

Investment, Partnership, Sustainability

*Policies for the
British Economy*



Policy Paper 16

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Summary

The British economy is facing massive change. New world-wide industrial revolutions - in transport and communications, manufacturing processes and energy use - will, by the time they are through, have transformed society just as radically as did the first Industrial Revolution two hundred years ago.

As a trading nation, Britain must face up to the challenge this presents. We too must change and adapt to this new global market place. There are no simple solutions. Above all, governments have to face up to the fact that there are now substantial limitations on their powers of economic management. Success depends upon working with the grain of the international economy and providing a framework which encourages other national players - industry, financial institutions, the education sector, employees, consumers - to commit themselves to the process.

The three key themes in Liberal Democrat economic policy are:

- *Investment for the longer term* - in education, industry and infrastructure, to encourage enterprise and innovation and to make sure that we use the skills and capabilities of Britain's people to the full.
- *Partnership* - between government, business and the financial sector; between employers and employees; between central and local government; between government and people. All can play their part, together, in helping rebuild and regenerate the British economy.
- *Sustainability* - in its widest sense to embrace economic and social cohesion as well as environmental sustainability. The aim must be to improve the quality of life for all, while at the same time tackling pollution and conserving and enhancing our natural heritage.

Investment for the Longer Term

Over the last fifty years Britain has consumed too much and invested too little. Investment is needed to up-date and extend our manufacturing and industrial capabilities, and especially in education and training and in research and innovation where the pay-off is long term and often difficult to measure. In a world where capital is mobile, the economy's key assets are the skills, knowledge and capabilities of the people and the quality of the infrastructure that supports them. Britain cannot afford not to make these investments.

Stability, Savings and Investment

Stable and consistent economic management is essential for business confidence and expanding long term investment. Liberal Democrats would establish a clear, consistent policy framework, targeted at increasing savings alongside investment. This includes:

- Separating capital from current expenditures in the public finances and ensuring that, over the course of the economic cycle, borrowing is only used to finance capital expenditures.

- Promoting savings by introducing a national savings Save -As-You-Earn scheme and replacing SERPS with an obligatory occupational pension plan.
- Giving responsibility for monetary policy to a Bank of England reconstituted as a UK Reserve Bank, with operational independence and a responsibility to keep inflation low.
- Co-operating with our European partners to establish and develop a workable structure for Economic and Monetary Union in which Britain would play a full part.

Investing in People

Liberal Democrats would give the highest priority to investment in education and training which we regard as the key to the country's future. Our proposals involve spending an additional £2 billion immediately on:

- Expanding nursery education.
- Upgrading the quality of primary and secondary schools.
- Expanding access and providing opportunities for part-time education and retraining throughout life.

If necessary these measures would be funded by an extra penny in the pound on income tax.

Supporting Enterprise and Innovation

Small and medium sized businesses are the fastest growing sector of the economy and generate three quarters of the new jobs in the UK. However, they need help with start-up funding and equity finance for subsequent development. Liberal Democrats would:

- Give new powers to local and regional authorities to promote economic regeneration, encourage the expansion of regional development agencies and local investment banks;
- Introduce capital allowances for investments of up to £200,000.
- Legislate to make interest payable on late debt payments.
- Work with the banks to develop new sources of private finance.

Promoting Research and Development

Britain has a poor record for investing in research and development. Too few firms are prepared to put money into developing new products and processes. Liberal Democrats propose to introduce a new infrastructure for innovation, including:

- Expanded support for science and engineering research and new links between academic research and industry.
- An upgraded Foresight Programme to encourage long term, strategic thinking in both business and government.

- Revamped research associations to provide technical support and specialist research facilities, especially for small business.

Partnership

Britain's traditional 'them and us' style of capitalism, inherited from the nineteenth century, is now out-of-date. Modern business finds success by motivating everyone involved with the enterprise to work together as 'stakeholders'. Liberal Democrats seek to establish this 'stakeholder' approach both in business and in the economy as a whole. We want everyone to play their part and feel involved in the process of regeneration and renewal.

A New Partnership between Central and Local Government

Britain's highly centralised economic system has robbed us of the economic vitality generated by initiatives at regional and local level in other countries. Liberal Democrats seek to harness some of that vitality by:

- Giving local and regional authorities the main responsibility for the regeneration of their economies, encouraging them in turn to access EU structural funds and work together with local business, banks, universities, colleges and research institutes to rekindle local pride in local enterprise.
- Promoting National and Local Partnership Initiatives to bring private money into the financing of public infrastructure projects.
- Removing the 'cap' placed on local government expenditure to encourage local initiative and local accountability, but with local government too only allowed to borrow to finance capital projects.

A New Business Culture

The casino culture of fast gains, low investment and short term vision must change. Liberal Democrats seek instead to build new relationships of trust and partnership within companies so that all those involved - employees as well as shareholders, bankers as well as managers - share a commitment to long term growth and success. We propose to:

- Work for a new approach to corporate governance, including improved rules on disclosure and an enhanced role for non-executive directors.
- Establish a new legal framework of rights and responsibilities for both employees and shareholders.
- Encourage genuine profit sharing, mutual ownership and employee share holding schemes.

Promoting Competition

A strongly competitive domestic market is an important ingredient for success in the global market. Competition provides choice and quality for consumers, stimulates innovation and

prevents the concentration of economic power in the hands of the few. Liberal Democrats would:

- Introduce clear, consistent rules for controlling monopolies, whether in the public or private sector;
- Establish a new regulatory regime for the utilities, replacing the separate regulators by a single Office of Utility Regulation and imposing more effective controls on monopoly profits;
- Introduce a new Restrictive Trade Practices Act to clamp down on restrictive practices and unnecessary mergers.
- Enact a new Financial Services Act and a new Banking Act to regulate the City and protect investors.

Sustainability

Britain must achieve *both* an improvement in the quality of life *and* a reversal of environmental degradation. We cannot continue with the sheer wastefulness of current ways of operating. Liberal Democrats seek to promote economic well-being in its widest sense. A high priority is, therefore, to adopt new and better measures of economic, environmental and social well-being and to ensure their use in both national accounts and, where possible, in international comparisons.

Energy Efficiency and Transport

Liberal Democrats seek to safeguard our heritage for present and future generations. The efficient use of energy and raw materials is a prerequisite for success; transport, particularly the motor car, is the fastest growing source of pollution. We propose to:

- Promote energy efficiency by switching taxation away from jobs (employers' NICs) towards pollution, and promoting energy conservation;
- Invest in public transport, particularly rail, and encourage walking, cycling and other alternatives to the private car;
- Encourage re-use and recycling wherever possible.

An Attack on Unemployment

Unemployment represents a huge burden on society, wasting resources and talents; exacerbating crime and social tensions and creating poverty and alienation. Liberal Democrats would promote jobs and employability by:

- Investing in Britain's social and economic infrastructure.
- Encouraging the adaptability of the workforce by improving the quality and rigour of training.
- Introducing a benefit transfer scheme to help the long term unemployed back into jobs.

The Challenge of Globalisation

1.0.1 At the end of the twentieth century the British economy finds itself in a very different world from that of even 30 years ago. Revolutions in transport and communication, in automation and in resource use, are combining to bring about changes which, by the time they are through, will have transformed our society just as radically as the Industrial Revolution did two centuries ago.

1.0.2 We see the beginnings, as large companies 'down-size' and 'de-merge', creating powerful slim-line enterprises which, footloose, are constructing a network of new, co-operative links with a myriad of smaller companies around the globe. We see it in the emergence of the new industrial powers of South East Asia, many of whose firms play a crucial role in these networks. We see it in a growing international recognition that environmental impact cannot be divorced from corporate behaviour. We see it perhaps most obviously in the telecommunications revolution - the Internet, the fax, the mobile phone - which passes information around these networks in micro-seconds. In the next century, these changes will alter the way we live as much as the motor car has altered lifestyles in the twentieth century.

1.0.3 As a trading nation, Britain has no choice but to participate in these revolutions. British companies, large and small, need to be able to compete with their counterparts abroad. Even the service industries, typically protected from international competition, are not immune. Indeed, it is industries such as banking and retailing that are in the forefront of the information revolution.

1.0.4 The key question for Britain - and the key issue in economic policy - is how can we best succeed and prosper in this new global market place? It will not be easy. European integration and globalisation are together

making nonsense of old notions of economic nationalism. For most British-owned firms the 'home market' is now the European market; many of them are manufacturing and creating jobs overseas, just as foreign firms are setting up and creating jobs in Britain. Where, in these circumstances, it is not always clear where Britain's interests lie?

1.0.5 Governments, too, have to accept they are part of a broader canvas. Many of the factors which determine the macro economy - the state of demand, imports, exports, interest rates, exchange rates - are now 'givens', set by world conditions and over which national governments have limited control. In such a world, where much that we think of as national is in reality international, the starting point for successful policy making is to recognise what governments can't do, and then consider what *is* possible.

1.0.6 Britain must face up to the realities of this new world:

- Competition may be tough but Britain cannot hope to compete on the basis of low wage costs alone - there are plenty of willing workers in newly industrialising countries prepared to accept even lower wages.
- If British industry is to compete it has to be in terms of quality as much as price - the 'value for money' features which German industry, with the highest wages in Europe, has exploited so well.
- The successful economies of the world share a number of characteristics. They put the highest priority on education and training - recognising that a quality workforce contributes to a quality product. They have a culture of long-term investment; adaptable labour markets; strong internal competition and a dynamic

small business sector. And they are increasingly what might be described as ‘partnership’ economies, based on a more co-operative, less aggressive style of capitalism than that found in Britain or America.

- As consumption continues to grow in the industrialised countries and as population climbs in the developing world, it becomes increasingly clear that the world cannot go on consuming resources and polluting the environment at its present rate. Again, countries such as Germany, with limited indigenous energy supplies, have led the way. They set high standards to maximise efficiency and reduce wastage in the use of energy and raw materials and in so doing increase productivity and minimise pollution.

1.0.7 Britain’s economic policies have to recognise these new realities. The challenge is to transform the British economy into a successful player in this new international marketplace. This, in essence, is what Liberal Democrat economic policies are all about. We start from the premise that, in a era when products, commodities, technology and capital for investment are all footloose, the only things that remain firmly rooted in the nation are skills of its people and the quality of its infrastructure. We have to build upon and improve these key assets. In doing so, the main themes are investment, partnership and sustainability.

1.1 Improving Economic Performance - The Conservative Approach

1.1.1 The World Economic Forum Competitiveness Report identified some of the priorities for an improved economic performance. Britain’s management was placed 24th among 41 countries and its education system 37th. Productivity levels lag behind most of our major competitors but wage levels are also amongst the lowest in Europe.

1.1.2 There is now general agreement over the causes of this economic weakness. British industry has, over the years, invested too little in plant and equipment, or even more importantly, in education and training, research and innovation. The Conservatives believe that inflation is the key issue. They argue that once this is under control, such investments will increase automatically. While a long term low-inflationary environment is a necessary prerequisite for economic growth, it is not sufficient to guarantee prosperity. More positive policies are required to steer the economy on the right course.

1.1.3 The Conservatives endeavour to persuade us that Britain’s economic problems are now over. Inflation, they argue, has been purged from the system; export growth is strong; GDP growth moderate and investment, though lagging, will improve of its own volition. Yet the loss of capacity (and the loss of skills) during the two very deep recessions of the last fifteen years present real constraints on growth, which in turn create the potential for inflation as soon as growth returns. The wages of bricklayers in the City of London, for example, have risen by 50 per cent as demand has picked up. Already, fears of inflation have already led to interest rates being notched upwards. This can rapidly kill any nascent rise in investment.

***We would increase savings
alongside investment.***

1.1.4 Indeed, Government policy is caught in a cul-de-sac. Investment is needed in order to expand capacity and loosen the bottlenecks on growth, yet the very lack of capacity creates inflationary pressures within the system and pushes up interest rates. Tax cuts do nothing to help. Rather, they ensnare the Government in precisely the trap they fell into in the 1980s. Tax cuts would fuel consumption, not investment. Far from easing capacity constraints, they threaten instead a rerun of the inflationary pressures of the late 1980s - stop-go all over again. And the fear of the boom-

bust cycle returning is deterring business investment!

1.2 Improving Economic Performance - The Liberal Democrat Approach

1.2.1 Some fundamental flaws in present economic policy and in the UK economy must be addressed. The primary requirement is to increase investment. For the last 100 years we have not been putting enough into renewing and up-dating our productive capabilities. The new industrial revolution, with its new technologies and the need to re-engineer society towards intellectual rather than physical capital and towards sustainable life-styles, offers us the chance to make the break - to rebuild, renew and revitalise our economy and our society for the 21st Century. This is where we have to begin.

1.2.2 Liberal Democrat economic policies aim to renew the British economy through:

- *Investing in people.* A high quality workforce is essential for competitive production. Unemployment, poor quality education and lack of proper skills' training together constitute a gross waste of resources which it is essential to reverse. Education, training, getting people back to work, renewing their self-confidence and providing equal opportunities for people to succeed come top of our agenda.
- *Promoting stability for investment.* One of the main reasons why industry is so loath to invest is the uncertainty engendered by the stop-go policies of successive Labour and Conservative governments. We aim to establish a stable, consistent framework for both fiscal and monetary policy, including an operationally independent UK Reserve Bank, so that industry (and government) can invest for the future with confidence.
- *Increasing investment and savings.* Investment in Britain as a proportion of national income has been too low. If

investment over the long term is to increase without straining the economy (and running the risk of re-igniting inflation) savings also will have to increase. We would raise savings alongside investment.

- *Improving the public sector infrastructure.* Business investment is the prime target but public sector investment has also lagged, especially in such areas as public transport, science and technical support. Improvements in this infrastructure are an important complement to industrial and environmental efforts. We will combine private enterprise and public investment.
- *Commitment to Europe.* Britain's future lies with Europe; our economy is increasingly a part of the European economy. To help strengthen and stabilise the economy, we will work with our European partners to achieve a workable, decentralised economic and monetary union.
- *Investment in innovation.* The quality of investment counts just as much as the quantity. If Britain is to compete in the world of new and resource-efficient technologies, investment needs to go into developing new products and processes and bringing these on stream. Small firms play a vital part in this process; we are determined they will have the support and finance they need.
- *Decentralisation of economic power.* Britain's economy, like its political system, is too highly centralised. Experience in other countries suggests that local and regional governments relate more easily to the small firm sector and can provide a useful focus and stimulus to economic regeneration.
- *Competition to stimulate innovation.* Competition provides choice for the consumer and keeps firms alert to new opportunities. There are important sectors of the economy, however, where it cannot work and where regulation has to substitute. In both cases, we will set out a clear and consistent set of rules.

- *Sustainability*. The efficient use (and re-use) of resources is not only good stewardship which we owe to future generations but also makes good economic sense.
- *A new partnership*. The more co-operative styles of capitalism which have evolved in countries such as Germany and Japan are more closely aligned to the needs of the 21st century than current practice in Britain. We set out policies to build relationships of trust and partnership between all the

‘stakeholders’ in the economy - between the City and industry, between managers and workers, between large and small firms.

1.2.3 Our general approach is a positive one. The challenges currently facing the British economy offer the opportunity for renewal and revitalisation. Government alone cannot achieve this transformation. The British people, working together alongside Government, can do so.

Stability, Savings and Investment

2.0.1 Liberal Democrats seek to promote long term sustainable wealth creation in the British economy. Our broad macro-economic strategy aims to:

- Provide stable and consistent management of the economy.
- Shift the balance of spending from consumption towards investment.
- Assist in implementing the objectives of sustainable development.

2.0.2 In using the term ‘sustainable’ we are conscious of the limitations of GDP measures of economic growth. Wealth creation means an increase in well-being and embraces the wider concepts of both environmental and social well-being. We need policies that embrace these concepts [see Chapter 7]. With the right policies, wealth creation and sustainability are complementary, not conflicting, aims.

2.0.3 There are, in any case, clear limits to what can be achieved through macro-economic policy. Neither monetary nor fiscal policy can readily be used to ‘fine tune’ the economy and the influence which governments exert is now much constrained. This is why the emphasis of policy has shifted to the micro side of the economy - with improving the performance of the individual players. The two, however, are interdependent. We cannot expect the players to perform well on a roller-coaster economy. For example, business will not invest when they fear a return of stop-go. One of the main functions of macro-economic policy must be to provide a stable and consistent framework of rules on which people can rely.

2.0.3 Liberal Democrats would achieve more stable and consistent economic management through:

- *Responsible and consistent fiscal policy*, including reforms to Government accounting to distinguish between capital and current expenditure.
- *Targeting monetary policy towards price stability* and giving a reformed central bank operational independence to pursue this goal.
- *Participation in European Monetary Union (EMU)*.

2.1 The Role of Fiscal Policy

2.1.1 Liberal Democrats’ fiscal policy has four key elements:

- Responsible public sector financial management aimed at creating the economic conditions in which investment can flourish.
- Promoting savings and investment - both public and private.
- Maintaining and enhancing the country’s capital stock, so that the needs of future generations are not sacrificed for the demands of the present.
- Encouraging long-term, strategic planning.

2.1.2 The Liberal Democrats guiding principle for public sector management would be that, over the long term, borrowing is legitimate to finance capital but not current expenditures. The key requirement is to distinguish clearly in the accounts between the government’s current and capital expenditure. *We would then ensure that, over the course of the cycle, government current expenditures are in balance and, as in business, that borrowing is used only to finance capital expenditures.* Such an approach to balancing the budget does not exclude the possibility of

running a (counter cyclical) deficit during recessions provided this was balanced by a surplus during boom years.

2.1.3 This clear and consistent guideline would improve confidence and assist the private sector to plan and invest. Within such a framework we would seek to promote savings in order to increase the scope for investment by both the private and public sectors without recourse to short-term borrowing from overseas. (See section 2.2 below) This would avoid a sustained deficit in the basic balance of the UK's external accounts which might undermine long-term confidence and adversely affect economic activity.

2.1.4 To facilitate long term, strategic planning, Liberal Democrats would reinstate forward planning commitments within the public expenditure round. Local authorities, universities, hospitals and other such public institutions could then themselves make forward commitments on a three to five year basis rather than facing, as they do now, considerable uncertainty about their annual finances.

2.2 Promoting Personal Savings

2.2.1 An increase in savings is vital to achieve our twin objectives of higher investment and economic stability. Current incentives in the form of PEPs and TESSAs are of limited value, mainly attracting savings which would in any case have been made.

2.2.2 To encourage personal savings Liberal Democrats would:

- *Introduce a National Savings Save As You Earn scheme*, to enable all employees to save on a regular basis, and to enjoy tax free returns, with the savings, like PAYE, deducted at source.
- *Replace SERPS with an obligatory occupational or personal pension plan.* This commitment, made in Federal Green

Paper 31, *Retirement with Dignity* (1993), would add six million people to the number saving for pensions and make a very considerable contribution to savings. Since it is widely accepted that there is need to make greater private provision for old age, the two objectives - savings and retirement provision - coincide.

2.3 Promoting Investment

2.3.1 In Chapter 4, we propose measures to encourage private sector investment and enterprise. Public sector investment complements that in the private sector. An efficient economy cannot operate without investment in its economic and social infrastructure. This includes the provision of roads, schools, housing and public transport. Under successive Conservative governments such investment, with the exception of roads, has been savagely cut, mainly for reasons of short-term opportunism. This is well illustrated in the saga of the Channel Tunnel where the need for a dedicated rail link to London was clear from the outset.

2.3.2 To make good this public sector investment deficit, Liberal Democrats would:

- *Separate capital spending from current spending in the public expenditure accounts.* It is quite appropriate for the state to borrow responsibly to pay for capital projects which yield long term and continuing benefits to the public. We would also adopt the New Zealand Government's asset accounting approach, which tracks the government's net worth.
- *Reform Treasury rules to enable public sector concerns to operate with greater commercial freedom.* For example, the Post Office should have the room to change and develop while meeting its public service commitment.
- *Introduce a National Partnership Initiative* to bring more private money into the financing of public sector projects. This would involve an expanded use of public

finance as ‘front end’ expenditure to attract private investment; the assumption by the public sector of risks that are primarily governmental responsibility; and an evaluation of social and environmental as well as economic returns.

- *Introduce a Local Partnership Initiative* to allow local authorities to go direct to the market to raise finance for capital projects. This would bring more private finance into local authority accounts; devolve power to local communities; and bring greater public control and accountability and efficiency in project management. Borrowing and the guidelines for borrowing would need to be carefully monitored by a Local Authority Debt Management Agency. We would also remove the ‘cap’ placed on local government current expenditures to further encourage local initiative and local accountability.
- *Release local authority capital receipts from past sales of council houses and lift ‘capping’ restrictions on local authorities* to help fund capital investment in housing. This would be phased in and implemented so as to meet local housing needs.

2.4 A Consistent Tax Framework

2.4.1 As an important part of fiscal policy, taxation also demands a consistent, long term approach. It is the means of paying for the things that citizens want and need and which are best financed by the public sector, for example, better schools, hospitals and health care, action to fight crime and policies to relieve poverty. Such benefits do not come without taxation. Liberal Democrats tax proposals, as set out in Policy Paper 7, *Opportunity and Independence for All* (1994), are underpinned by the following principles:

- *Fair tax, not high tax.* Tax bands, rates and reliefs should ensure that every one contributes according to their ability to pay and that the tax burden is fairly shared. We

would take some low earners out of the tax net completely and phase out some tax reliefs which favour high earners.

- *No promises unless the bill is attached.* The public has a right to know the Government’s priorities and how much they cost. We will not make promises without telling people where the money will come from.
- *No taxation without explanation.* We want central government, like local government, to report annually to taxpayers on how their money is spent.
- *We will not ask the people to do with less, unless the Government has first shown that it can do with less.* Taxes should be cheap and easy to collect; wasteful expenditure should be minimised. Tax allowances should be as few as possible to eliminate the scope for avoidance and to keep tax rates low.
- *Sustainability.* The tax system should discourage things the community does not want, such as pollution, and encourage things it does want, such as jobs.

2.5 An Open and Accountable Monetary Policy

2.5.1 The attainment and maintenance of price stability is the most useful contribution that monetary policy can make towards achieving an investment-friendly economic climate. Like fiscal policy, it must be exercised with consistency and restraint. There have been too many occasions, notably in the 1980s, when monetary policy has been manipulated for political ends to the detriment of Britain’s economy and people. Liberal Democrats will take the management of monetary policy out of the hands of the politicians and make it the responsibility of an independent and more accountable central bank. Our reforms would immediately bring greater reliability and stability to policy making. This would give UK monetary policy greater credibility, reducing

risk premiums and ultimately leading to cheaper loans for business and households.

2.5.2 We propose the establishment of a UK Reserve Bank, to replace the present Bank of England. This new central bank would have:

- *Operational, day-to-day independence from politicians* - with an Act of Parliament setting out the Bank's primary objective, the pursuit of price stability. The Government should only be able to change monetary policy goals with the consent of Parliament.
- *An open, transparent inflation target* - with a published agreement between the Chancellor of the Exchequer and the Governor defining price stability. This would take the form of an inflation target. For example, a range of 0 to 3 per cent would bring Britain into line with our major competitors.
- *Clear lines of accountability to Parliament* - its long-term operating guidelines would need to be ratified by Parliament and the Governor would be accountable through a Parliamentary select committee.
- *Regional representation on its Policy Making Council* - just as the Bundesbank has Lander (regional) representatives on its Council, so the UK would have regional representation. This is part of our policy to devolve power to the regions. Monetary policy would be developed after proper debate and consultation amongst the Council.

2.6 Economic and Monetary Union

2.6.1 Liberal Democrats support the principle of European Economic and Monetary Union (EMU). We favour fixed, stable exchange rates over flexible systems as, correctly established, they increase trade and promote price stability. A single currency also means a single monetary policy. This, in turn, requires an accountable European Central

Bank to control that policy and run it in the interests of member states.

2.6.2 The advantages of EMU can be summarised as follows:

- *Elimination of exchange rate volatility and currency speculation.* This would substantially lower transactions costs of international trade, particularly for small businesses which find it more difficult to hedge transactions.
- *Greater certainty and consistency in monetary policy,* which in turn helps to guarantee long-term price stability.
- *Lower interest rates* and, therefore, lower debt servicing costs in Britain.
- *Increased influence over European monetary policy,* through participation in a European Central Bank.

2.6.3 Like most economic reforms, EMU presents challenges. Member states will no longer be able to use devaluation to attempt to avoid tackling fundamental weaknesses in their own economies. And whilst there would be dangers in a too hasty pursuit of EMU and difficulties for Britain, the potential benefits of being inside clearly outweigh the costs of being outside. Staying out of EMU would cause Britain substantial harm, including reduced direct foreign investment, a diminished role for the City of London and further diminution of our influence within the European Union. Any diminution of the City of London's role will be a loss not just to the UK but to the EU. We should move forward with our main European partners into EMU, as a full member of the European Union. When the single currency is established, Britain can and should be part of it. It is vital that Britain plays a part in shaping the new institutions. We do not want to find monetary policy dominated by a central bank over which we have no influence. Britain should also share fully in the regional and social policies of the EU from which, thanks to the Conservatives, we are at present excluded.

Investing in People

3.0.1 Liberal Democrats want to build a country where every person can develop their own skills, their own strengths and their own personalities; where the natural energies and inventiveness of its people are encouraged and rewarded; and where individual lives are fulfilling - for the benefit of the community, both now and for the future. Britain's high levels of unemployment and underdeveloped education system are frustrating such goals. If we are to have a high wage/high productivity economy this must change.

3.1 Promoting Jobs and Employability

3.1.1 Unemployment remains the most important social problem facing the British economy. It wastes resources and talents; exacerbates crime, racial and social tensions; leads to poverty, misery, hopelessness and alienation. To some extent, unemployment can be addressed by specific measures to help unemployed people, such as retraining and investment in areas of high unemployment. More importantly, we must address the issues in the context of the changing nature of the economy and employment : the new industrial revolution. Liberal Democrats aim to expand employment opportunities by creating an economic environment which equips people with the skills they need and provides opportunities for those skills to be used.

3.1.2 Conservative policies in the pursuit of flexibility have often gone further than they need, removed employment rights and led to large scale casualisation of the labour force. Liberal Democrats seek an adaptable, not a disposable, workforce. In a civilised society, there must be protection of the rights of all those in work, whether full-time or part-time. This applies whatever the size of the employing

body, however long the employee has worked for the employer, through trade union or other representation. However, jobs have to be created and maintained by the demand for goods and services, not by government, although government may influence the latter through its macro-economic policies.

3.1.3 The key issues are investment and training. Investment in new plant and machinery, and in education and training, creates jobs in itself (in making the new machinery etc) and increases the productivity of those employed making them worth employing at higher wages. Recent research has suggested that if Western Europe's growth of investment had been 1 per cent higher over the last 20 years, there would have been eight million extra jobs.

3.1.4 There remains, however, a problem of timing. It takes time for new investment programmes to be developed and to create new demands in the economy. In Policy Paper 9, *Working for Change* (1994), Liberal Democrats set out proposals for jobs and employability, which help to bridge the gap. These include:

- *Promoting full employability.* Investing in education and training to ensure that every individual is skilled and adaptable enough to play a full role in today's competitive, dynamic labour market.
- *Boosting employment.* Stimulating the capacity of the economy to create additional jobs, by investing in Britain's neglected social and economic infrastructure, regenerating regional and local economies and assisting small firms to grow and compete. (See section 4.1 of this paper)
- *Increasing flexibility.* Improving the operation of the labour market by removing

obstacles to employment and job mobility and taking radical action to bring the long-term unemployed into economic activity. Our proposals include: reductions in employers' national insurance contributions (NICs); a benefit transfer scheme to advantage the long-term unemployed in the labour market and increase their long term employability; reforms to Low Income Benefit and the tax relief on workplace nurseries - including, if resources permit, a childcare voucher scheme to help parents into employment.

- *Encouraging community service.* We would introduce a voluntary 'Citizen's Service' to train and use the talents of young people.

Our proposals to enhance employees' rights and protection are summarised in section 5.2.

3.2 Investing in High Quality Education and Training

3.2.1 Britain must reject the dead-end low cost/ low productivity route chosen by the Conservatives. It is a strategy doomed to failure and it will also destroy our social cohesion. Britain cannot hope to compete in wage costs with emerging Third World countries who have no social infrastructure. We have much to learn from the experience of such countries as Germany, which has overcome its higher costs by raising investment, increasing productivity and adding value.

We seek an adaptable, not a disposable workforce.

3.2.2 Education and training are the route to higher productivity and to opening up choice, opportunity and self-fulfilment to people. The last 15 years have seen many wide-ranging

changes in British education. There are still, however, major deficiencies:

- Far too many adults (1 in 10) are functionally illiterate (ie cannot read well enough to follow instructions).
- There is a particular problem with maths - essential for any technically based training.
- Too many training courses for young people lack rigour.
- There is still too wide a divide between the academic and the practical.

3.2.4 Britain cannot afford *not* to invest in education and training. Economic realities are changing. A job for life is a thing of the past. The future lies with those able to switch jobs and career with relative ease. Therefore, a high level of general education is essential, with good basic skills and opportunities for training and retraining, up-grading and up-dating capabilities throughout life. Liberal Democrat proposals for education and training include the following:

- *Life chances for all.* From pre-school education through to the University of the Third Age, the doors of opportunity must be open to everyone.
- *Enhancing quality.* It is vital to improve the quality and rigour of education and training at all levels. We would increase funding for books, equipment and school buildings and build into the national vocational qualifications system a continuous review process to ensure consistent quality of delivery.
- *Opening up access.* We need more people than ever to participate in education, but the pattern will increasingly be one of moving into and out of the education sector throughout life. We seek the further expansion of universities and colleges, opening up access to higher education. More opportunities are needed for part-time education, modular courses, credit

accumulation systems, and the mixing and matching of distance and local learning opportunities.

- *Broadening the base.* We must provide for basic standards of literacy and numeracy and a wider base in both; in particular more emphasis is needed on science and engineering. Women are now improving their relative position in school-level maths and science but more progress is needed in higher education. We would like universities to offer more broad-based foundation courses across science, engineering and the humanities.
- *Training and retraining.* High quality vocational training is a vital aspect of our proposals to promote employability. We would make work experience, carefully structured to complement individual learning, part of education from the age of 14; require employers to release their employees aged under 19 for a minimum of two days a week off-the-job education or training; introduce an entitlement for every

adult, to a period of education or retraining at a time of their choice; reform the system of National Vocational Qualifications (NVQs) to cut bureaucracy; and introduce a remissible Training Levy, to encourage employers to invest in their staff.

Further details are contained in English White Paper 4, *Excellence for All* (1992) and Policy Paper 9, *Working for Change* (1994)

3.2.5 The revolution in information and communication technologies is about to transform the whole education process. The personal learning opportunities offered through the combination of the Internet and multi-media have yet to be appreciated. Britain should be at the vanguard of this revolution. Vital investments are required now in schools and universities, not least in developing new software and in training teachers and lecturers to make the best use of opportunities. Liberal Democrats pledge that every person will be entitled to have access to a broad based, nationwide interactive communication network by the turn of the century.

Enterprise and Innovation

4.0.1 Britain needs more investment in both the private and public sectors. Liberal Democrat policies to promote a stable macro-economic environment and improve the skills and competences of the workforce will help to encourage business investment. But investment in itself is not enough. In particular Britain lacks enterprise - the get up and go to establish and run successful new businesses - and investment geared to the future - innovation and clean technologies.

4.1 Unshackling Small and Medium Sized Enterprises

4.1.1 Small and medium sized enterprises (SMEs) are a vital part of Britain's economy. They provide a breeding ground for new enterprise and an important source of competition to large firms. As large firms shift from conglomerate businesses to slim line enterprises, SMEs are playing an increasingly important role as suppliers of specialist services. SMEs are the fastest growing sector and generate three quarters of all new jobs in the UK. However, they lack sources of start-up funding and equity finance for subsequent development. In particular, SMEs suffer from the problem of late debt payments. They are also burdened disproportionately by Government regulations.

4.1.2 To help SMEs overcome some of these problems, Liberal Democrats would:

- *Work with the banks to develop new sources of finance* including new routes to equity finance and the development of mutual guarantee schemes.

- *Legislate to make interest payable on late debts* and require such payments to be published in annual reports.
- *Reduce the burden of tax administration* by integrating and simplify the payment of employees NICs and income tax. (See Policy Paper 7, *Opportunity and Independence for All* (1994)).
- *Ensure that the banks serve the small business community better* by establishing vigorous codes of practice - including a requirement to notify businesses of any additional charges and extending the powers of the banking ombudsman.
- *Change the VAT rules* to soften the impact of firms crossing the VAT threshold.
- *End the bias in the tax system in favour of loan rather than equity finance.*
- *Introduce an investment allowance* limited to £200,000 a year, for every company. This would be of greater relative value to smaller enterprises.
- *Reform the Uniform Business Rate* ensuring that local revenues go to local authorities and giving them greater discretion to discriminate in favour of small shops and businesses.
- *Reform the insolvency laws* encouraging more use of administration and mediation.

4.2 Regional Initiatives

4.2.1 Many problems faced by small businesses are best dealt with at a regional level. Local authorities in Britain are closely constrained in respect of spending on business development. Consequently, Britain lacks the regional initiatives which have been a feature of

industrial regeneration in other parts of Europe and in the US. As always, too much power has been centralised in Whitehall. Liberal Democrats would reverse this, and give local and regional authorities the primary responsibility for industrial regeneration in their areas. We propose to:

- *Establish regionally based development agencies* to bring together the functions of DTI regional offices, regional technology centres, liaison with universities, TEC/LEC technology transfer functions, mirroring similar agencies in Europe. The agencies would operate as regional organisations responsible to local authorities and, eventually, as part of our programme for regional government.
- *Develop a new pool of seed-corn funding* to be administered by the regional development agencies and used either on its own or as leverage for other public (EU, City Challenge etc.) or private sector (banks, business angels) funding.
- *Encourage the banks to establish regional investment banks* to help small businesses at the local level. These would be backed and managed by joint stock banks, to provide competitive unsecured capital to small businesses with certificated management skills.

4.3 An Infrastructure for Innovation

4.3.1 Innovation - keeping ahead of competitors by continuously updating and improving what's on offer - makes for success, both between companies and between countries. Investment fosters innovation. Most companies, when installing plant and equipment, tend to buy the latest model, which embodies new ideas and process improvements. Therefore, countries with strong investment records tend to have more plant which is more up to date, incorporates innovations and is more productive. Innovation is also an essential component of any strategy for environmental

sustainability. New technologies tend to be cleaner and more efficient.

4.3.2 Britain has long been amongst the acknowledged leaders in world science, but has traditionally failed to translate this excellence into practical advantage. Part of the fault lies with British industry whose record of investment in research and development is poor. However, part of the problem is cultural and stems from a lack of knowledge in British society about things scientific and a resulting low valuation of science and technology. Early specialisation at school and university means our scientists are well trained and achieve highly, but then find themselves locked into a narrow career path and excluded from management. For its part, British management too frequently lacks the technical understanding to evaluate properly the returns it would get from investing in research and development and hence makes poor use of its science and engineering capabilities. Two-thirds of all research and development (R & D) in this country is undertaken by just eleven firms.

We propose an infrastructure for innovation, with government, industry and the academic sector working in partnership.

4.3.3 The Conservatives assumed that once profits had been restored, investment and innovation would automatically follow. In the 1980s, and now in the 1990s, we have seen company profits soar. While dividends and executive share options have expanded, R&D has remained stubbornly low. British industry must be encouraged to put more into innovation.

4.3.4 Tax concessions are no solution. Too frequently the money ends up in the wrong pockets. Nor should the government target one or two sectors and make them into 'national

champions'. Rather, Liberal Democrats propose an 'infrastructure for innovation' with government, industry and the academic sector working in partnership. Britain needs to have the competence to make use of modern technologies. Liberal Democrats would:

- *Re-establish the Office for Science and Technology (OST)* with a Cabinet Minister with direct responsibilities for science and engineering.
- *Expand support for science and engineering research* to help in stimulating new ideas and in training highly qualified staff. Good links between academic research and industry are essential.
- *Continue and expand the Foresight Programme* to encourage both the public and private sectors to think strategically and work together in developing new technologies.

- *Revamp the research associations* to improve specialist research facilities for different sectors of industry and expand the SPUR and SMART schemes to encourage innovation.
- *Encourage SMEs to employ scientists and engineers in R & D*, by offering a limited, five year subsidy on their salary costs.
- *Require the publication of R&D expenditures in Annual Reports.*
- *Introduce new accounting standards for R & D*, to give more emphasis to "intangible" capital assets, for example, intellectual property.
- *Improve management education*, to train engineers in the importance of cost accounting and the management of innovation and vice versa .

Further details are out in Federal Green Paper 21, *Science and Survival* (1991).

A New Business Culture

5.0.1 To compete successfully in the global economy, Britain needs a modern vision of corporate activity, oriented towards the rights and needs of all stakeholders in business - employees, customers, the community - as well as managers and shareholders. We need to build community support for the creation of wealth by developing well-managed, positive relations between companies, employees, customers, suppliers, investors and the community. By these means we aim to build a new culture of long-term commitment in individual companies, replacing the ‘short-termist’ attitudes that have done so much damage to Britain’s competitiveness.

5.0.2 Liberal Democrats will:

- *Support a new system of corporate governance*, aimed at increasing shareholder commitment to enterprises.
- *Build new bonds and stronger relationships between companies and their stakeholders* - particularly employees - to boost investment, training and business performance.

5.1 Corporate Governance

5.1.1 The culture of short-termism must change. Those companies that operate in a globally competitive market need to take a strategic view of their direction. It is profoundly in their self-interest, and also in the self-interest of their investors, to take a long-term, rather than a short-term, view.

5.1.2 There is no simple way of achieving such goals: the changes required are a process, not an event. Legislation by itself can only have a limited effect - existing company law points directors towards long-term sustainable growth in value, not maximising short term profits. To this end, Liberal Democrats endorse the aims of:

- The Final Report of the Royal Society of Arts’ *Tomorrow’s Company* Inquiry, which argues that all relationships with stakeholders must be measured, developed and positively managed, to maximise a company’s sustainable value over the long term. It highlights the importance of qualities such as loyalty, trust and respect for the individual and argues that intangible factors, for example intellectual property, innovation and quality, are the strongest determinants of competitive success.
- The work of the Cadbury Committee on Corporate Governance, including its recommendations to improve disclosure and enhance the role of non-executive directors.
- The work of the Accounting Standards Board, aimed at achieving higher accounting standards and greater transparency and consistency in company accounts.

The culture of short-termism must change. We support a new system of corporate governance, aimed at increasing shareholder commitment.

5.1.4 To facilitate the shift to a new business culture, Liberal Democrats would:

- *Require publication of additional measures of company success* including expenditure on research and development and education and training, to develop means of measuring less tangible factors that make for good business performance.
- *Encourage a greater use of the ‘creditor moratorium’ periods*, so that a bank rescue

plan can be devised for a company in difficulties without a secured lender (normally a bank) having a right of veto.

- *Require the remuneration committee of a listed company to be directly elected by its shareholders.* If business does not put its own house in order, then Government may need to consider other ways of discouraging excessive salary awards (eg by introducing fiscal penalties).

5.2 Employees as Stakeholders

5.2.1 Employees are particularly important stakeholders whose rights and contributions must be recognised. Their loyalty and motivation are important assets that should be nurtured. A working environment in which people feel fulfilled and fairly rewarded contributes to improving economic performance and frees up peoples' talents. Toyota's motto "quality goods, quality workforce" has been proven correct many times over.

5.2.2 Liberal Democrats seek to create an industrial climate in which employees are motivated to work together flexibly and co-operatively to meet the challenges of globally competitive markets. Specifically, we propose to:

- *Build a legal framework of employment rights and responsibilities* to provide every employee access to consultation and information on company performance, participation, training, trade union membership, profit-sharing (and, where appropriate, ownership) for all members of the workforce.
- *Establish structures for participation* most appropriate to individual employing organisations.
- *Encourage genuine profit-sharing schemes, employee share ownership, management buyouts* and the further development of employee share ownership trusts. Tax reliefs

for such schemes will be concentrated on the generality of employees' schemes, not those for 'fat cats'.

- *Establish a Low Pay Commission*, to recommend a regionally-varied minimum hourly rate of pay applicable to all adults in paid employment, with a separate (and lower) rate for those under 18. Employees deserve protection from acute exploitation and employers should be prevented from using state benefits to subsidise wages.
- *Reverse the Government's opt-out on the Social Chapter of the Maastricht Treaty* which provides a basic floor level in terms and conditions of work.

Further details can be found in Policy Paper 9, *Working for Change* (1994).

5.3 The Role of Investors

5.3.1 The Liberal Democrats' general principles on the role of investors can be summarised thus:

- Pension fund trustees in particular should be active shareholders, giving clear instructions to investment managers both to look for long-term sustainable growth in value and on matters of particular concern (e.g., top salaries).
- Given that County Council pension funds constitute 9 percent by value of occupational pension funds, Liberal Democrat councillors should take a positive role in their management.
- Investment managers should maintain a dialogue with investee companies. A process of mutual education is necessary to overcome present communication problems and to achieve a long term focus which concentrates on the future prospects for the company as a whole, rather than short term financial results.

Promoting Competition

6.0.1 One ingredient for success in the global market is a strongly competitive domestic market. Competition gives power to the consumer and brings more choice and better quality. It keeps producers on their mettle and encourages them to innovate and keep costs down. Liberal Democrats see competition as an important dynamic force within the economy. Generally, we favour market over non-market solutions; competition over monopoly; the small over the large; free trade over protectionism; and decentralisation over centralisation.

6.0.2 Markets do not always work perfectly and Government action may be necessary to protect the consumer and to make good market failure. Where this is the case, we favour tough but realistic regulation. “Competition where possible: regulation where necessary”, is our guiding principle.

6.0.3 This mix of competition and regulation is currently working least well in the substantial, regulated sector that has emerged in the British economy following privatisation. Utilities enjoying ‘natural monopolies’, by virtue of controlling large networked distribution systems, have been privatised and subjected to a varying and inconsistent mix of competition and regulation. The regulators have extensive and arbitrary powers with little or no accountability. Meanwhile, the rump of the old nationalised industries still within the public sector, the Post Office and most of British Rail, are shackled in their attempts to compete properly and have no satisfactory rules to govern them.

6.0.4 Liberal Democrats propose that where there is natural monopoly - whether in the public or private sector - the enterprise would be subject to regulation. Where there is reasonable competition, the normal competition rules administered by the Office of Fair

Trading (OFT) and Monopolies and Mergers Commission (MMC) would apply. This distinction between enterprises that are regulated and those subject to competition laws should apply irrespective of ownership. In this sense ownership is not the issue. What matters is the degree of competition that is possible and whether the public interest is served.

6.0.5 Liberal Democrats are pledged to keeping Railtrack and the Post Office in the public sector. If necessary, we would repurchase a 51 per cent share in Railtrack. These enterprises would be subject to the same rules as private companies. Railtrack, which has no competitors, would be regulated. By contrast, many of the Post Office’s activities now face competition. These would be subject to MMC/OFT overview rather than to regulation.

6.1 A New Regulatory Framework for Utilities

6.1.1 The privatisation programme operated since 1983 has put most of our essential utilities into the private sector. Many enjoy a considerable element of natural monopoly. Indeed, it is logical to regard all such utilities as being in the ‘regulated’ sector of the economy and to devise rules accordingly.

6.1.2 However, the regulatory framework established since privatisation is unsatisfactory. It places enormous power in the hands of one individual, the regulator, who is accountable to no-one. The result is that regulators have become subject to intense pressure from various interest groups. Moreover, the regulator remains dependent on the regulated enterprises for information on the cost structures of the industry, while the enterprise has a clear incentive to over-state costs and understate demand. There has also been

considerable inconsistency in decisions both between the utilities subject to different regulators and, in some cases, between decisions of the same regulator.

6.1.3 Changes need to be made in both the structure and the technical basis of regulation. We propose a new structure for regulation to:

- *Replace the separate regulators by a single Office of Utility Regulation and establish a panel of regulators for each industry working to a common set of rules.*
- *Require regulators to publish more fully the reasons for their decisions and make them subject to the scrutiny of a Parliamentary Select Committee.*
- *Allow regulators to appeal to the Monopolies and Mergers Commission for the right to change their decisions when they have been misled by the utilities.*

6.1.4 We propose new regulatory rules that would:

- *Combine the present price-based regulatory framework with a new rate of return criterion, establishing the norm of a low risk rate of return for assets (eg gas, water distribution) where the risk involved to the entrepreneur is negligible.*
- *Provide for a fairer distribution of profits between consumers and shareholders, particularly when returns are above such low risk levels.*
- *Require public hearings whenever utilities wish to raise their prices.*
- *Reinforce the pressures for efficiency by requiring regulated utilities, whether public or private, to market-test their services, including management, on a periodic basis.*
- *Allow regulated utilities such as the Post Office to diversify into other areas. At the same time the government guarantee on loan capital for such enterprises should be*

removed. The OFT would prevent anti-competitive practices.

- *Establish a least-cost framework for the energy utilities which requires them to consider other ways of satisfying demand (eg insulation) and promotes energy conservation and efficiency.*

6.2 Monopolies, Mergers and Restrictive Practices

6.2.1 Our support for competition means that Liberal Democrats are hostile to monopolies and restrictive practices and would restrain mergers and takeovers that simply build industrial conglomerates. We want to strengthen and give greater independence to the competition authorities and create new rules to deter mergers that are not well justified. Liberal Democrats would pass a new Restrictive Practices Act which would:

- *Merge the MMC and the OFT, making the combined body independent of Government but operating according to rules laid down by legislation and accountable to a Select Committee of Parliament.*
- *Make the decisions of the new, combined authority enforceable directly. To overturn them, the Secretary of State would need the sanction of the House of Commons.*
- *Extend the right to initiate proceedings against monopolies or restrictive practices to those affected by them.*
- *Encourage the break-up of monopoly enterprises, where appropriate and feasible.*
- *Tighten the rules on takeovers extending, in the case of those falling within the responsibility of the UK authorities, the grounds for refusal to wider aspects of market failure (for example, a likely reduction in R&D).*
- *Put the onus on prospective buyers to show that long-term and sustainable benefits will*

result from the acquisition for all mergers qualifying for investigation by reason of size or market share.

- *Require prospective buyers to seek shareholder approval for any qualifying merger*, making clear to shareholders the likely rate of return on assets that is likely to result from the merger.

6.2.2 Judgements on what constitutes monopoly depend crucially upon what is considered to be ‘the relevant market’. Within the UK, problems may arise at a national, regional or even at a local level (e.g., price-fixing for local authority building work). Liberal Democrats want to see markets working better at all levels and to rebalance economic power towards the small firm and consumer.

6.2.3 Given the increasing integration of the markets within the EU and the growing role of global markets, the influence that can be exerted by national authorities on powerful multinational companies is limited. However, the case for competition remains just as strong. Liberal Democrats support the European Commission’s increasingly tough stance on competition and the moves to develop within the new WTO an international policy on restrictive practices.

6.3 Financial Regulation

6.3.1 The present regulatory structure for financial services, put in place by the Financial Services Act 1986, includes a large measure of self-regulation. Liberal Democrats favoured self-regulation but the present regulatory set-up has recently been exposed as fundamentally inadequate in terms of both consumer and investor protection. Self-regulation has been seen to fail both wealthier investors at Lloyds of London and consumers of such financial products as personal pensions and endowment mortgages. The existing UK banking

supervision regime has also been exposed as wholly unsatisfactory by such recent events as the collapse of Barings. The demise of a major UK financial institution could both require substantial state financial support and pose a threat to the stability of the entire UK economic and financial system. Regulation is not, therefore, an issue to be resolved exclusively by the banks themselves.

6.3.2 To strengthen investor and consumer protection and to improve the soundness of and confidence in the UK financial system, we favour universal statutory regulation of the financial services industry. Such regulation should not, however, be allowed to stifle the operation of the financial services industry. Rather, our aim is to consolidate and improve, and not to undermine, the pre-eminence which London enjoys as a financial centre.

6.3.3 *We would therefore introduce a new Financial Services Act and a new Banking Act* to extend statutory regulation and address current deficiencies in regulation exposed by recent events. For example, we would make obligatory the separation of responsibility for ‘front-office’ and ‘support’ areas within investment banks.

6.3.4 Such a statutory basis will give regulators powers to impose heavy fines and/or withdraw a licence to trade where a breach of rules is established on a balance of probabilities. This is preferable to complex lengthy and often unsuccessful criminal proceedings where the standard of proof beyond reasonable doubt is extremely difficult to attain.

6.4.5 The Barings experience also demonstrates how vital it is to ensure that effective international regulation and standards are in place. Liberal Democrats would encourage the agreement and implementation of international standards of regulation, including minimum capital adequacy ratios.

A Sustainable Economy

7.0.1 Economics and the environment have always been inseparable. Several times in history the over-use of natural resources has led to the decline of a society. Today, however, the combination of economic and population growth and the resultant demand for resources and creation of waste have reached a point where they are beginning to threaten the global processes that sustain life.

7.0.2 This process must be reversed. It is entirely possible to achieve *both* an improvement in the quality of life *and* a reversal of environmental degradation - because of the sheer wastefulness of current ways of operating. Successful economies in the modern world will achieve prosperity by following the principles of environmental sustainability; the efficient use of energy and raw materials is a prerequisite for success. The necessary investments in pollution control and energy efficiency will themselves help to generate employment, improve international competitiveness and spread prosperity.

7.0.3 To achieve such changes, however, requires more than wishful thinking. It requires leadership from government and a framework which gives individual consumers, firms and governments both the encouragement and the ability to move towards more sustainable lifestyles. Economic policy plays a crucial role in this strategy.

7.0.4 Development must be sustainable in economic, social and environmental terms. Our proposals to promote socially sustainable development - in particular, to reduce unemployment - are summarised in Chapter 3. Accurate measurement of all aspects of economic performance, including sustainability, is essential. The traditional measure of national income, Gross Domestic Product (GDP), is totally inadequate as an indicator of national welfare. Liberal Democrats support the adoption of broader indicators of sustainability -

the ability of the environment to continue to provide services over time - and those relating directly to quality of life.

We would:

- *Require each government department to publish an annual report measuring agreed indicators within its policy area, together with international comparisons.*
- *Publish an annual report by the Prime Minister, debated in Parliament, on the state of the nation as measured by changes in these agreed targets.*
- *Require the Chancellor of the Exchequer to introduce with each budget a statement setting out progress in meeting certain key environmental targets in areas such as air and water quality and energy conservation.*
- *Work with international agencies, such as the OECD, to develop new and better indicators on which to base international comparisons.*
- *Require each major company to formulate and publish environmental policies covering the use of energy and raw materials and submit to independent audit on these from time to time.*

Economic policy plays a crucial role in our strategy for sustainability.

7.0.5 Improving energy efficiency is the most important first step: energy use is the major source of local and global air pollution. To create a framework in which consumers have a continuing incentive to conserve energy and

manufacturers are encouraged to improve the energy efficiency of their machinery and appliances, we would phase in an energy/carbon tax based on the EU proposals. We will feed the revenue back into the economy through reductions in other taxes, starting with the tax on jobs (employers' NICs); invest in energy conservation and compensatory payments to those least able to adjust to higher energy prices.

7.0.6 Liberal Democrats would:

- *Ensure adequate funding to energy conservation projects, particularly for domestic housing.* Up to 80 per cent of low income households' energy spending is wasted because of poor insulation and inefficient heating systems. The Government's Energy Savings Trust has been inadequately funded. We will strengthen Government energy efficiency initiatives.
- *Provide grants and subsidies to industry to replace energy-inefficient plant and machinery.*
- *Provide more research, development and demonstration funding for renewable sources of energy.*

A new paper on energy policy, due to be published in 1996, will develop these proposals in greater detail.

7.0.7 A strategy for transport, the fastest growing source of polluting emissions, plays an important role in achieving sustainability. Liberal Democrats would:

- *Invest in public transport* - we would shift expenditure away from building roads and towards investment in public transport. This in turn would be used as leverage for further private financing at both national and local level to help make good the massive backlog in this area.
- *Tackle urban road congestion by encouraging the use of urban road pricing and traffic management schemes, including*

traffic calming, parking controls and investment in public transport.

- *Shift the burden of car tax from ownership to use* cutting Vehicle Excise Duty on smaller engined fuel efficient cars balanced against increased duty on petrol.
- *Reform planning policy to encourage the development of more integrated communities* where work, homes, shops and facilities are all within easy walking/cycling distance.
- *Encourage distance working and telecommuting* also reducing the need to travel.

Policy Paper 15, *Transporting People, Tackling Pollution* (1995), sets out these proposals in further detail.

7.0.8 All sectors of the economy need to feature in the strategy for sustainability. Liberal Democrats would:

- *Introduce measures to encourage repair, reuse and recycling* wherever possible - with deposit refund schemes and measures to reduce excessive packaging.
- *Support reform of the Common Agricultural Policy* replacing price and production support with incentives for farmers and rural communities to meet social and environmental objectives.
- *Establish a Department of Natural Resources* responsible for implementing and administering environmental taxation, emission license systems, subsidies, appropriate regulations and controls and providing UK input into EU and global institutions. This Department would also take over responsibility for the functions once carried out by the former Department of Energy.

Policy Paper 8, *Agenda for Sustainability* (1994) sets out these proposals in further detail.

Towards a Stakeholder Economy

8.0.1 The new global capitalism of the twenty first century will be very different from the nineteenth century capitalism so admired by Lady Thatcher. The companies that are surviving and flourishing are those, large and small, plugged into new supportive networks of relationships, with specialist suppliers of equipment or components on the one hand, with customers prepared to pay a higher price for a customised product on the other. Technology makes feasible the tight control over stocks and inventories which underpins 'just in time' delivery systems; it also makes possible the customisation of all kinds of mass produced products - from micro-chips to motorcars. Cheap air transport means specialist parts can be moved around the world. For the system to work, however, it has to be able to guarantee quality and reliability.

Liberal Democrats seek to build 'stakeholder capitalism', based on co-operation, trust and partnership.

8.0.2 In such a world, the old adversarial style of capitalism, with cut-throat competition based on who could offer the lowest price, is giving way to a different style of capitalism where the premium goes to quality and reliability which in turn demands a more co-operative style of doing business. As Marks and Spencer discovered long ago, building trust and loyalty - with employees, suppliers and customers - pays many dividends. It is no surprise that British companies which gain the

Investors in People Award earn double the average rate of return on capital. Sadly, there are too few such companies.

8.0.3 To survive and flourish in this new world, Britain too must move with the times. Too many British institutions - Parliament, the legal system, industry, banking - are rooted in the adversarial tradition. The constitution needs fundamental reform because Britain would be better governed by a less confrontational, more co-operative style of government. (See Federal White Paper 6, *Here We Stand* (1993)) Similarly, the British style of capitalism is long out-dated. Any company has many 'stakeholders' - employees, customers, suppliers, the community - whose interests need to be considered.

8.2.1 Liberal Democrats seek to build 'stakeholder capitalism' in Britain, based on the principles of partnership, decentralisation and sustainability set out in this paper. In today's global economy, individual governments' ability to act independently of each other is limited. To rebuild and renew Britain's economy, we must motivate and harness the talents of all. Only by recognising people as stakeholders in the economy and society, involving them in decision-making and helping them to work together to rebuild and revitalise Britain, will we be able to achieve our aims.

- *To provide high quality education and training, we look to a new partnership between government, industry and the individual citizen. Government can provide the tools, the infrastructure - the schools, the colleges, the Internet, the computers - but unless companies and individuals accept that they too must play their part, little will be achieved.*

- *To assist the growth of small firms*, we seek to establish a new partnership at the local/regional level, bringing together local authorities, academics, bankers, the business angels, large and small firms, TECs and LECs to work together and provide an infrastructure of support.
- *To increase innovation*, we aim to forge a new partnership between academic science, industry and government at both national and regional level to build upstream and down stream linkages between those who develop the new ideas and those who seek to apply them.
- *To improve business competitiveness*, we seek to encourage companies to involve their stakeholders - employees, customers, suppliers and local communities - in decisions on their future.
- *To reform the financing of industry* we seek to build a new partnership between the banks, the financial institutions and industry, emphasising the two-way responsibilities of share ownership and financial management.

- *To protect the environment for future generations*, we would work in partnership with the community to embrace the objectives of sustainability.

8.2.2 Stakeholder capitalism is built on co-operation, trust and partnership. Many of these characteristics are alien to Britain where the adversarial culture is deeply rooted and distrust and cynicism rife. This is why the whole political system, rather than just the government, needs to change. We need political reform to rid the country of the sterile confrontational politics of Westminster and to build new bonds of trust between people and government. We need to carry that project over to give people and communities real control over their lives. And we need to make people feel that their contribution counts and that participation is worthwhile. Only when this is achieved can we hope to build the wider partnership on which the economic project of renewal and revitalisation depends.

This Paper has been approved for debate by the Federal Conference by the Federal Policy Committee under the terms of Article 5.4 of the Federal Constitution. Within the policy-making procedure of the Liberal Democrats, the Federal Party determines the policy of the Party in those areas which might reasonably be expected to fall within the remit of the federal institutions in the context of a federal United Kingdom. The Party in England, the Scottish Liberal Democrats and the Welsh Liberal Democrats determine the policy of the Party on all other issues, except that any or all of them may confer this power upon the Federal Party in any specified area or areas. If approved by Conference, this paper will form the policy of the Federal Party.

Many of the policy papers published by the Liberal Democrats imply modifications to existing government public expenditure priorities. We recognise that it may not be possible to achieve all these proposals in the lifetime of one Parliament. We intend to publish a costings programme, setting out our priorities across all policy areas, closer to the next general election.

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Note: Membership of the Working Group should not be taken to indicate that every member necessarily agrees with every section or every proposal in this Paper.

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