

# Building a new industrial strategy ... on shaky foundations?

By Nicholas Crafts

Following the lead given by the new Prime Minister, the UK government has recently published a Green Paper, *Building our Industrial Strategy*. It is hoped that this will build on UK strengths and extend excellence into the future, close the gap between the UK's most productive companies, industries, places and people and the rest, and make the UK one of the most competitive places in the world to start or grow a business.

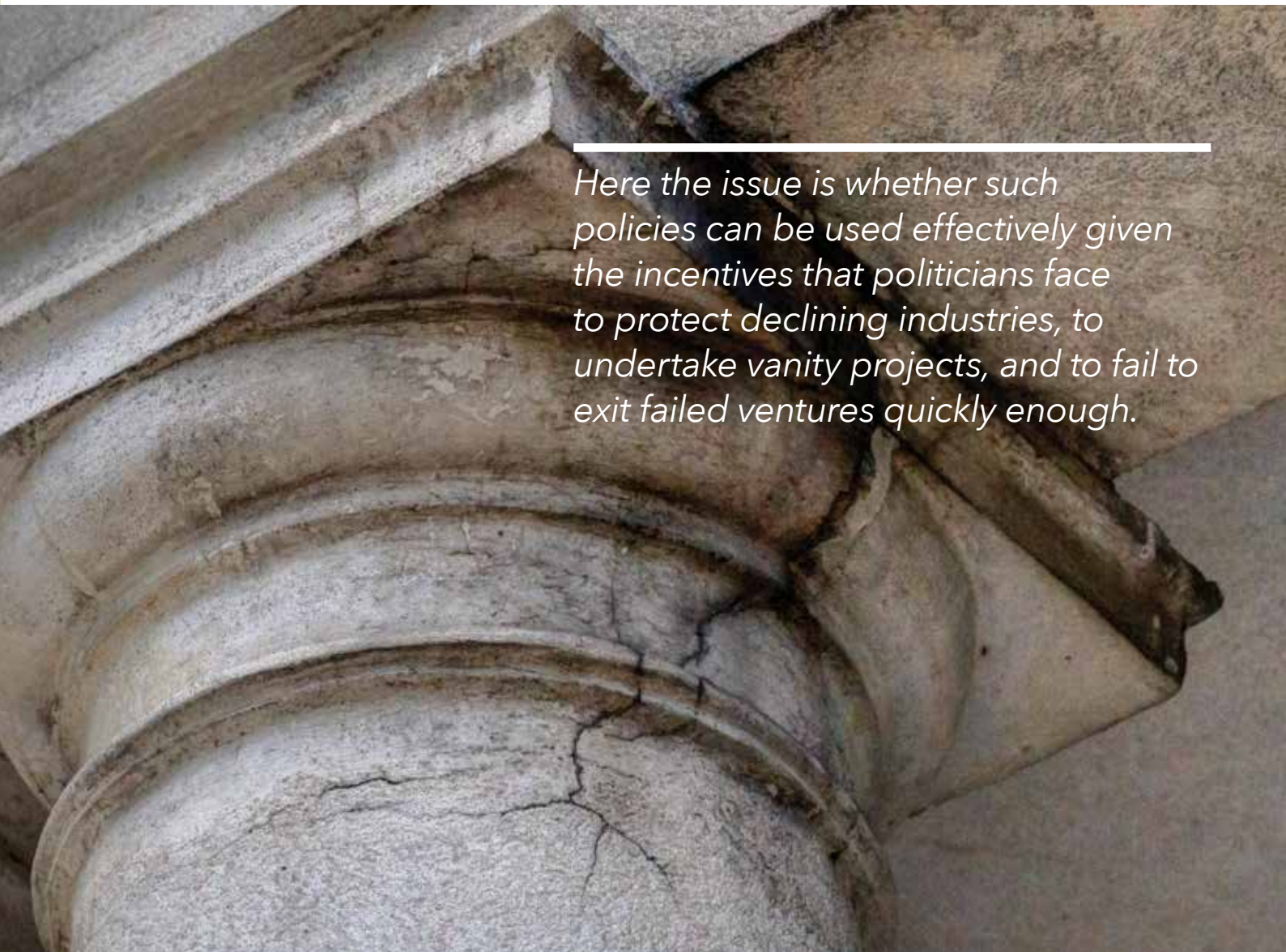
THESE HAVE, OF COURSE, been policy aspirations in the past but the context has now changed. Three points in particular are worth bearing in mind. First, UK productivity growth has been very disappointing in recent years. Second, an influential interpretation of the Brexit vote is that a key element in its core support

came from 'left-behind' voters. Third, Brexit potentially increases the scope for industrial policy free of constraints imposed by EU membership.

The strategy is to be based on ten pillars (see opposite page). Some of these, for example, investing in science research and innovation, developing skills, and upgrading

infrastructure address widely-recognised weaknesses in UK supply-side policy. The issue will be about how well the government will deliver rather than the desirability of strengthening policy interventions. Others, notably improving procurement, encouraging trade and inward investment, and cultivating world-leading sectors, seem to embody a return to selective industrial policy (favouring privileged industries and domestic producers) which was last used on a significant scale in the 1970s and has been largely precluded by EU rules on state aid. Here the issue is whether such policies can be used effectively given the incentives that politicians face to protect declining industries, to undertake vanity projects, and to fail to exit failed ventures quickly enough. ►

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## THE 10 PILLARS

1. INVESTING IN SCIENCE, RESEARCH AND INNOVATION
2. DEVELOPING SKILLS
3. UPGRADING INFRASTRUCTURE
4. SUPPORTING BUSINESSES TO START AND GROW
5. IMPROVING PROCUREMENT
6. ENCOURAGING TRADE AND INWARD INVESTMENT
7. DELIVERING AFFORDABLE ENERGY AND CLEAN GROWTH
8. CULTIVATING WORLD-LEADING SECTORS
9. DRIVING GROWTH ACROSS THE WHOLE COUNTRY
10. CREATING THE RIGHT INSTITUTIONS TO BRING TOGETHER SECTORS AND PLACES

The principal rationale of an industrial strategy might be to improve medium-term productivity performance by addressing market failures. For example, there is a strong reason to intervene to support research and development expenditure where we know that the social returns are much higher than the private returns. An important role for R and D is to facilitate the diffusion of new technologies from abroad as well as to stimulate the domestic invention of new products and processes. Among the important opportunities for the near future, artificial intelligence and robotics stand out. The scope for increasing productivity is substantial but this will entail job losses especially for low-wage/low-education workers. Managing this transition to achieve inclusive growth, which seems to be a strong aspiration of the Prime Minister, without holding back innovation and inhibiting productivity improvement will be a major challenge requiring, in particular, well-designed labour market policies. The Green Paper does not have anything to say about this.

More generally, a key aspect of modernising the UK economy is to strengthen rather than weaken forces of creative destruction – to encourage the entry of the new and the exit of the old – or put another way to promote the shift of productive resources, both capital and labour, to higher productivity uses. The UK is no better than mediocre at this as is shown by the ‘allocative efficiency’ (AE) scores in the table and this accounts for a large part of the productivity gap with leading economies. The Green Paper does not, however, address this issue and doing so would only exacerbate the woes of many pro-Brexit voters.

A hard Brexit with reliance on WTO rules to govern trading relationships appears to be a quite likely outcome of the UK’s negotiations with the EU under Article 50. If so, this will in effect allow much more scope for selective

industrial policy and it seems from the Green Paper that this would be welcome to the government. The problem is that this has the potential to increase ministerial discretion to support favoured industries and technologies ‘in the public interest’, to help the left behind or, more generally, to win votes rather than to pursue economic efficiency. In other policy areas, especially competition policy, we have come to realise that it makes sense to have a rules-based system which precludes such political opportunism. The imperative for government outside the EU is to establish a framework which controls the use of state aid. Unfortunately, on this topic the Green Paper is silent.

Ten pillars to an industrial strategy might seem like a lot. Yet, on closer inspection, the

unavoidable conclusion is that there are striking omissions and that many of the biggest challenges are not mentioned. A successful approach would include a strong emphasis on some of the ten pillars, notably the first three, but it would also address employment issues arising from the consequences of technological change, the prevention of the misuse of selective industrial policies, and the facilitation of creative destruction.

No doubt, the Green Paper serves a short-term political purpose but it is not a landmark in economic policymaking. A recent poll of economists found that a large majority thought that it is time for a new industrial strategy but at the same time they doubted that the government could implement one successfully. I share these opinions. ◀

#### Allocative Efficiency Scores

	Manufacturing	Services	Business Sector
France	0.461	0.161	0.296
Germany	0.443	0.399	0.460
Greece	-0.056	-0.235	-0.240
Italy	0.141	-0.190	-0.039
Spain	0.465	-0.052	0.117
Sweden	0.672	0.253	0.379
UK	0.300	0.065	0.156
European Union	0.272	0.036	0.140
United States	0.473	0.358	0.394

Note: the scores reflect the extent to which labour productivity exceeds that which would result from a random allocation of resources, i.e., for the business sector in the United States this is 39.4 per cent.

Source: online appendix to D. Andrews and F. Cingano, “Public Policy and Resource Allocation: Evidence from Firms in OECD Countries”, *Economic Policy* 2014, vol. 78.

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