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Centre for Progressive Policy (CPP) – Invest 2035: Industrial Strategy Consultation Response

Introduction

1. The **Centre for Progressive Policy (CPP)** is an economics think tank that champions inclusive economic growth. We believe that economic growth is a force for good: it is essential for raising living standards, and it can and should be delivered in line with the path to net zero. But the default model of 'growing the pie' first and redistributing the proceeds later does not work. The benefits of growth do not trickle down and efforts to reduce high and rising inequalities through taxation and welfare only take us so far. Instead, we need a model of economic growth that unlocks the productivity potential of all people and all places. At CPP we call this model inclusive growth.
2. Our work on industrial strategy focusses on **the intersection of place and sectoral economic performance**. Our response draws from CPP's back catalogue of relevant work including on place-based industrial strategy, clusters-mapping, local government reform and devolution, and skills policy. It is also informed from insights on best practices from **the Inclusive Growth Network (IGN)**, hosted by CPP, a network of 14 local and combined authorities across the UK pioneering new approaches to delivering inclusive growth locally.
3. **This response sets out how the UK's industrial strategy should pursue its ambition to achieve sustainable, inclusive and resilient growth.** The industrial strategy should treat both place-based and sectoral economic performance as equally important, mutually-reinforcing objectives. Policy should also look beyond conventional "economic development" levers to support progress against all of the government's missions: recognising the value of, for instance, good population health and access to affordable childcare for increasing labour supply.

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Consultation Answers

1. How should the UK government identify the most important subsectors for delivering our objectives?

The government could draw upon a wealth of data to identify sub-sectoral strengths, particularly at the place level. Crucially, using this data allows us to identify opportunities for both productivity growth *and* regional rebalancing, which should be reflected in both the UK government's modern Industrial Strategy and the Local Growth Plans and devolved economic plans being developed in the nations and regions.

Recent work by the Centre for Progressive Policy (CPP) identified 95 clusters of emerging economic activity in high-value sub-sectors taking place in low productivity, low earning local authorities (LAs).

The analysis applied a number of criteria to sub-sectoral (Standard Industrial Classification, two digit) data to identify where there may be cases of emerging local industrial specialism:

- Sectors must have above average productivity.
- Regional productivity of the sector must be no more than 15% below the national level.
- Sector productivity must have grown more quickly than the national average over the past 5 years.
- Sector must be of a reasonable size relative to the local economy. (This is to filter out sectors too small to have a meaningful impact on the local economy as a whole. The minimum threshold is set at 5% of local GVA)
- Sector share of local employment must be broadly similar to its share of economic output.
- Sector share of local employment must be broadly similar to its share of economic output (This is to exclude sectors which have high levels of GVA but low levels of employment, and thus limited ability to provide sufficient employment benefits to the local economy)

The 95 clusters that this returned were based in 72 underperforming local economies – across England, Scotland, and Wales, and concentrated mostly in the North West and the Midlands. Crucially, **81% of these clusters were manufacturing sub-sectors**.

2. How should the UK government incorporate foundational sectors and value chains into this analysis?

The industrial strategy green paper defines foundational sectors as "the sectors which provide critical inputs and infrastructure to our growth-driving sectors", and gives two specific examples: energy and defence.

Foundational sectors should be viewed as strategically important for the government's industrial strategy as major employers in their own right; as contributors to local labour markets for frontier firms; and as component parts of the supply chain.

The government, working with local and regional partners, should carry out systems analyses to better understand the relationship between foundational sectors and frontier sub-sectors within local economies. Doing so would enable a greater understanding of how foundational sectors may best enable growth of frontier sub-sectors, for instance through supporting a steady flow of skilled labour, and/or developing closer local value chains. Such analysis would also help identify the opportunities for frontier sub-sectors to support wider regional growth, for instance by identifying opportunities to create good jobs in foundational sectors, and driving productivity growth and decarbonisation through the local diffusion of innovation.

We believe that the industrial strategy should not limit itself to frontier sectors and their immediate supply chains. We would expand a focus on "foundational sectors" to a broader emphasis on the "foundational economy" – those sectors which are non-tradable (i.e. must be consumed locally) such as retail, hospitality, or care.

These foundational economy sectors account for a significant share of total employment (around 40% of employment nationally): improving the economic performance of foundational sectors is critical to raising the living standards of the millions of workers employed in them. They also directly impact frontier sector growth: the education sector supports human capital development, the early years and adult social care sectors support higher levels of economic activity; while high quality local services are important to attracting and retaining mobile, high human capital workers.

For these reasons, the development of foundational sectors should be a central objective of the government's industrial strategy, demanding close alignment between the industrial strategy and the Plan to Make Work Pay (especially with its commitment to sectoral bargaining). Local and regional governments have a role to play in particular in supporting foundational sectors to embrace principles of good

work – e.g. through promoting values-based procurement in local supply chains, and supporting take up of the real Living Wage and flexible working

Government, with local and regional partners, should consider questions such as the following when thinking about the role of foundational sectors (and the wider foundational economy) within the industrial strategy:

- Are there systemic bottlenecks on local labour supply for critical sub-sectors, that can be mitigated through closer partnership working between foundational sectors and the frontier?
- How can productivity and pay be improved within foundational sectors?
- What are the opportunities for frontier sub-sectors to drive the creation of good jobs, raise productivity, and support decarbonisation, across the wider regional economy?
- What are the most effective policy levers to create a positive feedback loop between foundational sectors and critical sub-sectors driving mutual demand within regional economies, and are combined authorities (CAs) equipped with them?
- Are there geographic disparities in the strength of connections between foundational sectors and frontier sub-sectors? If so, how can policy address these imbalances?
- How can local and regional authorities be better equipped to encourage foundational sectors to adopt practises that increase job quality, such as good work charters?
- How can foundational sectors' contributions to regional economic growth be better captured?

3. What are the key enablers and barriers to growth in these sub sectors and how could the UK government address them?

Given the breadth of broad industrial sectors that Invest 2035 identifies, a "one size fits all" understanding of the enablers and barriers to growth, at the sub-sectoral level, would be too simplistic.

Even within broad industrial sectors there can be different challenges. Take the example of green industries: for the wind energy sector, futures contracting and regulatory issues are arguably of greater significance to successful scaling; in comparison, for small modular reactors (SMRs) technological risk and risk sharing may be more significant barriers.

Government has a role to play in structuring the *institutional environment* to allow for the identification and remedy of sector-specific challenges. As set out in Juhász, Lane and Rodrik's *The New Economics of Industrial Policy* (2023), coordination externalities may be addressed through the remits of Sector Councils; risk mitigated through risk pooling or public underwriting through e.g. the National Wealth Fund; or sub-sector wide public goods (such as shared curricula or qualifications) designed.

Second, we would urge the government to focus as much on spatial clusters as on sectors or sub-sectors in its approach to industrial strategy. While clusters will have a sectoral bias (e.g. towards advanced manufacturing or services), they are more cross-cutting and dynamic – avoiding both the risk of incumbent capture inherent in Sector Councils and the pitfalls of policing sectoral boundaries in a complex economy.

Further, the barriers to cluster growth may be policy levers outside of the conventional "industrial policy" toolkit, with the constraints to local growth being more tightly linked to planning or transport (see e.g. Stansbury, Turner, Balls, *Tackling the UK's regional economic inequality: binding constraints and avenues for policy intervention* (2023)).

We would advocate an industrial strategy that is as "bottom-up" as possible: beginning with a sector agnostic mapping of clusters across the UK; then identifying the cluster-by-cluster barriers to growth; before setting out UK-wide policies where cross-cutting challenges emerge or where major employers are active in multiple clusters.

Business Environment

4. **What are the most significant barriers to investment? Do they vary across the growth-driving sectors? What evidence can you share to illustrate this?**

There are a number of major constraints that limit investment for industrial growth in general (i.e. beyond sub-sector-specific factors above). They include:

a) Weak public infrastructure: The UK's public infrastructure (particularly transport), is weak, disjointed, and underinvested in. This stifles productivity growth mainly through limiting the mobility of workers to access good jobs, which reduces the effective size of local economies, limiting the agglomeration benefits of clustering. Less than 1% of South Yorkshire's population live within a 30-minute public transport journey to its Advanced Manufacturing Park.

b) Technical skills mismatch: Over a third of job vacancies are due to technical skills shortages, with some of the most acute shortages being in priority growth sectors (the current "green skills gap" is estimated to be around 200,000

workers). Looking at the green economy, as an example, there are significant gaps at the local level in where there is potential for industrial development but where a lack of appropriate skills within the labour market will constrain the scope for investment and growth.

c) Access to finance and capital: The Invest 2035 Green Paper gives the specific example of venture capital (VC) at a UK level relative to the US, but acknowledges this is largely a (South East-biased) fintech story. Evidence from Daams et al (2023) has found that since the financial crisis in 2008 capital markets have typically favoured investment in London as lower risk, and have attached a significant risk premia to commercial investments outside of London. Likewise, analysis of the British Business Bank's regional funds identified a long-term trend of shortening travel times between investors and investees, while similar research has reached similar conclusions.

d) Overcentralisation of the state: While Combined Authorities (CAs) have been a positive development, they remain limited in covering only around half of England's population, and only around a quarter of its land. The UK is also one of the most fiscally centralised OECD economies, with local leaders being relatively limited in their powers to catalyse higher investment due to an over-reliance on fragmented, short-term funding streams, and lack of permanent income streams. Local powers are limited, and they are also fragmented horizontally: resource and responsibility for critical economic development tools (e.g. planning, transport), as well as non-traditional economic development levers that are important to raising productivity growth (e.g. health) – are split across CAs, local authorities, central government, and arms-length bodies. Crucially, political decentralisation is critical to ensuring *regionally balanced* growth in particular.

Business Environment – People and Skills

5. **Where you identified barriers in response to Question 7 which relate to people and skills (including issues such as delivery of employment support, careers, and skills provision), what UK government policy solutions could best address these?**

The government has made a number of positive first steps that could help reduce duplication or inefficiencies in the current skills system. The establishment of Skills England, and a broader commitment to devolving employment support services, are certainly steps in the right direction. The following recommendations are those that

CPP has previously called for, and could be logical next steps to strengthen state skills provision and widen access:

- Further devolution of adult education as well as the post-16 skills budgets, including devolution of further education (FE).
- Reforming the current 'Right to Train' by making it available to all employees who have worked for an employer for at least 26 weeks, and introduce a new 'Right to Retrain' that removes the requirement for workers to undertake training only where it improves their performance in their current role.
- Develop new 'geographic access' targets to ensure that everyone has access to a broad range of high quality further education (FE) and adult learning opportunities. An example would include working towards "full coverage" of T-Levels, within a 45 minutes commuting distance, across England. This could be delivered by establishing FE campuses in community hubs, vacant high street shops, or co-locating technical training in relevant local spaces (e.g. industrial parks, hospital sites) alongside remote and work-based learning opportunities. Improvements to local public transport to facilitate this should also be considered
- Respond to local needs but focus on good jobs: Colleges should offer high quality courses that respond to local labour market demand and the strategic economic objectives of areas. To enable this, Skills Advisory Panels should report to Mayoral and Council leaders on what skills are required locally. In turn, being democratically accountable, local leaders should hold ultimate responsibility for ensuring strategic tailoring of skills provision with the ultimate aim of delivering full employment and good jobs within areas.
- Create a Which? guide or equivalent for Further Education, driving up the quality of colleges and other technical education institutions by publishing accessible data and information on learner destinations, the extent these align with local labour market demand and objective measures of course quality, by institution. This could also allow for greater specialism within the FE sector, particularly where colleges choose to focus on subjects where there is a national – but regionally specific – training need (e.g. nuclear, hydrogen and wind energy).
- Establish a national infrastructure – single "front door" - for online skills training, regulation and certification – making it easier for employers to understand and trust these courses and increasing accessibility of learning for people in work and/or with caring responsibilities.

- Introduce a new Learners Living Allowance (LLA) to those unemployed or economically inactive to undertake training for a first Level 3 qualification, equivalent to the maintenance loans available for higher education students, to be paid back under the same conditions upon re-employment.
- Expand the provision of modular learning, to better support people in the workforce to upskill and/or transfer into sectors where there are skills shortages including green energy and retrofitting. Introducing more short form, occupation specific modules that could be added either into existing qualifications, or used separately to meet specific, lower-level entry requirements could fill skills shortages more quickly and create a more adaptable, resilient labour market.

6. What more could be done to achieve a step change in employer investment in training in the growth-driving sectors?

Employer investment in training has fallen substantially, across virtually all sectors, since 2011. It is particularly low among lower skilled workers - workers with a master's degree are almost three times more likely to have received recent work-related training than those without GCSEs.

The following recommendations could be logical next steps to raise employer investment in skills:

1) Expanding the full expensing scheme to include investment in human capital. To ensure that this is targeted towards increasing investment in lower-skilled workers while also helping reduce deadweight costs, we recommend that the full investment scheme initially be expanded to cover human capital investment for those with lower (or no) qualifications, e.g. <NVQ4.
2) Replace the corporate tax relief for employer investment in skills with a new payroll tax credit, taking the recommendation developed by the New Economics Foundation (NEF). The NEF recommendation proposes a new flat-rate payment at the National Living Wage to all employers for every hour a worker spends on an approved training course, paid via payroll taxes instead of a corporation tax deduction. Their analysis demonstrates how a payroll tax could support lower deadweight, better targeting towards lower-skilled workers, higher take up, as well as being targeted towards technical skills shortages in critical growth sectors.

Business Environment - Infrastructure

7. Where you identified barriers in response to Question 7 which relate to planning, infrastructure and transport, what UK government policy solutions could best address these in addition to existing reforms? How can this best support regional growth?

Planning, infrastructure, and transport are all areas in which regional and local authorities have a significant amount of influence in determining successful delivery. Yet, currently, there is a lack of alignment between the incentives to pursue higher economic growth at the national (Whitehall) level, with the regional and local.

Principally, the current system means that local and regional authorities absorb all of the costs of additional service pressures accrued through higher local demand, yet most of the additional proceeds generated through development flow to HM Treasury. Similarly, while local and regional authorities have some control over e.g. some transport budgets, public investment for major projects is typically determined and monitored by Whitehall departments and arms-length bodies, leaving them vulnerable to uncertainty (the recent decision to replace Phase 2 of HS2 with Network North projects is one well-documented example).

The government's industrial strategy should consider how to ensure that there are stronger local incentives that favour development, and that these are aligned with the government's wider mission on growth. Some of the levers that exist are rarely touched – few Metro Mayors have used powers to raise Council Tax precents, or establish Development Corporations, to fund new infrastructure.

Some initial first steps might include:

1) Building on proposed reforms to local government finance (multi-year spending settlements, single settlements for CA's, local growth funding consolidation) with further fiscal devolution. Initial steps may include, for example, 100% business rate retention for new projects. Some degree of devolution over some of the main taxes – income tax, national insurance, VAT – would provide a more stable stream of local incomes to support new public-private infrastructure partnerships, as well as seed capital for higher-risk investments to catalyse higher private investment for infrastructure development. The Centre for Progressive Policy has previously outlined a model for pursuing devolution of bigger tax levers, which compensates poorer local economies while maintaining an incentive to pursue growth.
2) Expanding new local authority (LA) land purchasing powers in the Levelling Up and Regeneration Bill to enable Tax Increment Financing (TIF) – enabling LAs to

borrow to invest in infrastructure against higher future land values. TIF is a common mechanism for infrastructure financing across the world, yet in the UK it is limited only to use in Enterprise Zones. LAs could also be allowed to collect uplifts in stamp duty on properties sold near new infrastructure.

3) Encourage "plan-led" developments. Previous recommendations by the Centre for Progressive Policy (CPP) on eradicating 'hope values' have been cited by Ministers as one lever to reduce land purchasing costs by LA's. Recent work by Thomas Aubrey for the Bennett Institute built upon this recommendation, arguing that the use of Development Corporations should be encouraged to a) develop integrated local plans for housing and infrastructure, and b) raise finance directly from capital markets for delivery.

Business Environment - Competition

8. **Where you identified barriers in response to Question 7 which relate to competition, what evidence can you share to illustrate their impact and what solutions could best address them?**

Work from the CMA's Microeconomics Unit and others (e.g. Datta, *Local Monopsony Power* (CEP; 2024)) highlight a growing body of evidence for less competitive consumption and labour markets in the UK's more peripheral areas. CPP's work finds a similar phenomenon for "doubly disadvantaged" neighbourhoods within the urban areas of the north and midlands. This monopsony power in private markets can be tackled through increasing transport availability; or directly through increasing minimum standards and bargaining power through the government's Plan to Make Work Pay.

Business Environment – Mobilising Capital

9. **What are the main barriers faced by companies who are seeking finance to scale up in the UK or by investors who are seeking to deploy capital, and do those barriers vary for the growth-driving sectors? How can addressing these barriers enable more global players in the UK?**

Evidence from Daams et al (2023) has found that since the financial crisis in 2008 capital markets have typically favoured investment in London-based firms and infrastructure as lower risk, and have attached a significant risk premia to commercial investments outside of London. Likewise, analysis of the British Business Bank's regional funds identified a long-term trend of shortening travel times between investors and investees, while similar research has reached similar conclusions.

The Centre for Progressive Policy has previously proposed the government introduce a new network of funds, "Regional Co-Investment Funds", to encourage higher levels of co-investment for projects that would reduce local barriers to growth. Based on a similar scheme in Sweden that was successful in diversifying private investment across a wider range of high-growth sectors, funds would consist of maximum of 50% of capital contributions from the public sector, with the remainder from the private sector.

Sitting under the National Wealth Fund, the proposed Regional Co-Investment Funds would be jointly created and managed by the UK Infrastructure Bank, the British Business Bank, private financial institutions, and local governments, capitalising on the strengths and resources of each institution. More detail can be found in [CPP's report Open for Business.]

10. <u>Do you agree with this characterisation of clusters? Are there any additional characteristics of dimensions of cluster definition and strength we should consider, such as the difference between services clusters and manufacturing clusters?</u>

We agree that the characterisation of clusters is broadly right. High employment, output, productivity, and innovation are all characteristics of a geographic area demonstrating strong agglomeration effects.

We also agree that clusters can cross administrative boundaries. Yet there are tangible differences between what might be considered a 'cluster' – lots of economic activity occurring within a concentrated spatial area – and a more general industrial specialism within a regional economy. We would advise against the use of defined area limits to define clusters – e.g. tax incentives for the current Investment Zones scheme are applicable to businesses based within a (locally defined) 600 hectare radius. Though there may be some cases where hyper-local targeting would support greater agglomeration effects, such interventions should be designed and implemented locally.

Agglomeration effects operate at different levels of spatial aggregation across service and manufacturing sectors (Rosenthal and Strange, 2020). Close spatial proximity of related firms is fundamental to raising agglomeration intensity in both cases. Yet manufacturing agglomeration can function more efficiently at a wider spatial level providing that a cluster's locational factors are ones that support the needs of

manufacturers: close proximity to suppliers, strong distribution networks, and good transport infrastructure. Service-based clusters, conversely, rely more highly on "soft infrastructure" such as high-speed internet and office space, meaning agglomerations can function at a smaller spatial level (e.g. city centres).

Previous work by the Centre for Progressive Policy outlined the framework for a new *Manufacturing Mission*, that suggested the areas in which the government should focus to raise levels of investment and productivity growth in high-value manufacturing:

- Driving up greater rates of digital adoption, as well as wider adoption of other productivity-enhancing products and processes, particularly among firms based in laggard areas.
- Increasing overall investment in manufacturing R&D, with a specific focus on raising public investment outside of London and the South East.
- Supporting the decarbonisation of high-emitting manufacturing sub-sectors, as well as greater adoption of greener products, processes, and practices by manufacturing firms.
- Widening access to external sources of finance for manufacturing firms located outside major urban economies.
- Establishing greater linkage between manufacturers, particularly in laggard areas, with regional and national centres of research and innovation, such as universities and Catapult Centres

11. How should the Industrial Strategy accelerate growth in city regions and clusters of growth sectors across the UK through Local Growth Plans and other policy mechanisms?

The government's intention to require CAs to develop new Local Growth Plans (LGPs) is a positive step that has potential to help the government realise its mission on economic growth, particularly on "good jobs and productivity growth" everywhere. It is, similarly, a welcome move to align the economic activities of regions with the national industrial strategy.

To this end, we have developed three principles to maximise the potential of new LGPs:

1) Good Local Growth Plans should be treated as a locally-owned commitment to driving growth, rather than a regional variant of national priorities.

In practical terms this means that the structures of Local Growth Plans should make room for the flexibility needed to secure strong, lasting local buy-in. Some places have built independently upon their Strategic Economic Plans from the Coalition-era, or Local Industrial Strategies from the May-era. In these cases it is less because of the strength of their theoretical underpinnings, but because in those places, they represented the culmination of a process that helped drive prioritisation, delivered new funding opportunities, and secured enduring buy-in from local partners.

In practical terms this means that the structures of Local Growth Plans should make room for the flexibility needed to secure strong, lasting local buy-in. That local flexibility – such as "local missions" that may deviate slightly from the national missions – should be welcomed by government if it can unblock tricky local politics or coordinate some big local investments. In addition to developing clusters and sectors, LGPs will have to tackle place-wide barriers to growth, including on economic and social inclusion, if they are to endure as local documents:

2) LGPs will have to tackle place-wide barriers to growth, in addition to developing sector and clusters, if they are to endure as local documents

We think this means considering three different types of intervention in an LGP:

- Bringing clusters to scale: The steps a place can take to support its local economic clusters. This is the bread and butter of a local industrial strategy: a hard-nosed assessment of where comparative advantages and growth industries are, detailed engagement with investors or incumbents to understand the barriers to even greater success, and a path to mobilising partners to clear those barriers away.
- Identifying binding constraints in place-based "horizontals": Local Growth Plans are an opportunity to identify and broker local consensus about priorities, and how to make progress in delivering them in practice. On transport, for instance, places may need to make hard trade-offs on road versus rail investment; or capital spending for buses versus active travel. Good Local Growth Plans should provide clear steers for the best use of the marginal pound in addressing binding economic constraints, and base them in strong chains of evidence (i.e. by using price signals where possible).
- Going beyond conventional "economic development" levers to meet the local need for inclusive economic policy: Local leaders have increasingly become aware of the fact that the old toolkit of economic tools – transport

infrastructure, land assembly and regeneration, business support and skills programming – isn't enough to shift the trajectory of a place. Chronic, complex problems like health, crime, or social immobility hold places and the people within them back too. In other words, Local Growth Plans should think about how the government's four other missions can support, or gain from, the growth mission. Government, in turn, should be open to devolving other domestic policy levers outside of "hard economics" where local leaders make a convincing case based on binding local constraints.

3) LGPs should be designed with specific projects in mind, and with thought to how a project pipeline can form the basis of a deeper partnership between places and government

A Local Growth Plan that actually functions as a Plan (as opposed to a strategy) should include a meaningful commitment from local partners to developing projects, and an honest assessment of where their pipeline currently faces gaps.

Being clear-eyed about which projects are of the scale for national significance and national intervention – and which priorities can and should be taken forward either through local funding or in partnership with the private sector – will help to sharpen the Local Growth Plans. It will also strengthen the offer of partnership with Government that should sit at the heart of any Local Growth Plan (mediated in some cases through pan-regional bodies like the Northern Powerhouse or Midlands Engine).

In return, Government should understand that project development is hard and shovel-ready projects are thin on the ground, and that the hard yards of generating, evidencing and prioritising new interventions will take time and capacity.

12. How should the Industrial Strategy align with devolved government economic strategies and support the sectoral strengths of Scotland, Wales, and Northern Ireland?

The three principles that we outline above, on LGP's, could also be translated to fit the different institutional architecture that supports industrial growth across the devolved administration's (DA's). Similarly to LGPs, we would recommend that DA's be asked to demonstrate how their economic plans currently fit, and could be refined to better fit, within the industrial strategy and wider missions agenda. Crucially, as we recommend for LGPs, we would recommend that where DA's can demonstrate that the further devolution of specific policy levers could support more efficient policy

design and/or greater targeting of public investment to catalyse private investment, then the UK government should be open to devolving them.

Additionally, the UK government may need to play an active role in arbitrating across the DA's so that future economic plans are consistent and complementary – i.e. that they do not breach the Internal Market Act.

Partnerships and Institutions

13. **How can the Industrial Strategy Council best support the UK government to deliver and monitor the Industrial Strategy?**

The Terms of Reference (ToR) for the Industrial Strategy Council should provide it with independence, and grant flexibility to pursue lines of inquiry of its own choosing. It should be provided with the autonomy to make unsolicited recommendations to government. There may also be scope for resourcing the Industrial Strategy Commission to support its activities, based on models such as, for example, the Climate Change Committee or National Infrastructure Commission.