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Evidence to the Barker Commission on Industrial Strategy

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Summary

1. This response to the Commission's consultation engages with two of the areas of interest it has identified: the role of the state; and lesson learning. It seeks to use past experience of successful industrial strategy to critique the government's Green Paper *Building our Industrial Strategy* and to suggest recommendations based on that history.

2. Placing the government's Green Paper in historical context emphasises its lack of ambition and its likely failure to meet its stated objectives because the degree of proposed government intervention and investment is likely to be insufficient. That is a product of the cross-cutting and higher priority requirements of current fiscal policy, with its clear and overriding focus on deficit reduction.

3. We should learn the lessons of past success in industrial strategy and

    i) Think more holistically, conceiving industrial strategy as being about more than just a set of specific policy ideas for raising industrial and commercial investment and productivity. Rather, an industrial strategy should place those policies within a broader strategy for the modernisation of the economy, including supportive macro-economic policy.
    ii) Embrace a balance sheet approach to national accounting.
    iii) Borrow to support much higher government investment in industrial strategy, recognising (via balance sheet accounting) the likely long-run return on that investment.
    iv) Set specific national and sectoral targets for faster economic growth and better productivity that are endorsed by the whole government (and particularly by the Treasury).
    v) Ensure that decisions in all areas of policy relevant the economy (not least on the level and form of government spending and taxation) are taken with the context of those targets.

In the remainder of this document I engage with two areas highlighted by the commission as being of interest: the role of the state and lesson learning.

The Role of the State

4. There are things worth praising in the Green Paper.

   4.1. The label 'industrial strategy' suggests a welcome return to an earlier (pre-1975) Conservative Party recognition that government has an important role to play in shaping and supporting the development of the UK's private sector and in correcting market failure.

   4.2. The focus on improving productivity is essential if an economy with record levels of employment and participation in the labour market is to raise its present rate of growth (which, let us remember, is lacklustre when looked at in historical context).

   4.3. The analysis in the Green Paper highlights many current shortcomings that serve to inhibit growth in output and productivity such as poor infrastructure, relatively low skill levels within the working population, relatively poor transport and communication infrastructure, and the profoundly unbalanced nature of regional economic development within the UK.

   4.4. The Green Paper rightly identifies government intervention as growth and productivity promoting via: government investment in science, research and innovation; vocational education; investment in new and improved infrastructure; using government procurement to drive innovation; promoting competition; and the need for new and/or improved institutions to support growth and better productivity.

   4.5. It hints at a new approach to regional policy in order to develop potential outside London and the South East.

   4.6. It recognises the importance of government working cooperatively with the private sector in order to support its modernisation and development, and to remove obstacles to growth and better productivity.

5. But Greg Clark's introduction highlights a fundamental problem for his industrial strategy when it reiterates this government's commitment to 'return the public finances to balance at the earliest possible date in the next Parliament'; to ensure debt as a proportion of GDP is falling by the end of this Parliament; and to meet a specific target for the structural deficit (below 2% of GDP).

6. Meeting the government's fiscal policy ambitions radically constrains its freedom of manoeuvre in industrial strategy. It forces that strategy into a much less interventionist form than characterised successful examples of past industrial strategy.

7. To take but one example, £740m to support fibre broadband and 5G investment over three years is significantly less than the £1.7bn investment by government, local authorities and the EU in extending 'superfast' (24Mbps+) broadband coverage to at least 95% of premises in the UK by 2017.[1] It is hard to see it making a significant difference except at the margin.

8. Put brutally, the overriding importance attached to deficit reduction transforms the Green Paper from a potentially workable strategy for higher growth and productivity into a list of platitudes and relatively small-bore government spending initiatives that are unlikely to achieve much.

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[1] House of Commons Briefing Paper CBP06643, *Superfast Broadband Coverage in the* UK, by Daniel Rathbone (August 2016), p 18

Lesson learning

9. History can be a guide to present day policy making inasmuch as it can: 1) help us repeating the mistakes of the past; 2) highlight past achievements that we can learn from; 3) provide institutional memory that is often lacking and so help policy makers avoid reinventing the wheel.

10. All three of these apply in the case of the Industrial Strategy Green Paper.

11. The Green Paper uses history selectively, looking back to the 1970s as an example of poor industrial strategy (identifying it as the cause of that decade's poor growth, due to poorly targeted investment and the concept of 'picking winners'). In setting out the government's new thinking on industrial strategy it argues that the 'lessons of the 1970s' have been learned. But the very difficult economic conditions of the 1970s (faced by all advanced economies) create an artificial sense of past failure in industrial strategy – not least because by in 1970s that strategy dissolved into a day-to-day battle to keep firms alive in order to sustain employment.

12. A less selective reading of history than that evident in the Green Paper serves to reveal that the 'industrial strategy' set out therein is probably too limited to be termed an 'industrial strategy' as opposed to a 'policy for industry'. Ironically, this is all too reminiscent of 1970s industrial policy.

13. Moreover, past experience (in the 1960s) suggests that the proposals contained in the Green Paper are both too limited in terms of commitments to government spending and too narrowly based to achieve its desired aims.

14. As now, Britain in the 1960s faced the challenge of modernising and retooling its economy as it reoriented itself in terms of international trade and embraced more competitive international trading conditions. Industrial policy was then more interventionist, much better financed, and embedded within a broad-based strategy that harnessed macro-economic policy to build confidence and create the conditions for higher private investment in human and physical capital.

15. In 1961, the seeds for a broad-ranging UK industrial strategy were sown when the Cabinet considered a memorandum from the Treasury setting out its analysis of the impediments to faster economic growth. The Treasury's 'Economic Growth and National Efficiency' report was incisive and wide-ranging. It identified a role for government in raising the level and quality of investment, and the quality and mobility of the workforce. It identified scope to improve the quality of management, generate sustainable employment in areas of declining industry, and attack both anti-competitive practices in business and restrictive labour practices. In the view of the Treasury, government could intervene to improve the business environment - by reducing tariffs on international trade, for example. Crucially, the Treasury identified the importance of explicitly crafting decisions on public spending and taxation with a view to creating 'an efficient full-employment economy capable of sustained growth'.

16. This forgotten Treasury document was the wellspring of a revolution in industrial interventionism under governments of different political complexion. It was given force first by the Macmillan government's creation of the National Economic Development Council (NEDC), its Office and subordinate industry-level development councils in 1962, and then by the publication of the NEDC's own analysis (which owed much to that of the Treasury) and programme for faster growth. Thus was inaugurated the era of 'indicative planning' whereby government worked with employers and with unions (the latter then powerful economic actors with the potential to derail

the strategy) in a partnership that set an overall target of 4 per cent annual growth, with subordinate targets for growth and investment in specific economic sectors. That overall growth target then received clear and public prime ministerial endorsement. More significantly, the then Conservative government undertook to assume the 4 per cent annual growth rate in its fiscal policy and investment plans over 5 years – the idea being that such a commitment would give private firms the confidence to raise both physical and human capital investment. When Labour came into office in 1964 it essentially endorsed and expanded the strategy.

17. The industrial strategy of the 1960s came to be seen as a mistake for four main reasons:

    17.1. Though it raised economic growth from an annual rate of 2.6 per cent p.a. at the start of the decade to 6.4 per cent by 1967 that proved unsustainable (the overriding commitment to sterling, in the context of then Bretton Woods system of fixed exchange rates, serving to derail the programme).

    17.2. It set very ambitious and very public targets that were ultimately missed (and governments failed adequately to explain that the targets were intended to be stretching and thus there was always a risk they might not all be achieved)

    17.3. Some of its investments (e.g. Concorde) failed commercially and, unlike private investment failures, that failure was both public and became a political stick with which to beat the government.

    17.4. Annual national income accounting emphasised the very significant cost of public borrowing to invest without recognising the long-run return on that investment (which ultimately led the Treasury to assess the effectiveness of the strategy in negative short-run terms as well as, again, providing ammunition to political opponents).

18. Yet in many ways, 1960s' industrial strategy was a major success.

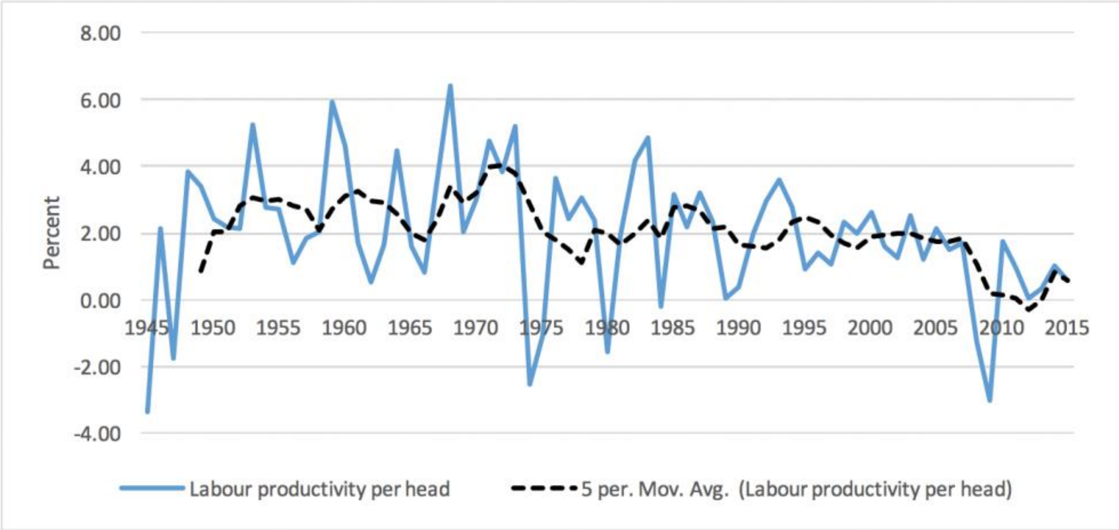
    18.1. It supported a reorientation of UK trade towards advanced economies in the European Economic Community.

    18.2. It raised productivity over the short- to medium-term until the onset of recession in 1973 in the wake of the OPEC I oil shock and the onset of stagflation (after which a clear secular trend for labour productivity to decline is observable, as can be seen in Figure 1 below).

    18.3. It laid the infrastructural foundations for longer-term growth. The investments of that decade long out-lasted the industrial strategy itself (e.g. the new motorway system, an entirely new national gas supply network, nuclear power stations, modernised state-owned industries such as coal, steel and the railways, and the significant expansion and improvements in schools, technical colleges and universities). When growth restarted in the late-1979s and 1980s much of it was built on these foundations. Indeed, much of today's economic output is still dependent on them.

    18.4. Despite high levels of government spending, the national debt as a proportion of GDP fell during the decade because of rapid economic growth.

Figure 1 Annual growth rate of labour productivity per head, 1945-2015[2]



19. We should learn the lessons of success in the 1960s and

    a. Recognise the need to get Treasury buy-in to more active government intervention to promote economic modernisation and investment.
    b. Embrace a balance sheet approach to national income accounting.
    c. Borrow to support higher government investment in industrial strategy
    d. Think more holistically – for example, by embed government intervention to promote output and higher productivity within a fiscal policy that supports specific targets in both dimensions

Notes

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Dr Pemberton is an expert on the political history of Britain since 1945, with a focus on economic policy. His evidence herein is provided in a personal capacity.

[2] Source: S. Hills, et al 'Three centuries of macroeconomic data, v.2.3' (London: Bank of England, 2016).