

# Business and Trade Committee

## Oral evidence: Industrial policy, HC 440

Tuesday 12 March 2024

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Watch the meeting

Members present: Liam Byrne (Chair); Douglas Chapman; Ian Lavery; Anthony Mangnall; Andy McDonald; Mark Pawsey.

Questions 46 - 95

### Witnesses

I: Dr Anna Valero, Policy Fellow, Centre for Economic Performance, LSE; Raoul Ruparel, Director, Boston Consulting Group Centre for Growth; Dr Mann Virdee, Senior Research Fellow, Council on Geostrategy.



## Examination of witnesses

Witnesses: Dr Anna Valero, Raoul Ruparel and Dr Mann Virdee.

Q46 **Chair:** Welcome to this morning's session of the House of Commons Business and Trade Select Committee. Today, we are taking evidence as part of our inquiry on industrial policy. Thank you so much to our witnesses for joining us. I need to make a very brief declaration of interest, in that Dr Mann Virdee was once employed by my good self in an advisory capacity on our work on the World Bank and the International Monetary Fund.

Dr Valero, perhaps I could kick off with you. Would you give us a sense, from your point of view, about how the competitive landscape is changing for the UK? We have quite low rates of economic growth in a world that is forecast to grow by three and a bit per cent, so global growth is faster than UK growth, but tell us what you think about the competitive challenges that arise.

**Dr Valero:** Thank you very much for having me here today. As you say, there are growth opportunities out there. On the positive side, the UK has a lot of relevant comparative advantages, which we will get into in this session, in areas that are growing and are forecast to grow globally. The reality, though, is that, for some time we have seen weak productivity and investment performance, which are concerning as other countries are really ploughing ahead with drives to get public and private sector investment up and to capture quite purposefully some of the opportunities of the future, such as clean technologies, digital technologies or AI. We have lots of strengths in those areas.

Q47 **Chair:** List the strengths for us. If you were to pick the top three or four, what would they be?

**Dr Valero:** The word "superpower" is used. We are, fundamentally, a services superpower, because we are a major exporter of services, and we are also highly specialised in services. Specialisation is measured by comparative advantage, in that you take your share of your own exports in a particular area and compare that to the global share, so we are specialised in services.

**Chair:** We are a services superpower.

**Dr Valero:** Within that, it is not just finance; it is also professional and business services, creative sectors and design and consulting. It is quite broad-based. On top of that, we are specialised in areas of manufacturing—things such as aircraft, pharmaceuticals within the life sciences, and beverages.

What I have just said is based on aggregations that we can look at over time across countries. Of course, there is always the danger that you are missing more detailed categories where we are also specialised.

Q48 **Chair:** Before we go there, though, let us take those three competitive



strengths. How is the global competitive landscape now changing in a way that is going to affect those strengths? What do we need to be worried about unfolding in the world?

**Dr Valero:** If we take manufacturing, there is a lot going on out there in terms of the Inflation Reduction Act, the EU's response and China's doubling down on clean technologies. If we are not doing something a little more purposeful in that space, we risk losing out on investment in the UK. It is not that we can specialise in all the clean technologies of the future, but we do have underlying strengths that we can build on.

If you take high-value manufacturing more generally, we know that manufacturing is an area of trade that has suffered since Brexit. It is really important for us to be close on regulatory and other areas with Europe when it comes to manufacturing. Otherwise, some of the analysis suggests that what might happen is that our manufacturing base might be at risk of moving to less high-value-add areas.

Q49 **Chair:** So the peril, if you like, is big state policy from other big players—Beijing, Bidenomics or Brussels—but we also have some peril from the fact that we are no longer part of this great big single integrated market.

**Dr Valero:** Yes, I think so. Even pre-Brexit, a lot of our services trade went outside of the EU, which is where there is scope to make more ambitious service trade agreements with countries further afield.

However, another peril is human capital and skills. It is not just that other countries have these industrial strategies or investment programmes. They are also improving their human capital and universities. Universities underlie a lot of our strengths in terms of the skills that we provide and the excellence going on in our universities in terms of teaching and R&D, but other countries are investing more in that and getting more competitive. If you think about services, high-value manufacturing and innovative activities in general, a lot of that relies on high-quality human capital that either we produce here or we are able to attract from overseas.

Q50 **Chair:** Raoul, would you add anything to the list of challenges?

**Raoul Ruparel:** The list of challenges is correct. Maybe just framing it, I would add that there are a number of trends going on in terms of the shift away from the rules-based international order, with a move to a more bipolar or multipolar world, and a shift away from reliance on efficiency within supply chains to a greater focus on resilience, which also ties into the energy transition. Those four trends underpin some of this shift, so that context is important. That is relevant when thinking about the tools and how you react.

I agree with a lot of what Anna said. When we look at how we can start to adapt to this, it does mean that traditional forms of using international organisations and trade defences and other rules within them, or trying



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to strike free trade agreements to deepen ties, have become more complicated and are not necessarily a priority for some of our partners.

If you look at the approach taken in the US, China and the EU, there are opportunities for co-operation, but my sense is that co-operation is not necessarily top of their mind. We also have to look at what we can do individually in developing our own industrial sector strategy, thinking about the strengths that Anna mentioned and areas that we can build on, and being quite clear about where and how we can compete in those areas.

Q51 **Chair:** Dr Virdee, do you have anything to add to the perils that we now confront?

**Dr Virdee:** Just on the strengths and weaknesses of the UK's science and tech ecosystem, quantum and life sciences are two of the strengths, but it is important to note that the UK may not be as world-leading as we like to think. Institutions such as DeepMind and the MRC Laboratory of Molecular Biology are outliers; once they are removed from the statistics, the UK performs more weakly than when they are included.

Q52 **Andy McDonald:** Perhaps I could ask Raoul this question, because we heard from Anna to some degree about this. What should our take be on comparative advantage? What does it mean?

**Raoul Ruparel:** Anna set out the textbook definition well, and that is an important part of it. We should also look beyond just our trade advantages and think about our research and maybe our patent advantages. For example, if you look at what is called our revealed comparative advantage in patents, where we produce relatively more patents than some other countries, we see that the UK has a relative comparative advantage in areas such as chemistry, biotech, medtech, consumer goods, civil engineering, engines and transport. We are quite good at churning out those ideas, which is an important context when thinking of our advantage. It is not just about where we are necessarily doing well in trade terms, but thinking down the line, where we produce good R&D and a number of patents.

Importantly, one of the things that we are probably less good at in this country is taking those ideas, commercialising them and scaling up companies on the back of it. We should take quite a broad view of our comparative advantage, and look beyond just trade and think about those areas.

We also have to think about a couple of other factors. One is where demand or supply will be globally. For example, the International Energy Agency has set out that the expected supply in areas such as battery and solar is probably going to meet demand up to 2030, but less so in areas such as wind and heat pumps. We also need to think about some of the global megatrends and how things are changing globally, with a rising middle class in emerging markets and a rising demand for services.



Between those things, in terms of our own comparative advantage in trade, in research and development and in ideas, as well as some of the global trends that we see, you can start to triangulate areas where the UK should seek to compete and where we might have an advantage.

**Q53** **Andy McDonald:** You touched upon this worrying departure from the rules-based system, so it is a pretty scary world to a very large degree. Looking at that broad scene of these advantages that we may have, where are the pinch points in terms of our strategic advantages in these key areas that might be upset by the abandonment of the rules-based system?

**Raoul Ruparel:** Starting at quite a high level, the UK is unlikely to compete on money and scale with the likes of the US, China or the EU in terms of the size of their market and the money that they are putting behind some of these sectors, and so we have to be quite clever about how we position ourselves.

If we start to look at some of the strengths that we have talked about, they are particularly in areas that are probably more upstream in technologies and industries, such as research and development, innovation and intellectual property. We have our long-standing skills in our universities and research institutes, so we could look to be an area of innovation and development. We probably will not be the market of scale and large-scale deployment for some of these industries and sectors, but focusing upstream is something that we can do and start to think about.

You also have to look at where money and investment is flowing in these economies and think about the opportunities that that gives to us. For example, what we have seen off the back of the US Inflation Reduction Act is a huge increase in their imports of EVs from South Korea and the EU. We should view these issues not just as a negative but as an opportunity in terms of markets created that we can export to.

Finally, we have to think about a lot of non-financial as well as just financial incentives. When we talk about industrial and sector strategy, we get very hung up on how big the subsidies will be and what the tax credits might be. When we speak to businesses, we hear a lot about the more non-financial side and the ease of doing business and of innovating—for example, changing the way in which we regulate certain industries.

We have a very “us versus them” approach to regulation. The market innovates, and regulators look at things after they have been innovated and take their time to regulate them. That approach is becoming increasingly difficult in a very competitive world and quite a distorted landscape, and so looking more at how regulators and the market can work together when it comes to innovation is important, as well as things like making it easier for trials and testing and bringing products to market in the UK, if we are going to target that innovation and upstream development space.



Q54 **Andy McDonald:** Anna, let me bring you in here. Given everything that Raoul has said, I am thinking about the resilience question in terms of this country functioning so that it is not under threat. We have seen with so many major crises in the world that there has been quite a lot of exposure of some of our weaknesses. What are your thoughts on how we can play this?

**Dr Valero:** Resilience is a key reason that we need to have a strategic approach to what we are good at. Before these increased resilience concerns, we were much more focused on the core story of, "Where is your comparative advantage?" either in trade or in patenting. We have done a lot of analysis on patenting. What are the areas that we are good at that are also growing and are quite large? They are clean technologies, AI, and other things.

Now we have additional resilience concerns, because we have seen a pandemic where we could have been more resilient, an energy crisis where we could have been more resilient, and various geopolitical risks too. That begs the question, "Which are the key supply chains that you need to have some capability on rather than relying entirely on importing? What are the connections between supply chains?" For example, if we want to have a car industry, we need battery manufacturing. Battery manufacturing, or the innovation alongside it, is not necessarily one of our comparative advantages currently, but there is generally an acceptance that we need that capability here in the UK.

Also, it is to do with understanding things. We have world-leading activities in research and innovation to do with AI, but if we do not maintain that to some extent, it will be much harder for us to understand developments and respond to them when it comes to things like cybersecurity or other regulatory challenges.

It is complex, but resilience and security have now become quite embedded in the considerations. There is growth and comparative advantage in growing areas. Comparative advantage in an area that might be, and is likely to continue to be, tiny will not necessarily get you growth. If it is a large area that is projected to grow, and you are good at it, that is a good way to focus things from a growth perspective, but the different aspects of resilience are also really crucial.

Q55 **Andy McDonald:** Dr Virdee, can I come to you in terms of tying together those competitive advantages and broader strategic ambitions? Could you address the role of Government? How can Governments target areas of comparative advantage effectively? Are they effective in their measures?

**Dr Virdee:** There are a number of things that Government can do, and one is to be a better customer. I am leading a study at the Council on Geostrategy on the strengths and weaknesses of the UK's science and tech ecosystem, and particularly on net zero. The study is still ongoing, so I am able to present only preliminary findings. One thing that innovators, scientists, policymakers and policy researchers tell me is that



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the Government can be a better customer—not just acting as a regulator, but leveraging their significant buying power, investing in innovative products, such as semiconductors, and perhaps offering incentives to businesses that support SMEs.

The Government could also commission a cross-departmental review of how they use public sector procurement as a tool to support cutting-edge science and technology. We have seen this happen before in other places, so we know that this kind of thing works. Silicon Valley is an example that people often talk about, although it is quite hard to replicate. Part of the success of Silicon Valley has come through Government support, particularly through military contracts. During the Cold War, Santa Clara County, for example, received almost \$5 billion a year in military contracts and went on to develop high-tech microelectronics and other weapons systems such as those used in the F-16, which had spillover effects in the wider region. Silicon Valley was eventually able to provide some of the electronics for the Apollo programme. It is really that kind of ecosystem that was developed during that period.

**Q56** **Andy McDonald:** You mentioned being a better customer, which is really helpful, but are we any good at identifying the existing areas of comparative advantage? Being a better customer for whatever might be out there is all well and good, but are we good at identifying those areas and supporting them appropriately?

**Dr Virdee:** I do not think that we are. Part of the reason for that is a lack of technical expertise within Government. That is certainly something that does need to be improved.

**Q57** **Andy McDonald:** In terms of that shift in direction, are you saying that we need to have long-term specialists embedded within the architecture of Government? Is that part of it, or is there anything else that we should be doing?

**Dr Virdee:** That is one of the things that we need to be doing, but the salaries being offered for these types of roles currently are not high enough to attract the sort of expertise that is really needed.

**Q58** **Andy McDonald:** Would anybody else like to comment on this? Something that we come across quite regularly is that there seems to be a mismatch of arms, as it were, in terms of those who are trying to steer the thing versus those in the commercial world who are just taking advantage. Is there anything in that space that we could better develop?

**Raoul Ruparel:** I agree that there is a need to build up skills in the Civil Service. I do not want to get into Civil Service reform, but the ability for people to develop as experts within the Civil Service and to progress just as an expert within a single line of work is quite difficult, so we need to think about how that can be made easier. At the moment, in order to progress within Civil Service, you tend to have to move across a number of different roles and you do not develop deep expertise.





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There are other things that we should look at. You are right that we are not good at identifying our strengths. For example, pharmaceuticals and automotive have traditionally been quite good in the UK and have been some of our strengths, but they have dwindled in recent years. Part of that is a Brexit effect, but it is a long-term effect as well. For example, in terms of our pharmaceutical and chemicals trade with the US, we have significantly underperformed pretty much all of our peers over the past 15 years. In certain pharmaceutical and chemical products, our trade has barely increased over the past 15 years. We need to better target and protect those areas of strength and really focus on how we can maintain them.

We also need to have a better and clearer view of the levers that we have, and what we are deploying and how. We tend to see four key levers across Government action in this space. One is governance, which is directions and frameworks and is not legally binding but can help. Second is regulation, which is legally binding and is about setting standards and providing regulatory sandboxes or frameworks for developing innovations. Third is subsidies—direct subsidies or investment, as well as indirect in the form of loan guarantees and underwriting. Fourth is taxation in the form of tax credits and those kinds of incentives, as well as taxation to drive activity—for example, a carbon tax or a carbon border mechanism. We do not have a clear sense of the levers that we have and how they are being deployed across certain industries and sectors to achieve the outcomes that we want, and so we could do much better with that.

Finally, we also need to do a better job of connecting the causes and consequences across Government. For example, the Department for Business and Trade has a number of the key stakeholders in industry in it, but it does not control all the levers when it comes to things within what I have mentioned. Subsidies and taxes are much more controlled out of the Treasury. That disconnect between controlling the levers and relationships, and understanding the sectors or the consequences, is also a challenge within Government.

**Dr Valero:** We have made recommendations that we need a growth and productivity institution in the UK, which would be a body of long-term expertise co-ordinating different bodies across the landscape that already exist and working on things that matter for growth. When we are talking about innovation and our strengths, this kind of institution would work with lots of the specialist bodies, sector bodies or research institutes that really have the in-depth knowledge of specific areas.

What is really important is that we have a holistic understanding of the types of metrics that guide decision-making. We mentioned trade data and patents data, both of which have their strengths and weaknesses, but, if you rely just on those, you will not capture things, because not all innovation is patented. For example, there are lots of high-growth firms





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accessing venture capital. Some of them might not have a patent, but they still have an innovation with high growth potential.

The way that we have approached this in some of our work on clean technologies and strengths is that we have done general analyses of the trade and the patents. By the way, on manufacturing trade, about 40% of products are classified as green, where we do have comparative advantage. We have complemented that with what we call a deep dive approach, where you go and talk to experts on a particular technology and on a sector, and get more of a holistic view of where the strengths are in the UK, what the different data sets to shed light on that are and, importantly, speaking to what Raoul was saying, what the market failures are.

In some cases, perhaps the market is working fine. In others, because we know that speed matters for net zero, and speed matters when we are talking about competition with other countries, maybe the market, left to its own devices, will not get us there fast enough. Maybe it is because of R&D spillovers—a key market failure that justifies innovation support. Maybe it is financial market constraints. We know that they particularly hold for clean technologies. We need a really clear understanding of where the strengths are, what matters based on our growth potential, the resilience that we talked about before, and what the appropriate levers are to try to encourage those areas.

**Q59** **Anthony Mangnall:** Dr Valero, on your point about creating a body or a new institution, why not use something that is already in existence, such as the Board of Trade?

**Dr Valero:** We wrote this report with Bart van Ark at the Productivity Institute last November. We reviewed a number of other countries in the OECD that have specialist productivity institutions, and then looked at other areas of economic policy in the UK. We stand out versus other countries for not having an institution. We had the Industrial Strategy Council, which was not fully independent and does not exist now. Also, growth and productivity stands out in the UK for not having a dedicated institution.

We have many institutions, as you say, that will work on relevant pieces of this, but, because productivity is driven fundamentally by investment in innovation, infrastructure and skills across the country with sectoral elements such as those that we have been discussing, as well as with horizontal elements, and because it is a long-term challenge that needs long-term policy, commitment and evaluation, we felt that there is a strong case for strengthening the institutions in this area if we want to begin to move beyond political cycles to a more long-term approach.

**Q60** **Anthony Mangnall:** That is a bold argument in front of a group of politicians, but I understand where you are coming from. You spoke in your opening remarks about the high-growth areas. The Chancellor spends a great deal of time talking about the trillion-dollar industries.



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How realistic is he on this? Can I also ask whether you have a view as to whether the UK sector in these high-growth areas is growing because we are on America's coattails, or because supply chains are diverging so far from the norms of what we have become so very used to? I would say that people may be shying away from China to a degree and then looking to diversify. Are our sectors growing, or are we just following in the wake of others?

**Dr Valero:** In the analysis that we have done on sectors, the strengths that we have found in the data correspond quite well with Jeremy Hunt's five sectors—things like digital, green industries, life sciences, where we are very innovative, advanced manufacturing, and creative industries, which is an area of services. For a lot of the analysis that we did when we published our *Enduring strengths* report for the Economy 2030 inquiry, the data finished in 2019 at that point. That was the consistent time series that we are able to use. Those strengths were based on data up to 2019, and they were enduring strengths that we have seen for some time. It is not just us, and the persistence of your comparative advantages is something that we see in many other advanced economies.

Q61 **Chair:** But those five sectors are basically right.

**Dr Valero:** They do not include professional and business services and finance. They are areas of strength, both on the innovation side in terms of patents in green industries, as well as what we can already see in areas of manufacturing and creative industries.

What we need in terms of scale and where our plausible growth can come from is the professional and business services, including finance. These are large employers across the country. They are well-paid jobs. We have done some other analysis for the Economy 2030 inquiry, where we asked, "If we have these strategic strengths, what does that mean for skills? What does it mean for workers in those sectors?" We find that those sectors pay well at all levels of education, so it is not favouring just the most highly educated. The highly educated earn a premium, but all levels of education do well in those sectors.

Q62 **Anthony Mangnall:** How do we take advantage of this? You are saying that it is more than the five and that, in fact, the Chancellor is underplaying it and should be talking about 10, perhaps. How do we take advantage on the global stage in terms of these comparative advantages?

**Dr Valero:** Part of it would be a clear signal of an industrial strategy with longevity that is based on what we are, and plausibly can be, good at. Rather than having lots of collections of technologies and sectors that the UK is supporting, we need to embed that into a framework. The Greg Clark-Theresa May industrial strategy began to do something like that, because it had a combination of technologies and grand challenges, which are missions where we also have strengths. It had sector deals, but it also had quite a focus on the horizontal aspect.



We know that a lot of our problems in terms of boosting investment are issues that are across all areas. Of course, they will impact different areas in different ways. If you look at capital allowances that were made permanent in the autumn statement, this is a policy to encourage investment. It will, of course, favour more capital-intensive industries more than others. In some sense, it has an industrial policy angle as a horizontal. This is the kind of thing that a growth and productivity institution could help to shape, monitor and evaluate.

**Q63 Anthony Mangnall:** You have a framework. If you go on to the Government website relating to the 2017 industrial strategy report, it is under the heading of "Archived", so I do not know what you want to make of that. What are the risks that we are seeing with these businesses that are exporting? How much should Government be stepping in to try to protect them? How much should Government be trying to factor in some of the risks that have already been mentioned by Mr Ruparel?

**Dr Valero:** As what we consider in economics a small or a small-to-medium-sized open economy, I do not think that we should really be thinking about pursuing a protectionist direction. What we can do is have well-designed policies to encourage investment when we know that there are market failures. It might be providing stability; it might be regulatory; it might be tax incentives. In the Budget, there were various tax incentives for the creative industries. We are not using that kind of enhancement as much as we could, particularly when you look at the Inflation Reduction Act in the US. Not only does it have these very generous tax credits, but there is the fact that they are enhanced in various ways to try to reach various objectives.

**Q64 Anthony Mangnall:** Thank you for bringing me on to this point about the IRA and about what we have done in free ports and economic zones and all of this side of things. Do we just need more of that? Do we need more incentivisation, more free ports and more areas of lower taxation with greater opportunities for export?

**Dr Valero:** We need to be careful when you get the spatial elements, and whether you are doing something that is additional in the end from the national perspective or moving things around. When we are talking about the UK's growth, we have to have in mind the national perspective. If you are talking about innovation clusters, you have to have Oxford, Cambridge and London—the golden triangle—as core to a global story. If you look at the World Intellectual Property Organization's global innovation index, they have a measure of innovation clusters. Cambridge and Oxford are in the global top three, so they have to be core to our national story. Then it comes to levelling up or addressing regional disparities.

Of course, there might be some displacement when you pursue those policies, but we need to try to maximise the additionality and really realise underlying strengths that are spread across the country,



particularly in clean technology. While we know that the golden triangle has a lot of innovation, areas outside of it are more specialised in things such as green technologies, due to previous sectoral endowments or the natural characteristics of the places—think about where offshore wind or CCUS opportunities are. There are a lot of opportunities in pursuing something that could be good for the UK as a whole in the regions as well.

**Q65 Anthony Mangnall:** Mr Ruparel, can I bring you in? You had a hand in the industrial strategy in 2017. To the point that Dr Valero has just made around where we can enhance and where we can support businesses, do you want to add any of your thoughts and views on where UK Government should step in and be supportive and helpful to the sectors that we seem to be doing well in?

**Raoul Ruparel:** I would add two things. We need to do some sector-specific stuff, which Dr Valero set out very well. There is also a structural reform bit across the piece here. If you look at why businesses are not investing and why business investment has, essentially, flatlined in the UK in the past six or seven years, if not longer, it is not a coincidence that business returns have also largely flatlined during that period. A lot of businesses do not see the returns on investment that they would like to see in the UK. We need to start to unpack why that is.

It comes down to some of the fundamental inputs and their costs for businesses. In terms of energy, industrial electricity prices from the mid-1980s to the early 2000s were broadly stable in real terms. They then doubled over the next 10 years, and over the last 10 years they have trebled again. While the UK is not alone in the recent spike in energy prices, that long-term trend is quite different from some of our peers, so we have a structurally high energy cost.

In terms of our labour market, we have talked about some of the acute skill shortages in certain sectors. Particularly when you start to think about the energy transition and the requirement for certain skills such as welding or knowledge of project management across the supply chain, you are going to see shortages, because there are lots of demands across the piece for very similar types of skills.

On capital, we generally have very large, deep capital pools, but there are certain areas where we lack that. I mentioned the scale-up funding and the diversity of funding and converting ideas into commercial entities, as well as the diffusion of best practice across sectors and regions.

On the whole, we are 10% to 15% below peers such as France and Germany in terms of productivity, but we have some firms that are up there with any of the best in the world. The problem is that we have a very wide range of productivity within sectors, within firms in sectors and across regions. We need to spread best practice and improve



productivity. While we need this sector focus, we also need some fundamental, underlying structural reform in these inputs for business.

**Q66 Anthony Mangnall:** You are being quite broad about your points here, which I accept, but we have had many iterations of industrial strategies over the years. It is quite difficult to see whether there has been any long-term success on the back of them. In specific cases, where there are industries and sectors that are doing really well, should the Government be tailored and focused on those and really help them, rather than trying to take a broad-brush approach?

**Chair:** Should we lean into the success, basically?

**Raoul Ruparel:** Yes, we have to. There are areas where we were previously successful, such as pharmaceuticals, chemicals and automotive, which have dropped off in recent years because we have not leaned in, we have not been sufficiently supportive of the industries, and we have not taken that long-term view on how to develop them going forward.

Automotive is obvious in terms of our development of batteries and EV tech. We were quite good at developing the early ideas and patents, and a lot of them came out of British universities, but we did not commercialise that, we did not bring it to the industry and we did not have a long-term strategy to compete there.

Similarly, in terms of pharmaceuticals and chemicals and the changing demand for certain products, we have not invested in and developed that over time; we rested on our laurels a bit. We need to lean in, even in areas where we have strength. We also, as we have said, need to think about long-term future opportunities and emerging technologies where there are trends and demand globally that we can tap into.

**Q67 Ian Lavery:** I want to look at the positive side of the advantages in the global market. Mr Ruparel, could you give us some examples of where the UK has lost its advantages in the global market?

**Raoul Ruparel:** The ones that I mentioned already are the primary ones in terms of losing ground: pharmaceuticals, chemicals and automotive. Figures for trade with the US in particular have been quite stark. If you look at the post-pandemic boom in the US, there was a huge boost to trade, particularly in certain goods and products, which the UK has missed out on. Some of that is because we do not necessarily produce those goods, whether it is finished consumer goods or electronics, but even in areas where we were traditionally strong, such as automotive, pharmaceuticals or chemicals, we have not been able to take advantage of that, for various reasons that I touched upon, but particularly due to a lack of investment into those sectors and long-term strategies.

There are areas where we need to lean in and protect those strengths. On the whole, the story on services is different. We have seen our services trade continue to grow very quickly and outstrip our goods trade



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growth, particularly post pandemic. We have been quite good at protecting our strengths in those sectors. Whether that was a conscious or an accidental thing, I do not know, but it is worth examining why that has been the case.

**Dr Virdee:** I will add one thing to that, building on what my two fellow panellists just spoke about, which is that industrial policy requires discipline in terms of monitoring, evaluating and learning about what works. Successful industrial policy is not really about picking winners but about knowing when to let losers go.

**Dr Valero:** I agree with that. To back up what Raoul said, our analysis has shown that ICT, in the latest data that we looked at, is within services and communications technologies, which is an area where we lost competitiveness. Within that, you can think of all the digital and tech start-ups that we have, so this is an area that we should be trying to protect. Pharmaceuticals is another area where we have seen a decline in our comparative advantage.

In terms of the top 10 products that we used to be specialised in but not so much any longer, one is power generating machinery. We are not necessarily specialised in areas of manufacturing strengths from the past, but, as I said, there are areas of manufacturing and green products where we still have specialisation.

I agree that you have to learn lessons. It is notoriously hard to evaluate industrial policies, but we need to do better at building up that evidence base, recognising that some mistakes will be made, particularly because how we do in these areas depends not just on what we do in this country, but on what other countries are doing.

Q68 **Ian Lavery:** You say that we could have done better. What could policymakers have done to prevent the loss of this competitive edge in the sectors that each of the panel have mentioned?

**Dr Valero:** We have various issues that prevent business investment in the UK, which is something that Raoul just mentioned. If you really study what has been preventing businesses from investing—that is what underlies, “Why are we not investing in things that we could be better at? Why are we not investing in adopting technologies that make us more efficient?”—there are a number of things.

There is a lot of discussion around recent uncertainty. We have been through lots of shocks. We have had policy uncertainty as well. There are various underlying things too, such as constraints in our planning system, which prevent not only infrastructure being built where it should be built, but housing, which then prevents the effective functioning of labour markets. They prevent things like lab space being built out in the areas that we know are very innovative clusters, Cambridge being a key example of that, as well as data centres being built. Planning is a key barrier to all sorts of development.





Pensions are a source of deep capital that exited UK equities; they have a particularly low share of equities, and within that UK equities, but also non-listed, productive assets. We are now seeing reforms to try to get UK pensions into productive investments in the UK. This is important not only for the scale-up phase of unlisted firms, for example, but also for having engaged ownership of larger firms, where listed firms have very dispersed ownership. There is a whole literature in economics linking engaged ownership with more long-termism in investment and long-term value creation in firms.

There are also issues in our tax system. Lots of change over time makes it harder to plan. We have made positive strides there in terms of capital allowances, but business support is a complex landscape and it is hard to get firms to sign up to business support programmes. We know that there are firms out there that want to adopt new innovations and processes but face various barriers to doing so.

Finally, we mentioned skills. We do well at the higher end of skills, but there are still shortages in some areas. Technical and vocational education is an area where we do not do particularly well. Our analysis suggests that lots of the jobs in our strategic sectors could be done with sub-degree qualified people.

**Chair:** I am just going to speed you up, because we are rapidly running out of time.

Q69 **Ian Lavery:** You gave a lot of facts there. The question really is whether policymakers could have prevented the loss of the competitive edge in global markets. I am really trying to get to the bottom of whether the policymakers could have made a big difference. Did they make a difference? Should they have done one thing or should they have done another, or are they absolutely 100% in the right place?

**Dr Valero:** There are areas where we have had these problems for really quite a long time, and we could have made progress on some of these areas. In some areas, progress is being made. It is just that it takes time to evaluate and see an impact on productivity.

Q70 **Ian Lavery:** Have policymakers been fine with this? Is there any blame that can be focused for the lack of the competitive edge, where we have lost the competitive edge, in the sectors that have been mentioned by each of the panellists?

**Dr Valero:** Of course, we have gone through a process of Brexit. In the pharmaceuticals industry, for example, that leads to a lot of regulatory duplication and complexity. There are things that we can say have damaged our competitiveness in the more recent period. There are other processes through which a more purposeful approach could have enabled us to maintain competitiveness, such as getting the right skills in place or enabling businesses to invest where they wanted to make investments, where we could have prevented that loss of competitiveness.





**Chair:** So there are some sins of omission and sins of commission by the sound of it.

Q71 **Ian Lavery:** You still really have not answered the question. Perhaps Dr Virdee or Mr Ruparel might. Could policymakers have made a difference?

**Raoul Ruparel:** Yes.

**Ian Lavery:** It is a simple question.

**Raoul Ruparel:** Let us look at where things have made a difference in the past. For example, in the late 1980s and early 1990s, we were well behind the productivity frontier in services. We took a regulatory approach that really promoted financial and other services, and we saw a very rapid catch-up. That was a policy-driven change. So policymakers can have an effect.

If you look at what is happening at the moment in the US under the IRA, that is a very concerted policy-driven change. Manufacturing and construction have risen by 90% since August 2022, when the US IRA was introduced. That is a policy-driven effect, so policy can make a difference.

That being said, it is hard to understand some of these very large changes while they are happening. We now have the benefit of hindsight, looking back, and it seems obvious to us, but policy interventions can make a difference in this space. We have now seen enough happen that we can understand what we need to start doing going forward.

Q72 **Douglas Chapman:** Can I just move on and look at services specifically? The UK is still a big player in terms of services globally, and the second largest exporter behind the US. What are the advantages and disadvantages of the UK's strengths in services at the moment?

**Dr Valero:** An advantage of that is that services have been growing. They are a large area of global trade and are predicted to continue growing. This is a strength that has generated growth for us and can plausibly continue to do so at scale. When we look at the types of jobs in these sectors, as I mentioned before, they are generally well paid at different levels of education. The key thing is that it is not just finance. Even in the years up to the financial crisis, our growth was also in professional business services more generally. The creative sectors are also a key source of strength, in terms of artists and creative content originators, et cetera.

Having services strengths is not a bad thing in today's world. France is also quite specialised in services. However, we also have these strengths in high-value manufacturing. Because of the resilience concerns that are increasing, and in a potentially more fragmented global trading environment, there is more recognition now that we should maintain and build various manufacturing capabilities in key supply chains, not least because some of that is important for our energy security, which determines the security of the overall economy.



**Q73 Douglas Chapman:** Would you say that the services sector is still a valuable contributor? If it is, how do we develop that? What would an industrial strategy for the services sector look like? What other things could we now be doing that would be helpful in terms of spreading the wealth across the rest of the UK and not just the golden triangle? What else could we be doing in terms of supporting the services sector throughout?

**Dr Valero:** A lot of it will be about skills and people. Some of the work in the Economy 2030 inquiry looked at what plausible growth strategies for big cities outside of London look like. The argument made there was that tradable services are a plausible route. Because big cities already have some specialisms in those things, it is something that can be built up more if you encourage homegrown skills and attractiveness to skilled people working in cities, accompanied with more investment, housing, infrastructure and improving the functioning of the local labour market.

It is not that our strength in services is going to boost just London and the south-east. It is a plausible route to growth in other parts of the country too, particularly in terms of these high-value-add tradable services. When you are thinking about the policies on top of skills, it is going to be things like technology adoption, having trading relationships that are expansive on services, regulatory alignment, and the recognition of qualifications and expertise internationally.

**Raoul Ruparel:** I agree with all of that. I would add a couple of things. On the regulatory side, we need to make sure that the regulators in this space have the right resources and can move quickly to ensure that innovation happens within the services sector. That is as true in services as it is in manufacturing goods.

I mentioned some of the fundamental inputs. Energy costs are still relevant. When we do surveys of businesses, we see that energy costs for services sectors are still a problem. In terms of the capital pool, we need to make sure that we are supporting services innovation that is coming out of universities, whether through the technology transfer offices or diverse funding pools, in order to make sure that we have the ability to scale up those businesses here rather than them going to seek investment from the US or somewhere else.

**Q74 Douglas Chapman:** I am quite interested in developing the economy outwith London and the south-east, because it just seems to be so unbalanced. In Scotland, we have European cluster accreditation for excellence in fintech. In the absence of a long-term industrial strategy, while not saying that it is piecemeal, we are relying on different initiatives across the rest of the country to lift the economy in these areas. Is that something that we should be thinking more of, or would an overarching long-term industrial strategy be the answer to looking at the whole picture rather than trying to put sticking plasters on things and trying to build up the economy like that?



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**Dr Virdee:** Coherence is really important. It needs clarity and stability across the whole of the UK, rather than, as you described it, a piecemeal approach for different parts. One thing that the UK really needs to do is to just send a clear signal to investors, businesses and partners about what the UK's priorities are, and that it does have a coherent plan and vision across the whole of the UK, rather than these different approaches.

**Dr Valero:** I would argue that we need both. Devolution is a good thing. Growth strategies at a more local level are a good thing, because local leaders understand the strengths and barriers to investment in their places better, sometimes, than national-level researchers or politicians. We need both. We need the national-level framework, because the UK is a country in the world, and we are talking a lot about international—

**Chair:** Anna, I have that point. That is perfect. Sorry, the clock is really against us.

Q75 **Mark Pawsey:** In the same way that Douglas Chapman asked about services, I want to ask about manufacturing, but I just want to follow up on a couple of things that people have said. Dr Virdee, you said that the Government should be a "better customer". Do you mean that it should pay an over-competitive price? What are the consequences of that for competition policy?

**Dr Virdee:** I do not mean that they should be paying more. It should be easier for businesses to receive, for example, an expression of interest or a memorandum of understanding, or for the Government to be there as a customer for small businesses.

Q76 **Mark Pawsey:** Does your suggestion of the Government being a better customer contravene the principle that the Government should always buy at the best possible price?

**Dr Virdee:** Sorry, could you clarify that?

**Mark Pawsey:** In their procurement policy, should the Government always buy at the best possible price, even if that does not mean supporting a domestic manufacturer, or should we pay more?

**Dr Virdee:** It really depends on the sector and what you are trying to achieve.

Q77 **Mark Pawsey:** Are you saying that, on occasions, Government should be prepared to pay more to support a sector of the economy where we want to improve our comparative advantage?

**Dr Virdee:** I believe so.

Q78 **Mark Pawsey:** Raoul, you said that there is no clear sense of lead to achieve the outcomes that we want. Who defines what the outcomes that we want are? Is there a common view about the outcomes that we want?

**Raoul Ruparel:** Ultimately, that is where democratically elected Government come in. It is their job to define the outcomes that we want.



Q79 **Mark Pawsey:** Do you think that Government know what they want? Do you think that the public know what they want? Do you think that our economy, people and businesses know what Government want?

**Raoul Ruparel:** We have to try to take a view, and that means bringing the right expertise and skills together, and having an understanding of what voters want and what the country needs. We have to have our best stab at it. It is not an easy thing to come to, but we need to have some direction.

To the point that was made about this piecemeal approach, we provide a lot of support to lots of sectors at the moment. There is a lot of ad hoc work going on, but it is just not coherent and is not driven to particular strategies or aims. We need to rationalise that. It is not as if we are not doing any of it now. We do lots of it. Putting it into a clearer framework and giving a clearer sense to it would be helpful.

Q80 **Mark Pawsey:** Moving to manufacturing, you spoke about pharmaceuticals, chemicals and automotive as being areas where, in your words, we “rested on our laurels”. Does that expression mean that we have not invested enough or paid enough attention? What exactly do you mean?

**Raoul Ruparel:** It is a combination of factors. My analysis is driven by the trade trends in those areas where our exports have struggled, particularly in certain markets that you would think we have good relationships with, such as the US. Some of that is down to a lack of investment. Some of it is down to a lack of strategy and thinking about where the areas of development and innovation are going to be in those sectors. Some of it is down to some international trends or Brexit, for example, where we have seen disruption. There are a number of factors that differ between sectors, but we have at times lacked a long-term strategic view of what we want to do in those sectors and where we might be able to compete in the future.

Q81 **Mark Pawsey:** Many of us want to see a greater share of manufacturing in our economy to provide some balance. Anna, you spoke about the need for security and resilience in supply chains as being one reason for that. Another one is that manufacturing makes up 50% of our exports, and the average wages in manufacturing are 12% above what they would be in a regional economy. Is the objective that we heard from the Centre for Social Justice to raise manufacturing’s contribution from 10% to 15% a reasonable aim?

**Dr Valero:** That seems like a plausible objective if we are saying from 10% to 15% of value added.

**Mark Pawsey:** It is a doubling in size.

**Dr Valero:** We have real underlying strengths in advanced manufacturing that we are not necessarily realising. We do really well on innovation. We do very well on start-ups. We are not necessarily doing so



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well at scaling up the firms to be big employers with value added and productivity here in the UK. That kind of ambition, given all the resilience and security concerns that we have been discussing, does not seem beyond the realms of possibility, but that is not to say that we will not primarily still be a service-based economy.

**Q82 Mark Pawsey:** Dr Virdee, if we are going to do that, we need to get across this valley of death. We have heard from all of our witnesses about how good we are in the academic world and in developing ideas, but we are not making it through to manufacturing. I am very proud that my constituency is home to the Manufacturing Technology Centre, one of the Government's catapult centres. What is your assessment of how effective they are at increasing the proportion of our economy in manufacturing?

**Dr Virdee:** The valley of death is a big problem for a lot of start-ups, particularly clean tech start-ups. Some of the issues that are particularly challenging for them are long-term investment and avoiding market exit or overseas relocation. There is also excessive complexity and administrative burden involved with funding for start-ups.

**Q83 Mark Pawsey:** How are the catapults doing in resolving that? They have been around for 10 to 15 years. Are we on the right track? Are they having an impact, or are they a waste of money?

**Dr Virdee:** I have not looked into the catapults.

**Q84 Mark Pawsey:** Raoul, do you have a view on the effectiveness of catapults in taking the innovation that we have and getting it into volume manufacturing?

**Raoul Ruparel:** They can have an effect and have been helpful in parts. If we look at the effect that happens in the US and other places, they are more effective in that translation of ideas and research into commercialisation. Part of that might be the role of catapults, but it is also the role of technology transfer offices within universities, how much equity share they take in start-ups, how they fund them, and the skills and expertise that are on hand to support the start-up. They can have a role, but we also need to look at other areas that support the translation of ideas into commercial entities.

**Q85 Mark Pawsey:** May I ask each of you about your views on the advanced manufacturing plan, which the Government announced last November, committing £4.5 billion to advanced manufacturing? Anna, is that going to be enough?

**Dr Valero:** It is a positive step, but it is not necessarily of the scale that we need in terms of resource committed to an industrial or growth strategy. If you look at public sector investment as a share of GDP, we have lagged for a very long time, and we know that there is a key catalytic role for public-sector investment, which we need to scale up more than we currently are.



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**Q86 Mark Pawsey:** Either you or one of our other witnesses said that there is no way that we are ever going to be able to match the size of the stimulus that the Inflation Reduction Act or even the European Union's proposals will bring forward. By how much should it increase?

**Dr Valero:** There is the broader point, which I have made in various reports recently, that public sector investment matters for growth in infrastructure, in things like R&D and advanced manufacturing plans. That is where we know that, for some time, we have been of the order of 1% of GDP—around £26 billion—lower than our main comparators, and we know that there are large-scale growth needs and justifications and net zero needs to increase that further. I am not saying that that could be achieved immediately, but we are currently seeing public sector investment falling as a share of GDP over a forecast period. That is the wrong direction of travel.

**Dr Virdee:** For R&D, although their spending has been increased, 3% would be a good target.

**Q87 Anthony Mangnall:** The next panel is sitting behind you, so do not let that impact your answers in terms of timing. Dr Virdee, can we just talk quickly about the comparative technological advantages that the UK has at the global scale, and how good we are at seizing those growth opportunities?

**Dr Virdee:** The UK is not always good at seizing those opportunities, partially because of reasons that we mentioned around the technical expertise in Government to be able to recognise those opportunities. There are also challenges that start-up companies face. This is something that we have broadly covered, unless there was something more to your question.

**Q88 Anthony Mangnall:** The follow-up to that is that we always tout the fact that we are a great place for VC and very good at attracting money into seed companies and all of this side of things, but we are not very good at growing them. You have said exactly the same thing. How do we do better at helping British firms scale up? How do we get them to recognise their domestic and international opportunities? What can Government do?

**Dr Virdee:** The level of funding is certainly something that we have to consider. There is also consistency of policy. With all the changes that we have seen in policy strategies, there has been a great deal of policy churn. I do not think that any of that has really helped this.

**Q89 Anthony Mangnall:** You have made a point here about where we might be a bit slow to recognise some of the new opportunities that have been presented. A former colleague of ours, who transitioned from having a degree in history to being a net zero expert, produced a report suggesting that there are huge economic opportunities within the net zero strategy. Do you agree with that? Where do you put the UK's ambitions around net zero?





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**Dr Virdee:** I agree that net zero has huge economic potential. The UK is a leader in many areas of green tech. As we have mentioned, carbon capture, usage and storage, and offshore wind, are areas that also generate a high spillover. These are areas that the UK is strong in.

Q90 **Anthony Mangnall:** Are we scaling up at a fast enough pace?

**Dr Virdee:** We have been scaling them up and, with recent initiatives that have been announced, we are heading in the right direction.

Q91 **Anthony Mangnall:** Finally, if all three of you could give a one-word answer, are the free trade agreements that we are signing helping these high-growth sectors that we are looking at for exporting? Are they furthering the cause or are they not getting enough attention in the deals that we are striking?

**Dr Valero:** We need to make progress with Europe on manufacturing.

**Dr Virdee:** We are making progress.

**Raoul Ruparel:** They are not helping much, but not harming.

Q92 **Chair:** Anna, when you think about a growth and productivity institute, can you pick an institution in UK economic history that is a similar parallel?

**Dr Valero:** We thought of something like the Committee on Climate Change.

Q93 **Chair:** So not the Board of Trade that Mr Mangnall proposed.

**Dr Valero:** No. It is something like the CCC, but focused on growth and productivity and, indeed, working with the CCC to understand where there are synergies and where there are trade-offs.

Q94 **Chair:** Raoul, is the idea of an independent growth and productivity commission a good one?

**Raoul Ruparel:** It certainly has merit. We need somewhere within Government and within Whitehall that thinks more about growth and productivity rather than purely fiscal matters and that side of things.

Q95 **Chair:** Dr Virdee, would it be a good idea to have this sort of institution?

**Dr Virdee:** Yes.

**Chair:** That has been incredibly useful. You have told us that the sectors that have been listed by the Chancellor are broadly okay, but that there are some that are missing, especially in services, but also some strategic spots in global industries where we might have a particular strength. It is important to avoid protectionism, given that we are a medium open economy.

You have told us that we are facing competitive pressures globally that are intensifying. We have lost the edge in some sectors. You have said, in





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answer to Mr Lavery, that there are some policy errors that have made this problem worse. There is some consensus around creating an independent body that could help us co-ordinate procurement regulations, scaling up, investment, planning, skills and energy. If that unlocks greater technical expertise in Government, that would be a good thing.

There seems to be quite a strong argument about the need to get the order of magnitude of investment scaled up to more than it is today, even if it is not 1% of GDP. Thank you very much indeed. That has been a flying start.