Regional Economic Development : Local Economy Briefing 14

A 'new' Industrial Strategy for a 'new' World

Introduction

The history of regional economic development (RED) in the United Kingdom (UK) is one of 'chop and change', especially compared with our international competitors where 'responsive evolution' has been more in evidence. In the modern era, UK policy makers have pursued periods of active engagement and growth in RED followed by periods of cutback or culling.

An example of this cycle was the creation of the nine English Regional Development Agencies in 1999 and the axing of eight of them (outside London) in 2010. The positive momentum built up by the middle of the 2000s was swept away just as positive evaluated impact began to be recorded. Expertise in long-term, productivity-led growth was dispersed just when the real economy was struggling with the aftermath of the "Great Recession".

To encourage "localism" in RED, the Coalition Government (2010-15) created 39 Local Enterprise Partnerships (LEPs) for England. The LEPs operate at varying levels of business involvement and scale (geography and funding), when promoting the delivery of local development needs. After another period of start up and capacity building, the LEPs' economic impacts are yet to be fully assessed.

In the Autumn Statement 2016, the Chancellor and the Business Secretary indicated that a "new" Industrial Strategy for national and local investment in the competitiveness of UK business sectors is forthcoming. This Strategy will be based on the 2015 Productivity Plan (Budget July 2015) and include a National Productivity Investment Fund (Statement November 2016).

The emerging Strategy will be a key ingredient in the economic policy response to the longstanding structural weaknesses of the UK economy: relatively low investment, productivity and export trade. Resolution of these deficiencies becomes even more pressing in the wake of the BREXIT vote, the forthcoming negotiations on future terms of trade with the EU and other international trading blocs, and the heightened risk of protectionism in America (following the election of Donald Trump – see afterword).

Regional Economic Development : Local Economy Briefing 14

The Autumn Statement

On November 23rd, the Chancellor of the Exchequer, Philip Hammond, effectively announced a tempering but also a prolonging of the “Austerity Era”, softening its overall impact in this Parliament and pushing planned surpluses back into the early 2020s. The government wants to spend more on public investment in a way that means bigger deficits and higher state borrowing.

Before the Autumn Statement, there was talk of a new Industrial Strategy for growth. In the end, this was overstated but there were measures to spend more on infrastructure – for transport, digital communications, research and development, and especially housing over this Parliament.

This is fine as far as it goes, but it only restores investment to pre-austerity levels (as a ratio of GDP). Furthermore, few of these interventions may be implemented in time to affect the growth trajectory over the next couple of years. Worryingly, this is just when uncertainty will be increasing over the terms of BREXIT and wider trade protectionism.

When the net investment stimulus does occur, to have a positive, lasting net impact, it must:

- Go into projects that build long-term capacity;
- Raise underlying growth potential; and
- Not spill-over into general departmental or current spending.

Otherwise, the risk is that ‘bigger’ government means a more sclerotic economy in the long run with higher inflation, taxes and interest rates than otherwise would have been the case.

The Economic Forecasts

OBR UK Economic & Fiscal Outlook (November 2016)

	2016	*2017*	*2018*	*2019*
Real GDP growth (% ch)	2.1	1.4	1.7	2.1
Inflation (% ch)	0.7	2.3	2.5	2.1
Unemployment (% rate)	5.0	5.2	5.5	5.4
Implied Productivity (% ch)	0.8	1.1	1.4	1.8
Net trade (% ch)	-0.2	0.3	0.3	-0.1
	2016/17	*2017/18*	*2018/19*	*2019/20*
Annual PSBR (£bn)	68.2	59.0	46.5	21.9
Annual PSND (% GDP)	87.3	90.2	89.7	88.0

In its document accompanying the Autumn Statement, the Office of Budget Responsibility (OBR) forecasts a more subdued UK economy (table above). Growth falls hard in 2017 and stays low through the medium term. It is lower than what is needed to sustain overall economic well-being. Moreover, inflation is set to accelerate above target and unemployment to rise.

There are wide risks around these macro forecasts.

- Some commentators suggest the positive effect of BREXIT on business spirits and global opportunities will bring higher growth and, thereby, better public finances.
- Others believe weaker private investment and stagnating consumption will mean that growth will be even more modest (perhaps even recessionary), whilst inflation will soar from the effects higher imported costs and monetary reflation and unemployment will climb.

Meanwhile, the net trade and implied productivity positions are expected to improve somewhat, following the post-BREXIT drop in the value of sterling. But, they will remain poor relative to historical and international norms. Moreover, the public accounts are expected to deteriorate (from the view stated in last March's Budget) with annual surpluses pushed back into the 2020s and the outstanding net debt rising towards £2,000 billion.

The 'New' Industrial Strategy

There is nothing "new" in RED, especially in the United Kingdom where the productive and competitive deficiencies of regional and local economies are long established and well understood. Sustained growth is all about boosting the drivers of productivity and employment. The former are about investment in capacity, innovation in products and processes, acquisition and dissemination of skills, support for entrepreneurial start-ups and growth, and building trade engagement and competiveness. The latter is about increasing active participation in the workforce.

In the papers accompanying the Statement, elements of the new Industrial Strategy were outlined as productivity-led growth through infrastructure investment. For example, during this Parliament (to 2019/2020), £23bn will be spent through a National Productivity Investment Fund with most of it going for new housing, transport, research and development and a bit on digital communications.

The Implications for Dorset

For the Dorset LEP and its partners, the question is what slices of the different Treasury pies will come here. With the government's sub-national emphasis seemingly on the Northern Powerhouse, the West Midlands Engine, the Oxford-MK-Cambridge Corridor and the Devolved Administrations, there is little left for the south. For example, the third round of Growth Deals for SW England was announced as £191mn: much less than the LEPs in this region hoped for.

It is not yet known how much of that fairly small pot will come to Dorset but the likelihood is that it will not be much, especially as areas with locally elected mayors remain favoured (e.g. Bristol): (there is some possibility that such authorities will be able to issue bond debt for "productive infrastructure" but there are no details about this as yet).

One welcome development was the announcement that the proposal for a Science and Innovation Audit by Innovation South (which includes the Dorset LEP and Bournemouth University) was approved. This brings no direct new support/money for the local economy but it offers the prospect of identifying areas of expertise and economic strength, and opportunities for technological and process growth in competitiveness, which should influence investment allocations and decision making in the longer term. At the least, it should establish the south as a centre of economic dynamism and raise the area's profile with government.

The Implications for Business

The 'new' Industrial Strategy has yet to be gathered together and disseminated in a coherent whole that offers the prospect of permanently raising UK growth potential. The elements so far announced follow the broad thrust of what is required (productivity-led growth). They offer some prospect of more capacity (for faster growth) in due course.

These measures are welcome, though the sterling amounts specified are modest and detailed delivery remains uncertain. The 'new' money coming to Dorset may be particularly sparse whilst the key growth issue, about the future trading relationships of the UK with the EU and the rest of the world, remains unresolved.

At a macro level, the net economic effect of the Autumn Statement seems minimal.

- There may be particular aspects of tax and allowance changes that are important for specific businesses. (I am sure Dorset's accountants are pouring over this in detail in order to advise their clients as I write.)
- There may be direct local spending or grant effects that might be relevant for particular sectors eventually. I expect the Dorset LEP, local authorities and business organisations will be publicising the detail in due course.

For most, however, it is the individual business response to micro opportunities in specific sector and spatial markets, with their varied risks and uncertainties that matter. The UK (and Dorset) economy is going into a period of change with respect to trade regimes, monetary policy and broad investment incentives. It is the entrepreneurial and competitive skills of business people and their workforces that will determine success rather than, or despite, the national and international effects of policy and the path of financial market events.

If the Theresa May Government means what it says about a 'new' Industrial Strategy to address the productivity deficit and to mitigate some of the effects of negotiating BREXIT, that is all to the good. As long as the Strategy is comprehensive and coherent, its principles are sound and set for the long term, and its delivery is effective and efficient, it can boost UK productivity and build growth that is both sustained and sustainable.

Nigel F Jump, Professor of Regional Economic Development
(November 2016)

<u>Afterword on President-elect Trump</u>

A lot has been said about the implications of President-elect Trump for the world economy. Most of this is no better than speculation. Really, all that can be said at this point is that there are some important risks:

1) Trade protectionism is usually bad for overall economic growth (especially if undertaken by the world's biggest economy). There may be short-term gains for some firms but, generally and inherently, protected businesses/sectors are less efficient than competitive ones and total output is less as a result.

2) Looser Fiscal Policy (tax cuts and increased federal/state spending on infrastructure) can cause an immediate (short/medium-term) spurt to growth but may be less positive in the long run. Bigger public deficits ultimately take resources away from a more efficient, profit and productivity seeking, private sector. Eventually, public deficits impose a borrowing cost, an inflation hit and/or a higher tax burden on future generations.

3) Uncertainty about future international relations (NATO, immigration walls - real or procedural, Russian and Chinese aggrandisement, the war on terror, and isolationism) can reduce business and market confidence leading to less investment, lower output, fewer jobs, worse productivity and slower growth than otherwise might be the case.

4) A halt or reversal of US plans to address climate change may have consequences beyond the normal economic cycle.

The world may be more complicated than these basic economic relationships imply. There are positive risks too. If President-elect Trump is right and his new approaches to trade, public investment and international relations will correct existing imbalances that are damaging, unfairly, the US economy, the net effect of his policies may be beneficial. They may release domestic entrepreneurial effort and innovation in a way that builds capacity, encourages (domestic and inward) investment and stimulates growth by knocking out dumping, corruption, unfair competition and other negative constraints in the current global trading environment.

Assuming effective implementation of better regulation and rules, America may achieve higher growth in the years ahead: a ‘good’ for us all. Certainly, for now, the securities markets (higher stock values and lower bond prices) seem to believe it will be good for private output and profitability in the foreseeable future.

The caveats are:
- How and when will the net public stimulus be paid for;
- How long will infrastructure investment take to have notable impact on growth and trend potential; and
- With higher interest rates, how will Quantitative Easing be reversed without constraining growth?

The complex interaction of all these variables will be fascinating to follow. The years 2017-2020 and beyond are going to be an interesting experiment for RED. It will be very different from 2008-16, making it difficult to predict how ‘Trumpton’ might turn out.