The Industrial Strategy Commission

The Final Report of the Industrial Strategy Commission

Executive Summary

November 2017

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About The Industrial Strategy Commission

The Industrial Strategy Commission is an independent, authoritative inquiry into the development of a new, long-term industrial strategy for the UK.

The Industrial Strategy Commission is a joint initiative by Policy@Manchester at The University of Manchester and the Sheffield Political Economy Research Institute (SPERI) at the University of Sheffield.

The Commission was formally launched in March 2017. The Commission's first publication - a response to the government's consultation on their Green Paper on industrial strategy - was published in April 2017. Its first major report – *Laying the Foundations* – was published in July 2017.

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Acknowledgements

This report has been prepared by Kate Barker, Craig Berry, Diane Coyle, Richard Jones and Andy Westwood, with research support by Marianne Sensier. The report has been overseen and edited by Tom Hunt.

The Commission's work has benefited greatly from the contributions of a wide range of individuals and organisations who have engaged with the Commission, submitted evidence and attended our events.

Get in touch

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The Final Report of the Industrial Strategy Commission is available to download from:
www.industrialstrategycommission.org.uk

Executive summary

There is welcome and growing support for a new industrial strategy, but there is currently neither consensus nor clarity about what industrial strategy should entail or seek to achieve. This report aims to redress this situation. Our recommendations seek to shape the design of a strategy and steer it towards a policy framework that can ensure future success.

Strategic economic management: Industrial strategy must be rethought of as a broad and non-partisan commitment to strategic management of the economy. It is a long-term plan, with a positive vision, to build on the economy's many strengths and address its weaknesses.

New institutions are needed: Industrial strategy at the centre must be transformed. A new powerful industrial strategy division, within the Treasury, is needed to ensure all other departments devise and implement policies consistent with the industrial strategy.

Monitoring and measuring success: A new independent expert body should be created to monitor and measure the long-term success of the new strategy. On the model of the Office for Budgetary Responsibility, we propose the 'Office for Strategic Economic Management'.

Outcomes: The new strategy should have an ambition to achieve positive outcomes and make material differences to people's everyday lives.

Place matters: An industrial strategy should not try to do everything everywhere, but it should seek to do something for everywhere. In 5 or 10 years' time we should be able to pick anywhere in the UK and say how the strategy has helped that place, its people and industries.

Further and faster devolution: Most places perform below the UK average, given the extent of centralisation; new approaches are needed. The strategy requires further and faster devolution to towns, cities and regions.

Universal Basic Infrastructure: All citizens in all places should be provided with Universal Basic Infrastructure. Everywhere in the UK should be served by high quality hard infrastructure and have access to high quality human capital-building universal services.

Health and social care: Achieving better outcomes for people's wellbeing must be central to the strategy. New thinking can ensure health and social care aligns with industrial strategy.

Diffusion of innovation: World-class innovation happens in the UK but the effects should diffuse throughout the economy. We need to re-link excellence in basic and applied research.

New methods of appraisal: Decision-making for large strategic projects needs to be overhauled to better account for the potential impact on everyday behaviour. Cost-benefit analysis should apply to the real world, not just to a spreadsheet.

Choices: When there is a trade-off between economic efficiency and the equitable treatment of communities, sometimes it is right for the fairness objective to predominate.

A focus on the strategic goals of the state: The new strategy should be designed to meet the strategic goals of the UK. Our assessment is that these goals in 2017 are:

- Ensuring adequate investment in infrastructure
- Decarbonisation of the energy economy
- Developing a sustainable health and social care system.
- Unlocking long-term investment
- Supporting high-value industries and building export capacity
- Enabling growth in all parts of the UK

Rethinking industrial strategy

The UK economy has historic weaknesses, yet the UK's people, places and industries have great strengths and huge potential. To both respond to current weaknesses, made more pressing due to Brexit-related uncertainty, and build on our strengths we need strategic co-ordination of all economic interactions between the state and the private sector. The new industrial strategy will only be successful if industrial strategy is thought about in completely new terms and if it is focused on clear goals. We recommend a focus on six strategic goals and the report considers how to meet each of them.

- Industrial strategy should be understood as a broad and non-partisan commitment to strategic management of the economy.
- The UK economy has many strengths and areas of opportunity, but the reality must be accepted that it also contains many sustained weaknesses. The government should commit to addressing all of the weaknesses through strategic economic management.
- The new industrial strategy must be designed with a comprehensive understanding of the state's unique powers of coordination and convening, and its ability to pool risk, create markets and provide public goods.
- Comprising a long-term and viable industrial policy framework, the strategy should be built on seven foundational themes: a new institutional framework; place; science, research and innovation; competition policy; investment; skills and the state's regulating and purchasing power.
- The UK needs significant cultural change in policymaking so that the new industrial strategy does not become paralysed by risk aversion and short-termism.
- The new industrial strategy should embrace technological change and seek to capture the benefits, but a critical perspective to occasionally overstated claims is always necessary. It should recognise the state's essential role in driving technological innovation, and focus on diffusion, as much as disruption.
- A new strategy should have an ambition to achieve positive outcomes and make material differences to people's everyday lives, and not confine itself to a few 'sector deals'. Our assessment is that the strategic goals for the UK in 2017 and for the foreseeable future are:
    - Ensuring adequate investment in infrastructure
    - Decarbonisation of the energy economy
    - Developing a sustainable health and social care system.
    - Unlocking long-term investment
    - Supporting high-value industries and building export capacity
    - Enabling growth in all parts of the UK

Institutional framework and delivery mechanisms

Institutional reforms are needed to ensure there is vision, impetus and co-ordination of industrial policies, but once the strategy is established there should be as much long-term policy and institutional stability as is politically possible. The new industrial strategy must be owned by and driven from the top of government, including the Prime Minister and the Treasury. It must be embedded throughout the state with institutional clarity in Whitehall and powers devolved to local, regional and devolved government wherever possible. The new strategy must pay particularly close attention to the operation of key industrial policy delivery mechanisms such as skills provision and the research and innovation landscape.

- A new industrial strategy division should be created within the Treasury, overseen by the Chief Secretary, with the power to ensure that all other departments devise and implement policies consistent with the industrial strategy. The existing structure of the Treasury must change to reflect a new approach to industrial strategy. BEIS should be retained as a key delivery department. Officials from several departments, including BEIS, the Cabinet Office and 10 Downing Street, along with local, regional and devolved authorities would be directly involved in the day-to-day work of the new division.
- Central government should devolve a significant array of powers and budgets related to industrial policy to sub-national political authorities, including those related to infrastructure, skills, business finance, planning and procurement, and some tax powers. Existing city-region and combined authority structures should be the basis for this programme of further and faster devolution, but other models should also be permitted where there is a strong consensus locally, including multi-tiered devolution whereby multiple city-regions establish a unified structure through which some powers can be exercised cross-regionally.
- Local Enterprise Partnership (LEP) boundaries should coincide with the appropriate economic geography. For the most part LEPS should be retained, albeit with greater attention to how they can support strategic economic management over the long-term.
- The government should create an independent mechanism for monitoring and assessing progress in the industrial strategy. On the model of the Office for Budgetary Responsibility, we suggest calling it the 'Office for Strategic Economic Management'. This would signal that industrial policy is as important as fiscal policy. The title would enable it to act broadly across government and specifically to draw in Treasury interests in areas that might otherwise be considered out of scope.
- Skills policy requires institutional and policy stability after decades of damaging instability. Cross-party consensus on supporting the framework adopted in the coming years will be critical to its success. To deliver both local and national industrial strategy objectives, closer working and co-operation is required between the Department for Education and BEIS, national and local authorities, and the higher and further education funding and regulatory systems.
- Particular attention should be given to how spatial objectives in the industrial strategy are built into current and planned higher education reforms including the introduction of the Office for Students and the Teaching Excellence Framework. In general, more skills resources and powers (within stable national funding and curriculum systems) should be devolved to metro-mayors and combined authorities.
- A long-term commitment to raise the R&D intensity of the economy, measured as the ratio of R&D spend, should be accompanied by a more detailed understanding of the whole innovation system and the channels through which spending is translated into meaningful innovation. This will require intermediate milestones for both business and government/HE R&D intensity, supported by proposals for concrete interventions at a material scale, and with a new emphasis on *demand-led* initiatives to supplement the supply-side approach characteristic of the last 15 years of science and innovation policy.
- The new UK Research and Innovation agency (UKRI) should inform, and be informed by, the proposed new industrial strategy division in HM Treasury. It is essential that there is a cross-government mechanism that has a two-way relationship with UKRI. The UKRI board should have a high-level advisory committee including representatives from all three Devolved Administrations, and from key local authorities with devolution deals.

- The UK should seek to maintain and enhance the international character of its research system, including through future participation in EU Framework Programmes, for example through associate country status.
- The new strategy should be designed with a comprehensive understanding of the whole R&D landscape and the relationships between its different parts. New institutions must have clarity of mission and be judged by the appropriate metrics.

Investing in Infrastructure

Ensuring there is adequate investment in infrastructure to meet our current and future needs and priorities is one of the immediate strategic priorities for the industrial strategy. Achieving excellence among our most productive companies and in our most dynamic places, and to ensure the benefits of a successful economy are shared fairly, will require increased investment in both hard (physical and natural capital) and soft (human capital-building) infrastructure. The UK needs new appraisal methods for infrastructure investment and a more devolved relationship between central government and sub-national decision makers.

- The new industrial strategy should commit to providing Universal Basic Infrastructure for all citizens in all places. Everywhere in the UK should be served by high quality hard infrastructure and have access to high quality human capital-building universal services.
- The UK should commit to a higher level of infrastructure spending. There should be more direct investment by the government, but also newer sources of finance. In particular we believe the regulated asset base (RAB) approach to utilities, should be more widely used.
- The UK should establish a public infrastructure bank which could crowd in private investment through a government guarantee and provide significant support for long-term investment through reinvesting all its profits.
- There is a strong case for more devolution of both decision-making and fiscal powers. We recommend the introduction of limited borrowing powers for local and regional authorities and limited local tax powers.
- Infrastructure appraisal methods and practice for strategic projects should take account of potentially large changes in behaviour. In particular, the agglomeration effects and regional distribution of spending must be taken properly into account. There should also be more evaluation of big projects after they have been in operation for a time, to inform future appraisals.
- The regulatory framework for privatised utilities needs reform. Consideration should be given to replacing the sector regulators for the network industries with a single body, sitting within the Competition and Markets Authority (CMA), with a remit to include investment incentives in its criteria for regulation. Sectors need to be regulated more consistently.

Decarbonisation of the energy economy

A key element of industrial strategy must involve supplying an effective energy infrastructure, for the generation of electricity, and the distribution of electricity and gas. The pressure of climate change means we must urgently decarbonise our energy supply. The energy transition we need to make to an affordable, low carbon future is enormously challenging, yet offers huge opportunities for UK industry to develop innovative new products and services.

- The government should seize the opportunity arising from the merger of the Departments of Energy and Climate Change and Business, Innovation and Skills to fully integrate energy policy into a new industrial strategy under the auspices of the Department of Business, Energy, and Industrial Strategy.

- The UK's energy R&D capacity must be increased. This will require the government take a much more active role in making sure this research takes place and that UK industry benefits from it. Particular attention should be given to building and strengthening R&D institutions that have a focus on scale-up and translational research.
- Achieving a 100 per cent low carbon electricity system will require investment in new energy storage technologies and better demand management. Carbon capture and storage (CCS) offers significant potential and the government should commit to invest in the necessary infrastructures for CCS technologies to be fully utilised and provide financial incentives to make them viable.
- The government should consider taking a significant equity stake in future nuclear new build projects, and should develop the supply chains for the UK nuclear industry to ensure that UK business is able to supply a higher proportion of the highest value components of new nuclear build.
- The government should undertake a review of environmental taxation and regulation to assess how effectively these are properly pricing externalities and incentivising innovation around sustainability through the whole product life-cycle. We suggest this would be an appropriate commission for the government to give to the new Office for Strategic Economic Management that we propose.

Health and social care at the centre of industrial strategy

Ensuring there is an effective, efficient and financially viable health and social care system, in the context of an ageing demography, is a key strategic goal for the UK. The new strategy must incorporate social care, public health, the NHS (as a market as well as a service), and the UK's strong industrial sectors in pharma/life sciences and medical technology, as one whole system.

- Health and social care should be integral to the new industrial strategy. This should aim to use the state's purchasing power to promote innovation in a way that creates new value in the pharmaceutical, biotech and medical technology industries; raise the direct productivity of the health and social care sector, and ultimately achieve better health outcomes in a financially sustainable way.
- Future increases in public spending on health should come with the strict expectation that investment should be used to raise productivity. The provision of health and social care in all places means that even small productivity increases could have a significant impact.
- The new independent Office for Strategic Economic Management should consider the delivery of publicly funded health and social care a key priority area for assessment.
- There should be a rethink of procurement for both health and social care, with the aims of improving purchasing practice in the short-term to accelerate the adoption of new technologies and of looking for ways to stimulate innovation especially in domiciliary social care which will reduce the risk of spiralling costs as the population ages. Successful programmes for demand-led innovation, such as SBRI Healthcare, should be expanded and emulated.
- The new industrial strategy should aim to achieve higher productivity and better health outcomes by ensuring more skilled and satisfying jobs in the health and social care sector. An urgent focus on redesigning training and education should aim to both raise the skills of existing employees and attract new people to the sector.

- Health and social care services should be integrated, but this should be steered by the goal of achieving better outcomes for people's wellbeing and not purely by reducing costs. This will lead to savings but not on a sufficient scale to meet the spending pressures of an ageing population. Lessons must be learned from the places which are now experimenting with health and social care integration to build the evidence base for how to achieve better outcomes.

Unlocking long-term investment

Compared to other leading economies the UK's investment rate is below average and there is an urgent need for more long-term investment. Ensuring that there is a plentiful and appropriate supply of capital to the most (potentially) productive economic activities should be part of the strategic management of the economy.

- To support industrial strategy objectives, the government should recognise that public investment is indispensable - part of the solution to the UK's economic predicament, not part of the problem. The government should therefore, firstly, adopt criteria for public investment which better recognise its crowding-in effects. Infrastructure, public services and early-stage technological development are clear priorities.
- Commitment to public investment should go hand-in-hand with new local and national institutional mechanisms for investment, bringing greater coherence and stability to investment funds currently available, and ensuring they are aligned with overall industrial strategy objectives.
- We strongly encourage HM Treasury to ensure that the recommendations of the Patient Capital Review are aligned with overall industrial strategy objectives. We welcome the apparent commitment not to extend tax reliefs to venture capital, but would urge the government to go further by reforming these reliefs so that they support riskier, early-stage innovations throughout the whole of the UK – and indeed to redirect the relevant budgets towards direct investment. We also encourage greater consideration of the relationship between pensions provision, regulation and long-term investment.
- The government should commission new research, and pilot studies, into the possibility of a) extending private bank finance for innovation, through schemes such as intellectual property-backed lending, and b) expanding the role of public investment banks (albeit independent of any direct government control) especially where particular industrial and/or place-based needs can be demonstrated which align with strategic economic objectives.
- The government's proposals around corporate governance should be revised in line with industrial strategy objectives, and evidence on the relationships between company forms and long-term value-creation. The UK's corporate governance regime does not prioritise long-term investment over short-term income. There is no consensus on how best to achieve this but we suggest solutions will include greater employee engagement, collaborative and cumulative learning within firms, and prohibiting quarterly financial reporting.

Supporting high-value industries and building export capacity

Meeting challenges that transcend industrial categories – such as decarbonisation and population ageing – will require the development of high-value industries and so this must be core to the new strategy. High-value industries that are built on the UK's specialisms are key to increasing the UK's export capacity which in turn will help to raise productivity.

- The new industrial strategy should seek to significantly increase the UK's export capacity. It should strengthen existing mechanisms for export, focusing on incentivising challenger firms in high-value industries, rather than simply supporting incumbents. Improving productivity also requires that UK firms are both disciplined by overseas competition, and able to fully participate in international supply chains through which technological progress is disseminated.
- Competition policy must form a central part of a new industrial strategy and seek to support excellence in high-value industries where the UK has a (potential) comparative advantage. Competition policy needs to be considered with a more strategic long-term approach bringing together competition, merger, regulatory and consumer policies under the strategic direction of the Competition and Markets Authority (CMA). A priority Brexit-related task for the CMA is to implement its own state aid policy outside the EU. All sector-focused regulatory bodies (excluding the media and financial services' regulators) should be replaced with a horizontal regulator.
- The new industrial strategy must encompass a serious commitment to business support, with advice focused on enabling firms in high-value industries to emerge and grow – and shaped by overarching industrial strategy objectives. Business support should be joined-up with other services, such as innovation and export finance. There will clearly be a need for better co-ordination between national and local services and institutions: the new Office for Strategic Economic Management should certainly consider how to rationalise the policy and delivery landscape, based on evidence of best practice internationally.

Enabling growth everywhere

The performance of the UK economy is held back by our high degree of regional imbalance. It is right that the new strategy should seek to improve this imbalance. An industrial strategy should not seek to do everything everywhere, but it should seek to do something for everywhere. There should be nowhere where industrial strategy makes no impact at all, even if the requirement to focus means that some places receive more attention than others. Policymakers must acknowledge the trade-off between economic efficiency and the equitable treatment of communities. Sometimes, in these cases, it is right that decisions are made where the fairness objective predominates.

- Industrial strategy should seek to help all underperforming areas. In 5 or 10 years' time we should be able to pick any place in the UK and demonstrate how the industrial strategy has helped that place, its people and industries.
- The new Office for Strategic Economic Management should have an explicit mandate to monitor the health of local and regional economies, supported by improved data and statistics at regional and sub-regional level.

The Office for Strategic Economic Management

It is crucial that the new industrial policy framework is monitored and measured effectively, and that the UK develops a policy culture and capacity to understand and use the subsequent data appropriately. Strategic management of the economy and meeting the goals of the state is a long-term endeavour. It is essential policy interventions are monitored over the long-term to ensure progress is being made and maintained.

- The new Office for Strategic Economic Management should focus on evaluating government policy over the long-term, and on analysing the economic environment in which industrial strategy operates. It would provide independent advice to government and carry out specific commissions on behalf of government.
- The first key task of the new Office would be to develop and agree the metrics that it will monitor. Metrics should be designed by considering economic data that relate to meeting the strategic goals of the state.
- The new Office should publish in-depth analysis of the industrial strategy on a four or five-year basis and only once within a parliament. It should provide a summary assessment of its key overarching indicators on an annual basis, and report this to Parliament and the devolved national assemblies.
- To effectively monitor and measure the new strategy improved sub-national economic data is required. The new Office should work with the relevant data-producing national organisations, and local and regional institutions to agree metrics at the appropriate spatial and sectoral levels.
- New sub-national economic indicators should give consideration to measuring the resilience of local and regional economies.

The Commissioners

Dame Kate Barker (Chair)

Kate Barker was an external member of the Bank of England's Monetary Policy Committee between 2001-2010 and is a former Chief Economic Adviser at the CBI. She has conducted major independent policy reviews for the UK government on Housing Supply and Land Use Planning. She now works primarily in a range of non-executive and trustee roles. In 2017 she was appointed as a Commissioner of the National Infrastructure Commission.

Dr Craig Berry

Craig Berry is the Deputy Director of the Sheffield Political Economy Research Institute (SPERI) at the University of Sheffield. Craig's research specialises in UK economic policy, finance, manufacturing and pensions. Craig was previously a policy adviser on state pensions and older people at the Treasury, Pensions Policy Officer at the Trades Union Congress, and Head of Policy and Senior Researcher at the International Longevity Centre-UK (ILC-UK).

Professor Diane Coyle

Diane Coyle is Professor of Economics at The University of Manchester and co-director of Policy@Manchester. Diane is the founder of Enlightenment Economics, a Fellow of the Office for National Statistics and a member of the Natural Capital Committee. She was Vice-Chair of the BBC Trust between 2006-2015, a member of the Migration Advisory Committee between 2007-2012 and a member of the Competition Commission between 2001-2009.

Professor Richard Jones

Richard Jones is Professor of Physics at the University of Sheffield and a Council Member of the Engineering and Physical Sciences Research Council. From 2009 to 2016 he was Pro-Vice Chancellor for Research and Innovation at the University of Sheffield. He is an Associate Fellow of SPERI and a Fellow of the Royal Society. Richard is an experimental physicist specialising in nanotechnology and soft matter, who has also written extensively on science, innovation, productivity and economic policy.

Professor Andy Westwood

Andy Westwood is Professor of Government Practice and Vice Dean of Humanities at The University of Manchester. He is a Visiting Professor of Further and Higher Education at the University of Wolverhampton. Andy has worked as an expert adviser to the OECD and the IMF and has held senior roles at The Work Foundation, the Centre for Economic and Social Inclusion and GuildHE as well as working as an adviser within various government departments.

Tom Hunt, Policy Research Officer at the Sheffield Political Economy Research Institute (SPERI), has managed the work of the Industrial Strategy Commission. Tom managed the evidence gathering and engagement activities of the Commission, contributed to the Commission's reports and oversaw their production.

Dr Marianne Sensier, an economist at The University of Manchester, has provided research support to the Commission.

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