Policy by lists – the Green Paper and the new industrial strategy

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It is often a good guide to new policy initiatives to jot down the list of things proposed - the list of new initiatives, reviews, funds and institutional reforms - and then try to work out what they have in common. Sometimes governments start with a clear rationale, but even then the lists tend to take over. It happened with the National Infrastructure Plan. In the latest Green Paper *Building our Industrial Strategy,* January 2017, there is stuff about "active government", a "fairer Britain that works for everyone" ensuring that "more people in all corners of the country share in the benefits" "beyond short term thinking to focus on big decisions that will deliver long-term sustainable success". The government is going to "build on our strengths and extend excellence into the future", ensuring that "every place meets its potential" making "the UK one of the most competitive places in the world to start or grow a business".

Few could disagree with any of this. But that is precisely the problem: it is a commitment to everything and everybody, not a strategy. It is therefore unsurprising that the Green Paper lists out in 135 pages a complexity of ambitions, pledges, re-announced funding and public expenditure, around its 10 "headings". No wonder it got such a mixed press.

A second guide to such policy initiatives is to take a look at the pictures. Pictures tell a story, and the pictures in the Green Paper are good. But the more pictures, the more the "story" takes over from the formal substance. In aggregate, this Green Paper has 25 pages of pictures. 10 whole pages are given over completely to pictures. It is worth calculating the ratio of pictures to text. Take out the repetitions and bureaucratic stuff, and it is around 20% of the whole document. It is up there in the top list of picture-driven government papers.

Make no mistake, Britain needs an industrial policy. But not all industrial policies are alike, and not all lists make a coherent policy framework. The requirements for a good one are: first, some clear simple objectives; next, a diagnosis of the problem to which the interventions are supposed to be answers; and then, interventions which pass the tests of being consistent with the objectives, targeted at clear market failures, and starting with those with the greatest expected net present values. The Green Paper fails on all three.

The objectives

In the Green Paper, the objectives are messy. The forward from the PM and introduction from the Secretary of State noted above are like almost all current government aspirations understandably obsessed with BREXIT. But it is not clear that BREXIT makes a business strategy any more necessary than it was before BREXIT. Britain needs competitive industries whether or not it is in the EU.

What really turns the Green Paper into a list is that it aspires not only to deal with low productivity and competitiveness issues (more on this later), but the muddle of introducing the mantra that the industrial strategy must be "for everyone". It has explicit regional and distributional aims. Between the lines it is anti-London and pro the "just about managing" who have now become the "ordinary working families" and indeed in the sister Housing White Paper "the working class" for the PM.

There is of course nothing wrong with looking after those "left behind" and the "working class". On the contrary, this may turn out to be a shrewd political position to move the Conservative tanks onto the muddy patch that passes of the Labour Party's lawn.

The point is rather that it is not entirely clear why this distributional priority is at the heart of the problem to which the Green Paper is supposed to provide answers. In particular, the distributional aim is probably best met by a policy of raising wages for these groups and redistribution. The Green Paper does not explain how higher wages and more progressive taxation are going to make Britain's industry more competitive, desirable as these objectives may be in political terms. Rather it echoes the attempts by Gordon Brown to disguise higher welfare spending (notably on health) as designed to encourage "endogenous economic growth". It is better to be honest: if redistribution is the objective, then use re-distributional policies, but don't pretend that they will have the happy consequence of making Britain more competitive. Efficiency and equity often conflict and trade offs are unavoidable. Sadly everyone can't have everything all the time.

The regional aim is also political, and indeed its political significance was reflected in the votes for UKIP and BREXIT in the General Election and then the Referendum. Britain's economy is unbalanced, but then so is Germany's and indeed Europe's and the US'. Greece is not less competitive than Germany because Europe's industrial policy is not encouraging more cutting edge manufacturing firms to relocate to Athens. Munich, Stuttgart and Frankfurt are not better because the German Government has unfairly favoured them. Sad though it may be, the fact is that there are very good reasons why London is a leading world city, and a leading competitor in finance and services. Relocating banks and legal and accounting firms to Bury or Halifax or Blackpool is not going to make the British economy more competitive.

Diagnosing the problem

The Green Paper does recognise that the core problem is all about low productivity. This was a problem long before BREXIT. Governments of both political persuasions have tried to address it for decades, from Harold Wilson's "white heat of technology" through Margaret Thatcher's privatisations to Gordon Brown's endogenous economic growth. Regional policies have been tried for decades, tested and are widely deemed to have failed. The salutary point to keep in mind is that none of these government-driven initiatives has made much difference – productivity appears largely immune to government encouragement. But it is worse: not only has government made little positive impact, from time to time it has made things worse, and sometimes a lot worse.

So what exactly is the productivity problem? Why do some countries have higher productivity than others? How does the Green Paper tackle this, before moving on to list out all its policies? Perhaps surprisingly, there is little agreement as even how to measure productivity, and hence whether there is really a problem at all. Productivity is what it says on the tin: the ability to turn inputs into outputs for which there is demand, and at costs which are competitive with rivals.

You might think that the Green Paper would start with these inputs – capital, labour and ideas. In the 1960s and especially in the 1970s, the problem was thought to lie with capital and the financing of industry. Harold Wilson was obsessed with "short termism" in the City. Wilson was also much focussed on capital scale, and encouraged the formation of great national champions, most notoriously in the car industry. Tony Benn thought that the commanding heights of the economy could be state-directed through a state national plan. (Earlier in the 1960s, George Brown had built hopes on comprehensive national planning).

Perhaps British industry does not invest in the right sorts of capital? Perhaps it is investing in services rather than in new technologies? Perhaps it is not digitalising as fast as German companies? A moment's reflection on the relative ability of the state and the private sectors to pick winners should give pause for thought. It is not that the private sector is particularly brilliant at picking these. Indeed capitalism is very much a process of creative destruction: lots of losers are tried, tested and fail. The trouble in the public sector is that governments are tempted to try losers, test then and then bail them out.

Lobbying, vested interested and capture – the herd of elephants in the room

The selection of investment problems is a different one, not recognised in the Green Paper. It is not just that governments are particularly bad at this, but rather that losers are particularly good at picking governments. Governments succumb to the lobbying and vested interests for two very good reasons: they are captured by these interests; and the political pressures in a geographical constituency system give losers a much bigger voice than gainers.

Capture is pervasive and given too little consideration. It works in lots of different ways. There is the outright role of money. Examples of the big chasers of government subsidies (often presented as government industrial policies) include the renewables industry, the farming industry, the pharmaceuticals industry and the myriad trade associations. Renewables UK, the NFU, the BMA, the Crop Protection Association are all set up to advance the interests of their members, to get things from government. All of the above are very good at it – professional, focussed, informed and excellent at media management. They are brilliant at it, and brilliantly successful. The regulators, the civil servants and the politicians play musical chairs with these interests. From energy and climate ministers to the companies they paid subsidies to, from civil servants to the consultancies and the trade bodies that lobby, and from regulators to regulatees – these transfers are all too familiar.

Then there are the political pressures. The theory of industrial policy does not survive long when faced with the reality of a steel closure, or the threat that a car company will invest elsewhere. Whatever the stated objectives and the rhetoric about keeping out and allowing market forces to work, most industrial policy is diverted to propping up lame ducks. There is a very long list right back from the 1960s of lame ducks that eventually had to put out of their miseries. There is nothing in the Green Paper to suggest this is now going to change much, and picking sectors rather than industries or companies is unlikely to withstand the political heat of the losers in declining businesses. Jobs trump competitiveness, and once the constraint of EU State Aids regulation has dropped away, the Green Paper may become a licence to intervene.

Skills and the labour market

Perhaps then poor productivity is not about capital, but about labour, and in particular about a work force ill-equipped to compete internationally? It is of course easy to say that the workforce needs more skills, and industry will always want the government to bear the costs of training its workers. Yet this is not new. It was a worry throughout the twentieth century, and there have been more attempts to address the "skills crisis" than almost any other aspect of productivity.

It is of course true that the government needs a strategy on education and training. It does a lot of it. Some it does well, and some badly. It can always improve. This is what the educational departments and educational policies are for. Britain has world class academic universities. It wins lots of Nobel Prizes. It does not have such good technical universities. Germany is better. Hence the easy and lazy argument that if only we kept the academic leadership *and* added German style technical universities, all would be well.

If only it were that simple. The recruits to industry are the outputs of the educational system considered *as a whole*, from nurseries through to universities and technical colleges. It is not an accident that the reshaping of higher education and training has been a recurrent theme for decades. Britain's educational system leads the world in the frequency and depth of its reforms. We have had grammar schools and more technical secondary moderns, we have had comprehensives, free school, academies, national curriculums, and central government directions on everything from STEM subjects to sex education, we have had universities and polytechnics and then just universities. We have even made a university degree necessary for nursing, and turned agricultural colleges into universities too. We have had O levels and A levels, and GCSE's. We have tried to give everyone high grades in GCSEs, A levels and in degrees.

There is still lots of scope for improvement, but it is obviously not for want of trying. It is hard to think of anything we have not tried already. The Green Paper majors on this, but it would not be unduly sceptical to expect this effort to go the way of so many predecessors.

Technologies

Where the Green Paper might be expected to give a clear lead is on the transformation that digitalisation is bringing. It does not need a horizon scanner to see that robotics, 3D printing and Artificial Intelligence (AI) are going to revolutionise industry and eliminate lots and lots of jobs. Politicians want to be seen to be “the future”, and to align with the new technologies, but over decades they have had little idea how to identify the winners and work out why they have something to offer. The Wilsonian “white heat” should give serious pause for thought.

The hard answer is that innovation, the so-called “valley of death” for new companies, and the growth of new enterprises is better done by the private sector, whilst the basic research upon which these innovations are built on is better done by the public sector. It is the old distinction between primary research and industry. Successive governments have undermined this, trying to move research funding closer to “near market” areas. This has not had many happy outcomes. What the private sector cannot easily do is absorb the sheer waste that primary research involves, nor capture the public goods that new knowledge represents. This is what the great universities are for, why innovative companies locate on their science parks, and why their spin-offs are so valuable. A good industrial strategy reinforces the enormous R&D capabilities in these world leading institutions – and the international researchers upon which it relies.

General, not specific interventions

Education and skills policies are inescapable and they can always be done better, even if well-intentioned interventions often have made the outcomes worse. Where the Green Paper is on more solid ground is when it comes to the infrastructures within which companies have to operate – the energy, water, transport and communications networks. This government and its predecessor have rightly identified infrastructure as a core part of industrial strategy and of productivity, even if the exact relationships are hard to pin down. Get this right and the government would achieve a step change for industry.

The important point is that infrastructures are *general* purpose, supporting *general-purpose* technologies (just as skills and R&D are best thought of as *general* too). These are the essential assets for competition and markets to function effectively. They are not the same as "sector-by-sector" partnerships and deals, whatever these mean. They are not "winners" or "losers".

The job of government is to ensure these general frameworks for businesses are in place, on a non-discriminatory basis. This is a world apart as an objective from playing out a pork-barrel game for *specific* subsidises to whichever *specific* sectors and *specific* companies can lobby hardest and do the best job of capturing ministries and regulators.

What assets do businesses need government to ensure are in place and in good shape? The way to think about this is to concentrate on the different sorts of capital. The main ones are: natural capital; physical capital; and human capital. Natural capital is essential for business. Clean and abundant water, waste disposal, river catchments protected from flooding, and especially clean air, are all essential. Physical capital in the form of energy, transport, water and communications networks are both essential and at best in patchy supply. Then there is human capital, and the role of R&D, innovation and skills discussed above.

Getting these general-purpose assets in good shape is a big ask, and just getting this right would make a big difference to the key identified problem in the Green Paper, productivity. To this can be added the institutional and tax characteristics of markets, notably competition and corporate law.

A litmus test for the Green paper is therefore: does it sort these problems? The answer is at best mixed. Instead of these being the main parts of the paper, we have 10 headline areas, which mix and muddle the general with the particular, the specific subsidy and the express intention of picking winning sectors, and supporting specific projects.

On the infrastructure side – the most important of the physical capital from a policy perspective – there is already an infrastructure plan and a National Infrastructure Commission (NIC) as well as lots of announcements in the Autumn Statement last year, and the Spring Budget in 2017. No doubt there will be more in the Autumn Budget 2017 too, and the subsequent ones. We are not short of "announcements".

The problem areas are well known: the trains are expensive and in a bad state; the energy systems are expensive and the capacity margin is close to zero; the water and flood defence systems are stretched against the growth of housing on flood plains and climate change, though they are at least not particularly expensive; and on broadband and fibre, the government and Ofcom have ducked the question of dealing with BT's market power and setting up Openreach properly in the face of BT's resistance. It is not a pretty picture overall.

On natural capital, the government has a manifesto commitment to draw up a 25-year environment plan. This hardly gets a mention in the industrial strategy, but it is key to sustainable economic growth. London and other cities' air is bad, and too frequently dangerous. The climate change targets are challenging. The wider health, recreations and leisure opportunities are at risk. The costs of getting this right are low, but the consequences of inaction are high.

Infrastructure policy is not rocket science, but it has not been a success. Why? Because politicians focus on the shorter term and when their eyes glance out ahead, it is on big prestige projects that they frequently alight. The job of ensuring adequate capital maintenance and timely enhancements requires a national balance sheet and a longer term commitment to the capital maintenance. Instead the focus is on tax and spending now, and on short term budgeting. That is why the flood defences, the roads and city transport systems lurch from crisis to crisis, and the potholes in the roads never seem to get mended. The privatised networks do better because they are out of the political cycle and the shorter term comprehensive spending reviews.

Politicians tend to confuse the expedient with the long term needs they aspire to address. Nowhere is this more apparent than in the case of broadband. David Cameron grasped that broadband is a new universal service obligation (USO). If there is any area of infrastructure that is most immediately in need of attention it is broadband. A digital economy cannot work without it, and companies' productivity is directly affected by its quality. Yet when it comes to this key aspect of industrial strategy, politicians and regulators have decided that the interests of BT's pensioners and the desire to avoid any involvement of Brussels is more important than setting up Openreach as an independent company free of BT's pensions and its other dividend and capital rationing needs. BT has won. Britain has lost out. The government has bottled out. There will now be years of regulatory haggling to try to keep up with our international competitors.

What is the consequence? It is a slower roll out of fibre, a higher cost of capital and the biasing of investment to benefit the potentially stranded copper wire assets of BT. When it comes to the most important single aspect of industrial strategy that government can and should address now, it has preferred short term narrow interests over the long term interests of the economy. No wonder productivity is low. Few would locate in Britain because of the attractiveness of its existing network infrastructures. Few will be attracted by the state of its broadband.

What next? The added problem of BREXIT

Though all of these issues are pre BREXIT, the PM and the Secretary of States are right that BREXIT will make failure even more painful than it already is. In the next few years the cash cow of the North Sea will be gone, the City of London is likely to take a big hit (from New York as much as Paris and Frankfurt) and the continuing chasm between government spending and government revenue is forecast to start rising again after 2020. Less North Sea monies, less City monies, and more debt is not an enticing platform for our post BREXIT world.

There is an argument to make that what Britain needs is a very hard and brutal shock, and that exposure to global competition without much more than the WTO trade rules will be a huge wake-up call, forcing the sorts of adjustments seen when Thatcher came to power back in the early 1980s (when 25% of manufacturing output close down within just 18 months). It could work, but it is unlikely that the political and social consequences would be the sort that the PM would want. This is a government pushing up the minimum wage to the living wage and keen to see the JAMs, the OWPs and the "working class" getting better off, having been "left out" by globalisation. This is where all the political rhetoric quoted at the beginning of this paper is most telling. A new economic model along these lines is blatantly inconsistent with the political project of the PM.

There are two ways out of this. The first is to slim down the objectives of industrial strategy from the "for everyone" ambitions and to focus directly on the productivity problem, to learn the lessons from the numerous previous attempts, and focus the resources where government can have greatest impact – *general* infrastructure, *general* education policy, *general* university support and *general* R&D funding. It has policies for all of these, as have had governments for decades. The task is to make these better, and to avoid making things worse. It is all about roads policies and potholes, standing up to BT and its pension deficits, and spending on core research without trying to micro-manage the universities. It is about an educational policy, which stops trying to have new initiatives and tries to make the schools function better, from fixing the buildings to investing in the teachers.

The other is to go down the *specific* sector-by-sector route, and risk a return to the 1970s. The jury is out. The Green Paper could go either way.