Resolution Foundation, November 2021.

66 To obtain this estimate we use the parameter estimates in S Baker, N Bloom & S Davis, Measuring Economic Policy Uncertainty, Quarterly Journal of Economics 131/4, November 2016. We multiply the coefficient on the interaction between policy uncertainty and sales share to government by the ratio of intermediate consumption of industries O, P and Q as a share of total domestic output, and then assume that EPU falls to the post 2007 average excluding the 2016-20 Brexit negotiation period and late 2022 volatility around the mini Budget. This will be an underestimate if EPU affects firms with no sales to the government.

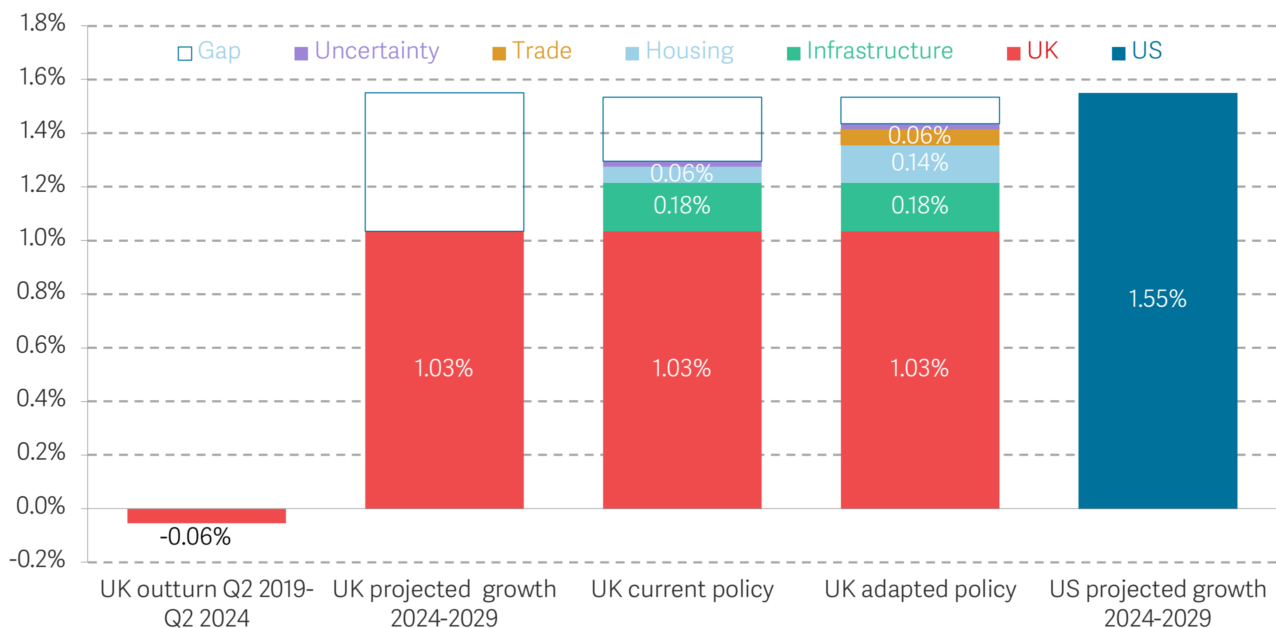
67 The effects could be larger because this panel evidence effectively assumes that the only channel is on firms exposed to policy uncertainty through their sales to governments. It could be smaller if uncertainty normally rises due to an increase in the chance of bad policy.

The measures we quantify add up to a small but worthwhile boost to growth, but do not yet add up to a growth strategy

Stepping back, the Government has set out an ambitious growth mission and a set of policies which, if delivered, make strides towards it. In less than three months, it has introduced infrastructure and housing policies that could add over 0.2 percentage points to annual GDP growth (see Figure 15). Reducing policy uncertainty could also contribute a small boost to growth, but its effects are very uncertain. And the trade measures announced thus far would have minimal impacts, though the potential for regulatory alignment offers some upside. Altogether, and acknowledging the huge uncertainty with this exercise, we judge that these measures could provide about half the boost needed for the UK to become the fastest-growing G7 economy, based on IMF forecasts.

FIGURE 15: **Current growth policies provide half the boost needed for the UK to become the fastest growing G7 economy, but a major turnaround is needed**

Annual GDP per capita growth, and impact by measure within this Parliament: UK



NOTES: This chart combines IMF forecasts for average GDP per capita growth for 2024 to 2029, with estimates of the average growth impact from trade, and the maximal growth impacts from infrastructure and housebuilding given that these take time to ramp up.
SOURCE: RF analysis of IMF World Economic Outlook Database April 2024; ONS; MCHLG; S Dhingra, E Fry, S Hale & N Jia, The Big Brexit: An assessment of the scale of change to come from Brexit, Resolution Foundation, June 2022.

There is of course considerable uncertainty surrounding these estimates. It's one thing to promise 1.5 million new homes, but quite another to actually build them.[68] British public investment has been notoriously volatile over the past 60 years, leading to chronic

68 C Aref-Adib, J Marshall & C Pacitti, Building blocks, Assessing the role of planning reform in meeting the Government's housing targets, Resolution Foundation, September 2024.

underspends.[69] And, the IMF forecasts already assume a rapid turnaround in growth that might not materialise, leaving a bigger gap with the US to close.

In terms of timing, some of these areas can deliver growth soon – once houses are built, infrastructure projects completed and stability demonstrated. But gains from trade depend on the Government articulating a clear strategy with the EU and negotiating toward those goals. If they pursue the more ambitious path of bilateral regulatory alignment, the broader benefits are likely to take time and won't be fully realised until the end of this Parliament, rather than incrementally throughout.

The fact that the announced measures don't close the whole growth gap doesn't mean the Government will miss its growth target. Other parts of its announced policy agenda – especially labour market reforms – will affect growth, as will the announced pensions consolidation. The major tax and spending decisions in the Autumn Budget 2024 could help or hinder growth.[70] But there are also important policies which will affect growth but are as yet not well developed, including skills, competition and industrial policy. It is crucial that these other policy areas are joined up with the growth mission.

More fundamentally, we are yet to see the Government articulate a growth strategy. A proper growth strategy is essential, among other things, to help the Government to understand the scale of the task it faces, and to resolve the trade-offs that exist between its full set of policy instruments and policy objectives. For example, when deciding where to build extra houses, the Government could legitimately choose to prioritise affordability or productivity. But the first step to choosing well is to know that the trade-off exists, and this is one thing that a strategy will tease out.

A clear strategy is essential, even acknowledging that much of the UK's economic growth will hinge on global and technological forces beyond the Government's control. Even the baseline growth acceleration to 1 per cent that the IMF predicts is far from certain, and would require a sharp turnaround from recent performance. While the Government rightly highlights policy stability as key to achieving growth, we believe that, while necessary, it is insufficient on its own to deliver the transformative results the economy urgently needs.

Instead, the opportunity lies in building the Government's initial set of policies into a strategy. This is a big task: implementing the initial growth measures, complementing them in other key areas, and underpinning them by a strategic framework which manages the major trade-offs and interdependencies. But the prize would be worth it – a better chance of breaking out from the economic stagnation of the past 17 years.

69 F Odamtten & J Smith, Cutting the cuts: How the public sector can play its part in ending the UK's low-investment rut, Resolution Foundation, March 2023.
70 A Corlett, Revenue and Reform: What tax changes could – and should – we see in Autumn Budget 2024?, September 2024.

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