



# A Strategy for Economic Growth

---

David Green and  
David Merlin-Jones

---

Second Edition, December 2011

---



© Civitas 2011

55 Tufton Street  
London SW1P 3QL

Civitas is a registered charity (no. 1085494)  
and a company limited by guarantee, registered in  
England and Wales (no. 04023541)

email: [info@civitas.org.uk](mailto:info@civitas.org.uk)

Independence: Civitas: Institute for the Study of Civil Society is a registered educational charity (No. 1085494) and a company limited by guarantee (No. 04023541). Civitas is financed from a variety of private sources to avoid over-reliance on any single or small group of donors.

All publications are independently refereed. All the Institute's publications seek to further its objective of promoting the advancement of learning. The views expressed are those of the authors, not of the Institute.

# Contents

---

Foreword.....	ii
Chapter One: Stop making matters worse .....	1
Reduce the cost of electricity .....	1
Chapter Two: Britain’s strategic position and why we need to re-industrialise.....	2
Declare an exchange rate target .....	7
Encourage import substitution.....	9
Establish an industry bank.....	10
End the unbalanced focus on ‘advanced manufacturing’ .....	14
Chapter Three: The conditions for enterprise .....	16
Reduce company taxation .....	16
Eliminate unnecessary workplace regulations .....	17
Cut personal taxes to make it easy to start new businesses .....	19
Export support .....	20
Intelligent procurement .....	22
Make the most of European Union state aid rules.....	23
Free trade, foreign investment and the common good .....	23
Conclusions .....	25
Notes.....	26

# Foreword

---

It is generally accepted that the best way to reduce a national debt burden is to increase economic growth, but at present the economy is growing very slowly. Numerous MPs, journalists, think tanks and business organisations have called for economic growth to become the Coalition's urgent priority, and in his October 2011 conference speech Mr Osborne listed measures intended to increase output. 'Don't tell me this Government isn't going for growth', he said. But so far the public policy response has fallen well short of what could be achieved. We question some of the assumptions behind the Government's economic policies and suggest a new approach.<sup>1</sup>

Whether explicitly or not, governments work within a 'definition of the situation', which inevitably includes some considerations and leaves out many others. If the problem to be solved is wrongly defined, then policies may not only fail but do more harm than good. The current Government thinks we face two main national challenges. First, it believes we have too much public debt and that it has a duty to adopt fiscal policies that will gradually reduce the size of annual deficits and prevent total national debt from getting out of control. And second, it believes climate change is a threat and believes we should fight it by subsidising renewable electricity generation and artificially forcing up the cost of carbon emissions. We contend that its approach to debt reduction is understandable but in need of refinement, and that its energy policies are making matters worse and should be reversed.

More importantly, we argue that we should define our national problems in a different way. The scale of our national debt is a major cause for concern, but it is not the biggest challenge we face. Nor is climate change. It is de-industrialisation. In fact, the massive de-industrialisation of our economy in the last 30 years has been a major cause of our high public and private debt. In particular, it led to a current account deficit, which has been partially funded by borrowing. Moreover, the reduction in manufacturing has structurally weakened our economy and impaired the ability of the private sector to grow rapidly. The spare productive capacity that could be taken for granted in the economic downturns of the early 1980s and early 1990s is simply no longer there. This means that tight control of fiscal policy of the kind currently in favour can not be counted on to spark automatic economic growth in the private sector. Large scale investment, especially in new manufacturing capacity, is needed; and in the immediate future some of it will have to come from the public sector. That will inevitably mean adding to the national debt in the short-term, but for a

good reason. In current conditions, borrowing to invest in productive capacity is desirable, whereas borrowing to pay for consumption is not. The Government is rightly critical of past policies that borrowed to permit consumption, but has only partially recognised the important role it needs to play in rebuilding our national infrastructure. It is investing with great enthusiasm in one area, the building of highly inefficient wind turbines, but neglecting where it could do far more good, namely in manufacturing .

In addition to solving the wrong problems, the Government has also failed to achieve some of its declared objectives. It sincerely wants to provide the most favourable conditions possible for enterprise, but has fallen a long way short of introducing reforms whose effectiveness is taken for granted by our main rivals. We identify the main areas where we think policies can be improved.

In particular, we argue that the exchange rate is often the most important determinant of trading success in manufactured goods. The manufacturing sector is especially important in the quest for economic growth because the potential for productivity gains is far greater than in services. Much of the disastrous fall in manufacturing output as a proportion of GDP has been the result of an unsustainable exchange rate, not the innate inefficiency of our manufacturers. The pound has fallen since 2008 and we argue that the Government should aim to keep it close to or below its current level against key currencies like the dollar and the euro, even at the risk of higher inflation.

The argument is presented in three parts. The first suggests how the government could stop making matters worse. The second argues that Britain is now at a strategic crossroads and highlights four especially important measures to encourage re-industrialisation. And the third describes the conditions for enterprise that are the responsibility of government in all circumstances.

David G. Green

# Chapter One:

## Stop making matters worse

---

### *Reduce the cost of electricity*

A golden rule of policy is not to make matters worse. However, some policies intended to combat climate change are undermining the competitiveness of our companies by increasing the cost of electricity relative to our main rivals. These policies are seriously threatening the existence of Britain's energy-intensive industries, including the steel, glass, paper, chemical and ceramics industries. Together they account for one per cent of Britain's GDP and employ 225,000 people. These figures do not include the broader contribution such industries make to GDP and employment via other sectors reliant on their products.<sup>2</sup> Taking the chemicals sector alone, the Royal Society of Chemistry found that 15 sectors in 2007 were reliant on chemistry as 'a necessary (but not the only) condition for their operation'.<sup>3</sup> These 15 industries supported £222 billion in GDP contribution and 5.1 million jobs.

Despite this considerable benefit to the economy, the average energy-intensive company could be forced to pay nearly £20 million in costs by 2020 as the result of the Government's climate change policies.<sup>4</sup> In the chemicals industry, Dr Stan Higgins, Chief Executive of the North East of England Process Industry Cluster (NEPIC), predicts that 'anything approaching £30 per tonne of CO<sub>2</sub> will be prohibitive' to chemical production in the UK.<sup>5</sup> Deutsche Bank estimates that with the introduction of the European Union's Emissions Trading Scheme's third phase in 2012, costs per tonne of CO<sub>2</sub> could reach €40, even before the additional costs imposed by UK regulations are included.<sup>6</sup> The misguided 'green' policies of the current Government have already caused job losses. In May 2011 Tata Steel cut employees at two of its UK plants in response to 'uncertainty about the level of further unilateral carbon cost rises that the UK government is planning'.<sup>7</sup>

Domestic consumers are also adversely affected. The Government commissioned Professor John Hills, director of the Centre for Analysis of Social Exclusion at the London School of Economics, to investigate the impact of higher fuel bills on the poor. His report concluded that an estimated 2,700 people die each year because of health conditions, such as respiratory infections or cardiovascular problems, linked to fuel poverty, which is defined as occurring when fuel costs more than 10 per cent of income.<sup>8</sup>

Even more perplexing is the fact that driving key industries out of the UK would contradict the Government's declared aim of reducing carbon emissions. Total world emissions would not be reduced, but rather re-located outside the UK. In the case of the chemicals industry, we may drive overseas an industry that makes products, such as insulating materials, that are essential to a low-carbon future.<sup>9</sup> This is despite the Government having identified the chemicals industry as deserving of support in the growth review of December 2010.<sup>10</sup>

The Coalition's energy policies are obstructing growth, increasing unemployment and are self-defeating. The Government has recently become aware of the harm it is doing and, in his speech to the annual Conservative conference in October 2011, George Osborne said: 'We're not going to save the planet by putting our country out of business.' He went on: 'So let's at the very least resolve that we're going to cut our carbon emissions no slower but also no faster than our fellow countries in Europe'. If the Government's policies were to be based on this principle, it would be a significant step in the right direction, but it would be better still to restrict all climate-related measures to those that keep the UK among the most competitively priced energy markets in the developed world.

There have been some desirable policy changes, including significant reductions in feed-in tariffs, but many current Government policies are not consistent with Mr Osborne's principle. If the principle were followed, we would aim to produce the cheapest possible power attainable using the best technology now available. Both economic and environmental goals could be satisfied in the short term by relying on zero-carbon nuclear power and comparatively low-carbon gas power as our main fuel sources for the next few years. Above all, it would mean avoiding the huge waste of money on wind farms, especially those offshore, and carbon-capture and storage technology, as well as feed-in tariffs paying households over 400 per cent of the commercial rate for electricity that never even contributes to the Grid. In particular, public policies have yet to reflect the discovery of shale gas in Lancashire. The discovery of shale gas in America has transformed the market there, leading to a fall of 50 per cent in the price of natural gas in five years. We should develop our reserves at the fastest possible rate in order to develop gas-powered energy without jeopardising energy independence.

Mr Osborne's principle also calls into doubt the Government's plans to impose a unilateral carbon price floor in addition to the EU's Emissions Trading System (EU ETS). In the Autumn Statement, the Government granted concessions to energy-intensive industries, to shield them from some of the costs of the EU ETS, the carbon price floor and other green levies. Mr Osborne said: 'we shouldn't price British business out of the world economy' and his concessions are fine as far as they go, but

the Government is still ignoring the hidden effects green taxes will have on non-energy-intensive SMEs and prospective businesses not covered by the opt out. The foolish unilateral imposition of costs is a silent killer of enterprise, and the carbon price floor should be abandoned if Mr Osborne wants to remain true to his word.

## Chapter Two: Britain's strategic position and why we need to re-industrialise

---

Britain was the first country to industrialise and among the first to experience a shift to a service economy, but now we may need to be the first to re-industrialise. During the last 30 years, de-industrialisation was assumed to be the fate of all advanced nations. We would evolve inevitably from smokestack industries to a service economy. The champions of de-industrialisation theory were not completely wrong, but they made the mistake of thinking that the shift to services would continue permanently and could increasingly provide growth and jobs. It turns out that we can't pay our way in the world with manufacturing at only about 11 per cent of national economic output.

The gravity of our situation is inescapable. We last had a trade surplus in goods in 1982.<sup>11</sup> It's true that services made up for the deficit for several years, but the last time we had a surplus in goods and services combined was 1997. The deficit in goods for the first half of 2011 was £47.4 billion, following a record deficit of £98.5 billion in 2010.<sup>12</sup> The latest figures for 2011 show no fundamental change. Many hoped that manufacturing could rescue us from the recession, and initially the trend looked good. But ONS figures show that manufacturing output is about eight per cent below its pre-recession level.

We need to become the pioneers once more, discovering through the innate energy, inventiveness and drive of the British people how best to take the next steps in economic development. We can learn much from other countries but, as we have so often done in the past, we must be prepared to cut our own path to prosperity through the uncertainties of the new economic world order. Two main structural forces are at work. First, economic success depends on having 'retainable' industries, and not merely specialising in any sector in which a company or nation has a comparative advantage at any one time. Second, human capital is now more important than physical capital.

The unspoken background assumption of policy makers is that 'the market' allocates capital in such a way as to winnow out high-cost producers and leave behind only the efficient ones. When this happens we are all better off. If China can make things for less, then we must accept our fate and allow whole sectors to close: it will be hard on the displaced workers in the short run, but they will

soon move to higher-value activity. The trouble is that there is now a substantial economic literature questioning this orthodoxy.<sup>13</sup> One respected study by Ralph Gomory and William Baumol has shown that if there are economies of scale and high-start-up costs, markets entrench the position of existing producers and deter rivals.<sup>14</sup> Consequently, the competitive advantage of some producers is not the result of being the most efficient manufacturer but of having started early. When these conditions apply, industries are capable of succeeding in many locations. The list includes automobiles, shipbuilding and steel.

In such cases, public policies should examine whether or not an industry is 'retainable'. It may or may not be high in financial value but, if it is profitable and retainable, it is worth keeping. If an industry is 'retainable' but not currently located in the UK, it is worth substantial investment to establish it in order to gain the advantages of high-entry barriers and economies of scale. On this reasoning, for example, it would be worth Britain developing the manufacture of civil aircraft. A generation ago Brazil had no aircraft industry, but today it is a market leader in short-haul aircraft. If Brazil can do it from a standing start, there is no reason Britain cannot utilise its aviation heritage and do likewise. The skilled workforce is still here (but only just) and once lost, it will be nigh on impossible to reconstruct.

A recent BBC television documentary argued that 'brains not hands' were the way to go. The future lay in using our brains to contribute to design, marketing, branding and high-tech innovation. But the real challenge is to discover what makes for success and the key force is constant improvement or innovation of any kind. It is a mistake to associate innovation solely with 'ideas' that are found in realms separate from manufacturing plants, such as science labs or design suites. It is crucial to realise that the changes that defeat rivals could be in the process of production, or the way components are stored or supplied, and that these ideas can be found as often on factory floors as whiteboards.

Professor Gary Becker has estimated that 70 per cent of all capital deployed by companies is human capital, a term which includes the know-how and skills of production workers.<sup>15</sup> Nor is the distinction between high-tech and low-tech the key difference. It's staying ahead of rivals by constant improvement of any sort. If human capital is more important than it was even 30 years ago, it may explain why unemployment in the current recession has not been higher. The skills of the workforce are not easily replaced and employers have been keen to hang on to them. Compared with the

recession of the 1980s, a trained workforce is often the main asset of a company, a fact not fully captured in balance sheets.

Nor does it necessarily matter if a manufacturer supplies low-priced products. Manufacturers of low-cost parts, perhaps involving welding, casting or forging, are frequently supplying a high-value primary producer. They may be part of the supply chain and within a cluster. Their competitive advantage may be that they are local, which makes it easier to maintain an intimate knowledge of their customer's requirements and provide a custom service. Or a few key staff may have unique expertise. As the distinguished analyst of city economies, Jane Jacobs, has long argued, 'economies of location' can sometimes be more significant than 'economies of scale'.<sup>16</sup> Moreover, the same process of continuously searching for improvements is found in firms making low-price products. Being profitable is the main test of success.

The dramatic decline in manufacturing from over 20 per cent of GDP as recently as 1997 to about 11 per cent in 2009 means that the policy instruments that worked in the economic downturns of the 1980s and 1990s no longer have the same power. In particular, surplus capacity that can quickly be expanded is not there, as the Bank of England's Monetary Policy Committee recently acknowledged. It expressed surprise that manufacturers were not seizing the opportunities presented by the favourable exchange rate. The April 2011 minutes said it was 'puzzling that import growth had remained so robust, despite the substantial depreciation of sterling'. It concluded that this was probably because 'domestic substitutes for some imported goods and services were not available'. Moreover, it was 'possible that UK firms in some industries lacked the plant or capacity to expand production rapidly in response to the past depreciation of sterling and it would take time for them to install it'. Consequently, 'a lack of domestic alternatives had been a significant factor' reducing the substitution of home-produced goods for imports.

As a result, our economic revival now depends to a greater extent than in the past on investment in new capacity. This requirement puts the spotlight on another problem. We do not have financial institutions well suited to large-scale re-investment in productive enterprise. Again, in Mr Osborne's October 2011 speech we find recognition of the importance of manufacturing, but as yet, the necessary reforms have not happened.

We have singled out four main changes of direction. The single most important is to maintain an exchange rate within a range consistent with a current account balance, that is a rate that avoids a

persistent deficit and which does not seek to maintain a persistent surplus at the expense of other nations. In addition, we advocate import substitution; an industry bank; and avoiding an unbalanced focus on high-tech production.

### *Declare an exchange rate target*

We usually think of international trade as a competition to discover who is the most efficient producer and consequently able to charge the lowest prices. Trading success in world markets is the deserved reward for efficiency. If a firm in a foreign country can make cars more cheaply than our own manufacturers, then good luck to them. Today it is often said that cheap labour is the main factor in producing goods at low prices, and consequently we must accept that our jobs will travel east to countries such as China. But how valid is this line of reasoning?

Economists frequently debate the merits of protection versus free trade and tend to argue in favour of free trade because consumers will benefit from low prices. Import tariffs would preserve jobs for a minority of home producers at the expense of higher prices for the far larger number of consumers. However, the main problem for any producer of internationally tradable goods is that the exchange rate can wipe out the efforts of even the most diligent of companies. A firm may have the most up-to-date equipment, the best attainable labour productivity, and offer excellent quality, reliability, and prompt delivery, but prices matter most and often the margin between the lowest price and that of the nearest rival is small and easily overwhelmed by the exchange rate.

The exchange rate was a major explanation of the success of nations that grew to prosperity in the 25 years after the Second World War, notably Japan and Germany. They both enjoyed favourable exchange rates until the collapse of the Bretton Woods agreement after 1971. When its exchange rate became less favourable, Japanese growth slowed dramatically. Japan enjoyed a very fortunate exchange rate until 1971 when it was 360 yen to the dollar. By 1985 it was 285, and then it fell sharply to 145 by 1987. In 1995 it was just under 100, increasing to 131 by 1998. Without the exchange-rate advantage, its export success diminished and economic growth slowed.

We can see the size of the benefit by comparing domestic price increases in Japan with its export price increases from 1952 until 1979. Over that period the general price level in Japan rose by 364 per cent whereas the average price of Japanese exports rose by only 33 per cent. In Britain over the same period the general price level rose by 442 per cent and export prices by 380 per cent.<sup>17</sup>

The importance of the exchange rate can also be seen by comparing the different policies pursued by Britain, France and America in the 1930s. From 1929 until 1931 Britain had a minority Labour government that pursued a balanced budget and public spending cuts. The Government fell in 1931 and its successor left the gold standard, which resulted in the pound falling in value by 24 per cent. An Exchange Equalisation Account was established with resources of five per cent of GDP to keep the pound at its new level. In addition, the money supply expanded by 15 per cent from 1931 to 1932 and another 19 per cent in 1933. Interest rates were close to zero. Manufacturing output increased by 48 per cent from 1932 to 1937. The workforce increased from 18.7m to 21.4m between 1931 and 1937 and unemployment fell from 3.3m to 1.8m. There was no inflation.<sup>18</sup>

France initially followed a different path. It stayed on the gold standard until 1936 and between 1930 and 1936 GDP fell 17 per cent in total. Unemployment increased dramatically. When the exchange rate fell from 1936 the trend was reversed.

In America from 1929 to 1933 GDP fell by 30 per cent. Industrial output fell by nearly half and by 1933 25 per cent of the workforce was unemployed, with 13m out of work. In 1934 the dollar was devalued by 41 per cent and credit was increased. The money supply (M1) rose from \$20bn in 1933 to nearly \$30bn in 1936.<sup>19</sup> Between 1933 and 1936 GDP rose 32 per cent. Unemployment fell from 25 per cent to 17 per cent. There was little inflation. Then in 1936 the policies were partially reversed and federal spending was cut and GDP fell four per cent between 1937 and 1938. Unemployment rose to 19 per cent.<sup>20</sup> It is not easy to separate the impact of lower exchange rates from the effects of increasing the money supply, but it seems indisputable that the exchange rate had a significant effect.

The other fundamental dimension in any debate about the exchange rate is the extent to which trade should be seen as a method of gaining advantage at the expense of other nations, or as a way of securing mutually beneficial increases in prosperity. If any government sets an exchange rate target, then it is important that it should choose a figure that is consistent with a current account balance. The rate should be chosen to avoid not only persistent deficits but also persistent surpluses.

If our ultimate aim is a free society in which everyone has a chance to succeed, then governments play a decisive part in creating favourable conditions. Foolish policies can eliminate the potential gains from individual hard work and inventiveness. In an age of fiat money, the money supply and the exchange rate are vital elements in the creation of the conditions for personal responsibility.

Above all, under modern conditions, if we want significant economic growth it can't be accomplished by supply-side measures alone.

An exchange rate target should be set to give potential exporters the confidence that investment is worthwhile. We urgently need to increase manufacturing capacity but few will take the risk of investing in costly productive infrastructure if the low prices achieved through higher productivity could be swamped in a year or so by fluctuations in the exchange rate. The broad aim should be to maintain the exchange rate within well-defined narrow bands that allow the current account to be in balance. Policy should not seek to gain at the expense of other nations, nor meekly to accept that we can't compete with cheap Eastern labour. We should plan to maintain an exchange rate that is advantageous for all trading partners who play by the rules of mutual benefit from trade. Of course, there are implications for monetary policy, especially if bank rate is used as the chief policy instrument. A high interest rate may squeeze out inflation, but at the expense of attracting foreign money and pushing up the exchange rate. For this reason, the central bank should make greater use of more direct quantitative measures and credit controls to manage the money supply.

### *Encourage import substitution*

Our massive current account deficit could be narrowed by increasing exports, but it is far easier to reduce imports. Of course, increasing exports is desirable too, but it requires significant investment in overseas infrastructure and local contacts. In the short term, it will be faster and easier for UK-based firms to increase their output for the home market, especially now that the lower exchange rate has made imports more costly. Many goods, not just finished consumer goods but also the semi-manufactured goods required to build British products, are imported when they could be made here.

In a Civitas report, *Reviving British Manufacturing*, the distinguished entrepreneur Alan Reece argues that the Government should examine each sector of the economy to determine whether or not its own activities are putting companies at a disadvantage when competing with foreign rivals.<sup>21</sup> In the cement industry, for example, Britain was a net exporter until high energy costs began to push production overseas. Cement had a trade deficit of minus £87m in 2009 and now firms are building importation docks in the UK rather than new kilns.<sup>22</sup>

There is significant potential for import substitution within supply chains. Many goods finished in the UK are made using components from other countries. However, as many British companies are finding out, producing these commodities domestically can be advantageous and foreign goods and services can be unsatisfactory. To encourage domestic production, the Government needs to be more aware of successful sectors of the British economy which provide employment and reduce our reliance on imports. For instance, an investment by the German firm Palm Paper in 2009 reduced Britain's reliance on newsprint imports by one third. Inward investment in the glass industry has recently turned the UK from a net importer to a net exporter of fibre glass.<sup>23</sup>

There has already been a small trend towards bringing work back to the UK and a major trend has been noticed in the USA, described recently by the Boston Consulting Group.<sup>24</sup>

### *Establish an industry bank*

Because we urgently need to increase manufacturing, significant capital investment is required. Our existing banks are not focused on the development of manufacturing but rather on short-term trading gains, starving many SMEs of the necessary funds to invest in their businesses and maintain jobs. Five large banks have established the Business Growth Fund, with capital of £2.5 billion. In addition, the National Loan Guarantee Scheme has been set up to provide £20 billion of cheaper credit. Both these measures are steps in the right direction but on a scale far below what is required. To make up for their neglect, an industry bank to invest in productive enterprise could be established, and perhaps called the Enterprise Bank, as it would exist to promote enterprise in all areas of the economy. There is a precedent to build on.<sup>25</sup> In post-war Britain, the Industrial and Commercial Finance Corporation was established and proceeded to invest effectively in businesses until the 1980s, when it was privatised.<sup>26</sup> It was charged with selecting promising business ventures and backing them for as long as necessary. Germany's KfW and America's Small Business Administration are alternative models for overcoming the present lending crisis. These successful models are described in a separate, forthcoming report.<sup>27</sup>

The simplest method of funding the new Enterprise Bank would be to allocate £10 billion from the £75 billion recently added to the money supply by the Bank of England under its Quantitative Easing programme. Buying treasury bonds from the commercial banks in the hope that they will increase

their lending to businesses is not working rapidly enough, and under current conditions the main banks are incapable of altering their behaviour.

A national industry bank could play a vital role, but local banks are also important. Germany has numerous local savings banks that account for 23 per cent of German bank deposits and 20 per cent of all business loans.<sup>28</sup> They have an even larger market share of loans to SMEs and households. They are only permitted by law to invest in local businesses or mortgages, thus preventing local deposits from being siphoned off by casino banks. Local banks proved their worth during the financial crisis by increasing their lending to small businesses. Whereas the big commercial banks saw a net reduction in lending volumes of €9 billion since the third quarter of 2009, the savings banks increased lending by €18 billion.<sup>29</sup>

Similarly successful during the recession were the Cantonal banks in Switzerland, which have a similar business model of taking local deposits and lending to local businesses. Between 2006 and June 2011 the Swiss Cantonal banks increased total lending to Swiss businesses by 29 per cent. By contrast, UBS and Credit Suisse reduced lending by 15 per cent.<sup>30</sup>

Along with encouraging the creation of effective local banks, and setting up an Enterprise Bank, the Government also needs to ensure that it disposes effectively of its stakes in Royal Bank of Scotland (RBS) and Lloyds Banking Group. At present it appears that UK Financial Investments Ltd (UKFI), the company that holds and manages the assets of RBS, Lloyds and Bradford and Bingley for the Treasury, is prioritising price when selling the shares of these state-owned firms, rather than ensuring that any sale improves competition in the market for financial services. At present the banking market in the UK lacks competition but there is little in UKFI's mandate to tackle this. Although the framework document<sup>31</sup> states that the role of UKFI is to sell the public stakes 'in a way that promotes competition', this is just one of three goals and one which is secondary to the goal of 'maximising the realisation of value for the taxpayer as shareholder'. In fact promoting competition is only a consideration 'if another incumbent bank was seeking to acquire a controlling stake in one of the businesses'.<sup>32</sup> The sale of Northern Rock to Virgin Money for an upfront sum of £747 million was aimed at increasing competition in the financial sector, but given the comparatively small size of Virgin Money, this will be a drop in the ocean. The Government claims to want 'to increase competition in retail banking', but will need to bring this about itself.<sup>33</sup>

The sale of the public holdings in Lloyds, RBS, Northern Rock and Bradford and Bingley should, as far as possible, help create or increase the market share of banks that demonstrate a willingness and an ability to serve SMEs more effectively. RBS is 85 per cent owned by the government and its existing network of branches and highly trained staff could easily be transformed into an industry bank.

Proposing an industry bank inevitably raises questions about selective assistance. After the heavily criticised industrial policies pursued from 1945 until 1979, proposals for a modern variant are often treated with scepticism. But during the Thatcher years much public money was awarded to nationalised companies such as British Steel, Rover and Rolls-Royce. The aim was to prepare them to face their rivals in the market, but it was accepted that they needed a respite of a few years before they were ready.

One of the mantras that gets repeated when the possibility of taxpayer support for enterprise is discussed is that governments should not 'pick winners'. In reality, every government throughout history has assisted business enterprises and our current Government is no exception. At present it has a Regional Growth Fund with a budget of £1.4 billion and an advisory committee chaired by Lord Heseltine that selects the investments (picks the winners!). The Government has also invested huge amounts in wind turbines, both onshore and offshore, and in carbon capture and storage. These too are examples of the government trying to pick winners.

The usual argument against government investment decisions is that the decision makers do not personally bear the losses and are inclined to make irresponsible decisions. They may invest in grand prestige projects (sometimes named after political leaders), or in projects that benefit their own political party (crony capitalism), or take decisions without giving the necessary careful and detailed consideration, knowing that they will not lose anything in the event of failure. Civil servants, too, may lack the sense of personal responsibility of an investor who stands to lose everything.

But are the banks any different? It is now a commonplace that some banks were seen as 'too big to fail', which meant that they could count on the taxpayer to pick up any losses. Profits were private; but the losses were public. It is now widely accepted that this awareness encouraged them to take greater, often reckless, risks. Their position resembles that of political leaders or civil servants who invest public funds. What they have in common is the moral hazard that arises when individuals have control of other people's money while being aware that they will not suffer personally if they make bad decisions.

For this reason it is desirable for the investment of public funds to be conducted at arms length from political leaders and civil servants with lifetime job security. Of equal importance, we should ensure that non-government organisations never have claims on the public purse regardless of their success or failure. Other countries have developed systems that mitigate against these potential flaws. German savings banks, for example, despite being ultimately controlled by local authorities, are required by law to make investments on strictly commercial criteria.<sup>34</sup>

And the countries that grew to prominence while Britain was declining, such as South Korea and Japan, successfully provided selective assistance. They tried to overcome the risk of pouring money into bottomless pits, or the pockets of people with good political connections, by devising objective tests of performance that were not easily manipulated. For example, between 1945 and 1960 about 30 Japanese car companies were established. Most failed. Going to the Japanese Government with a hard-luck story didn't help. It supported only those firms that were able to demonstrate success on independent measures. The most significant was the ability to export, an objective test that is impossible to fabricate. If we were to assist companies in Britain, a similar objective test would be their ability to supply consumers who currently prefer to buy imported products. But all such policies should be temporary. The government would be 'buying time' to increase pluralism.

But, in any event, channelling investment through an industry bank is not the same as directing investment via political leaders (whose priorities may be distorted by the needs of their party) or civil servants (who lack full personal responsibility for outcomes). Nor is it re-creating the perverse incentives of commercial bank executives who know that costly mistakes will make no difference to their remuneration.

The primary justification for the use of some public funding is that the benefits of new investment are not restricted to the people who put up the money. When a new venture is established there will be a rebound effect on the wider community in the vicinity of the factory; and there will be a national benefit if the balance of payments is improved. New jobs will reduce unemployment, which will benefit not only the immediate employees, but also the other taxpayers who will be able to spend less on out-of-work benefits.

There is an underlying assumption that the market allocates efficiently and that the public sector does not. However, as we have become aware since the Great Recession of 2008-09, banks can often make more money through arbitrage than by selecting which manufacturers to back. Many

creditworthy projects do not receive support, as a recent ONS survey found. Banks have argued that reduced lending reflects a fall in demand from businesses, but an ONS survey of small and medium-sized enterprises (SMEs) found that demand rose between 2007 and 2010: 35 per cent of businesses sought finance in 2007, rising to 42 per cent in 2010.

Over the same period there was a fall in the number of businesses that were successful in securing loans: 65 per cent were successful in 2010, down from 90 per cent in 2007.<sup>35</sup> If we assume that private investors seek the highest return, and they can make more money by buying and selling securities or foreign exchange for its own sake, they will do it. The full benefit of the transaction returns to them, whereas if they invest in a factory the return to capital is only one small part of the overall benefit. One way of avoiding the partiality of private investors is to increase investment by taxpayers. If the funds are provided through an industry bank that is legally obliged to invest in commercially viable enterprises, then the risks of political distortion are much reduced.

### *End the unbalanced focus on 'advanced manufacturing'*

Current Government plans to 'rebalance the economy' partly rely on the argument that Britain should support advanced manufacturing and the Autumn Statement provided an enlargement of the research and development (R&D) tax credit scheme. The term 'advanced' is often and confusingly used interchangeably with 'high-tech'. Ministers appear to have assumed that the Britain's competitive advantage needs to rely on ventures based on R&D. There are three problems with this argument.

First, it ignores the 86 per cent of British manufacturing which is not high-tech. Moreover, low-tech does not mean low value.<sup>36</sup> Second, it ignores the fact that sectors do not exist in isolation. And third, it ignores the reality that R&D is not synonymous with innovation, which is a key source of competitive advantage. The result is an unbalanced strategy that will hinder economic development.

High-tech/advanced manufacturing, as the Government understands it, is defined by the OECD as spending over five per cent of turnover on R&D. The case for supporting it was made in 2010 in the Dyson Report, but this report and ministerial speeches that followed paid little attention to the low- and medium-tech businesses that make up the majority of UK manufacturing. In 2007, high-tech companies employed just 12 per cent of all workers involved in manufacturing and contributed only 14 per cent of the total manufacturing output.<sup>37</sup> Given the size of Britain's non-high-tech industries,

Nick Clegg, the Deputy Prime Minister, was wrong to suggest that ‘a new economy might be able to rise, phoenix-like, from the ashes of the old’.<sup>38</sup> We are not starting again from scratch but should be building on what we already have.

The manufacturing growth review conducted by the Government in December 2010 identified seven ‘successful UK Advanced Manufacturing sectors’.<sup>39</sup> Similarly, the Autumn Statement brought the news that the Government is to ‘invest an additional £75 million in supporting technology-based SMEs’.<sup>40</sup> These sectors are important, but the economy cannot be built on them alone. Nor indeed can these industries actually survive without equipment and components from other British manufacturers. We need to encourage all kinds of manufacturing, not just specific types that have come to the Government’s attention. If the Government is intent on supporting certain sectors, then it must do so throughout the wider supply chain, regardless of research intensity.

The Government’s preoccupation with funding R&D appears dangerously close to the out-dated ‘linear model’ of innovation, a doctrine which assumes that investing in research leads to inventions that then need to be brought to market by an entrepreneur. For most companies, however, their competitive strength lies elsewhere. An EEF survey found that only two per cent of companies said research was their main source of competitive strength, as opposed to 29 per cent who said their production processes gave them the edge.<sup>41</sup>

This response reflects the fact that many British companies use high-tech processes to make low-tech products that are still demanded by customers. Any manufacturing firm that has survived to 2011 and retained UK production has had to transform its production. For example, JJ Churchill makes fan blades for Rolls Royce. They are fairly basic solid metal products, but have to be made with some of the most precise machines on the planet.

The Government should recognise that innovation occurs in many different and informal ways – sometimes employees discover inefficiencies or managers restructure production to deploy the very latest machines or reorganise the supply chain. Innovation and R&D are not synonymous. Research is only one element in the continuous search for innovation. Public policies should aim to create favourable conditions for any productive business that can support itself, whether it is high-tech or not.

## Chapter Three: The conditions for enterprise

---

Chancellor of the Exchequer, George Osborne, described his March Budget as ‘unashamedly pro-growth’. Unfortunately, since the Budget growth has been slow.<sup>42</sup> It is all too clear that more needs to be done, despite Mr Osborne’s renewed declaration of enthusiasm for growth in his October conference speech. The Government should be straining every sinew to provide the most favourable conditions for enterprise that are within the gift of government. In particular we should aim to provide better conditions than any of our main economic rivals.

### *Reduce company taxation*

Corporate taxes in Britain are high compared with those of many of our competitors: the UK imposes the 19<sup>th</sup> lowest tax rate of the 34 countries in the OECD. The Government plans to reduce the headline rate of corporation tax to 23 per cent by 2014 but this reduction is too small to provide a real boost to growth. We should aim for a rate much closer to the Republic of Ireland’s 12.5 per cent, the lowest in the OECD, which has allowed it to attract many investors away from the UK.

To a considerable extent, multinational companies are able to choose in which country they pay corporation taxes. In 2008, it was estimated by the Commons public accounts committee that because of this, £8.5bn was lost, mostly to offshore low-tax regimes.

We should unashamedly make the UK the tax regime of choice. There is international competition for the location of major companies and it is better to attract them by creating conditions favourable to all enterprise, rather than through selective assistance. Mr Osborne announced his hopes for corporation tax in his speech to the *Telegraph* Festival of Business in September 2011, when he said, ‘we want Britain to have the most competitive business tax system of any of our major competitors’.

To achieve that aim, we have a long way to go. A headline corporation tax rate of about 15 per cent would be feasible. Within a short period, it is likely that income from the tax would increase as more companies installed themselves in the UK. This would more than make up for any temporary reduction that might initially result from lowering rates.

While accommodating the needs of companies, the UK should also make sure that the abuse existing within the current system is ended. At present, 98 of the FTSE 100 companies utilise offshore tax havens. If Britain were drastically to reduce its corporation tax rate, the *quid pro quo* should be the closure of these tax loopholes and swift, heavy punishments for those found to be dodging tax payments.

Capital allowances also need reform. The current proposal to reduce capital allowances claws back two-thirds of the cost of lowering the corporation tax rate, achieved by reducing the main recovery rate from 20 per cent to 18 per cent commencing in April 2012. Furthermore, the annual investment allowance is to fall from £100,000 to £25,000. If we are to increase exports and reduce manufactured imports, we need our companies to invest in plant and machinery. Reducing capital allowances penalises the very companies whose help we need most.

### *Eliminate unnecessary workplace regulations*

The need for less regulation is widely accepted and as part of the Coalition Agreement a 'one in, one out' policy was introduced. On the surface this sounds like a good idea but the practical reality is different. There are still out-dated regulations lurking in legislation, some imposed in the 18th and 19th centuries. If they were replaced by new regulations, it would not cut red tape but replace obsolete regulations that make no practical difference with new obstructions. The overall effect for companies would therefore be negative.

In September 2011 the Government published its statement of progress for the 'one in, one out' policy and was keen to emphasise the fact that the net annual regulatory cost to businesses had fallen by £3.2 billion by June 2011.<sup>43</sup> However, a closer look at the figures reveals that the Government was expecting a net increase in business costs of £45.2 million between June and December 2011. Moreover, the vast majority of the reduction in costs was the result of a change in pension indexation, which allowed companies to pay less to their defined-benefit pensioners. Furthermore, Whitehall officials calculate that the implementation of the EU's Agency Workers Directive will cost British businesses £1.8 billion a year.<sup>44</sup>

In October 2010 additional parts of the 2010 Equality Act were introduced. The previous Government had produced an 'impact assessment' making immense claims about the financial benefits of the Act. There were a few initial costs, followed by massive annual gains; social evils were

to be reduced while contributing to the economy at the same time. However, Civitas statistician Nigel Williams has re-examined the figures and found that the surplus of benefits over costs vanishes when looked at more closely.<sup>45</sup> Annual benefits in excess of £62 million are described as a benefit to society resulting from greater equality. However, there is no factual basis for this figure, which comes only from a series of contestable assumptions. £62 million represents a notional value that the assessment's authors placed on equality, before making the further assumption that the Act's measures contribute to it. The costs of the Act, on the other hand, are very real. The impact assessment sets the first year's cost in a range from £240.9 million to £282.6m.<sup>46</sup>

In March 2011 the Government published *The Plan For Growth* in which it voiced concern about the cost of regulation and declared its ambition to eliminate excessive red tape. The aspiration has often been repeated since. In his September 2011 speech to the *Telegraph* Festival of Business, Mr Osborne said that it was the Government's ambition that 'Britain should be the best place in Europe to start, finance and grow a business'. Over the last decade the UK had fallen behind in the Global Competitiveness Index, going from 4th in 1998 to 12th in 2010, but in September 2011 Britain had re-entered the top ten. Britain, he said, 'is becoming once again a competitive place to do business' because the Government was 'tackling the suffocating burden of red tape'. In the first half of 2011 he claimed to have scrapped over £3 billion worth of 'unnecessary regulation' and imposed 'a moratorium on new regulations on small businesses'. In addition the Government was 'battling with Europe – the origin of so much new red tape – to make them stop and realise that if they carry on then they will price our entire continent out of the world economy'.

Mr Osborne's heart is in the right place, but a more concerted effort to reduce regulatory red tape is needed. The ideal would be to apply a moratorium to all new business regulations and radically transform employment tribunals and related laws. In his speech to the Conservative conference in October 2011, Mr Osborne announced that the Coalition will 'double to two years the amount of time you can employ someone before the risk of an unfair dismissal claim' and introduce a fee for taking a case to a tribunal, returnable if complaints are upheld. In the Autumn Statement, this was further developed with the idea of a 'Rapid Resolution' scheme, aimed at providing quicker, cheaper alternatives to a tribunal hearing. So far so good, but the Government should go further and impose a cash limit of £5,000 on all unfair dismissal and discrimination compensation awards. At present some awards have no set limit. Above all, the Government should exclude avaricious 'no win no fee' lawyers by transforming employment tribunals into mediation procedures.

### *Cut personal taxes to make it easy to start new businesses*

Mr Cameron recently said that for many who aspire to start a business, there was one simple problem – ‘they just don’t have the money’.<sup>47</sup> The Government has therefore set up the new enterprise allowance, providing up to £2,000 to those who wish to start their own business. But the scheme is only for people who are unemployed and will be of no use to the vast majority of potential entrepreneurs: 88 per cent of start-up funding comes from personal savings or loans from friends and family, whereas only 12 per cent is from banks.<sup>48</sup> At the moment people ‘just don’t have the money’ because of high taxation.

The best way to create a new generation of entrepreneurs would be to cut personal taxes, starting with the 50 per cent rate. In 2009 the Institute for Fiscal Studies examined the previous Government’s plan to set a tax rate of 45 per cent for those earning over £150,000. The IFS estimated the degree to which high-earners would reduce their tax burden in response to the tax increase and concluded that ‘the proposed income tax rate of 45 per cent on incomes above £150,000 would therefore cost rather than raise money’. The Government disagreed, arguing that the IFS had overestimated the extent to which individuals would be able to reduce their tax burden. However, even when using the Government’s assumptions, the IFS calculated that the tax would only raise £0.6 billion a year, when changes to the consumption patterns and payment of national insurance by high earners was included.<sup>49</sup> The IFS recently reiterated the fact that the economic benefit of the tax was extremely uncertain.<sup>50</sup>

Whether or not the tax actually raises any revenue, the Government needs to consider the wider effects of the tax. Is it worth sending the wrong signal to potential investors and wealth creators for little, if any, financial gain? The Government needs to cut what was always supposed to be a temporary tax measure and encourage investment.

In October 2011, Mr Osborne repeated his view that you can’t borrow your way out of debt. However, you can borrow your way to economic growth, which will reduce total national debt as a proportion of GDP. Mr Osborne is fearful that cutting taxes will increase borrowing and force up interest rates, but economic growth will be more likely to achieve his ambition of keeping interest rates low. Bond markets fear default, and if national debt is a lower proportion of GDP then the chances of default are lower, leading to lower interest rates.

The main asset a nation has is its people and the first aim of policy should be to engage as many as possible in productive work, through which they make a net addition to national economic output. Keynes made this case effectively in the 1930s, but idleness is even more costly today because welfare provision is now so much more generous. There is a grave danger that high levels of personal taxation will subdue consumer demand and increase the number of people no longer adding to output.

Raising capital gains tax (CGT) for higher-rate taxpayers targets those most likely to invest their savings in productive ventures. The Government is intending to freeze the CGT annual exemption amount at £10,600 for 2012-13, but this is not enough of a boost for the economy. Although the Government is concerned that wealthy individuals use capital gains to reduce their tax burden, this ignores the distinction between capital gains from short-term speculation and those that result from productive businesses. If an enterprise economy based on saving and investment is the aim, we should stop taxing gains that are the legitimate result of investments. People who have put their own money into productive ventures are public benefactors and taper relief is one long established method of distinguishing between speculators and genuine investors. Its credibility was undermined by Labour's policy of permitting tax breaks after investments had been held for a mere two years. After about eight years we can safely say that investors are not pure speculators and a reasonable approach would be to reduce capital gains tax on productive assets held for eight years and cut the rate to zero after ten years. At present the normal rate is 18 per cent, but a lower rate is available to owners of a business. Entrepreneur's relief applies to gains arising on disposals of the whole or part of a trading business (not including a property letting business other than furnished holiday lettings) carried on by an individual, either alone or in partnership. Gains are taxed at an effective rate of 10 per cent, compared with the normal 18 per cent.

### *Export support*

Most nations hope for export-led growth, but we can't expect to increase our exports without a strong focus on manufacturing. Even at its maximum output in 2008, the financial services sector generated exports of £52.8 billion, while British manufacturing generated £194.2 billion.<sup>51</sup>

Exporting is risky and beyond the means of many companies.<sup>52</sup> Furthermore, the risk involved in exporting increases in times of economic uncertainty as banks and insurers become wary about

issuing guarantees or insuring transactions because of the increased possibility that overseas buyers or sellers will default. Economic uncertainty has plagued the world economy since the financial crisis and British exporters have suffered from reductions in the coverage of export insurance and increases in its cost. In March 2010, the British Chambers of Commerce carried out a survey of exporters in the Greater Manchester area which indicated that one in eight exporters had reported problems with their trade financing arrangements over the previous 12 months.<sup>53</sup>

In response, the British Government set up a number of schemes, such as the letter of credit guarantee scheme, providing reinsurance or counter-guarantees encouraging banks and insurance companies to be less risk-averse. The problem with such interventions is that they are reactive and so may go unnoticed by the firms in need of them. Moreover, businesses are also still reliant on banks and insurers who retain the final say over whether cover is granted and at what price.

The case for government involvement in trade finance is not just limited to periods like the present when private provision is constrained. The majority of governments recognise that in some markets or for some time-periods, there is a shortage of private provision of trade finance. Unfortunately the British Government is far less supportive of its exporters than other governments.

The Export Credit Guarantee Department's Fixed Rate Export Finance scheme enables UK exporters to offer medium- and long-term loans to their overseas buyers at fixed rates of interest. It would be of great value if it also provided an exchange-rate hedging service. It should cover, not only imports of raw or semi-finished materials for use in industries that will add value, but also exports of goods and services. Commercial banks already provide hedging but it can be expensive for small businesses and is not available for all risks.

Unlike most of our rivals, the British Government does not run a state-backed export insurance agency for short-term, non-capital goods financing. In contrast, the governments of many other developed countries run export credit agencies, often in partnership with private firms. Such agencies, as well as providing long-term financing for capital and semi-capital goods, also provide short-term financing for firms trading non-capital goods in risky markets, the market segment that is least likely to be served by private providers.<sup>54</sup> Compared with other OECD countries, the current level of provision places British exporters at a severe disadvantage. Most importantly, the Government needs to create a permanent, publicly-backed, insurance scheme that provides short-term, non-capital goods financing for trade in risky markets.

It is generally accepted that the Government should be actively campaigning abroad on behalf of British companies. UK Trade and Investment (UKTI) was established to fulfil this role and was granted an extra £45 million per annum in the Autumn Statement with the intention of doubling the number of SME's supported. However, prior to this, UKTI had its funding cut by 17 per cent by 2015, meaning a reduction of £46 million per annum by then.<sup>55</sup> Overall then, UKTI gains nothing and is stagnating at a time when most foreign governments are backing their industries more than ever. In addition, UKTI has altered its fee system. Whereas previously a fee would be charged for a physical product or service, there is now a policy of charging for UKTI time and resources.<sup>56</sup> In itself this need not be a problem, but many companies have expressed concerns about the clarity of the new system; businesses need to know what they are paying for and to be reassured that their money is being spent wisely.

This is also important because more needs to be done to ensure that UKTI is operating as effectively as possible. In a recent analysis by the National Audit Office, nearly 50 per cent of respondents felt they would have achieved similar results without UKTI assistance or would have achieved the same end but not as quickly.<sup>57</sup> This result masks the fact that some UKTI services and some UKTI offices are more effective than others. Rather than cutting funding, the UK Government should ensure that UKTI funding is being used in areas where it is having the greatest effect, and that under-performing UKTI offices are improved. The evidence suggests that UKTI adds the most value to a company's efforts to expand its business when that company has no export experience. A company's need should be the main factor in any decision by UKTI to provide assistance, and arbitrary considerations such as whether the business is high-tech or an 'advanced' manufacturing firm should play no part. Low- and medium-tech companies account for 35 per cent of UK manufacturing exports.<sup>58</sup>

### *Intelligent procurement*

In March the Government promised to reform procurement. David Cameron has announced that he wants at least 25 per cent of government business to go to SMEs. Paradoxical regulations such as allowing only companies who have already supplied the Government to apply for certain tenders are widespread and act as a significant barrier to fulfilling this pledge, which appears to have been quietly dropped of late. While SMEs constitute 50 per cent of the British economy, they only win between five and ten per cent of government tenders.<sup>59</sup> With an annual procurement budget of £191 billion, there is huge potential to seed the growth of many more businesses.

The Government must ensure that public procurement supports British companies and the British economy. The failure of the Government to do this was glaringly obvious in the recent decision to award the £1.4 billion Thameslink contract to Siemens rather than domestically-based Bombardier.

### *Make the most of European Union state aid rules*

Both Labour and Conservative politicians blamed one another's interpretation of EU rules for the failure to award the Thameslink contract to Bombardier. The reality is that successive British Governments are to blame for failing to make the most of European Union rules on procurement and state aid.

Other European countries dedicate more public resources to supporting their industries, especially their manufacturing industries. Between 1992 and 2007 the UK Government spent less than one per cent of its state aid on manufacturing; the German, French, Italian and Spanish Governments spent an average of 15.2 per cent.<sup>60</sup> Historically, the British Government has dedicated less public spending to specifically supporting British industries and British businesses, choosing instead to concentrate on pan-European objectives endorsed by the European Commission. Other EU Governments have seldom been as keen to place European objectives above national ones. Since 1992 Britain has only spent 18.7 per cent of its state aid specifically supporting British interests while France, Germany and Spain have all spent over 40 per cent supporting domestic firms and industries.<sup>61</sup> A close examination of the state aid measures scrutinised by the European Commission in the last three years indicates that the British Government used state aid to support the growth of the green economy, but failed to support specific firms, industries or underdeveloped regions.<sup>62</sup> In its relations with the EU, the UK must take a firmer stance towards the European Commission and push for the abolition of the state aid rules.

### *Free trade, foreign investment and the common good*

Even in a mature economy like our own, it is questionable whether foreign investment, including foreign direct investment (FDI), is always favourable to competition. Clearly, the UK must remain a world-beating location for inward investment. The investments made by Japanese car companies in the 1980s and 1990s, and more recently by firms such as Tata Steel and Bombardier in Belfast,

represent a real attempt by businesses to locate production in the UK. However some investments are made simply to reduce competition. For example, the French company Alstom took over Metro-Cammell, but after it had built the Pendolino train for Virgin, it closed the factory down. Similarly, Coles Cranes, a successful North-East company, was taken over by the American crane manufacturer, Grove, and closed down. As guardian of our own national interest and the international community's public interest, the Government is entitled to ask whether or not specific investments are likely to increase or reduce competition. The Government should apply a public interest test to all FDI. Until the 2002 Enterprise Act the Government had such a power. The Takeover Panel has proved to be a rather weak instrument, and it would be more effective to empower the Government to protect the public interest by referring acquisitions and mergers to the Competition Commission if it fears that competition will be reduced.

# Conclusions

---

The Government is aware of the need for growth but lacks urgency and consistency. GDP is about four per cent below its peak in the first quarter of 2008 and manufacturing output is over eight per cent below its pre-recession level. In these circumstances, a government that acknowledged the long-term value of industry would have prevented the Thameslink contract from going to Germany at the expense of jobs at Bombardier in Derby, and it would have moved heaven and earth to prevent the loss of skilled manufacturing jobs at BAE. Instead, it has failed dismally. Above all, the Government continues to make matters worse by pursuing a misguided energy policy and persists in denying itself some of the most effective policy measures, not least an exchange-rate strategy and an industry bank. It has not even been resolute in pursuing deregulation or other widely accepted supply-side measures. There is a long way to go.

## Notes

---

- <sup>1</sup> This is an enlarged and re-written edition of a shorter report published in March 2011. Some of the original text has been retained.
- <sup>2</sup> Waters Wye Associates, *The Cumulative Impact of Climate Change Policies on UK Energy Intensive Industries – Are Policies Effectively Focused? A summary report for The Energy Intensive Users Group and the Trades Union Congress*, July 2010.
- <sup>3</sup> Royal Society of Chemistry, *The Economic Benefits of Chemistry: summary report*, September 2010, p. 2.
- <sup>4</sup> Waters Wye Associates, *The Cumulative Impact of Climate Change Policies on UK Energy Intensive Industries – Update Against New Government Policy A summary report for The Energy Intensive Users Group*, March 2011.
- <sup>5</sup> David Merlin-Jones, *Chain Reactions*, Civitas, 2011, p. 32
- <sup>6</sup> CQuestCapital, *CQC's view of supply and demand in the CDM offset market*, May 2010, p. 5
- <sup>7</sup> [http://www.tatasteeeurope.com/en/news/news/2011\\_long\\_products](http://www.tatasteeeurope.com/en/news/news/2011_long_products)
- <sup>8</sup> <http://www.decc.gov.uk/assets/decc/11/funding-support/fuel-poverty/3226-fuel-poverty-review-interim-report.pdf>
- <sup>9</sup> David Merlin-Jones, *Chain Reactions*, Civitas, 2011.
- <sup>10</sup> Department for Business, Innovation and Skills, *Growth Review Framework for Advanced Manufacturing*, December 2010, p. 11.
- <sup>11</sup> Ken Coutts and Robert Rowthorn, *Prospects for the UK balance of payments*, London: Civitas, 2010.
- <sup>12</sup> ONS, Statistical Bulletin, *Balance of Payments Second Quarter 2011*.
- <sup>13</sup> For example Dani Rodrik, *The Globalization Paradox*, Oxford: OUP, 2011.
- <sup>14</sup> Ralph Gomory and William Baumol, *Global Trade and Conflicting National Interests*, London: MIT, 2000; Ha-Joon Chang, *23 Things They Don't Tell You About Capitalism*, London: Allen Lane, 2010.
- <sup>15</sup> Gary S. Becker, *The Age of Human Capital*, in E. P. Lazear, *Education in the Twenty-First Century*. Palo Alto: Hoover Institution Press, 2002, pp. 3-8.
- <sup>16</sup> Jane Jacobs, *The Nature of Economies*, New York: Vintage, 2001, p. 81
- <sup>17</sup> John Mills, *Europe's Economic Dilemma*, London: Macmillan, 1998, p. 139.
- <sup>18</sup> John Mills, *Managing the world economy*, London: Palgrave Macmillan, 2003, p. 87.
- <sup>19</sup> Mills, *Managing the world economy*, p. 91.
- <sup>20</sup> Mills, *Managing the world economy*, p. 92.
- <sup>21</sup> Alan Reece, *Reviving British Manufacturing*, Civitas, 2011.
- <sup>22</sup> David Merlin-Jones, *'Rock Solid?' An investigation into the British cement industry*, November 2010, <http://civitas.org.uk/pdf/CementMerlinJones.pdf>
- <sup>23</sup> Stephen L. Clarke, *Four Industries and a Funeral*, July 2011, <http://www.civitas.org.uk/pdf/FourIndustries.pdf>
- <sup>24</sup> Boston Consulting Group, *Made in America Again*, August 2011.
- <sup>25</sup> David Merlin-Jones, *The Industrial and Commercial Finance Corporation: Lessons from the past for the future*, October 2010, <http://www.civitas.org.uk/pdf/ICFC.pdf>
- <sup>26</sup> <http://www.civitas.org.uk/pdf/ICFC.pdf>
- <sup>27</sup> David Merlin-Jones, *The Case For An Industry Bank*, Civitas: forthcoming 2011.
- <sup>28</sup> Deutsche Bundesbank, *Monthly Report August 2011*, Statistical Section, p. 24
- <sup>29</sup> Deutsche Bundesbank, *Bankenstatistik Stand vom 15.8.2011*, August 2011

- 
- <sup>30</sup> Stephen L. Clarke, *German savings banks and Swiss cantonal banks, lessons for the UK*, December 2010, <http://civitas.org.uk/pdf/SavingsBanks2010.pdf>
- <sup>31</sup> UK Financial Investments Ltd, *UKFI Framework Document*, October 2010.
- <sup>32</sup> <http://www.ukfi.co.uk/about-us/investments-strategy/>
- <sup>33</sup> H.M. Treasury, *Autumn Statement 2011*, 2011, p. 28
- <sup>34</sup> <http://civitas.org.uk/pdf/SavingsBanks2010.pdf>
- <sup>35</sup> [http://www.ons.gov.uk/ons/dcp171778\\_235461.pdf](http://www.ons.gov.uk/ons/dcp171778_235461.pdf)
- <sup>36</sup> OECD, *STAN SStructural ANalysis Database*, 2007.
- <sup>37</sup> OECD, *STAN SStructural ANalysis Database*, 2007.
- <sup>38</sup> Nick Clegg, speech, Rotherham, 4 February 2011.
- <sup>39</sup> Department for Business, Innovation and Skills, *Growth Review Framework for Advanced Manufacturing*, December 2010, p. 11.
- <sup>40</sup> *Autumn Statement*, p. 40
- <sup>41</sup> EEF Business Trends Survey cited in: Technology Strategy Board, *High Value Manufacturing Key Technology Area 2008-2011*, 2008, p. 11.
- <sup>42</sup> Office for National Statistics, Quarterly national accounts, 2nd Quarter 2011, October 2011.
- <sup>43</sup> HM Government, *One-in, One-out: Second Statement of New Regulation*, September 2011, p. 5.
- <sup>44</sup> *The Telegraph*, 'British workers to lose jobs under new EU rules', 30 September 2011.
- <sup>45</sup> <http://www.civitas.org.uk/pdf/WilliamsEqualityAct2010Cost.pdf>
- <sup>46</sup> Equality Act Impact Assessment: final version (Royal Assent), Great Britain Government Equalities Office, TSO (The Stationery Office), London 2010, page 5.
- <sup>47</sup> David Cameron, *Speech to the Conservative Party Conference*, March 2011.
- <sup>48</sup> Dr Stuart Fraser, *Small Firms in the Credit Crisis: Evidence from the UK Survey of SME Finances*, Centre for Small and Medium-Sized Enterprises, Warwick Business School, University of Warwick, 2009, p. 83.
- <sup>49</sup> M. Brewer, J. Browne, IFS Briefing Note BN84, *Can More Revenue be Raised by Increasing Income Tax Rates for the Very Rich?* 2009.
- <sup>50</sup> *The Daily Mail*, '50p income tax rate costs economy £500m a year as high earners move their cash abroad', 15th September 2011.
- <sup>51</sup> ONS, *The Pink Book 2010*, pp. 37 & 46
- <sup>52</sup> British Chambers of Commerce, *Manufacturing for Export, Make or Break for the British Economy*, January 2011, p. 47.
- <sup>53</sup> The British Chambers of Commerce, *Exporting Britain: Trade Finance*, March 2010, p. 8.
- <sup>54</sup> The British Chambers of Commerce, *Exporting Britain: Trade Finance*, March 2010, p. 5.
- <sup>55</sup> UK Trade & Investment, *UK Trader & Investment Annual Report and Accounts 2010-11*, July 2011, p. 18, Fig. 4
- <sup>56</sup> House of Commons Business, Innovation and Skills Committee, *Exporting out of recession Third Report of Session 2009-10, Volume I*, January 2010, p. 25.
- <sup>57</sup> House of Commons Business, Innovation and Skills Committee, *Exporting out of recession Third Report of Session 2009-10, Volume I*, January 2010, p. 30.
- <sup>58</sup> OECD STAN Indicators, edn. 2009.
- <sup>59</sup> David Cameron speech, *PM Speech on Government Procurement*, 11 February 2011.

---

<sup>60</sup> The European Commission, *State aid by sector and objective, in million Euro (1992-2009)*, December 2009.

<sup>61</sup> These figures do not include spending on financial services between 2007 and 2009. The European Commission, *State aid by sector and objective, in million Euro (1992-2009)* 2010.

<sup>62</sup> Stephen L. Clarke, *The EU made me do it!*, Civitas, forthcoming.