ECONOMIC GROWTH
CRY ME A RIVER

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Economic growth: Cry me a river

The UK press and politicians are fixated on growth.

Economic growth top priority of Labour's 2024 manifesto…

The Labour Government came into office 12 months ago promising a new dawn. Its top priority was growth. Its manifesto, "*Labour Party Manifesto 2024: Our plan to change Britain*"[1] devoted an entire chapter to *"Kickstart economic growth"*.[2]

In this article, we cover:

- Why growth is important
- The downside of growth
- What do politicians and markets mean by growth?
- Is growth in aggregate GDP the right measure to focus on?
- Mistaking current spending for investment in growth
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…but a culture where entrepreneurship is celebrated, and free flow of capital are missing

We believe that two key elements are being missed: i) the need to create a culture in which entrepreneurs are celebrated, rather than often vilified; and ii) that capital can flow freely between companies that generate cash and have no need for more, to those that need it to develop and scale up; currently, many measures freeze capital in the wrong hands.

We would like to see education about entrepreneurship, measures to let businessmen and women keep more of the wealth they have created and a tax system that encourages the flow of capital rather than its fossilisation.

Why growth is important

Growth should mean improved living standards

A growing economy means, in aggregate, that the population gets wealthier every year and living standards rise. It makes it easier for the government to raise more tax, without it being felt, to pay for more public services.

It is part of the human psyche to hope for better things to come as you go through life, or at least to have hopes for a better life for your children. Inevitably, politicians understand this ideal and the politician who promises no growth or even decline is rare. Indeed. politicians also use GDP as a measure of success, comparing their own country's performance with that of competitors.

The downside of growth

It is true, that, in recent times, more people have questioned the desirability of growth. Generally, their concerns are allied to worries about the effects of economic growth on the environment; they believe that the planet just can't take it.

[1] https://labour.org.uk/updates/stories/labour-manifesto-2024-sign-up/
[2] https://labour.org.uk/change/kickstart-economic-growth/

This objection has similarities to the ideas of Thomas Malthus, an $18^{th}/19^{th}$ century English economist and cleric, who was convinced that the resources of the planet could not grow as fast as the population and the result would be hunger and poverty; history, however, has proven Malthus wrong.

What do they mean by growth?

Generally, talk of growth means growing aggregate GDP

When it comes to markets and politicians, the term "growth" usually means growth in aggregate GDP.[3] This is a measure of annual total domestic economic output. There are various ways of measuring it and defining certain inputs; this article is not going to explore that.

Generally, markets are interested in the absolute measure of GDP, how the figure is changing over time and the comparison with other countries.

Is growth in aggregate GDP the right measure to focus on?

Objections to the focus on aggregate GDP come in several forms:

Some worry about environmental impact…

…others think the focus should be on happiness instead

1. **The planet cannot cope:** We have already mentioned that some believe the planet cannot cope with more economic output.

2. **Should we not be focusing on happiness instead?** A related objection is not against "improving" people's lives as such, but holds that we are measuring the wrong thing – we should, instead, focus on improving aggregate happiness.

   On the face of it, this approach might seem appealing. The difficulty is in measuring "happiness". It is relatively easy to add up economic output in Pounds. Measuring "happiness" runs into the problems of deciding what factors to include, what their weighting should be and how you measure the factor. For example, should a score for health be weighted the same, more than or less than leisure, and how do you measure it? Do we look at changing life expectancy or the number of ingrowing toenail operations?

   Philosopher and political economist, John Stuart Mill, was among the first to have a crack at defining this. His book *Utilitarianism*[4] explored the principles of creating a society that strove to maximise happiness (or utility as the Victorians often called it) – "greatest good for the greatest number as the result of human action". To give a flavour of some of the difficulties of measuring happiness, Mill struggled with the idea that the happiness of a child playing hopscotch is the same as, say, reading poetry. As a result, he suggested a distinction between "higher pleasures" (watching opera, for example) and "lower pleasures" (attending a football match, for instance). This gives some idea of the issues faced when using happiness as a measure of success.

[3] The author has searched the Labour Manifesto, but can find no definition of growth
[4] John Stuart Mill: *Utilitarianism*, 1863

For some assessments, GDP per capita may be better

3. **Should aggregate GDP be replaced by GDP *per capita*?** Aggregate GDP might be a good benchmark for the heft of a country in the world. For example, Professor Mark Harrison, a specialist in the economics of war, argues that, unless there is a swift knockout blow, the country with the higher aggregate GDP in a conflict will always eventually win.[5]

   Other parties may be more interested in the GDP *per capita* figure; this is a way of measuring the standard of living of a country.

   Let us consider the comparison between India and the UK.

India and the UK compared

	India	UK
GDP (Nominal) 2025 estimate ($bn)	4,187	3,839
Pop 2023 est. (m)	1,428	68
GDP *per capita* 2025 estimate (£)	2,932	56,456
Gini Coefficient 2021 (%)	33	37

Source: Hardman & Co Research

The table above shows that India and the UK have very similar aggregate GDPs (India's is greater by 9%) and, one might argue, their influence on the world stage is similar as a result. However, since the populations are very different, the GDP *per capita* is vastly different, reflected in average living standards.

Distribution of GDP can matter as well

4. **Aggregate GDP does not account for the distribution of GDP*:*** Even GDP *per capita* has its limitations as a means of measuring the standard of living. It is just an average figure. The evenness of distribution is measured by the Gini Coefficient, a methodology developed by the Italian statistician and sociologist Corrado Gini.

   The Gini Coefficient can vary between "0%" where everyone's income or wealth is the same to "100%" where all the wealth and income is in the hands of one person in a society. There is room for lots of contention in what should be included (for example, housing benefits). On this basis, there is not a lot of difference between India and the UK.

   Just considering GDP *per capita* not only disguises the gap between rich and poor but may also hide a gulf between young and old. In most economies, debts are highest among the young (mortgages and student loans) while net wealth is concentrated in the hands of older citizens.

Mistaking current spending for investment in growth

There is a temptation, particularly among politicians, to mix up current spending and investment. Investment in growth is thought of as good, so the more of it you can claim the better. Hence, comments such as "we've invested £xxbn in new policemen, nurses" or whatever. That is not investment, it is simply more current spending.

[5] Stephen Broadberry and Mark Harrison: *The Economics of World War I*; Cambridge University Press

Critical elements needed for growth

Many elements are needed to create a growing economy. There are two that the UK seems to struggle with: i) valuing entrepreneurs; and ii) the recycling of capital.

Encouraging entrepreneurs

We do not celebrate enterprise like the Victorians did…

In the Victorian age, entrepreneurs were celebrated in Britain. Men like William Armstrong, who built steam-driven pumping engines, hydraulic accumulators and armaments, or Henry Bessemer, who invented the steel-making process that bears his name, and was instrumental in turning Sheffield into "Steel City" were lauded for their work, the successful businesses they had created and the risks they had taken.

Today, an element of British society distrusts entrepreneurs, businesspeople and profits. Some commentators think that companies should only be allowed to make "fair" profits. In their minds, the word "fair" has an objective meaning when, in reality, it is just a subjective description and your "fair" is different to my "fair".

Growth is driven by entrepreneurs, people who have good ideas and are prepared to risk everything. Governments have an abysmal record of backing projects, companies and businesses; civil servants simply do not have the right skill set and a career in the Civil Service is, probably, the definition of a risk-free job.

Not only do many people denigrate businesses and business people, but also the tax system takes much of the reward for successful enterprise. For example, the Entrepreneurs Relief used to enable a successful business person to take the first £10m of gain on crystalising the value they had created at a lower rate of Capital Gains Tax (10%); today, that benefit (now called "Business Asset Disposal Relief") is restricted to just £1m, the value of an average family house in London.

Taxes restrict the free flow of capital

…and we starve new ideas and scale-ups by putting barriers in the path of capital flows

In a healthy growth economy, capital is recycled from mature businesses that are generating surplus cash to companies that need it to get going or scale up. That was one of the reasons the "Industrial Revolution" took off. Capital was freed up from agriculture as that went through dramatic productivity gains, and recycled into new industrial opportunities.

If capital cannot be reallocated to where it is needed, and where the returns are best, suboptimal growth results. Companies that generate surplus cash are less likely to distribute it in dividends and, instead, find a way to deploy it themselves. That is what happened at BAT, one of the world's largest tobacco manufacturers. Tobacco was a mature business throwing off cash. Rather than pass that surplus onto shareholders, it made multiple acquisitions over time; among these were the retailers, Saks Fifth Avenue and Argos, and financial services companies, including Eagle Star and Allied Dunbar. What did the management of a tobacco company know about running retail and financial services? Many BAT shareholders would say "not much" and that they should have been given the cash to allocate themselves.

Another example was BT, a near monopoly in telecommunications, which, long before the need for massive investment in fibre broadband came along, just threw off cash. In 1986, BT bought 51% of Mitel, a struggling producer of telecom systems, based in Canada. Would the management of a telecom service be able to run a manufacturer? Six years down the line, they decided that the answer was "no" and sold out.

Dividend and capital taxes hinder capital flows

Today, in the UK, taxes on dividends and capital gains tend to trap capital in mature businesses and starve new opportunities of life-giving capital. In a healthy growth economy, the flow of capital is encouraged. Capital Gains Tax (CGT) was already a serious barrier to capital flow before the last Budget; the regime was tightened in that Budget and looks set to be squeezed further in the next one. These high rates of tax and low tax-free allowances clog investment – investors become more reluctant to sell their existing holdings to fund new ones. In turn, this reduces liquidity in quoted companies as investors just hold on to what they already have and ignore IPOs and fundraisings.

Of course, CGT is worse than that. There is no adjustment to the base cost of an investment for inflation, so investors can be taxed on nominal gains when they have made a loss in real terms! With the much lower annual exemptions we now have in place, that will hurt.

The author appreciates the assertion that lower rates of tax on dividend and capital gains provides an incentive to switch income into these. We hear a lot of that argument. Rarely do we hear the balancing argument about the benefits of allowing the free flow of capital.

Labour does support Business Relief schemes, however

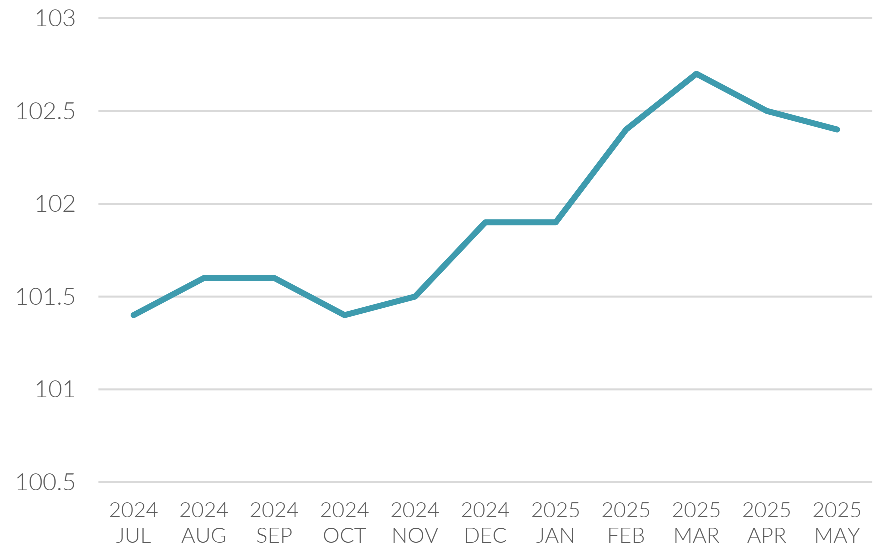
Perhaps, the author is being too critical of the Labour Government. It has supported the Enterprise Investment Scheme, which benefits from generous tax allowance, recognising the high risk there is in these investments. Similarly, the wrapper of a "Stocks and shares ISA" enables investors to move money between investments without HMRC taking a clip in the form of CGT along the way.

Maybe, the idea of a wrapper should be extended to holdings of shares outside ISAs. If an individual were to receive CGT rollover relief when the proceeds of a sale were fully reinvested, and only paid tax on money taken out, capital would flow more freely. In the current environment, this is unlikely to be on the agenda since ca.£13bn was probably raised by CGT in 2024-25.

The UK's recent track record

Growth in aggregate GDP for the UK has been pedestrian in recent years. To some extent, this is true of many developed countries. However, for a government that promised a laser-like focus on growth, the results have been poor.

Monthly GDP estimates for the UK



Source: Office for National Statistics, Hardman & Co Research

The data for the first 11 months of this government,[6] shows GDP remaining completely static for two months and falling in three. For the full 11 months, only 1% progress has been made. This will not generate the tax revenues the government requires to meet its growing list of needs and will be undetectable by the man in the street.

It can be argued that growth is a marathon, not a sprint, and should be judged over the long term. However, in the first mile of this marathon, the UK economy seems to be a backmarker.

What can be done to boost growth?

In our opinion, we need three things to happen:

- to educate the public that the term "profit" can be a good thing – it's the reward for successfully fulfilling a need;
- to encourage entrepreneurs by letting them keep more of the return; and
- to accelerate the flow of capital from companies that do not need it to those that can scale up or get started.

[6] ONS https://www.ons.gov.uk/economy/grossdomesticproductgdp/datasets/gdpmonthlyestimateuktimeseriesdataset

About the author

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Keith Hiscock is the Chief Executive of Hardman & Co.

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Keith has more than 45 years' City experience and has developed long-standing relationships with many major institutional investors, including Private Client Brokers and Wealth Managers. He started his career at James Capel, at the time the top-ranked research house in London. He was a founding member of Schroder Securities and of Agency Partners, a leading research boutique house, and was a member of the five-man securities board at Evolution. Keith has also advised companies, large and small, on their relationships with the capital markets.

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