REFORM PERSPECTIVES

Time to think big

A UK Sovereign Wealth Fund

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About

Reform is established as the leading Westminster think tank for public service reform. We are dedicated to achieving better and smarter public services. Our mission is to set out ideas that will improve public services for all and deliver value for money.

We work on core sectors such as health and social care, education, home affairs and justice, and work and pensions. Our work also covers issues that cut across these sectors, including public service design and delivery and digital public services.

We are determinedly independent and strictly non-party in our approach.

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About *Reform* Perspectives

***Reform* Perspectives –** These are long essays, akin to a newspaper long reads, showcasing a particular opinion or angle on a policy issue. These are meant to be thought provoking and inject new and bold policy thinking into the public sector debate and wider public policy debate.

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There’s an old saying that, if you laid all the economists in the world end to end, they still wouldn’t reach a conclusion. Well, maybe. But most of them would agree on at least three things about Britain.

Firstly, that we save less, invest less and build less economically-vital, growth promoting infrastructure than we should. We’ve got a rock-and-roll economy that lives for today, and doesn’t invest for tomorrow.

Secondly, that Britain is better at inventing clever new widgits than at turning them into profitable, world-beating companies. Brilliant British academic discoveries have a harder time getting out of the lab and into a factory than in Silicon Valley. And when they do they are more likely to be bought by big firms like Google or Tencent and then moved abroad, so the wealth and jobs in cutting-edge sectors of the world’s new economy are created by clusters of firms based in other countries rather than here in the UK.

And finally, that Britain’s demographic timebomb of ever-more elderly people, with ever-bigger medical bills, social care costs and state pensions, funded by ever-fewer working-age folk, is about to create a massive, structural challenge for our economy. We are ageing faster than our economy can possibly grow, and marking up the costs faster than working-age people’s wages can possibly rise. In other words, we are writing enormous IOUs that promise us all a warm, comfortable retirement, and expecting our children and grandchildren to pay the bills when they’re due.

Unless we do something, the result will be ever-higher taxes, or ever-bigger borrowing as future generations struggle to cope with the extra spending. And, equally importantly, because big government debts hamstring economic growth – crowding out private sector investment so wealth-creating projects can’t happen and driving up interest rates so the remainder cost more than they should – we risk stifling growth and stunting our wealth creators for years.

These three problems aren’t just theoretical questions for ivory-towered academic conferences. The effects on British jobs and living standards are already showing up in our democracy and politics: try explaining to someone in Manchester why it takes so long to commute to a job on the other side of the city, when it would take half the time in London. Or to a young professional why there aren’t enough high-skill, high-paid jobs to enable people in their 20s and 30s to afford a decent place to live.

Even worse, the demographic timebomb is creating a moral test for us all, and we’re failing it badly. There’s nothing wrong with promising ourselves a comfy retirement. But expecting our children and grandchildren to fund it, instead of saving to pay for it ourselves, is immoral and unjust. We cannot burden them with enormous bills because we were too lazy, or too cowardly, to fix the problem while there was still time. Our demography should not become their destiny. Future generations will have their own bills to pay; we shouldn’t expect them to pick up the tab for ours as well.

The good news is that, whether each of us voted for it or not, Brexit creates a once-in-a-generation opportunity to reset our economy. To put those deeply-ingrained bad habits behind us, rebalance the country, and fix these problems once and for all.

It's time to think big

There's at least one, game-changingly big idea that would deal with all three of these problems in one go. If we set up a UK Sovereign Wealth Fund like Norway's[1] extremely successful version, we could create a pot of savings to pay for all the state pension and benefits that we've promised ourselves when we retire. It would build slowly over time and would go a long way to preventing our children and grandchildren from having to shoulder the costs of our lifestyle through higher taxes in years to come.

Not only that, but a Sovereign Wealth Fund would create an 'anchor investor' for British entrepreneurs and start-up businesses, to make it easier for all those clever inventions to get out of our country's university research labs and scale up into world-beating UK firms.

Anchor investors can help stop 'founder flight' where UK companies move abroad for the next stage of their growth, partly by strengthening Britain's venture-capital ecosystem for funding cutting-edge technology businesses. And partly by using the Fund's financial muscle as an investor on company Boards to stop key new-economy firms and technologies from moving abroad. Either way, it will mean the jobs and wealth of new industries will be born, grow and become established in clusters of UK firms, instead of in the USA or China.

Last but not least, in time the Sovereign Wealth Fund would create a huge pot of patient, long-term investment capital for everything from transport infrastructure projects to full fibre broadband. This will wean us off our rock-and-roll addiction to consumer spending and equip us to grow much faster in future.

Seeding the Fund

Like saving for a pension, we've got to put a little aside for a long, long time, so the fund would build slowly as investment returns compound. It would take decades, but taking our time makes sense for a project this big, because it wouldn't be fair to expect current taxpayers to pay to set up the new system while they're still paying their taxes to fund the old one too – that would be asking them to pay twice. Instead, we need to spread the costs by building the fund across the generations.

But the demographic timebomb is already ticking, so even though it's a project that will take 50 years or more to fully mature, we've got to set up, and start saving into, the Fund straight away. There are five investment acorns we've got to plant so the Fund can grow into a forest of mighty oak trees.

The first would be to make the Fund the legal owner of all the existing and future state-owned commercial investment funds, for example those held in the British Business Bank. These are already investing in just the kinds of early-stage companies which the new Fund should cover, and the profits should be ploughed back into more of the same.

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[1] Norway's Sovereign Wealth Fund is officially named the Government Pension Fund Global; https://www.nbim.no/en/

We should do the same thing with state-owned land and property, making the Fund the legal owner of everything from the Crown Estate, to heritage buildings like Somerset House and valuable chunks of real estate around city-centre hospitals. Lots of them have long-term leases, but as each one comes up to be redeveloped or re-let in future, the Fund could manage the process and invest the profits on behalf of us taxpayers.

Lots of other countries have sovereign wealth funds already, and most of them were set up with the proceeds of mining and drilling for everything from oil to copper. We can't go back in time to change how we spent our bonanza of North Sea Oil revenues, but we can change our ways so the Fund owns the rights to all future mining and extraction, whether it's of gravel for building, lithium in Cornwall or mineral deposits that haven't even been discovered yet. Either way, if we are reducing Britain's non-renewable natural capital by digging or pumping it out of the ground, we ought to replace it with financial capital on the national Fund's balance sheet, so it can be invested forever instead of just spent today.

Then there's the National Fund; a venerable old charity that was set up decades ago with the aim of repaying the national debt. It's grown quite a bit since then, and is worth about £500 million at the moment. A drop in the ocean compared to our £1.8 trillion national debt, of course, but it would make a great start for the new Sovereign Wealth Fund.

Last but not least, the Government has – rightly – set itself a fiscal rule for its budgets, to make sure it doesn't overspend. Conservative governments live within the country's means, so the National Debt doesn't balloon out of control. The rule says that the 'current budget' of day-to-day spending on everything from police to schools and hospitals, has to be balanced across the economic cycle. It means we can borrow to invest in things like new roads or railways, but we've got to pay our way for everything else.

But if we are balancing day-to-day spending across the economic cycle, it means that bit of the Government's budget will be running a surplus for every year the economy is growing. Otherwise it won't stay in balance the next time there's a recession. So we should lend those growth-year surpluses to the Sovereign Wealth Fund, on the condition that they are repaid during the next recession to balance the budget and obey the fiscal rule. In the meantime, the Fund would invest the cash in investment-grade commercial projects, so it can retain and then reinvest the profits when the loan is repaid. Hey presto, the Government sticks to its fiscal rule while the Fund gets investment acorns it can plant and grow.

Sticky-fingered politicians

There will be a few risks along the way, of course. The biggest will be sticky-fingered politicians who, as soon as the Fund gets big enough to be tasty, will want to grab bits to spend on whatever will help them get re-elected. Whether it's proposals to invest in politically-fashionable projects which won't earn any investment returns, or which preserve jobs in a key marginal constituency, or which ease the pain of a difficult public spending round, a long-term project like the Fund will inevitably become a target over the years.

Fortunately, the UK's Fund won't be the first to face these risks. It will need rock-solid defences to make sure it doesn't get diverted from what it was created to deliver, and there are already tried and tested ways to build them.

The most important is to set up the Fund as a National Insurance Trust with a heavyweight board of trustees like the Bank of England, to maintain its independence. The Trustees would keep political interference and meddling at arms-length, and have the same legal duties as any other pension fund trustees to make sure the money is invested safely and profitably. And framing the Fund as a Trust for UK taxpayers would make it much harder for politicians to raid or interfere with it, because the money wouldn't belong to the Government but directly to each and every voter instead.

Social and financial capital

Even though the Fund would take decades to reach full maturity, our economy would feel the benefits much sooner. From the first day it was set up, the Fund would start rebalancing Britain's economy, creating stronger and more reliable financial foundations so we invest more for the long-term. The extra infrastructure, from better railways and roads to faster broadband, would level up places that hadn't seen enough investment in the past, and help the entire economy grow faster.

Likewise the presence of an enormous 'anchor investor' would help British tech start-ups grow without moving offshore, so the jobs and innovation clusters of the new digital economy are built in the UK rather than China, India or USA. And, in turn, the faster growth and extra jobs would underpin stronger and better public services, insulate us against future big economic shocks like the last banking crisis and build our international heft around the world.

But the real prize of establishing the Fund isn't just the way it would transform our economy; it's how it would change British society for the better too. Setting up a new Sovereign Wealth Fund would create a political legacy for this Government as profound as the Attlee Government's creation of the NHS or the modern welfare state. We would have made post-Brexit Britain a generationally fairer society, by refusing to leave today's IOUs for future generations to pay.

We'd become a more socially-just society, too, because rich and poor would all own the same, equal stake in the Fund and the wealth it contained. Everyone in British society, whether their parents were Dukes or dustmen, would get their state pension and benefits paid to them as dividends by the Fund, rather than by the Government.

Britain would become the biggest and most equally-distributed asset-owning democracy on earth. And our generation would be remembered as the one that broke the mould, and got it done. Even if the economists didn't agree, the historians surely would: it would be a turning point in our country's history.

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