Written evidence submitted by Professor David Bailey and Dr Ivan Rajic (Birmingham Business School, University of Birmingham and The UK in a Changing Europe programme) (PEG0088)

The UK economy in 2020 is facing the dual shock of the coronavirus and Brexit uncertainty. While it is still too early to tell, the situation may well end up rivalling or even surpassing the biggest shocks in the post-WWII period, such as the oil shock in the 1970s. Planning for the post-pandemic recovery is of paramount importance, particularly because it will coincide with the economy adapting to the new post-Brexit conditions.

We are academics working in the fields of industrial policy and regional development, and Brexit and the coronavirus pandemic are of utmost importance for our current project, which focuses on the UK automotive sector. We therefore think that sharing some of our findings and thoughts on these issues can be of help in planning the post-pandemic recovery package.

Summary

In this evidence submission, we consider several question relevant for the inquiry:

a) Guiding principles in the recovery package – we argue that the government should focus on policies that work, irrespective of how little or more interventionist they are.
b) Sources of borrowing – we argue that government borrowing directly from the Bank of England should become a standard part of the policy toolkit, as we think that the fears usually attached to this kind of borrowing, namely, that it could create runaway inflation, are for the most part unfounded in the UK context.
c) Reforming local and regional government – we argue that giving sub-national authorities secure, permanent, long-term funding and wide discretion in how they can spend them is essential for a successful recovery and for future economic development policies.
d) Sector prioritisation and criteria for that – we argue that sectors should be prioritised, and that the criteria to do that should include tools, such as input-output analysis, technology foresight, etc., that can capture their dynamic effects, such as the capability to induce technological development.
e) What lessons can the government learn from the pandemic – we argue that the government should keep a policy toolkit ready for dealing with shocks, as it has become clear that these can come about at any time.

f) Post-Brexit and post-pandemic opportunities for export growth – we argue that there is very little evidence that there will be any particular export opportunities post-Brexit, and, as a matter of fact, exports are likely to suffer.

What core/guiding principles should the Government adopt/prioritise in its recovery package, and why?

The policy measures being undertaken currently as a response to the coronavirus pandemic are more interventionist than anything seen in the UK in decades. What we hope this will show is that the typical fears attached to such measures – such as that they are bound to fail or at least be inefficient and ineffective – will be dispelled and that the current and future UK governments will be willing to consider a broader range of policy measures as part of their policy toolkit.

In that sense, the guiding principle in any recovery package, as well as more long-term economic policies, should be pragmatism, namely to adopt policies that actually work, irrespective of how little or more interventionist they are. Such policies may well include promoting competition and private enterprise, while, where appropriate, also include targeting sectors and even companies that are considered strategic, using public financing and ownership, fostering investment, and creating institutions and mechanisms for collaboration with business. Such measures have been used with great success in a number of other countries (for example Germany) by governments of all political orientations, and there is no reason why the UK should not itself find ways of developing such approaches.

How can the Government borrow and/or invest to help the UK deliver on these principles?

The current coronavirus pandemic has pushed the government to engage in direct borrowing from the Bank of England. The typical fear over this sort of borrowing is that it can lead to runaway inflation, as the government essentially faces no risks and no borrowing constraints, which can result in theoretically unlimited additional money being pumped into the economy.

However, for the most part we consider these fears to be unfounded, for the reason that creating runaway inflation requires a high level of incompetence and/or political irresponsibility. We do not think that incompetence would be a problem, as the UK has the institutional capacity to assess how much borrowing from the central bank would be acceptable given specific economic conditions. The UK also has a robust democratic system, and it strikes us as extremely unlikely that any government would knowingly create economic havoc through very high rates of

inflation, as this would almost certainly mean losing the next elections. There is, in fact, ample evidence that monetary financing of fiscal spending has been used successfully by various governments to achieve different goals. We therefore consider that direct financing from the Bank of England can become a standard part of the government's policy toolkit, particularly as any future UK-EU treaty is unlikely to place constraints on this (unlike the current EU framework which does do this).

Of course, the UK government is seen as a secure and stable borrower and it would be almost unbelievable for it to be unable to get the funds it requires from financial actors at an acceptable rate. This sort of borrowing can easily continue. However, borrowing from the Bank of England can be cheaper and is risk-free, which is still better than the small risk involved in borrowing from the private sector.

In addition to considering the source of funds, it is important to think about the vehicle for their delivery as well. The UK is one of the few developed countries that does not have a national development bank. The German KfW is an excellent example of how successful such institutions can be, when they combine large funds and a critical role in setting a country's industrial policy goals. Similarly, the British Business Bank can be made more autonomous and upgraded into a full-blown SME support bank, instead of merely guaranteeing parts of private sector bank loans to SMEs. It could, for example, give direct loans in pursuit of the government's 'levelling up' agenda. Overall, having such publically-owned institutions would make it much easier to directly implement any future government recovery and development plans.

How should regional and local government in England, (including the role of powerhouses, LEPs and growth hubs, mayoralties, and councils) be reformed and better equipped to deliver growth locally?

Economic recovery plans, as well as more long-term economic strategies, such as the UK's Industrial Strategy, work better if they contain a strong regional component, with a proper division of roles between the central and sub-central levels. Currently, however, devolution in England is limited, and even the Scottish, Welsh and Northern Irish administrations could be given more economic powers.

In England, devolution mainly consists of Local Enterprise Partnerships (LEPs) and Combined Authorities (CAs), as well as a couple of initiatives such as the Northern Powerhouse, all of which have relatively limited powers and insecure non-permanent funding.

The LEPs are essentially boards of representatives drawn from local councils and businesses from an area. They set economic strategies for their regions, and then apply for funds from various sources (central government, currently still from the EU, funds attached to the UK's Industrial Strategy, etc.) to pursue projects that further these plans. What this means is that LEPs' hands are for the most part bound by the project funding they receive, and it may be difficult for them to pursue opportunities as they arise, given the time it takes to apply for and get funding. Even worse, their

plans are often focused on what funding they think they can get, instead of around their regions' needs, and these two things may or may not coincide. Their funding is also insecure, as it almost completely depends on project funding – they may or may not be successful in obtaining the funding, and even if they do, such funding usually lasts for a couple of years at most, so it is nearly impossible to make any long-term plans. Finally, the LEPs do not actually have any legislative powers, so they cannot, for example, use business rates adjustments, tax incentives, etc. to help local firms. They can try to coordinate with local councils and central government ministries for this, but how successful this can be is wholly dependent on the specific LEP's situation.

The CAs are somewhat different. They are also composed of representatives from local councils, in a number of cases they have an elected mayor as well, and they set out common plans for their areas. Most tend to focus on transport and skills. The difference compared to the LEPs is that the CAs negotiate with the government to get devolved powers and funding to pursue these goals (although they also can and do apply for project funding). Unlike the LEPs, CAs do have some legal powers and their funding is somewhat more long-term (but still non-permanent). However, they are still in the end bound to agendas set outside of their areas, as they are unlikely to get a devolution agreement with the government that does not conform to whatever government agenda is current. In that crucial sense, they are not free to pursue their areas' needs as they see fit.

Overall, there is very limited room for local manoeuvre. In the wake of the pandemic, city regions like the West Midlands have brought together a range of local actors to highlight challenges and opportunities and bid to central government for post-pandemic support. This has shown that the Mayor and CA can provide effective place leadership, but at the same time clearly demonstrates the limits of what is doable at the city regional level in the current set up. Addressing long standing regional issues such as skills, remediation of sites, infrastructure and connectivity should not be dependent on asking for central government funding. Rather, the city region needs a much wider set of powers and resources at the local level so that it can make such decisions itself in a collaborative process with business. The need for further decentralisation of powers and resources to the regional level should itself be a goal going forward.

The Northern Powerhouse and the Midlands Engine are also partnerships made up of central and local authorities and businesses, with their main focus being business support. The main difference compared to the LEPs is that they cover much larger regions. They too suffer from the same problems that the LEPs and CAs do, namely, a lack of secure, permanent funding, and they do not have any legal powers.

For economic plans to work for England's regions, the devolution landscape would have to substantially change. First, a proper division of roles between the central and sub-national authorities would have to be created. A potentially useful solution would be for the central government to focus on objectives that require large resources or power (e.g. support for the development of expensive technologies or negotiations

with large international firms about their investments in the UK), while sub-national authorities could provide the support for this, such as mapping out the capabilities and supply chains that exist within their regions, and how new technologies could combine with sectors in those particular places. This bringing together of technology, sector and place was largely missing in the last government's otherwise welcome industrial strategy. Operating within such a policy framework would not only focus resources to where they can be most useful, but would potentially also help avoid inter-regional competition that has been plaguing the English devolution landscape, by creating a clear role for all actors in such a way as to avoid competition. However, it would be essential that some of the government's goals directly benefit specific regions. Indeed, a more participatory form of setting industrial policy goals could be envisaged, in which sub-national authorities have an actual say along with business, in a process of discovery. A number of mechanisms could be envisaged to ensure this.

Second, sub-national authorities would need to get larger, and, crucially, long-term and secure funds, as well as broad discretion in how they can use them, and not be limited to essentially being a local vessel for delivering centrally-set policies. This should come in addition to their participation in central government strategies, and provide them with the resources to identify regional economic opportunities and support them. It is not that centrally set policies are necessarily inferior, but it is likely that sub-national authorities can have a better and more detailed understanding of their regions' capabilities, challenges and opportunities. In contrast, central government is much more likely to focus on growth and recovery wherever it can get it, and this almost invariably ends up with a focus on already successful regions, as is the case with the current Industrial Strategy.

It is worth emphasising here that England does have prior experience with more extensive regional economic policy making, with the former Regional Development Agencies that used to cover English regions. They had responsibility for economic development, but, unlike the LEPs, CAs, and initiatives such as the Northern Powerhouse and Midlands Engine, they had much larger and long-term and secure funding to pursue their goals. An extensive assessment of their performance in 2009, shortly before they were abolished, showed that they provided value for money. The regionally-based Manufacturing Advisory Services (MAS) are one example of the things that were made possible by this. MASs provided crucial technical and supply chain advice to manufacturing firms in different regions, and also had a good understanding of the industrial capabilities that existed in their regions. Institutions such as these should be resurrected and put on stable financial footing, and used to support manufacturing, for example in relocalising supply chains and in taking up Industry 4.0 technologies (building on the Made Smarter initiative).

Whether the Government should prioritise certain sectors within its recovery package, and if so, what criteria should it use when making such decisions? What conditions, if any, should it attach to future support?

Sectoral priorities should normally be set in any relevant government policies. This is because some sectors have (much) greater potential than others to induce technological development, link with other sectors, create new products, employ people, etc. Setting sectoral priorities is even more important in the current context where both the coronavirus pandemic and Brexit uncertainty are causing shocks to the economy.

There exist standard cost-benefit analysis tools that are typically used to assess the case for government policies. They are useful, but we need to recognize that it is generally difficult to include in them the more dynamic effects that policies can produce. For example, if deciding on a sector to support, GVA or job growth can perhaps be reasonably assessed, but it is more difficult to do that with the potential of the sector to induce technological development or to expand inter-sectoral linkages. When picking sectors to prioritise, such more dynamic assessments should be taken into account. They can be obtained through technology foresight methods, the use of input-output analysis, etc., or even through simple indicators, such as market growth or investment rate trends. We need to accept that including such additional measures may lead to the conclusion that certain sectors merit support, even if the more standard cost-benefit analysis shows that they do not. Such dynamic indicators are especially important in the context of post-pandemic recovery, as they can provide insight into how big the damage can be from losing certain sectors of the economy.

With regards to conditions attached to future support, post-pandemic recovery packages can be used as an opportunity to have firms commit to developing UK-based supply chains. This could be combined with other measures aimed at reshoring UK production, which is anyway a goal of government policy, especially in the context of Brexit.

What lessons should the Government learn from the pandemic about actions required to improve the UK's resilience to future external shocks (including – but not limited to – health, financial, domestic and global supply chains and climate crises)?

There are a host of measures that are used by governments to cushion economic shocks. Some are meant to provide financial support to affected companies. This can be done through public loans given at preferential interest rates, temporary wage subsidies (of the sort being used throughout the economy during the coronavirus crisis), equity financing, temporary tax reductions, debt write offs, tariff rebates, etc. Other measures can lessen various administrative burdens. There are even some unconventional measures, such as the announced temporary VAT reductions for meals at restaurants, which is effectively an extremely targeted tax relief that works through reducing the costs that households face. The government had to come up with most of these measures from scratch and on the fly, and what it could learn from this is that it could have a policy toolkit ready for any future shocks, and to

assume that such shocks can happen at any time. It is likely that this won't be the last pandemic to hit, after all.

More broadly, there are longer-term measures that the UK government could take to help the UK economy grow. In particular, this relates to the UK's manufacturing base, where such measures might be seen as part of 'industrial policy'. Some of these measures relate to skills – the government could provide more funding for training and retraining workers. Others relate to infrastructure – increased investment in 5G networks, communication, transport, reclaiming of derelict industrial sites, electric vehicle charging infrastructure etc. Other measures may be used to help innovation. The UK already has some such measures that work well (e.g. the High Value Manufacturing Catapult network of research centres), but funding for them could be increased. Long-term funding can also be provided via public loans and investment for small firms (this already exists, for example through the British Business Bank, but can be expanded), and bigger loans from a national development bank (as noted, the UK is one of the few developed countries that does not already have such a bank). Finally, there are measures that are meant to help companies by providing them with relevant information and support – for example help with using new technologies such as 'Industry 4.0', informing them about new market opportunities (particularly in the supply chains of bigger companies), and so on.

The problem with the above is that consecutive UK governments have not been pursuing a holistic industrial strategy, and for that reason, the UK currently has a substantial capacity gap in planning and executing such measures. But, as an example of how this could work, in the automotive sector, there exists the Automotive Council. This is an advisory body made up of firms and unions in the sector that interacts with the government regularly, and promotes longer-term measures centred on upskilling workers, setting technology development goals, suggesting market strategies, etc. Prior to the Automotive Council, the Rover Task Forces were set up before and after MG Rover's bankruptcy, to promote both cushioning measures, such as the ones we listed above, and also to help diversify the supply chain, with many positive effects. The current coronavirus pandemic should make it clear that different key sectors should have such bodies, as they can provide the basis for the close links and sectoral understanding that is needed to pursue effective growth measures.

Perhaps most importantly, industrial policy measures must be part of a coordinated larger strategy, with a clear division of roles between central and regional/local governments. It is only in this way that industrial policy can work to full effect. At the moment, the UK does have an industrial strategy, but it is underfunded, focused primarily on innovation, and lacks strong (and sometimes any) coordination mechanisms between various actors. It also allows only a relatively limited role for sub-national actors and initiatives that focus on specific places (as opposed to specific sectors).

Here it is also important to remember that the UK has been facing several challenges irrespective of Brexit: a) the need to reduce regional disparities, and in

that context to restructure regional policies, b) the need to move to 'net zero carbon emissions' (meaning to at least not increase overall carbon emissions, and preferably lower them) and ecological sustainability more generally. In the current context, the UK also has to deal with 'rebooting' the economy, including manufacturing, after the coronavirus crisis is over. Industrial policy can play an important role in this regard.

On regional disparities and industrial policy, the UK government is already promoting its 'levelling up' agenda, essentially a drive to help the UK's poorer regions. As it stands, the current industrial strategy's sectoral focus (e.g. pharma, aerospace) and its focus on supporting R&D are such that, on average, the already richer regions benefit more, as they have more employment and far more R&D in these sectors than the UK's poorer regions. But, industrial policy could be 'done' differently, and could focus some of its measures either directly on poorer regions or on sectors that dominate within these regions (e.g. steel, automotive). (We need to note that this is not in conflict with supporting sectors in the richer regions, as it would just require extra funding to do both things.)

What opportunities exist for the UK economy post Brexit and the pandemic for export growth?

Looking at Brexit, depending on the outcome of the UK-EU negotiations, the UK may be able to pursue its own trade deals with third countries, set its own technical, safety, and other standards, reduce regulation that businesses consider to be "red tape" that is reducing their competitiveness, and decide on its own state aid rules (within the limitations set by the WTO). However, the mere possibility of doing these things does not *automatically* mean that UK firms will benefit from them. Overall, at least looking at the manufacturing sector, which contributes almost 50% to total UK exports, there is little evidence to suggest that UK firms will have opportunities outside the EU that they did not have prior to Brexit.

Trade deals with third countries are likely to be of limited benefit for UK manufacturers for several reasons. For many products, such as cars or steel, the UK's biggest export market is the EU27, to which the UK will have reduced market access. In other sectors, such as aerospace, much international trade already entails 0% tariffs, so no further gains can be made even with independent trade deals with third countries. It is possible that the UK could independently negotiate some reduction in non-tariff barriers, which would be beneficial. However, the UK may not be in a very strong position in such negotiations; some major economies, such as Japan, are counting on being able to gain further concessions from the UK than they could from the EU. In addition, in some sectors, such as steel, the UK has zero-tariff access to third countries by virtue of being an EU member benefitting from the EU's free trade agreements. Once the UK leaves the EU, it will lose the benefits of these agreements should the Government not manage to roll them over. There are also very specific situations: tariff-free exports of steel to Turkey (around 8% of total UK

steel exports) are based on a special EU-Turkey free trade agreement that in all likelihood won't be rolled over. As a result, UK steel exports to Turkey will face an average tariff of 15% (and up to 40% for some products) post-Brexit.

What all this means is that many manufacturers will almost certainly face at least short-to-medium term disruptions to trade, and it is likely that there will be long-term negative effects as well. We should also bear in mind that even short-term disruptions can turn into long-term negative impacts, because during the period of disruption, former customers may permanently switch to buying from other companies.

The possibilities for expanding exports to markets that the EU does not have free trade deals with, such as the US or China, are also limited. Negotiating free trade deals with these countries could take years. Japan wants to start new trade deal negotiations instead of rolling over their existing deal with the EU. And in a number of sectors the gains from these potential deals would be fairly low; for example, US tariffs on EU (currently still also including British) exports of cars are set at only 2.5% and firms like JLR, Bentley and Rolls Royce already export large number of cars to the US. Although the elimination of even such low tariffs would certainly be welcome, it is difficult to imagine it providing any significant boost to UK exports. In this context, we should also note that trade deals may not be as important for exports as other factors. For example, Germany exports 4 to 5 times more in value to China than the UK does, even though it is an EU member, and the EU has no free trade agreement with China.

It is also worth noting that there may not be that many products where UK manufacturers can easily expand into new markets by virtue of leaving the EU. The UK does export goods to non-EU countries; more than half of total goods exports are to outside the EU. As an example, luxury and premium cars (such as Bentley, Rolls-Royce, Aston Martin, and JLR models) are already recognised and sold globally, and over the years these companies have expanded the number of markets to which they export. However, these export expansions were not hindered by the UK's EU membership, so there does not seem to be an obvious reason why the UK leaving the EU would provide a further boost to them. Also, although there has already been a non-negligible pro-active reorientation of exports from the EU to non-EU countries by UK SMEs, we do not know if this is a trend that can continue and whether such reorientation is an option for the majority of manufacturing exporters to the EU. What is more certain, however, is that leaving the EU will have a negative impact on UK manufacturing firms, as highlighted in our recent UK in a Changing Europe report 'Manufacturing and Brexit', which will almost certainly negatively impact their ability to export as well.

There has also been some discussion that the UK can make itself more attractive for FDI after it leaves the EU. One of the suggested ways to do this, that is particularly relevant for exports, is through creating additional 'free ports'. These are geographical areas where companies can enjoy various benefits, such as tax reductions, tariff rebates, quicker building application approvals, etc., and currently it seems that the plan is for such benefits to be tied to promoting exports.

However, it is not entirely clear how this should work. The main attraction of free ports for companies that wish to export is that they reduce operating costs. Very often, the biggest cost reduction for firms is that free ports are located in countries with cheap labour. But, the free ports also obviously have to be located in countries from which the companies in question have good export market access. The UK has a problem on both those counts. With regards to labour costs, while the UK may have cheaper labour and laxer labour standards than a number of other developed countries, including some of its major competitors in the EU, it is by no means a cheap labour country, especially compared to the nearby East European countries. And, with regards to market access, while the UK has a good geographical position and good infrastructure, it will lose unimpeded market access to the EU from January 2021, and it does not yet have other important trade deals with large markets lined up. All of this means that it is hard to see why UK free ports would prove particularly attractive to foreign companies looking to produce for exports. It is more likely that some exporting companies that are already in the UK and plan to stay here may decide to move their production to the free ports, to take advantage of whatever opportunities for cost reductions they may get. This, however, is a case of relocation, rather than the creation of additional economic activity, though it may end up providing some wider benefits (e.g. if the firms use the advantages they've obtained to increase their production and investment). Still, this would have to be weighed against the costs of the free ports, and in any case, it is difficult to envisage the benefits, such as increased exports, being particularly large. Overall, free ports, export processing zones, and the like, are mainly used by countries with cheap labour and cheap access to large and rich markets (e.g. the maquiladora sector near the Mexican side of the US-Mexico border). To our knowledge, they are not a particularly effective policy tool in richer countries.

Finally, with regards to the coronavirus pandemic, there has as of yet not been any systematic research on what its longer-term effects will be on international trade, but it is very likely that it will magnify the problems

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