A Labour Economy: Are we nearly there yet?

by

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A Labour economy: are we there yet? Of course not. Yes, we've made a decisive break with the economic volatility of the past, removed political temptation from interest rate decisions and delivered the lowest mortgage and interest rates for decades. Reinforced by the New Deal, sustained economic growth has created a million and a half new jobs and virtually eliminated long-term unemployment. Thanks to the first ever national minimum wage and intelligent re-regulation of the labour market, we have largely eliminated the worst jobs – those £2.20-an-hour/bring-your-own-dog security guards that became notorious under Thatcher and Major – and brought 200,000 more workers under the umbrella of a union recognition agreement.

It is a lot. But is it enough? No. Not when women are still earning only 81p for every pound earned by men; Black and Asian British workers are twice as likely to be unemployed and people over 50, however much they want a job, find it almost impossible even to get an interview. Not when some of our regions and too many of our communities do not share in the prosperity enjoyed by most. Not when parents struggle to find jobs that let them balance work and family. Not when we still have employers who think it is acceptable to risk their workers' health, or tolerate sexual and racial harassment. Not when too many customers find themselves fobbed off with shoddy goods or poor service.

We believe in a high-wage, high-skill, high-productivity economy. And the best businesses in Britain are amongst the best in the world. But we do not have enough of them. The result is a productivity gap with our major competitors. This is the direct result of years of under-investment in technology, R&D and management and workforce skills that leaves us turning out less value for every hour we put in than our counterparts in the United States, Germany and France. ‘Productivity’ may sound dry and technocratic but the reality is that makes the difference between worse or better jobs, lower or higher wages, lower or higher profits, therefore lower or higher tax revenues to fund our public services.

Nor can our benchmarks simply be the G7 industrialised economies. The economic geography of our world is being transformed. China, India, Brazil and South Africa – home to over 2.5 billion people, leaders of the new G21 – do not speak for all, or even the majority of developing countries. But this coalition of the world's largest emerging markets has already transformed the dynamics of the World Trade Organisation, just as it will transform the dynamics of trade itself. Closer to home, ten new member states of the European Union also offer new opportunities, but new challenges too from countries with far lower wage costs but often enviably high standards of technical education.

In this new world, Labour needs to move decisively into a new phase of economic policy. At the heart of any economy are individual businesses: in the UK, the 3.3 million self-employed, sole traders and other small and medium-sized businesses, who together with a far smaller number of large, often multi-national firms make up our wealth-creating private sector. These businesses – many of them at the heart of their local communities – must be central to the next stage of our economic policy-making.

Labour's historic attitude towards business has traditionally been suspicious if not downright hostile. That made perfect sense for a Party born out of the struggle of labour against capital, against the exploitation of the many by the few. Labour was for the public not the private sector, workers not employers, producers rather than consumers. Even twenty years ago, Labour rarely consulted business people about economic policy and it was commonplace for CLPs to refuse membership to managers in the private sector.

Part of new Labour's unprecedented electoral success was undoubtedly our ability to lure business away from the Conservatives. But today, we stand accused of abandoning traditional values and our supporters to get into bed with big business while for their part business worries that we are abandoning our pro-enterprise policies for a return to tax-spend-and-regulate. If we are to move forward with confidence, we cannot rely upon tactical accommodations: something for business here, something for trade unions there. We need instead fresh thinking about the principles and values upon which we base our engagement with business.

Modern social democrats should be able to take it for granted that our country needs strong, successful, innovative businesses: generating good jobs, creating the wealth that sustains our pensions and our public services. We should be able to take it for granted that any successful modern Labour government will support enterprise and entrepreneurs, and will want to create an environment in which more businesses start-up, grow and prosper. Monopolies and cartels are a threat to consumers, and competition – pitting smaller against larger, new entrant against incumbent, the innovative against the lazy – is a progressive good.

Culturally and politically, however, it may seem quite a stretch for Labour to embrace the entrepreneurs and small traders who were perceived to be the bedrock of Margaret Thatcher’s support. But Labour’s banners have long proclaimed the dignity of labour, while William Morris rejoiced in the medieval craftsmen who were ‘masters of their time, tools and materials’. It no longer makes sense for the left to celebrate employment and sneer at employers and the self-employed. As job growth shifts from larger to smaller firms, and more people express their talent and energies in self-employment, we should celebrate entrepreneurs as much as employees.

Let's be quite clear: a progressive, pro-enterprise agenda does not mean abandoning our values. What we want is good businesses and it is time to define more sharply what we mean by good businesses and how we can get more of them. In his book, *The Truth about Markets*,[1] John Kay eloquently demolishes the claims made for the American Business Model (ABM) that greed is good, and that profits are the sole purpose and measuring-rod of enterprise. He argues that it is not true that profit is the purpose of a market economy, and the production of goods and services is a means to it, rather the purpose is the production of goods and services, and profit the means. Consequently, the businesses that are most successful are those that create long-term value, whose founders and directors are most admired and not those that merely pursue short-term profit. They are passionate about the quality of what they produce; honest and fair in their dealings with consumers, employees and suppliers; and careful with their reputation.

Progressives in Britain and other advanced economies can readily define a good business as one that provides the best goods and services and makes a profit by doing so. But we do not stop there: we rightly criticise products produced in third-world sweatshops. We expect business to be a good employer, treating all employees with respect and dignity, providing even those engaged in less demanding tasks reasonable pay and the opportunity of advancement. We want businesses to understand and accept their environmental responsibilities, instead of pursuing profit by ignoring the costs of pollution. And we want directors and senior managers to work in partnership with their investors and fellow-employees.

[1] John Kay in *The Truth about Markets*, Allen Lane 2003

But, good businesses are not simply the product of inspired individuals, nor will they be created by appealing to altruism. Businesses are social as well as economic institutions, and they operate within a wider social context only in part the outcome of government action. Government cannot simply create good businesses, whether through regulation, direct support or tax policy. But progressives have more levers at our disposal than we sometimes understand.

These levers, of course, include regulation. The minimum wage, for instance, has closed off to business the bottom-end route of low-wage, low-skill, low-margin production and, far from destroying 2 million jobs as our opponents claimed, has been accompanied by record job creation. Although caution was amply justified at the start, we now know that the minimum wage has covered fewer workers than originally intended so the above-average increases now planned for October 2003 and 2004 will bring up to 2.5 million workers within its scope.

Regulation is generally more effective at eliminating the worst than creating the best. But we are starting to find ways of using regulation to stimulate best, or at least better, practice. The companies who lead the way in working time reform – offering all their employees the chance to achieve a better work-life balance – do so because they have learnt they will be more successful as a result. Managers who have not woken up to these new realities will not change their minds because a law tells them to, nor can legislation impose the different solutions that will suit different people in different jobs. But by entitling every employee to ask and negotiate new working patterns, our new laws can and will help to stimulate and accelerate the deep culture change we need.

Similarly, regulation cannot force managers to make the huge investment needed to create effective workplace partnerships with employees and, where present, their trade unions, all the evidence suggests, are an essential part of high-performance, high-productivity workplaces. But the Information and Consultation Directive can eliminate the worst practices, like workers hearing they've lost their jobs over breakfast radio or by text-message. And by setting minimum standards for sharing information and seeking employees' views, it will encourage more managers to aspire to best practice.

Nor should we under-estimate the role of competition or the progressive case for pro-competition policy. It is not the job of the centre-left to defend a firm whose under-investment, lack of innovation or foresight, poor management or out-of-date processes has left it at the mercy of domestic or international competitors. Faced with the challenge of raising productivity we need competitive markets that speed up the rate at which the less innovative and competitive are replaced by the more dynamic businesses.

But unlike our political opponents on the right, however, we will never walk away from the people who suffer from such inevitable economic restructuring. But the priority must be to help those affected to get new jobs and, where necessary, new skills as quickly as possible. There are too many firms stuck in what economists call a low-investment, low-margin equilibrium. These firms, producing goods and services that require only less-skilled workers and low levels of technical equipment, cannot afford good wages or generate high profits: they, and their employees, are the most vulnerable to competition from lower-wage economies. Investing in their employees – who include many of the 7 million British workers without basic literacy and numeracy skills – may not save the employer, who may not have the management know-how or market opportunities to use better-skilled workers. But it will enable those workers to find better jobs with more competitive businesses and, in doing so, raise the productivity levels of the UK economy as a whole.

Skills, strong regions, competition, intelligent regulation, better infrastructure, investment incentives and a sound economic climate: these are familiar ingredients of Labour's economic policy, and no less essential for being familiar. But it is time to turn to a less familiar issue, a new front in our economic policy: how to mobilise owners to create better businesses.

It is time for a change. Time for a new economic democracy that reconnects companies with their owners. For a party for whom ownership mattered above all, we have been curiously slow to grasp the change that has taken place in the ownership of the UK economy. Publicly quoted companies are only 0.1 per cent of the UK's total businesses but they account for 25 per cent of turnover. And we the people own over 50 per cent of their shares: not just through the individual share-ownership in which Margaret Thatcher invested so much hope (and which accounts for around only 14 per cent), but more significantly through pension funds, insurance, as well as unit and investment trusts. The recent corporate flight from final salary to money purchase pension schemes (which we are addressing in our pension reforms) does not alter the fundamental reality: companies now belong to the many, not the few.

It is in our name – in the name of creating share-holder value, of 'aligning managers' interests with share-holders' – that huge share options have been granted, so many mergers and acquisitions and financial re-engineering pursued, so much value destroyed.

We have already made a start on the issue of executive pay. The public has rightly been outraged as directors responsible for massive corporate failures walked away with huge pay-offs when employees were losing their jobs and investors their pensions. Rather than dictating corporate pay, we acted to put information and power where it should belong: in the hands of shareholders. By requiring companies to publish full details and hold annual shareholder votes on executive pay, we have made company directors properly accountable to those whose interests they are meant to represent. And by empowering people to make their own views heard, and consulting widely on what further (self-regulatory or government) action is needed, we are reinforcing a change in public and corporate attitudes towards payment for failure.

Such an approach is already delivering real change in the boardroom, as illustrated by the packages announced by companies such as Invensys and Vodafone in response to shareholder and investors concerns. This is a classic example of modern social democracy in action: using the power of government not to impose solutions, but to transfer power into the hands of people, so that they can drive change forward themselves.

We have also acted to strengthen company boards and to ensure independent, honest auditing. The globalisation of markets meant that the horrific events at Worldcom and Enron in the US demanded a response from governments around the world. Our response in the UK, through the Higgs and Smith reviews ensured that robust action was taken to improve standards but not at the cost of further market instability and investor confidence.

But more action is needed. At several of this year's company AGMs, we heard loud and clear the voice of individual shareholders and trade unions. But too little was heard from the pension fund managers. Voting levels of 55 per cent must surely be improved. In some cases, millions of votes – our votes – simply went AWOL. And company directors – from whom we are demanding increasing transparency and accountability – are not surprisingly frustrated by the actions of investment institutions, who do not always practise the same standards of transparency demanded of the companies in which they invest.

It is encouraging that some institutions are now advocating a new approach, and exhibiting greater responsibility, for example, Hermes, a fund manager responsible for managing £40 billion of pension fund monies, including BT's 178,000 pensioners. Their starting-point is that 'the primary goal of a UK listed company is to be run in the long-term interests of its shareholders, to generate value for them.'[2] The key is 'long-term'. Because most of us need to save and plan for a retirement that can now last for many decades, pension fund members' liabilities are inevitably long-term: on average, according to Hermes, over a quarter of a century.

Furthermore, because companies' real owners are a majority of the population, and each individual's investments are widely diversified (each pension scheme contributor owns a tiny fraction of most large UK companies), companies must also have a broad understanding of their responsibilities. It does not help the shareholders if one company makes a profit by dumping high costs on society at large, in essence 'robbing Peter to pay Paul'. But much of the interaction between company directors and investors focuses only on the short-term - despite the fact that pension fund or insurance liabilities are met out of absolute returns over the long term, not relative ones in the short term. Long-term value creation needs managers who can understand and build real competitive advantage for their companies, and fund managers willing to support long-term investment.

The 'Hermes Principles' set out the expectations that this one fund has of the companies whom they back. They want companies to develop coherent strategies for each of their businesses; to identify and grow activities that best support long-term value creation; to find cost-effective ways of incentivising managers accordingly; to behave

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[2] *The Hermes Principles* Hermes Pension Management Ltd, 2002

ethically and manage effective relationships with their employees, suppliers and customers. This does not mean business accepting limitless social obligations: their responsibility is still to generate a surplus. After all, no profits, no pensions. But companies that act fairly, and engage in an open dialogue with investors and the wider public, are likely to do better long-term than those who simply pursue short-term profit.

This underlines the value of active involvement by owners. Too many fund managers, faced with an under-performing company, continue to support an inadequate management. Where were the critical investors and analysts, where were the rigorously independent non-executives, as companies like Marconi went downhill? How many of us, as pension fund contributors, even knew if our pension schemes had a share in the firm or asked how the fund manager was casting his vote?

Others simply pull the plug and switch investments. As the share price tumbles, a merger or take-over becomes the only route to replacing failed management. But a different approach can be taken: using investment in under-performing companies as a lever to change management, corporate strategy or both, and by rebuilding the firms' value, reaping well-above-average returns for investors.

The old agenda for the left was to own or control large companies on behalf of the people. The new agenda must be to enable people themselves to move the large companies they already own towards sustainable prosperity through responsible management. As an American writer on corporate governance, Dr Steve Davis, has cogently argued, we need a new ‘civil economy’, underpinned by a fundamental change in the behaviour of institutional investors. Whether through voluntary codes or regulation, they need to become accountable to the millions of people whose savings they handle, disclosing their investment criteria and how they vote their shares.

Some companies have already expressed a fear that, with new and more demanding standards of corporate governance and ever more complex markets, too many fund managers will resort to ‘box-ticking’ instead of taking the trouble to understand the firm properly to make a sound judgement on the board's explanation. Active ownership takes time and trouble: to make sure the right management is in place, to set new financial frameworks, and support improved workplace. But active owners, accountable to a company’s ultimate owners – the people – is what a progressive economy needs.

I shall now be inviting the Labour Party's Trade and Industry Policy Commission to take this agenda forward, building on the changes we are already making to company law and corporate governance.

We need a more transparent process and more active involvement from the members of pension schemes in electing trustees. Investors need regular information on how fund managers are acting and voting on their behalf. There should be a greater flow of information on how fund managers are exercising their powers and how active an interest they are taking in the companies in which they invest. Obviously, trade unions have a vital role to play here: supporting the election of pension fund trustees, equipping those trustees with the skills they need, and representing their members when management proposes changes to schemes. By requiring firms to consult employees/pension fund members on changes to pension schemes, we will encourage more people to become more active owners of the UK economy.

We should also consider how to further advance the agenda for collective employee share ownership. And, recognising that pension fund investment is increasingly international, we need to consider how to mobilise the power of owners – as well as consumers – to promote better businesses globally as well as at home.

Some people have sought to use rewards for failure, or the scandals of Enron and Worldcom, as an excuse for a general onslaught on business. Progressives must not make that mistake. Our best businesses – those that are innovative, profitable, and socially and environmentally responsible – are great places to work in and deliver leading-edge products for consumers. Such businesses should be our pride and joy, and those who lead them our allies. But our country needs far more of them. By empowering people – the people who indirectly own so much of the British economy – we can help to deliver better businesses, better jobs and a better quality of life for all.