UK Competitiveness after Brexit

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Scope

- How has UK competitiveness evolved in the run-up to Brexit?
- What should the UK do domestically to raise its competitiveness?

- Not about whether Brexit is good or bad (it is bad)
- Not about how to negotiate with the EU (although that matters a great deal)

A. What is competitiveness?

B. UK economic performance, competitiveness, and policy in the run-up to Brexit

C. Key dimensions of a UK competitiveness strategy after leaving the EU

What is Competitiveness?

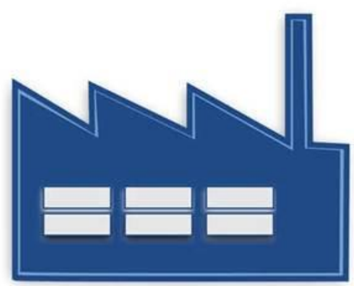
A nation or region is competitive to the extent that firms operating there are able to **compete successfully** in the national and global economy while maintaining or improving **wages and living standards** for the average citizen

- Competitiveness depends on the **long-run productivity** of a location as a place to do business
  - Productivity of **existing** firms and workers
  - Enabling **high participation** of citizens in the workforce

- Competitiveness is **not:**
  - Low wages
  - Low taxes
  - A weak currency
  - Jobs per se

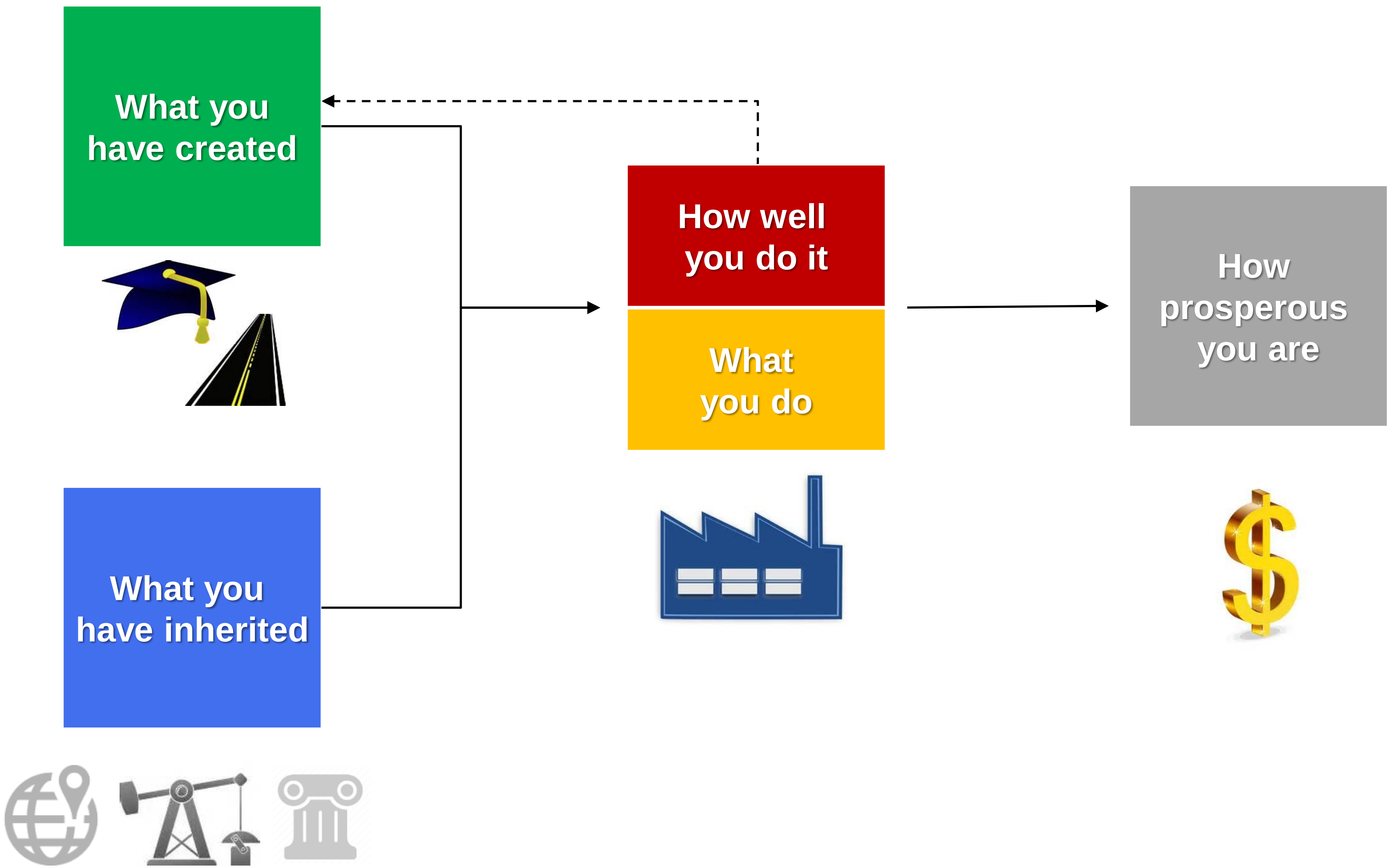
What Drives Competitiveness?

What you have inherited	What you do	What you have created



What Drives Prosperity?

An Integrative Perspective



What You Have Created

Microeconomic Drivers of Competitiveness

Business Environment	Cluster Presence	Company Sophistication
• Skills, knowledge • Infrastructure • Efficient public services • Access to capital • Competitive markets • Rules and regulations • Demand conditions	• Critical mass in specific groups of related and supporting industries • Strengths of linkages and cluster dynamics	• Quality of companies' operational practices • Nature of companies' competitive advantages

Upgrading Competitiveness: Principles

WHAT

- Many things matter; there is no silver bullet
- What matters most depends on what you already have
- Every location is different, but all adhere to the same economic principles and dynamics
- Everything can't be changed at once, even if all has to change eventually
- Success is driven by unique strengths, not just by removing weaknesses
- Change requires action by many

HOW

Developing an Economic Strategy for a Location

Diagnostics

- What is the profile of our performance?
- What business environment conditions do we offer?
- What clusters do we have? How are they positioned?

Choice

- What business environment conditions do we want to offer?
- Which type of companies and skills do we aim to attract with these qualities? In what clusters?

Action Plan

- What are the priorities for action?
- Who is going to do what?
- How do we deploy our resources?
- What channels and platforms can we use?

UK Economic Performance: Prosperity

Prosperity

- **Prosperity gap** to the US, increasingly also to Germany
- High levels of **income inequality**; high levels of regional inequality

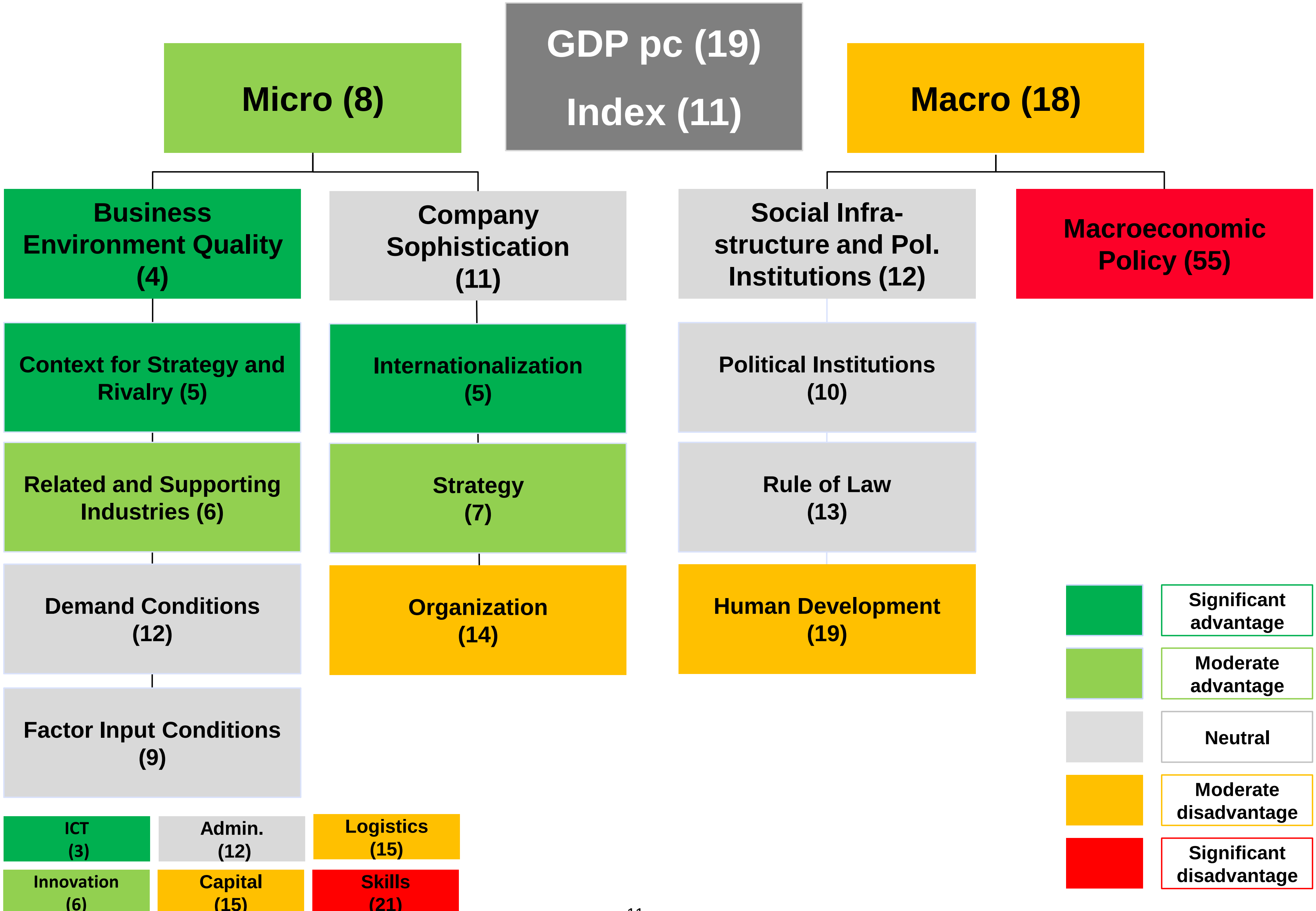
Labour Productivity

- Persistent and growing **productivity gap** to leading peers
- High levels of **regional differences** in productivity

Labour Mobilization

- High levels of labour mobilization, especially in terms of **hours per employees**
- Essentially all post-crisis gains in prosperity achieved to **rising labour mobilization**

UK Competitiveness Profile 2015



Source: World Economic Forum Global Executive Opinion Survey 2015, ISC analysis, 140 countries

Competitiveness and Prosperity

The “Bathtub”-Model

- Dimensions of competitiveness have a largely independent impact on prosperity

The “Puzzle”-Model

- Dimensions of competitiveness depend in their influence on prosperity critically on the presence of other factors

UK Competitiveness Revisited

World-Class Science

Strong Core Clusters

- Strong positions in some **high-tech/high-skill fields**, serving European and global markets (finance, biopharma, advanced manufacturing, IT)

Flexible labour and product markets

Highly developed capital markets

Modest general skill base

Some weaknesses in infrastructure

- Wider economy characterized by **cost-based strategies** and asset sweating
- **Limited incentives** for firms to invest in upgrading capabilities

UK Competitiveness Redux


dti

DTI ECONOMICS PAPER NO. 3

UK Competitiveness: moving to the next stage

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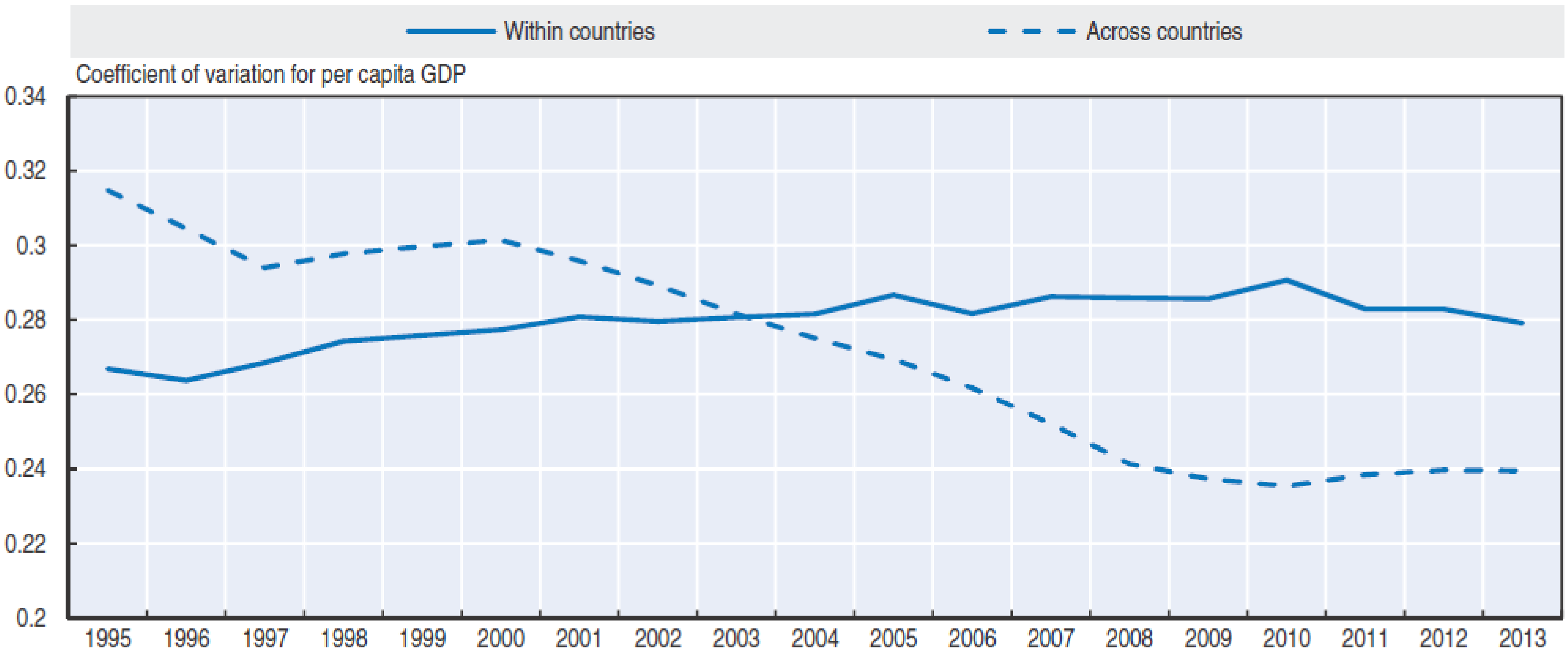
MAY 2003

E·S·R·C ECONOMIC & SOCIAL RESEARCH COUNCIL

- In 2002/03, the then UK government asked us to conduct a review of UK competitiveness
- Their hypothesis was that the productivity gap was driven by **poor management**
- What we found was a competitive environment that made **low-productivity strategies** a viable and often profitable choice
- Frustratingly, the UK competitiveness profile in 2017 is **eerily similar** to what we saw 15 years ago

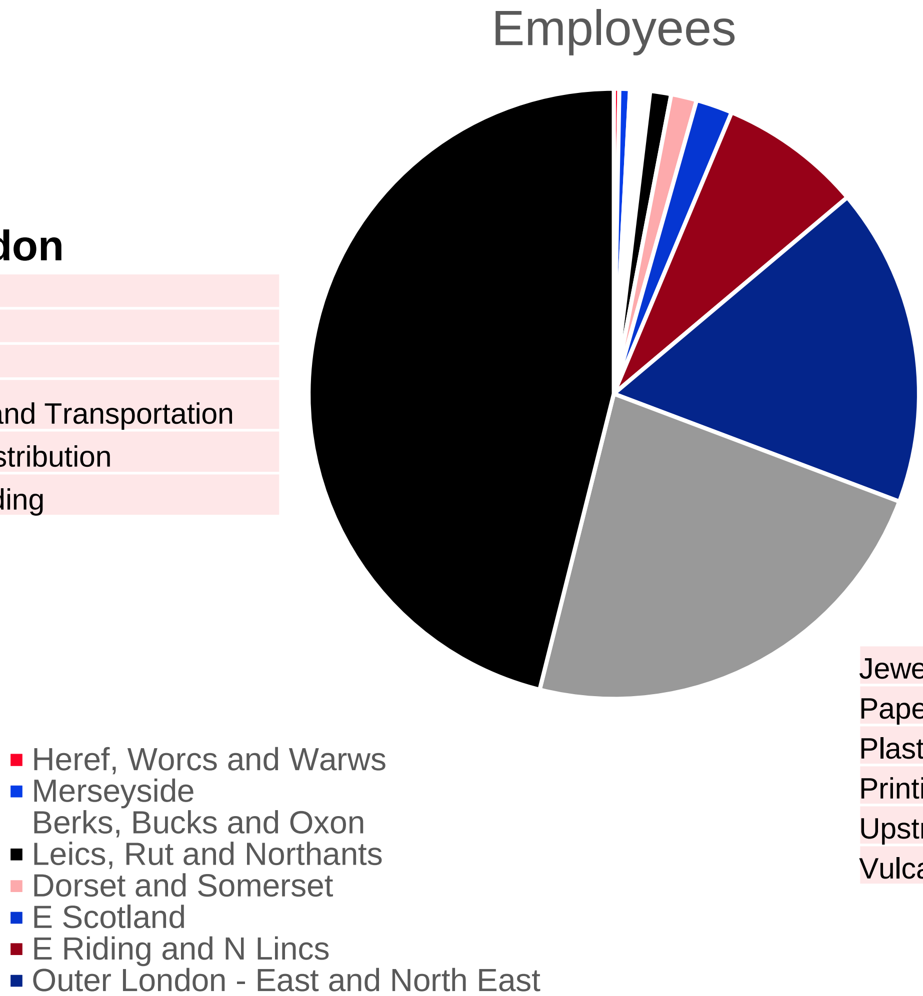
Competitiveness and Geography

Figure 1.3. **Country convergence has been accompanied by divergence of regions within countries**



Source: OECD, 2017

Employment in Strongest Clusters* by UK Region



Inner London

- Financial Services
- Insurance Services
- Metal Mining
- Oil and Gas Production and Transportation
- Video Production and Distribution
- Music and Sound Recording

Outer London

- Education and Knowledge Creation
- Communications Equipment and Services
- Metal Mining
- Music and Sound Recording

W Wales

- Jewelry and Precious Metals
- Paper and Packaging
- Plastics
- Printing Services
- Upstream Chemical Products
- Vulcanized and Fired Materials

*Strongest clusters defined as ‘four star’ clusters by the methodology of the EU Cluster Observatory, EU (2017)

Centralized, Horizontal Policies and Disparities

- Horizontal policies implemented at the national level appear to be **sector- and location-'neutral',** avoiding market distortions

- The impact, however, is **far from neutral**
- Locations and industries with initial advantages have **higher capacity to attract and absorb policy support** instrument (and tilt their design to match their needs)
- It is not obvious that this is welfare maximizing in a **'second-best' world** of constantly changing market circumstances
- There are also questions about the **efficiency of policies** that are not integrally anchored in specific locations and sectors/clusters

UK Policy Response Pre-Brexit

Innovation Policy	Industrial Policy	Regional Policy
• NESTA mandate broadened in 2003, made independent in 2010 • Technology Development Board was made an independent agency in 2007, renamed Innovate UK in 2013	• New approach outlined in 2009; then Vincent Cable-speech in 2012 • Sectoral partnerships like the Automotive Council • British Business Bank, risk capital tax incentives	• Regional Development Agencies were launched in 2003 as public-private entities • Dissolved in 2010, with new Local Enterprise Partnerships assuming their responsibilities • Northern Powerhouse plan • Devolution efforts and Mayoral elections

Catapult Program
Advanced Manufacturing Supply Chain Initiative

- Overall rhetoric and individual programs **sensible** and much in line with advanced economy peers
- Questions about their **coherence and integration**
- Spending levels appear to be **lower** than in peer countries

A Detour: The EU and UK Competitiveness

Context for Firm Strategy and Rivalry

- Common market enhanced competitive dynamics at the cost of some extra EU regulatory burden
- Competition policy controlled both government intervention and private market power
- Some distortions through EU trade rules, especially in agriculture

Factor (Input) Conditions

- Strong UK science system benefited from access to competitive EU science funding schemes
- Inflow of human resources across all skill classes
- EU structural funds to lagging UK regions
- UK a net-contributor to the EU budget

Demand Conditions

- Demanding EU rules and regulations, often setting standards for future global rules

Related and Supporting Industries

- Full integration of UK clusters into European value chains, for example in automotive
- Strong UK clusters attracting further FDI through ability to serve EU markets

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- EU membership **did neither solve nor cause** the UK's competitiveness challenges
- Leaving the EU will **hurt UK competitiveness**

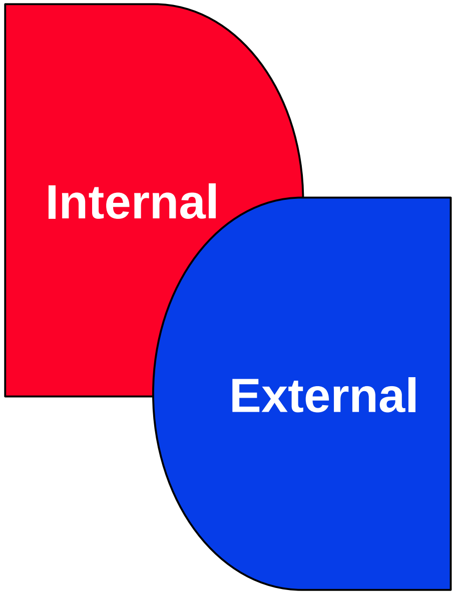
UK Competitiveness after Brexit: Five Action Priorities

1. **The UK Needs to Develop a New Value Proposition**

Value Proposition

The value the location provides to economic activities, reflected in the role of the location in the broader regional and global economy

- Help in the process of **prioritizing policy actions** over time
- Enable **coordinated policy choices** across different areas of government



- Clarify the **location's message** to mobile capital, skills, and ideas
- Help investors to **self-select activities that** fit the location
- Set **expectations** towards the future development of the location's competitiveness profile

The UK's Future Value Proposition

- The UK's attractiveness was heavily based on its ability to provide an **efficient base** for global firms and talent wanting **to serve the European market**

- While Brexit will critically undermine this claim, a range of important **UK assets and capabilities** remain in place
  - World-class science base
  - Deep global connections
  - Strong clusters in finance, biopharma, parts of IT, and some advanced manufacturing

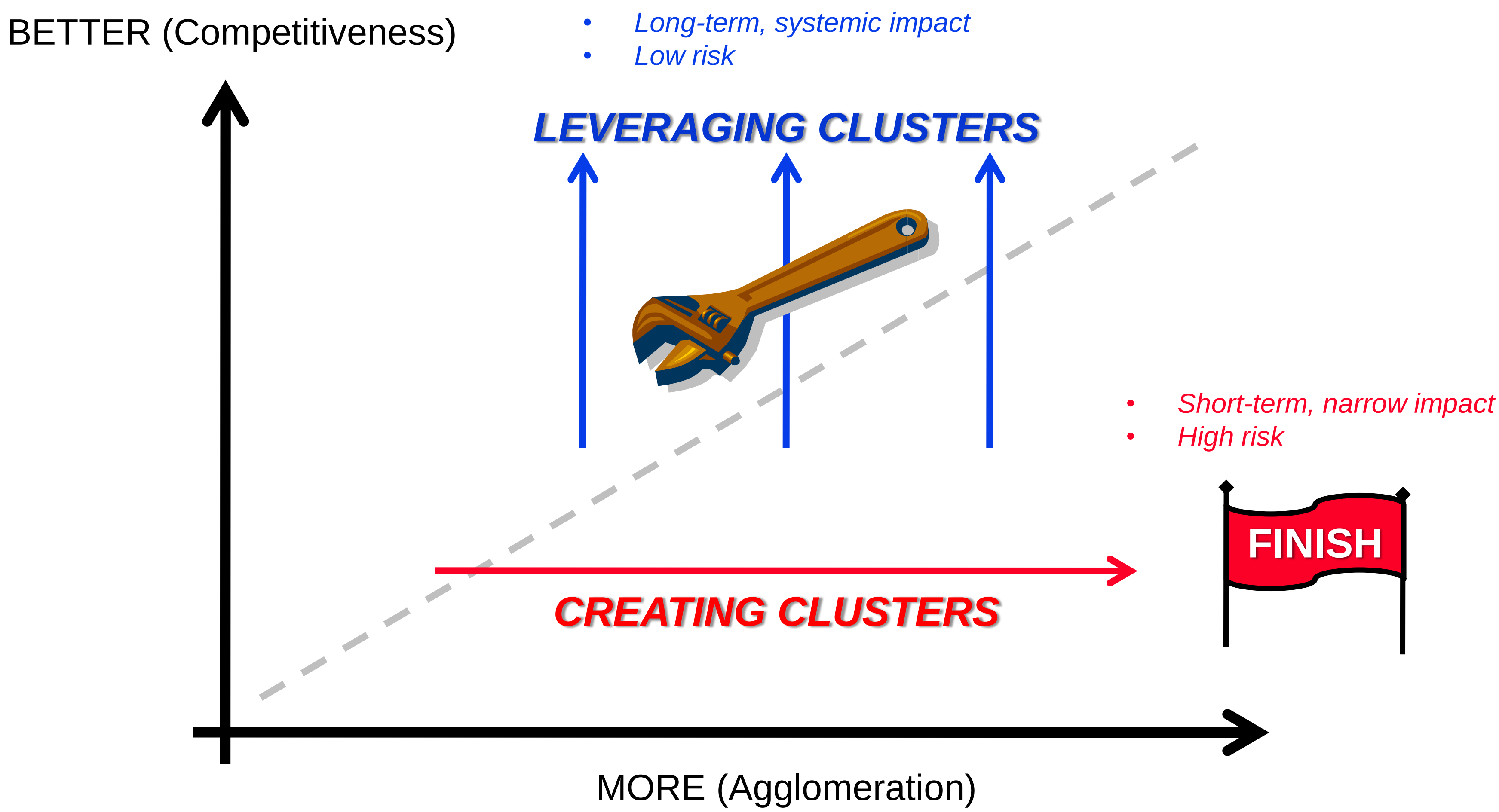
- A public debate on what qualities the UK **aims to offer** would help
  - The government has made statements about trying to offer lower taxes and lower levels of regulation than others, especially the EU members
  - At the same time it's ambition to create a fairer UK created the impression of more regulation and government interference

UK Competitiveness after Brexit: Five Action Priorities

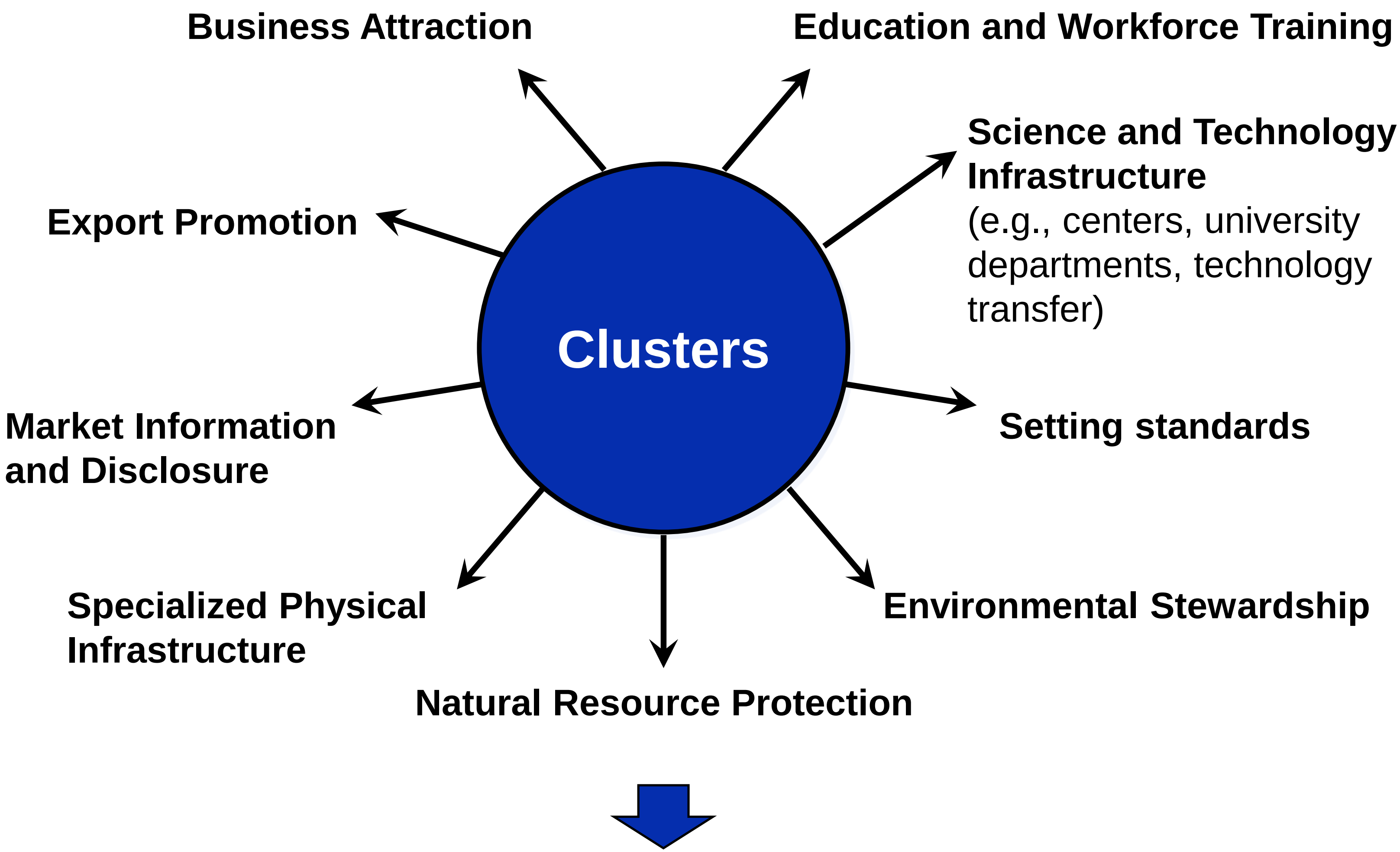
1. The UK Needs to Develop a New Value Proposition
2. **Adopt a Cluster-Based Approach to Economic Development**
3. **Develop Regional Capacity for Competitiveness Upgrading**

Cluster-Based Economic Development

Two Opposing Visions on Cluster Policy



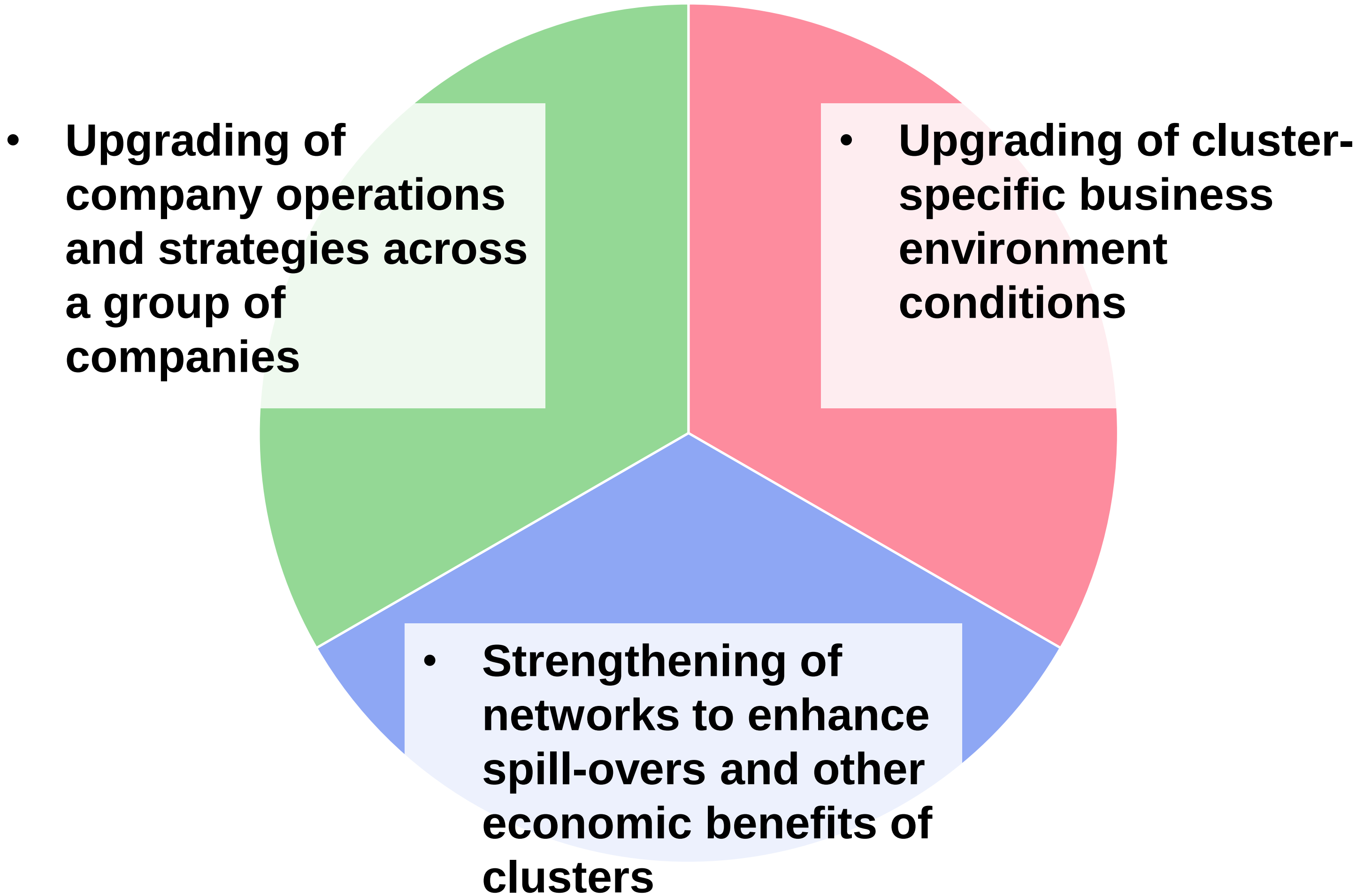
Organizing Public Policy around Clusters



- Clusters provide a framework for **organizing the implementation** of public policy and public investments towards economic development

Cluster Initiatives: Facilitating coordinated action

Cluster initiatives are ***collaborative activities*** *by a* ***group*** *of companies, public sector entities, and other related institutions with the objective to improve the competitiveness of a group of* ***interlinked economic activities in a specific geographic region***



The Traditional View: Policies for Clusters

- Select clusters

- Focus policy action on them

- Economic impact

The Traditional View: Policies for Clusters
Challenges

- Select clusters
  - Political zero-sum competition across sectors
  - Cross-cluster opportunities remain unexploited
- Focus policy action on them
  - Cluster efforts as a new policy silo
  - Cross-cutting policy areas easily ‘off-the-table’
- Economic impact
  - Limited size of even the strongest clusters limits impact
  - Ultimately strong clusters need a strong region

Regional Competitiveness Through Clusters – and Vice Versa

metropolregion
mitteldeutschland
WIRTSCHAFT, WISSENSCHAFT & KULTUR IM ZENTRUM

The Technology-Network:
Intelligent Technical Systems
OstWestfalenLippe . Germany
it's owl

South Carolina Council On
Competitiveness

Elements of a Regional Economic Strategy

Outcome Ambitions

Positioning

- The specific value the location provides as a place to do business in the national and global economy

Business Environment

Cluster Portfolio

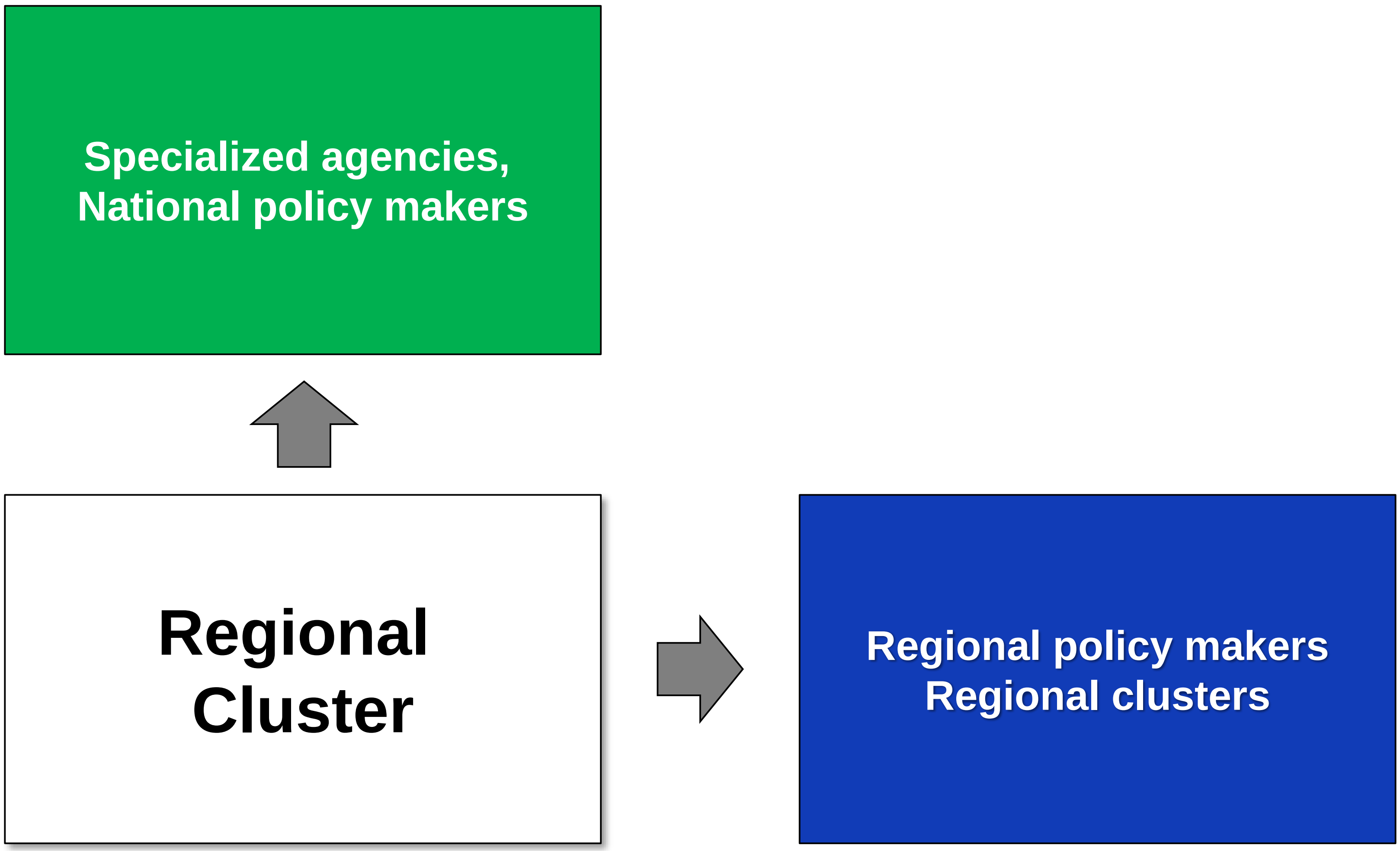
- Activities to upgrade cross-cutting business environment conditions that are most critical for the location's value proposition

- Activities focused on existing and emerging clusters that draw most benefits from and emphasize the location's value proposition

Implementation Architecture

- Responsibilities, resources, capabilities, and coordination

Key Relationships for Clusters



UK Competitiveness after Brexit: Five Action Priorities

1. The UK Needs to Develop a New Value Proposition

2. Adopt a Cluster-Based Approach to Economic Development

3. Develop Regional Capacity for Competitiveness Upgrading

4. **Focus on Achieving Inclusive Growth**

UK Competitiveness after Brexit: Five Action Priorities

1. The UK Needs to Develop a New Value Proposition

2. Adopt a Cluster-Based Approach to Economic Development

3. Develop Regional Capacity for Competitiveness Upgrading

4. Focus on Achieving Inclusive Growth

5. **Minimize Costs of Leaving the EU**

Looking Beyond Brexit

Policy Challenges

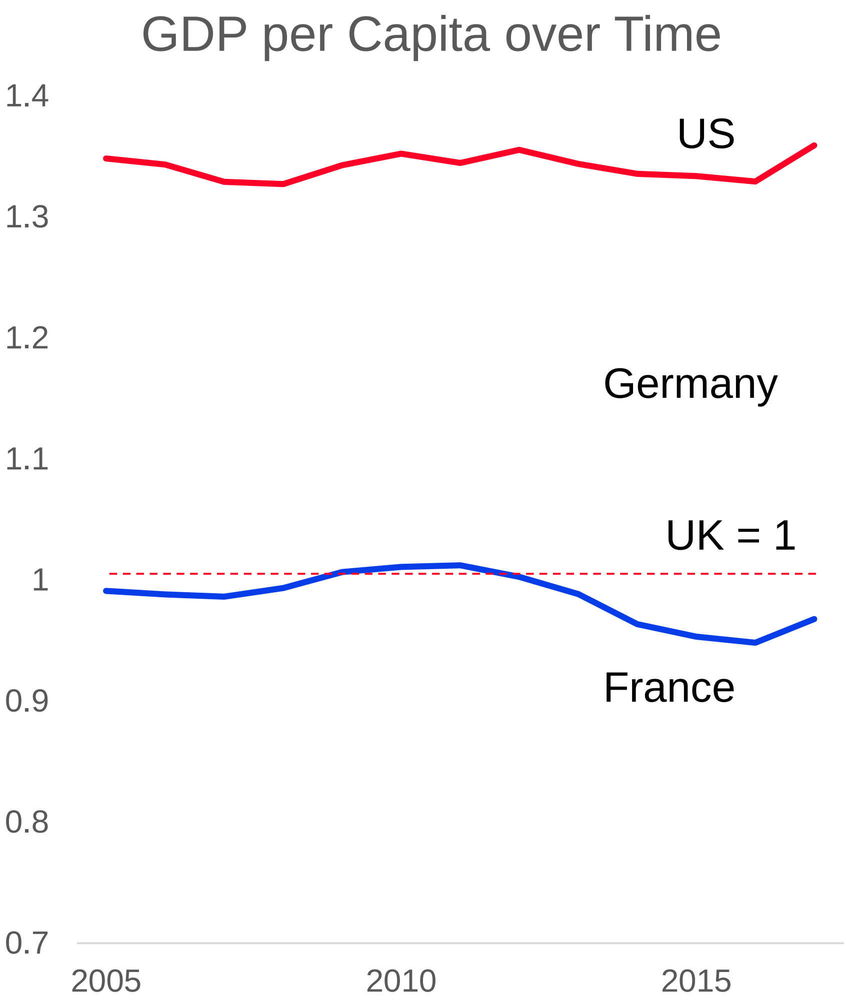
- Issues the UK is facing are to some degree universal: how to react to the new **realities of globalization and technological change**?
  - EU ended up in the cross-fire
- Answers
  - Economic nationalism (Trump)
  - Unilateral liberalism
  - Location/cluster-based competitiveness upgrading in public private partnership

Policy Responses

- Discourse about effective policies to support economic development much more about the **how** than the what
  - UK, too, has been struggling with effective action more than with the ideological disagreements about what to do
- Broadening view that **a new type of industrial policy** is needed, focused on enhancing productivity and anchored in public-private collaboration
  - Disagreement on whether clusters or locations provide the appropriate entry point into the discussion

Back-Up

Prosperity Trends over Time

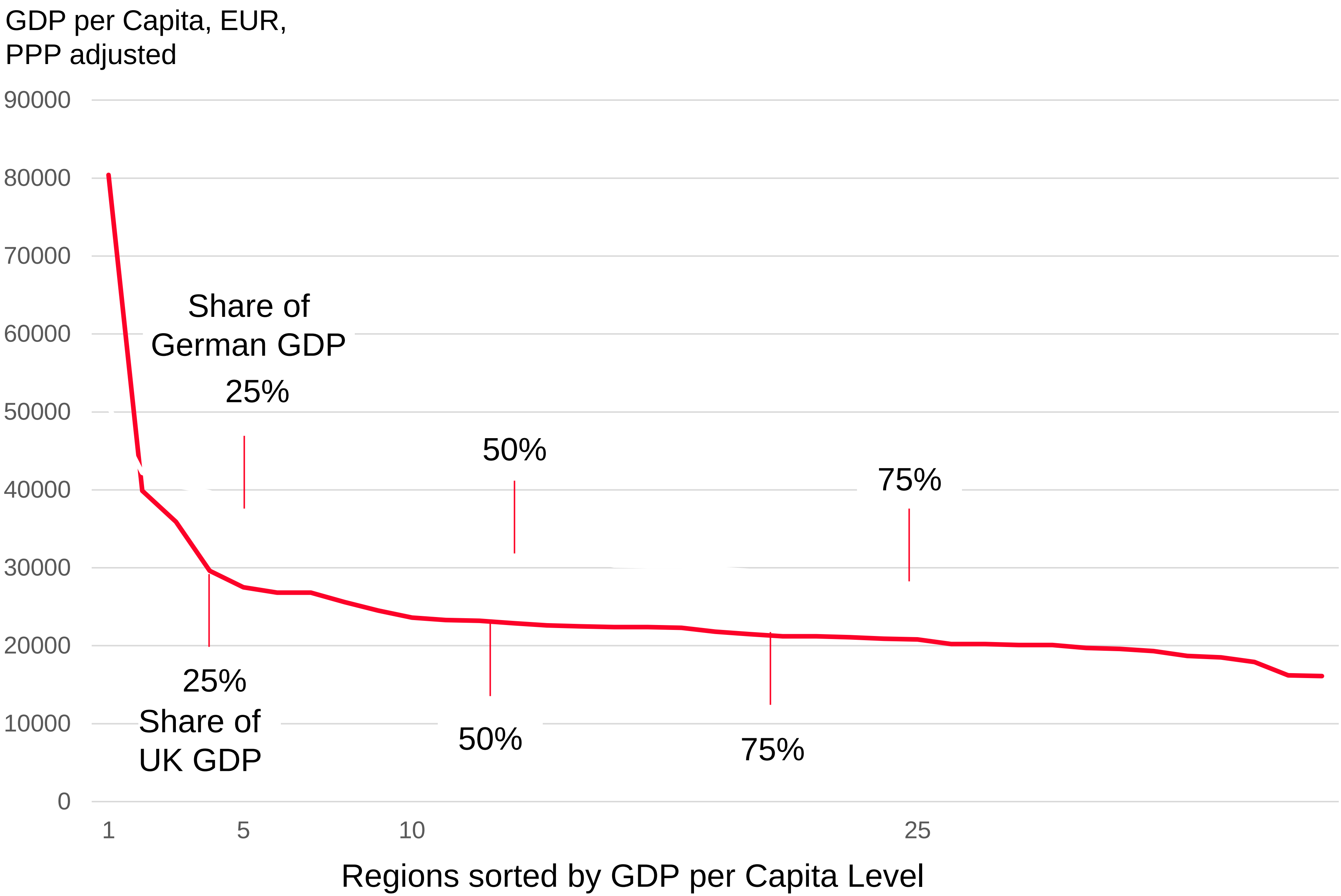


- UK (and US) show significantly higher levels of **income inequality** than their Continental European peers
- **Wage dynamics** have been weak and for the most part widened inequality

Source: Conference Board Total Economy Database, 2017

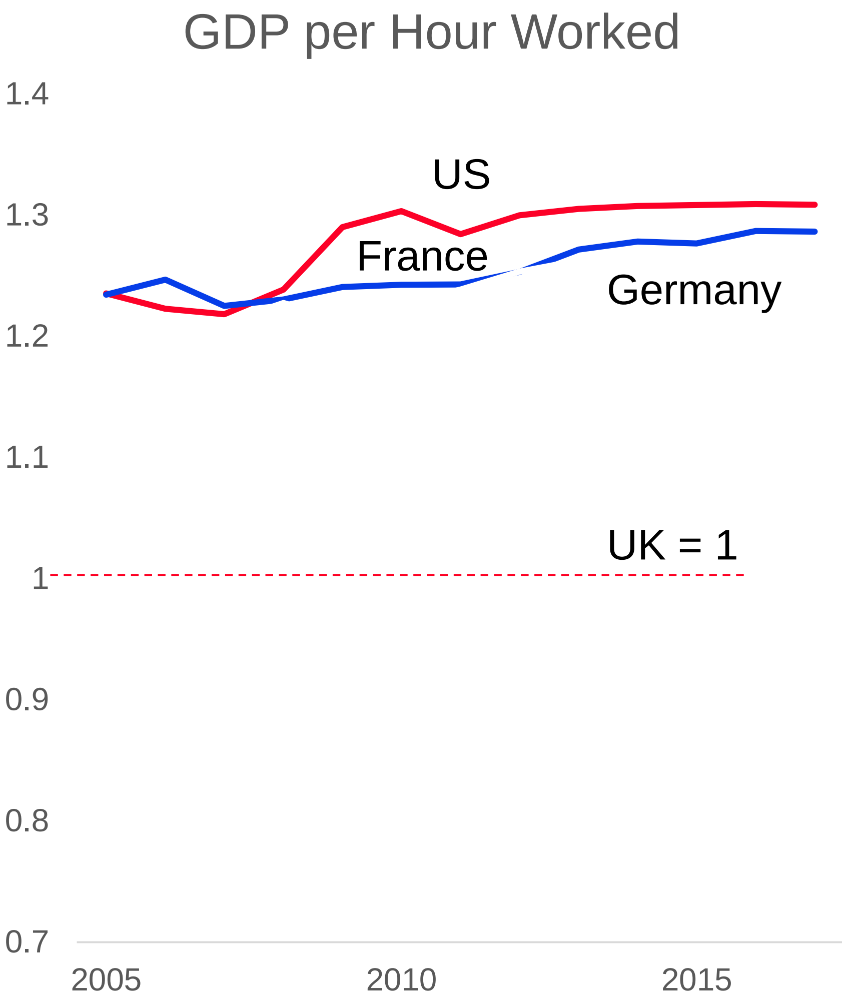
Prosperity Across Regions

UK vs Germany



Source: Eurostat (2017)

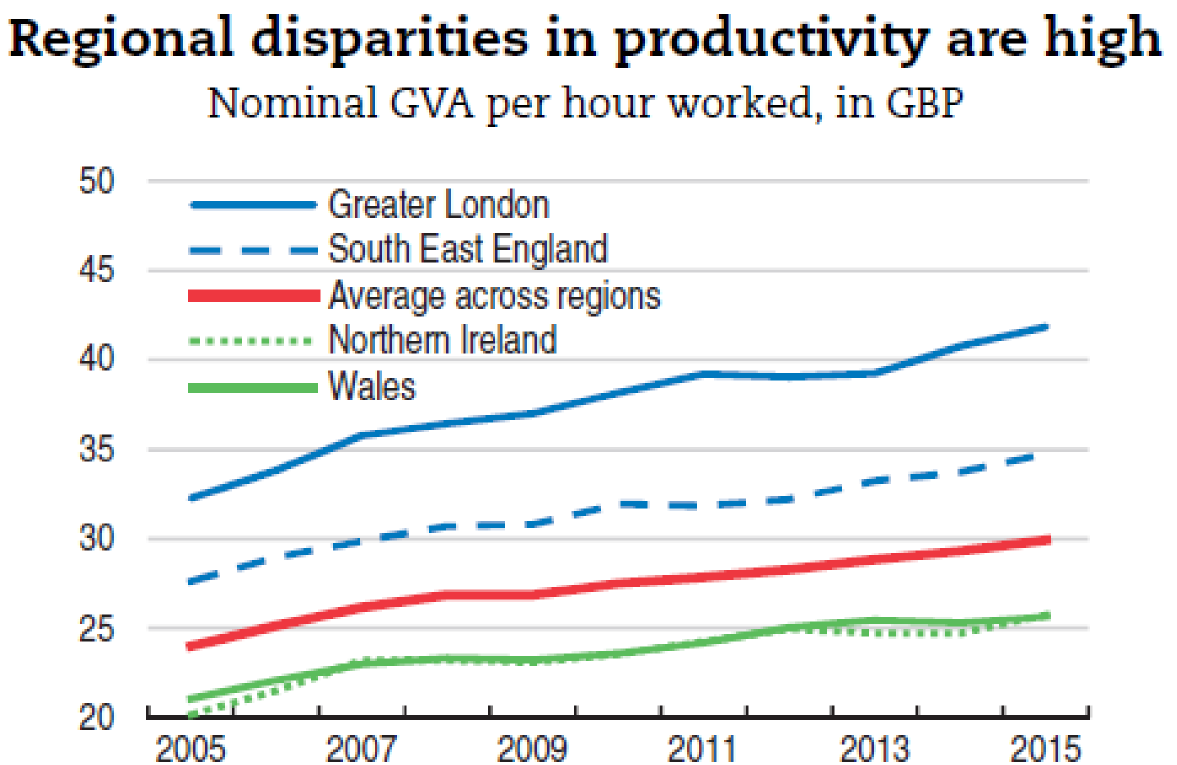
Labour Productivity Trends over Time



- Pre-crisis improvements in UK productivity are more likely to have been driven by **cyclical** rather than structural factors
- Post-crisis performance has been **weak**, even when measures of competitiveness recovered
- Wage dynamics have been weak, consistent with stagnant productivity

Source: Conference Board Total Economy Database, 2017

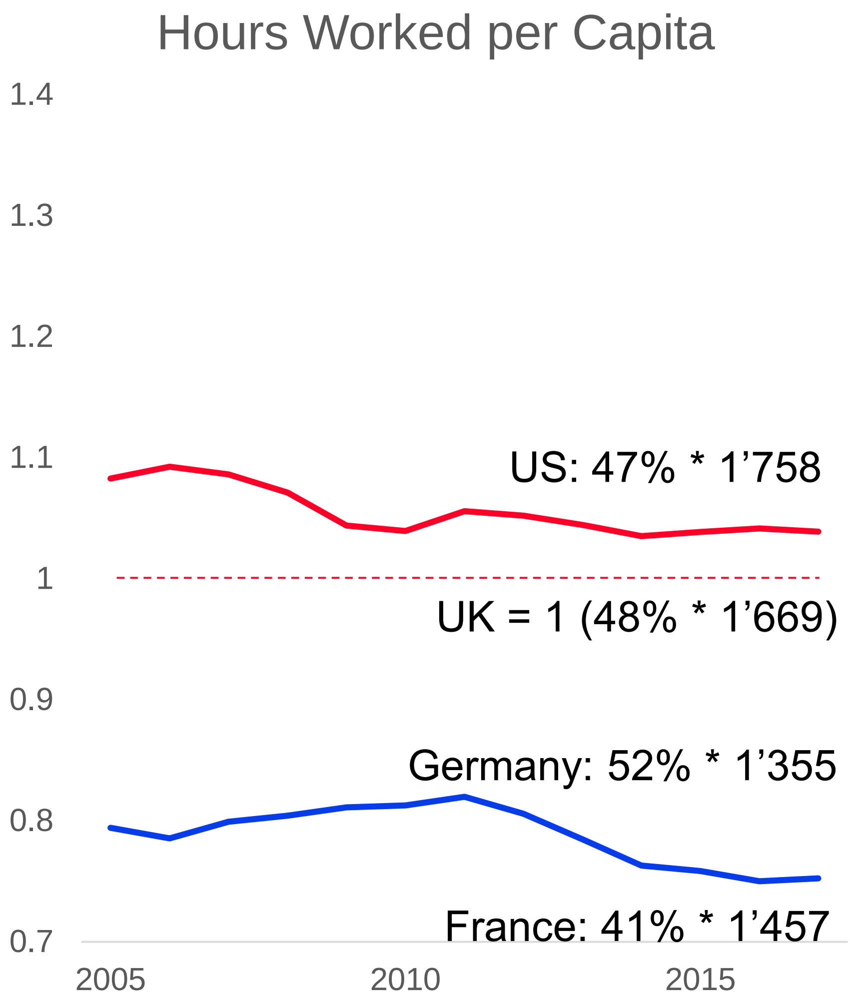
Productivity Disparities across UK Regions



Source: ONS (2017), "Regional and sub-regional productivity in the UK: Jan 2017", Office for National Statistics, January.

- There is additional evidence that **productivity differences between firms** are also higher than in peer economies

Labour Mobilization Trends over Time



- Economic growth in the UK has been primarily driven by **changes in labour mobilization**, especially working hours per employee

- This is an important but upward bounded path towards higher prosperity

Source: Conference Board Total Economy Database, 2017

What You Do

Understanding Composition

What you do

- More prosperous locations do **different things** than poorer locations
- More prosperous locations do **more things** than poorer locations
- More prosperous locations do **things better** than poorer locations

- Composition is a reflection of the underlying competitiveness of a location; it is a **symptom, not a driver of competitiveness**
- Prosperity is affected by **what** you do as well as **how well** you do it
- Targeting what you do **can change the composition** of your economy but **much less the prosperity** you can generate
- What you do today defines a specific **opportunity space** for what you are most likely to be able to do tomorrow

UK Regional Disparities Revisited

Centralized approaches

- Take **national choices** that exploit existing **national strengths**

- Reinforces disparities in competitiveness
- Policy response largely compensatory, providing direct transfers to laggards
  - Economic development support often focused on ‘hard’ infrastructure

Regionalized approaches

- Provide **national tools** to make **regional choices** based on **regional strengths**

- Enables (but does not guarantee) catch-up
- Policy response of channeling more national resources to laggards