PEOPLE AND PLACES FIRST

AN INDUSTRIAL STRATEGY TO REBALANCE THE ECONOMY

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INTRODUCTION

This paper argues for an industrial strategy for the UK that aims to achieve prosperity, social justice and ecological sustainability. Government must get national policy right – delivering certainty for investors in sustainable industries and ensuring that the 'rules of the game' deliver decent, well-paid jobs across the UK. But it would be wrong to conceive, as is often the case, of industrial strategy as starting and ending in Whitehall. In reality the diverse needs and different strengths of areas and regions in the UK compels a bottom-up and empowering approach. Industrial strategy must be, therefore:

- place-based, with people in control of local developments;
- built on the different strengths and assets that already exist in each locality;
- making sure that marginalised areas and communities are not held back.

We briefly review the rationale for an industrial strategy and for the goals set out above. We consider, again briefly, what kind of strategy is likely to achieve these goals. We then set out proposals for shaping an effective industrial strategy which puts people and places first.

OVERVIEW OF RECOMMENDATIONS

1. ***Set overarching goals: Prosperity, equality and sustainability.*** Success should be measured not just through conventional indicators such as gross value added (GVA), but also by assessing the impact on jobs, wellbeing and long-term sustainable development.
2. ***Begin industrial strategy from the needs and assets of local places.*** Industrial strategy must be "place-based", tailoring approaches to local needs and sectors of the economy that matter most to people, and that deliver the most local value, rather than imposing specialisation choices from the top. Focus must be given to sustainable job creation in all regions, for workers with all levels of skill.
3. ***Strengthen local decision-making institutions.*** Bodies that can have the remit and power to champion the diversity of local needs and interests are essential. There should be regional or local bodies capable of planning and coordination, but which are driven by the expressed priorities of local people and by participation from democratically elected local politicians, employers, trade unions and representatives from the third sector.
4. ***Tailor skills investment to the local needs of the whole economy.*** Greater devolution to local government or other local institutions of investment and planning of education and training will help to make the most of local knowledge about an area's particular requirements – not just in 'high-tech' sectors. Local skills strategies should be developed through the genuine and active participation not only

of education institutions, employers, and local government, but of unions, workforces and young people as well.

5. ***Create new national and local banks specifically to finance place-based development.*** A National Development Bank would be a tried and tested solution to regional development and should be prioritised. Local banks, thriving in other parts of Europe and the US, would be another approach.
6. ***Support SMEs to collaborate and win public contracts.*** Institutions that help SMEs collaborate on shared services should be encouraged and subsidised by central government. Public procurement should favour regional SMEs when tendering for goods and services.

WHY DOES THE UK NEED AN INDUSTRIAL STRATEGY?

The UK economy has been largely anaemic since the 2008 crisis and has performed poorly in recent years. Forecasts for growth have recently been downgraded. Below 5%, unemployment masks poor job quality and chronically low pay with two in every five jobs below living wage.

Britain is facing an "economic malaise" driven by falling living standards, growing indebtedness and increasing wealth inequality. Our economy consumes more than its industrial base produces and generates less revenue abroad than it spends. Rising levels of external indebtedness mean increased exposure to swings in the exchange rate and the shifting moods of international markets.

The 2008 financial crisis did not lead to a change in UK economic policy, but to a deepening of the pre-crisis model. The fundamental failings of the financial system remain: nearly ten years after the financial crash, Sir John Vickers, chair of the Independent Commission on Banking and former chief economist of the Bank of England, described progress to ensure the banking system is more resilient as "really disappointing."[1]

GDP growth is still fuelled by consumption paid for by households using debt, a mortgage-based housing bubble, and services. Our manufacturing exports are heavily concentrated in a handful of sectors. Many consider that this path is likely to lead to a new financial crisis.

Compared with other advanced economies, the UK is less innovative and has relatively poor levels of productivity and growth – not least because of lower spending on research and development and lower levels of investment in new plants and machinery.

Historically, manufacturing has played a central role in increasing productivity and driving innovation – this is as true today as it has ever been. While the ratio of manufacturing to GDP has declined in all advanced economies, only in the UK has manufacturing declined in absolute terms[2].

There are three further problems:

1) The UK has the highest regional inequalities among advanced economies
2) The UK economy is not decarbonising quickly enough. It is off pace to meet its own legally binding carbon budgets[3]
3) Brexit is likely, certainly in the short term, to intensify current imbalances, uncertainties, and risks

This is a compelling context for an industrial strategy – clearly there is a strong need to intervene in an economy which has led to such a wide range of problems. For too long the notion of even having an industrial strategy was effectively taboo. But even though the need for a strategy is now more widely accepted, the prevailing direction of intervention risks missing the real problems and opportunities.

In recent years, the Government's approach to industrial strategy has been to support a number of high-profile, export-oriented and relatively glamorous sectors – such as pharmaceuticals, oil and gas, and offshore wind – leaving the more fundamental and 'foundational' (see below) parts of the economy overlooked and exposed.

In the aftermath of the EU referendum, the newly appointed Prime Minister Theresa May created the Department for Business, Energy and Industrial Strategy – industrial strategy was seemingly present in name in Whitehall. In addition, throughout 2017, the Industrial Strategy Commission, and independent, academic endeavour, has heard evidence on the need for strategic economic coordination and has recently published its final report, promising a real shift in the terms of the debate on the role of government in the UK economy.[4]

And yet, for all the focus, the core notion of addressing profound regional inequalities and – critically – bringing economic policy closer to and under the control of people who most need to benefit is still missing. For industrial strategy to be truly effective, it must begin to address these omissions.

THE UK GOVERNMENT'S INDUSTRIAL STRATEGY

Brexit sets the landscape for industrial strategy: the vote itself underlined the UK's sharp regional differences and the widespread disillusionment with 'elites' and the primacy of big finance, to which post-Brexit policy must be seen to respond.

The UK government now acknowledges the need for a rethink and has produced an industrial strategy that apparently signals a new approach. This is described as 'not just stepping back and leaving business to get on with the job, but stepping up to a new, active role that backs business and ensures more people in all corners of the country share in the benefits of its success.'[5]

Its green paper, "Building our industrial strategy," seeks to distance itself from "the failures of nationalised industries like British Leyland, 'picking winners', poorly targeted government investment and sclerotic growth." (ibid) Yet much of its content remains within the orthodox framework. Tax breaks, deregulation and "free market economic policies" are trumpeted as having led to success in South Korea, the US and Germany.

Some of the "10 pillars" the green paper introduces are aligned with objectives set out in this paper. These include the focus on a low-carbon economy (Pillar 7), countrywide growth (Pillar 9) and the need for new institutions (Pillar 10). It remains to be seen how far the strategy, when finalised and implemented, will provide a sufficient corrective. There are considerable unknowns that will have a big impact on how effective the strategy will prove to be, in particular around the 'type' of Brexit that ultimately emerges and the nature of any trading arrangements with the EU or other blocs.

WHAT SHOULD AN INDUSTRIAL STRATEGY AIM TO ACHIEVE?

The first task of any effective industrial strategy is to be very clear as to the type of economy and employment landscape that it intends to build. Post-Brexit, three imperatives appear clear:

1) Prosperity: A resilient and rebalanced economy
2) Equality: A less unequal economy
3) Sustainability: An environmentally thriving economy

A successful strategy would pursue these three goals together. This implies a set of indicators beyond gross value added (GVA), but which assess performance against jobs, wellbeing and long-term sustainable development.

PROSPERITY

By prosperity we mean building a macroeconomic system as well as regional economies that are resilient: able to withstand external shocks and to benefit rather than suffer from changes in areas such as technology, trade and geopolitics.

To build resilience at the expense of social cohesion or sustainability is indefensible – on practical as well as ethical grounds. We will assume here that the ethical grounds are uncontroversial and focus briefly on the practical implications.

EQUALITY

The UK's economy is by far the most regionally unequal among advanced economies (as shown in Figure 1), and income inequality is at a higher level than at any time since the early 20th century.

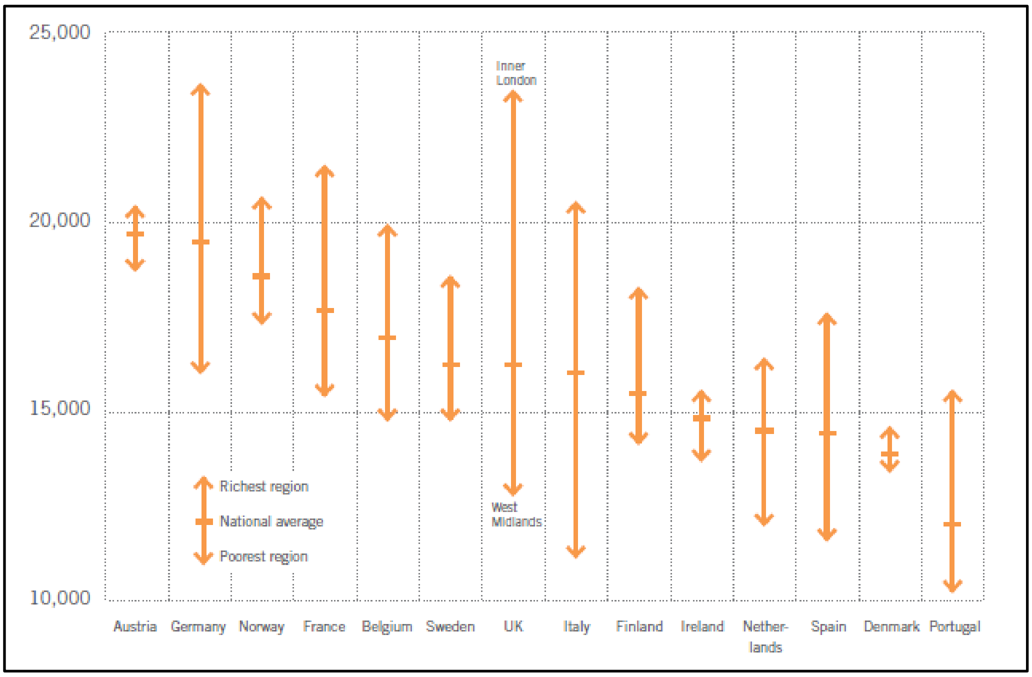

Figure 1: Disposable household income in the richest and poorest nations in Western Europe[6]

Average weekly earnings have fallen since 2016 and have never recovered from the crisis in 2007/8. Even where there is growth in advanced industries, wage levels remain stagnant or decline.[7]

The EU referendum exposed the extent to which many communities across the country feel 'left behind' and unable to determine their livelihoods. These fractures were a predictable result of the economic model that has prevailed since the early 1980s, the core tenets of which have been to deregulate markets, specialise in sectors that markets consider competitive, and minimise state intervention – regardless of the effects on regional disparities, income inequalities or social cohesion.

Yet there is growing evidence that inequalities can have a negative effect on the nation's economy. Most economists see innovation as a key determinant of the rate of economic growth. Studies have found a clear positive correlation between the extent of equality and the degree of innovation, as measured by the number of patents per head of population.[8] Other recent work suggests that the 'social distance' between workers in different professions and disciplines and at different levels of the workplace may strongly influence the capacity of firms to innovate.[9] [10]

Innovation matters, but equally important is the well-documented fact that income inequalities can be a major contributor to economic instability. Low wages encourage households to take on debt, both to pay for necessities and to achieve living standards they see others enjoying. According to the Bank of England, consumer credit, which includes credit card debt and unsecured loans, climbed by 10% in the year ending June 2017, bringing total consumer debts to more than £200 billion for the first time since the eve of the financial crisis.[11] The size of the UK's ballooning consumer credit market is worrying the credit rating agency Moody's, whose analyst Greg Davies recently warned: "Household debt is high and still growing, leaving consumers vulnerable to an economic downturn, while higher inflation, weaker wage growth and levels of indebtedness leaves those in lower-income brackets the most exposed" (ibid). High levels of debt among low-income households can turn an economic downturn into a crash as repayments diminish and lenders foreclose. Moody's has downgraded its assessment of most 'UK structured finance sectors' in the belief that they will perform negatively over the next 12 to 18 months.[12]

The pursuit of greater income equality between and within regions can thus be seen as a condition of prosperity, rather than an irrelevance or inhibitor.

SUSTAINABILITY

The overwhelming weight of scientific evidence shows that, if trends in greenhouse gas emissions continue, they will lead to a perilous rise in global average temperatures – well beyond the goal of 2°C set by the 2015 Paris Agreement, let alone its more ambitious target of 1.5°C.[13] The Stockholm Resilience Centre warns that the exponential growth of human activities could trigger 'abrupt or irreversible environmental changes' that are potentially 'catastrophic for human wellbeing.'[14] This has been described as 'the single most important challenge facing society today''[15] and an unprecedented threat to economic functioning at all levels. Leading economists have pointed to the vital, evidence-based necessity of reducing greenhouse gas emissions and depletion of natural resources. An industrial strategy that is not focused on this challenge is not serious about equipping the UK economy for the realities of the 21st century.

Alongside warnings about the accumulating costs of inaction, there is the promise of advantage to be gained by leading the field in sustainable technologies – currently being lost to other countries such as Germany, Belgium and Denmark. The UK is falling down independent international league tables that track investor confidence in the low-carbon economy[16]. Yet across sectors, from manufacturing of renewable technology, to electric vehicles and innovative reuse and recycling techniques in waste management, there are significant opportunities to increase exports and create jobs.

As Lord Stern has argued, the aftermath and economic stagnation of the 2008 crisis was a huge wasted opportunity[17] to invest heavily in low-carbon infrastructure, industry and communities; instead, the UK reverted to an iteration of its previous, financialised form, propped up by consumer debt (see above). This opportunity remains. Growing green sectors through active domestic demand and supply-side support can positively contribute to reducing the trade deficit, as the Confederation of British Industry has repeatedly argued.[18] Boosting 'circular' economic production would not only help develop innovative sectors for the future, but also reduce current imports of materials from abroad.[19]

As the United Nations Environment Programme argues[20], the successful targeting of government levers such as direct public investment, regulatory and tax measures are essential to incentivise private investment in green sectors and create sufficient consumer demand, on the timescale required. An industrial strategy is essential to closing the green investment gap; the latter is itself essential to achieving economic success and resilience in the medium to long term.

WHAT KIND OF INDUSTRIAL STRATEGY CAN ACHIEVE THESE GOALS?

Although there are competing definitions, it is generally agreed that an industrial strategy should set out how a national state (or other public authority such as a regional or local government) is to intervene to shape the productive capacity of the economy.

From some economic perspectives, states should only intervene to compensate for market failures, such as poor access to information or credit, lack of coordination, or failures to provide appropriate education, infrastructure, or investment in research. According to this view, state intervention should treat the economy as a single system, with policies designed to benefit all parts of it equally. This type of industrial policy is known as "horizontal", as it cuts across industries. In this, perhaps the dominant paradigm of current economic thought, a focus on particular sectors or regions is dismissed as mere distortionary interference in the decision-making ability of markets. This approach has, for the reasons stated earlier, failed.

In contrast to this view, it can be argued that market failures are the norm and markets are generally poor at identifying and delivering structural changes. This view calls for public intervention in specific industries whenever it can enhance economic activity and deliver more and better jobs. This type of "vertical" industrial policy is often referred to as "picking winners", a piece of journalistic shorthand used to describe the Harold Wilson government's attempt in 1975 to provide support for some companies, which were chosen on an assessment of their long-term viability[21]. It can include government intervention to stabilise threatened industries, such as the package suggested when Tata Steel threatened to leave the UK, risking thousands of jobs.[22]

The distinction is not as sharp as the nomenclature suggests, as horizontal measures can often also have a vertical element. For example, liberalising financial markets affects the economy as a whole, but serves principally to boost the financial services sector. More often than not, states have created waves of innovation in new activities through public funding and support. What distinguishes one strategy from another is not vertical vs. horizontal but rather the degree and scale of "picking winners". Examples include the coalition government's active support for new creative industry clusters,[23] the EU's support for farming through the Common Agricultural Policy (CAP) and the US government's pivotal role in developing shale gas extraction.[24]

There have been fresh attempts to broaden the scope and objectives of industrial policy, notably by the OECD.[25] Accordingly, metrics other than GDP – such as measures of wellbeing[26] – should be used to assess economic performance. According to the Industrial Strategy Commission, basing decisions on commonly used cost-benefit methodologies may undervalue outcomes that are important to future, socially just prosperity and sustainability (Industrial Strategy Commission, 2017).[27] Industrial policy should respond to a wider range of challenges than simply enhancing economic outcomes –including climate change[28] and resource depletion.[29] It should promote cohesion by reducing inequalities, boosting wages or closing gaps between different regions. And it should support forms of specialisation that enable competition based not simply on cost (e.g. through cheap labour), but on quality.

Of course, strategic choices are not made in a vacuum. They are constrained and shaped by external forces including globalisation and climate change, as well as by the capabilities, institutions and economic history of a country or region. In addition, industrial policy is closely linked with all facets of public policy and therefore requires a high level of coordination between different actors, including the public sector, the private sector and wider civil society.

In summary, we can broadly define an industrial strategy as *the use of public policy tools to shape our economy – deciding what we produce, where and how – for delivering societal goals that match our collective aspirations.*

THE NEED FOR A PLACE-BASED INDUSTRIAL STRATEGY

Critically, there is now a growing recognition that industrial policy must start from places (regions and communities), their needs and their capabilities, rather than from the national level. Every place needs a tailored approach. This should recognise that, while some things apply generically (such as decent digital & transport infrastructure; national pay levels, fair working conditions and enforcement of equal rights legislation), local industrial strategies should be rooted in the specific needs and assets of each area.

Too often we conceive of 'one' industrial strategy for the UK as a whole, but it is more instructive to envisage a suite of local/regional strategies that sit underneath an overall strategic approach from government. This requires a more sophisticated set of principles to successfully guideindustrial strategy – namely, a commitment to:

- ensuring that local people and institutions are at the decision-making table and have power to shape policy and practice;

- delivering good jobs (defined as: voice at work, fair and decent pay, regular hours, fair treatment and respect, healthy workplaces, and learning and progression);[30] and
- ensuring that local people benefit from the value and wealth generated in their areas.[31]

Overall, the mission of a UK industrial strategy should be to promote prosperity through resilience, social justice and ecological sustainability. We have briefly explained the rationale for these goals. We now consider how to achieve them, and show why and how they can be achieved largely though measures that are place-based, smart and diversified, with local people in control.

A PROSPEROUS AND RESILIENT ECONOMY

A resilient macro economy depends on geographical rebalancing – so that economic performance is more equally spread among all UK regions. This involves supporting the growth of existing sectors as well as building new sectors, in order to provide the maximum possible number of good jobs across regions and particularly in marginalised areas. The aim is inclusive growth with local and regional diversification that reduces the exposure of communities to income and employment risks when sectors or activities move or shut down.[32]

It has sometimes been argued that public resources for economic growth are best focused on major cities, where 'agglomeration' effects can be reinforced. But there is evidence that medium-sized cities can also achieve rapid growth in activity and output, particularly where high levels of connectivity exist.[33][34] At the same time, new technologies have made it possible to site industrial and service sectors in smaller towns and rural areas.[35]

The UK outside London has significant economic potential for growth. The north of England alone has five major cities, home to 11 million people: if it were a country in its own right, it would be the eighth-largest economy in Europe.[36] Scotland's economy also enjoys a far better sectoral balance than the UK as a whole, with almost half of all jobs created since the recession being outside the service sector.[37] A sharper public policy focus on encouraging investment in the UK's regions outside London and the South East – through infrastructure spending, skills and industrial policy, and the devolution of economic and taxation powers – has the potential to deliver significant benefits not just to those regions, but also to the UK economy as a whole.

A MORE EQUAL ECONOMY

This involves promoting greater equality between regions and different social groups, and ensuring that those who are currently disadvantaged are not left behind. It means promoting equality of access to good jobs, decent wages, education and training. It requires close co-ordination with other policy areas, as noted above, to ensure that industrial policy goes hand in hand with policies to promote health and wellbeing, decent housing and transport across regions and groups.

Crucially, the aim must be to ensure that communities across the country feel in control of their economic destiny, rather than at the mercy of economic forces beyond their control. This calls for active participation by workers and other residents in key decisions, both in strategic planning forums and in the workplace.

It is also important to anticipate and adapt to the implications of future changes in industry and the labour market, for example through increased automation, and to adjust policies to ensure that risks and benefits are equally distributed. As NEF has argued elsewhere, proactively moving to a shorter working week is one option here.[38]

A SUSTAINABLE ECONOMY

A sustainable industrial strategy will give priority to decarbonising the UK energy system, and maximise the potential – for the economy and for employment at national and regional levels – of the generation and supply of renewable energy as well as energy efficiency measures. The ecological footprint of all sectors must be steadily reduced on both the input and output side. This means reducing greenhouse gas emissions and supporting the use of renewable materials across all sectors. It calls for support and development of circular economy measures across UK industries, for example through 'industrial symbiosis', where one producer makes use of outputs and by-products of another producer. The UK should become a world leader in cutting-edge environmental technologies, across all major industries.

A PLACE-BASED STRATEGY WITH LOCAL PEOPLE IN CONTROL

Economic theories of regional development predict that, left to their own devices, markets will tend to concentrate, rather than diffuse, economic capabilities. If the aim is to reduce geographic imbalances, there must be active planning and public intervention to steer, shape or even curb market forces.

Faced with this dynamic, policy-makers have, broadly speaking, two options. The first, which has been the implicit choice of successive UK governments, is to let economic concentration run its course in the name of efficiency and to address grievances of left-behind areas and communities through policies that are "place neutral". These are UK-wide "parallel" measures that aim to help people regardless of where they live, so that they can acquire the skills and capabilities they will need to move to wherever better jobs are located. The effect is to strengthen, rather than curb, disparities between regions and communities by growing the richer, highly performing agglomerations.

The second option is to create a range of centres for economic development across a territory. This view accepts that agglomeration can bring efficiencies and is to some extent inevitable (Swansea or Newcastle will never be as rich as London, nor rural Devon as rich as Bristol), but recognises that economic dynamics are fundamentally shaped by public policy. Germany and France, for example, have both managed to facilitate multiple successful agglomerations; not all are equally wealthy and successful, but economic activity is sensibly distributed across their respective territories.

This second option favours “place-based” development, through policies that aim to stimulate economic activities and sectors within specific geographical boundaries. A place-based approach acknowledges that local and regional development patterns are historically dependent on institutions, local resources, and sets of knowledge and skills. Because these long-term determinants are place-specific, the objective of policy should be to build on local and regional assets in order to deliver better economic outcomes.

There are several reasons to favour place-based over place-neutral policies. First, the latter have so far failed to help peripheral regions or their residents: if the aim is to enable people to take more control over their economic destiny, then this is best achieved through active participation in place-based development. Secondly, the experience of other countries suggests there is no need to sacrifice economic efficiency for policies to develop lagging regions and communities: the German economy, for example, is performing better than the UK’s on virtually all counts while actively supporting industrial development across its regions. Thirdly, UK-wide approaches have in fact been far from place-neutral. Per capita public spending on education and infrastructure is far higher in London and the South East than in the Midlands or the North.

Finally, continuing on the same path is politically toxic, particularly in the context of leaving the European Union. Brexit means losing access to EU Structural Funds, which precisely focus on poorer regions, so that marginalised areas are bound to lose jobs and income unless the UK adopts a new approach to regional development.

A genuinely place-based approach will enable local areas and regions to grow and enhance their economic capabilities, through interventions that are not based simply on national priorities. It will start from the respective knowledge, experience and capacity of each locality. It will value and build upwards from essential sectors that support everyday life, known as the ‘foundational economy’ (see below).

To achieve this, it will give priority to engaging and empowering local people – workers, residents, businesses, the community and voluntary sector and the public sector – in designing and delivering change. Recognising the dynamics of control will be essential (as we argue below).

A place-based strategy must also be equitable. The aim is not to leave people to fend for themselves at local level, or to enable better off communities to thrive while others struggle in poverty. Overarching national policies have a key role to play in ensuring that infrastructure, services and other resources are distributed across the country to counteract existing inequalities, so that disadvantaged areas are not left behind.

SMART SPECIALISATION – OR A GROUNDED INDUSTRIAL STRATEGY

In line with a place-based framework, an industrial strategy that aims to deliver positive results for people and communities must build from the bottom up. It must start by understanding the full range of assets, skills, sectors and supply chains that already exist in different local and regional economies, rather than imposing specialisation choices from the top.

This approach draws on recent academic and policy evidence, which has been promoting, notably through the EU Cohesion Policy, "smart specialisation".[39] The fundamental idea is that industrial policies should build explicitly on a region's existing economic structure.

For example, strategies that aim to upgrade a region's productive capacity towards higher value-added products should identify and exploit technological and market opportunities that are consistent with that region's existing industries, skills, knowledge and wider assets. Similarly, enhancing a local area's value chain would typically start from existing activities and attempt to link supply chains to them. For example, an agricultural area could develop a food processing industry that links existing sectors and assets with new value chains.

It is important to avoid over-dependence on sectors that may eventually fail, or move elsewhere as a result of international competition. Smart specialisation therefore calls for diversification strategies, provided these are compatible with existing local skills, knowledge and business capacities. Engaging and empowering a wide range of local stakeholders will be essential to achieve this.

Spreading innovation and advanced technology is vital for the UK economy, which is better placed to compete on quality, through frontier technologies, than on price. Initiatives such as Innovate UK[40] and the Catapult Centres[41] are useful in this respect. However, getting the right approach to innovation is all-important.

Efforts to create high-tech clusters from scratch are likely to fail unless they take full account of local assets and circumstances. Not only would such clusters be unlikely to provide enough income and jobs for the local population, but evidence suggests that spreading proven innovation and technologies across existing sectors is more effective for local development than focusing solely on cutting edge innovation. The UK economy has so far been better at generating innovations than at spreading them across different sectors of the economy, or through small and medium sized enterprises (SMEs). A strategy that gives priority to generic innovation is not viable; one that seeks to generate jobs across sectors within regions, for workers with all levels of skill, is much more likely to succeed.

Focusing on the 'foundational economy' is an important place to start.[42] This is described as 'the sheltered sector of the economy that supplies mundane but essential goods and services such as: infrastructures; utilities; food processing, retailing and distribution; and health, education and welfare.' According to Williams and colleagues, who have theorised this approach, it is important 'because it is used by everyone regardless of income or social status, and practically is a major determinant of material welfare.' It employs around 35% of the working population, compared with 8% employed in manufacturing. It follows that a key dimension of smart specialisation should be to strengthen these sectors and develop them in ways that ensure they meet local needs and retain value within localities (ibid).

We set out below two examples of smart, place-based strategy: the historic transformation of the Ruhr in Germany[43] and the Blue New Deal, an action plan for coastal communities in the UK.[44] In the first, the policy choice was to create a new sector. The second focuses on upgrading the capacity of existing sectors, expanding markets for them, and building supply chains to keep resources circulating locally. Both approaches are important. However, as the Resolution Foundation recently commented, "Higher pay won't simply trickle down to retail and hospitality from banks and advanced manufacturing". Instead, "the hard yards of investment in skills and machines" are needed in those sectors too, to help boost pay across the board.[45]

In any event, a smart, place-based approach is inherently bottom-up, with local SMEs, larger corporations, public representatives and local communities identifying the respective needs and assets of their areas. This can only be achieved if there are local and regional institutions through which appropriate industrial strategies can be designed and which can liaise with central government to support their implementation. In the final section, we turn to the components that are needed to make this approach work at a local level: strong local institutions; access to finance, support for SMEs, changes in systems, culture and practice, and support from national government.

Example 1: Transforming the Ruhr

The response of the German government to the decline of steel and coalmining in the Ruhr typifies the smart specialisation approach. As the traditional labour market went into crisis, the response of local, regional and national government was to embark on a policy of "transformation from within". From the start, this focused on diversification, launching new economic sectors and creating technology parks clustered around regional universities. However, policy-makers quickly realised that this approach would not be sufficient for providing local jobs, firstly because it was detached from the region's labour skills and traditional industrial knowledge, and secondly because the new activities were not labour-intensive. Successful transition was instead achieved through developing, among other things, an environmental management industry.

The choice responded to local demands for ecological restoration in an area that had been heavily contaminated by the old industries. Critically, it also matched the accumulated know-how and skills of the region, which could be transferred to environmental management and associated technologies. Industries in the Ruhr had already developed waste management techniques, had experience in building elaborate ventilation systems for mining, and already specialised in dealing with and transporting hazardous waste. In short, the choice was based on existing assets, which could be transferred to new, viable activities and further developed.

The German state not only supported the creation of this industry, but also progressively steered the sector towards national and international markets. This was notably achieved through local links with universities, technology parks and other research institutes, which contributed to the roll-out of innovative products. The Ruhr has now become one of Germany's major hubs in environmental management technologies, with its industries well placed to diversify into renewable technologies and energy efficiency markets as the government develops its energy transition policy to replace fossil fuels and nuclear power.

Example 2: Blue New Deal

The New Economics Foundation has been working with disadvantaged coastal communities across the UK to develop ways of building robust, sustainable local economies. Its 'Blue New Deal' is described as an action plan but has many features in common with a smart, place-based industrial strategy. It has four key objectives:

1. Local people need to be in control, leading a new approach to regeneration.
2. Coastal communities need to work together to explore how different areas of the coastal economy – including tourism, energy, fisheries, and aquaculture – can help inspire and support each other, to turn again to the sea for jobs and economic prosperity
3. More needs to be done to support coastal areas to plan for a changing coast. Proactive and innovative approaches are needed to help make the UK coast more resilient to climate change.
4. Government must build the capabilities of places, people, and communities; support projects, small or large; and ensure there is the digital and transport infrastructure that communities need to thrive.

It recognises that, while coastal communities share many characteristics and can learn from each other, they have assets and challenges that are locally specific. People who live in each community are best placed to decide how to build on local assets, and to define local success. They need support from local and national government to build capacity and opportunities to shape their local place and economy, as well as more control over the public goods and services they rely on, such as housing, energy, land and transport. They also need national government to support and build strong local institutions, to develop infrastructure geared to local needs, to ensure access to finance for SMEs and to construct an appropriate regulatory framework.

The Blue New Deal focuses on four areas of the coastal economy to build local employment: tourism, energy, fisheries, and aquaculture. It points out that, by working together, these can be mutually reinforcing and support innovative business models. For example, innovative marine energy projects, such as tidal lagoons, offer wider opportunities for coastal regeneration, including a range of tourist attractions.

This is a holistic approach, addressing the everyday needs of local people and promoting sustainability. For example, alongside sectoral development, the Blue New Deal includes plans for retrofitting local homes as well as defending the coastline from rising sea levels.

Local plans are encouraged to support a diverse network (in sector and scale) of businesses and organisations, which are well connected by short supply chains, so that money keeps flowing into the local economy as much as possible, rather than leaving the area straight away. This strong 'multiplier effect' can be achieved by channelling public and private sector procurement through SMEs.[46]

SUPPORTING SMART, PLACE-BASED INDUSTRIAL DEVELOPMENT

STRONG LOCAL INSTITUTIONS

An effective strategy needs local institutions that are able to champion local interests, liaise with central government and co-ordinate activities between organisations at different levels – from a position of strength. Local Enterprise Partnerships (LEPs) lack sufficient power, clarity of mission and resources to provide a useful model here;[47] the National Audit Office has expressed concern over whether they provide value for money and have sufficient capacity to deliver.[48] Regional Development Agencies (RDAs) were flawed, not least by poor levels of engagement and accountability, but probably fitted these requirements more closely, until they were abolished in 2010.

Local government, as it currently stands in the UK, does not have enough capacity to plan or deliver place-based industrial strategies. It lacks sufficient power and resources. Local councils and their partners are expected 'to respond to ever growing social care demands with dwindling funds, develop plans to economically regenerate their areas with limited and fragmented powers and provide homes to their residents in an absurdly complex and highly politicised regulatory context'.[49]

The UK affords its regions and localities much less administrative and tax raising powers than most other European countries, and 'devolution deals' struck between Westminster and the regions are focused fairly narrowly on requiring what powers are granted to be used to boost GVA. Powers of governance tend to be correlated with the distribution of public resources and it is notable that, since devolution, Scotland, Wales, Northern

Ireland and London have each received around twice as much public investment per head as the rest of England outside London.[50]

Local authorities are often at the mercy of "one size fits all" central government policies so that they cannot customise support for an area's particular requirements. This means, for example, that provision of education and training may not respond adequately to the specific needs of local sectors. If local authorities are to be strong enough to deliver smart, place-based industrial development, they need central government to devolve the necessary tools and levers to them. More local autonomy is needed over investment and planning, not only for industry, but also for education and skills development, transport, housing and land-use.

Local autonomy must be firmly embedded in an inclusive, participative approach to decision-making. Institutions must move beyond routine 'consultation' and strive to put local people in control – so that local strategies are fully informed and driven by their knowledge, assets and experience. This means putting the idea of local control at the centre of the process of developing local industrial strategies. It calls for a nuanced understanding of control: what it consists of and how it can be achieved.

The process of gaining and exercising control is complex and dynamic. NEF has developed a model of *collective control* (that is, where groups of people are empowered to act), which is set out in the diagram below. This suggests that to have control, both actual control (the external conditions that make control possible) and a sense of control are required. The components of control include social connectedness, resources, capacity, status and influence, as well as feeling confident that it is possible to make or influence change.

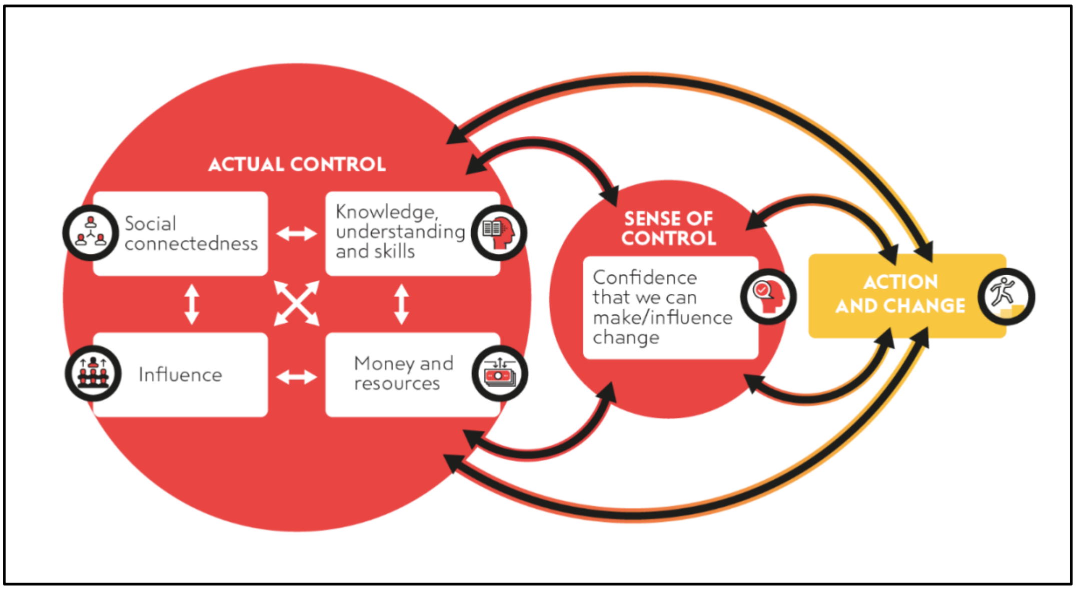

Figure 2: NEF's dynamic model of control[51]

In summary, local – and regional – institutions will need the following attributes if they are to provide effective support for place-based industrial development:

- Participation from democratically elected local politicians as well as trade unions, employers and representatives from the third sector.
- Time: funding and accountability structures that allow for serious horizon scanning and planning for future trends, looking to 2030 and beyond.
- Money: financial resources to properly fulfil its functions.
- Powers: to act locally as the coordinating body for infrastructure investment, skills coordination, coastal management and social partnership approaches to industrial transition.
- Accountability for its decisions.
- Improved ability to work more closely with neighbouring areas.[52]

ACCESS TO FINANCE

The failure to decentralise financial tools and mechanisms has seriously inhibited local development. The UK banking sector is highly concentrated and notoriously poor at channelling loans to SMEs, particularly in peripheral regions.

The UK market is overwhelmingly dominated by national and often internationally orientated banks. Approximately 67%, 57% and 34% of the banking systems in Germany, Japan and America respectively are locally controlled, compared to just 3% in the UK (see Figure 3 below).

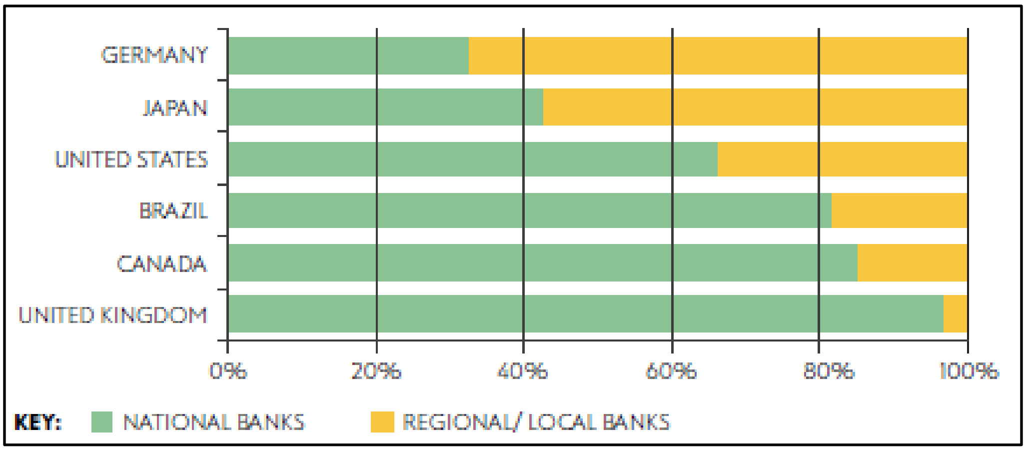

Figure 3: Banks' market share of deposits by geographical scale[53]

In other countries local banking sectors play a key role in promoting local economies, and these banks are often characterised by stakeholder ownership and governance – in other words the mission of the bank is not to maximise profits but to optimise returns to a range of stakeholders, including customers and the broader local economy. These often take the institutional form of co-operatives, mutuals and public savings banks.[54]

Empirical studies from European countries have shown that geographically-limited stakeholder banks help reduce 'capital drain' to urban centres and thus regional inequality, and other studies have shown that such banks direct a much greater proportion of their capital towards real economy lending.[55] Local sources of finance are often an important determinant for economic development by creating and retaining wealth regionally rather than reinforcing existing geographic lending imbalances.

So far, the UK has failed to create a national development bank – even though it is a tried and tested public instrument. To do so would be a step in the right direction. Public authorities could also impose on major national banks a mandatory requirement to lend to SMEs, for example setting a specific proportion of total lending to be allocated to SMEs.

The creation of local banks could be an even more effective solution to this problem.[56] Across Europe and the US, successful industrial strategies have relied on localised banking systems to provide long-term finance to SMEs at a reasonable cost. Figure 4 shows the recent sharp decline in investment in SMEs by the Royal Bank of Scotland (in green, bottom line) compared with German stakeholder banks (in red).

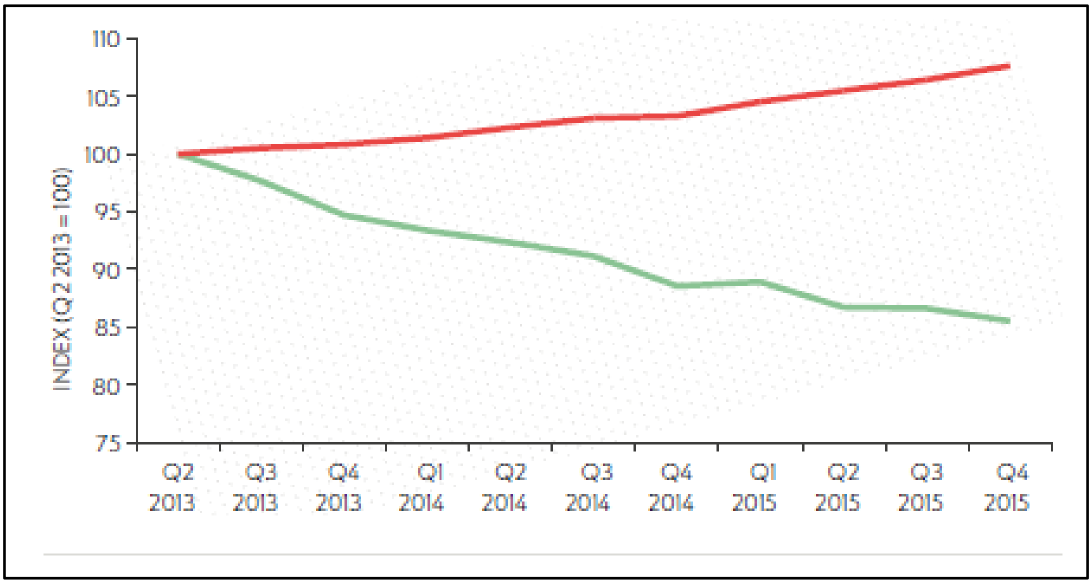

Figure 4: SME lending: Royal Bank of Scotland and German stakeholder banks [57]

Local banks can take various forms, ranging from stakeholder banks, to credit cooperatives. What they usually have in common is a specific geographical remit and the involvement of local stakeholders, including public officials, business representatives and workers, in their decision-making.

SUPPORT FOR SMES

SMEs have a central role to play in smart, place-based industrial development, in all areas – but especially in parts of the country where there are no major industries.[58] As well as access to finance,[59] they need institutions that are able to provide services they cannot afford individually, or that the market underprovides. These include market intelligence, notably regarding export markets, supply-chain linkages, or diversification options. In other countries, this is provided through complex webs of cooperative organisations and public institutions.

In the UK context, the creation of SME joint cooperatives, grouped by their geographical location and the sector in which they operate, could be a vehicle for pooling funds in order to arrange collective finance for activities they cannot individually afford, such as research and development, consultancy services, or training. These could be partly subsidised by public funds.

Public procurement should be used strategically to support SMEs. This would help to overcome another major barrier they face: the lack of stable income streams. Only 10% of public supply chain expenditures currently flow towards SMEs. This practice will be especially important in poorer regions, where there is less guaranteed demand for products and services. It could incentivise investment and innovation by creating relatively stable market outlets and income flows, thereby reducing uncertainty. So-called “anchor” institutions, such as large local CVS organisations and universities, could also use procurement to support local SMEs.

TAILORED SKILLS

In some regions in the UK, such as the West Midlands, the skills budget has been devolved to an elected mayor and combined authority. This could give regions greater ability to tailor their approach to skills development based on the bottom-up, grounded industrial strategies unique to their area. Where such regional authorities do not exist, it is important to have local institutions empowered to develop these strategies (see above).

For a tailored skills approach to work, it is crucial that education institutions, employers, local government, unions and workforces are genuinely able to participate in its development. Voluntary efforts by trade bodies or particular education institutions are to be welcomed and supported with funding. An intentional and coordinated approach is essential to ensure better business-education partnerships can help shape provision to meet future opportunity and needs so that young people can access opportunities.

CHANGING SYSTEMS, CULTURE AND PRACTICE

In addition to strong local institutions, access to finance and support for SMEs, local systems, culture and practice will have to change if they are to provide adequate support for a smart, place-based industrial strategy. For example:

- Local authorities, anchor institutions and their partners in business and civil society must be able to work together collaboratively, putting local people in control, and engaging all local stakeholders in identifying local assets and deciding how to build on them.[60]

- Planning must be for the long term and anticipate impacts on local people and on the environment. In all matters, priority must be given to local early action to prevent harm (rather than coping with the consequences),[61] and promoting social justice and ecological sustainability.
- Close attention must be paid to how resources flow through local economies, and how to capture revenues for local reinvestment for the benefit of local people.[62]
- Relations between workers and managers in the workplace should move towards greater equality, both by narrowing pay ratios and by applying the principles of co-production to decision-making.[63]

SUPPORT FROM NATIONAL GOVERNMENT

In all this, there is a crucial role for central government. In the first place, it will provide a framework to set direction and coordinate the development of industrial strategies across regions and localities. It will need to distribute national resources effectively to support smart, place-based development on an equitable basis.

Through collaboration and support, it must ensure that local and regional industrial developments deliver results that are consistent with national goals and targets for promoting prosperity, greater equality and ecological sustainability.

Central government will play a critical part in building appropriate local, regional and sectoral institutions, with sufficient powers and resources to support place-based development. It can ensure that these institutions have a firm commitment to engaging local people in decisions and actions, not as a box-ticking exercise, but as a clear pathway to local control. It can use its powers of resource distribution and regulation to make sure that industrial strategies focus on the foundational economy and become a route to better jobs and working conditions, especially for those who are currently disadvantaged.

Through the National Infrastructure Commission, it can ensure that infrastructure development properly engages with and helps to fund local plans; by reforming the law around Compulsory Purchase Orders, it can help direct housing development to benefit local people. It will be responsible for keeping developments under review and enabling regions and localities to adjust and improve their performance over time.

Last but not least, as plans to leave the European Union are eventually realised, central government will need to replace EU funding with long-term funding support for research, innovation and more equitable regional development.

CONCLUSION

The phrase 'industrial strategy' means many different things to different people. To some, it is about 'picking winners' and interfering in the natural selection processes of the market. To others, it is about massive investment in high-tech sectors as a way of kick-starting and shaping the wider economy.

In this paper we have made the case for a different emphasis. We believe the only way of achieving an industrial strategy that secures a prosperous, socially just and sustainable economy is by starting with the needs of existing local economies and communities and building from the bottom up. By putting people and places first, a UK-wide industrial strategy would look very different in different parts of the country. National government's role would vary depending on the local context. And the degree of investment in particular sectors would not be uniform across the country. There would still be an important place for investment in the more glamorous and high-tech sectors, but the need for that investment would be driven by local knowledge, need and priorities.

If this approach is adopted, we would start to see real control being exercised over local economies by local people. Everywhere, local institutions would be supported to plan for economic success based on the real needs and participation of its people. Regional inequalities would diminish as grounded economies would be given the space to flourish according to their own logic and criteria for success.

A place-based, people-based industrial strategy is the only way to lay the groundwork for a sustainable, fair and prosperous economy. By putting people and places first, we can take the first steps towards a new economy that genuinely works for all.

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