



# Interim Report #6

## 1 October 2020

## INTRODUCTION

On September 21st, the LSE Economic Diplomacy Commission conducted its sixth round of evidence sessions concerning specific regional and sectoral issues and strategies for the UK's economic diplomacy. The discussion broadly covered advancing the government's 'levelling up' agenda, modernising the UK's infrastructure oversight and investment bodies, re-centring local actors in the economic diplomacy process, establishing national industrial priorities, as well as learning from countries which have achieved sustained and spatially equitable growth in recent decades.

The witnesses, who embody a broad range of academic, political, and professional expertise, were provided a set of questions in advance and were invited to follow up afterwards with further thoughts. Given the degree to which COVID-19, the US-China trade war, and UK-EU negotiations remain dynamic, the opinions expressed here should not be taken as the final considerations of the witnesses, the Commissioners, or the Commission. As such, the Commission may wish to re-engage with these issues towards the end of the year.

## CHALLENGES

Long-standing regional and sectoral disparities have been exacerbated by the economic consequences of COVID-19. Without proper attention, the UK's withdrawal from the EU, the future course of the US-China trade war, globalisation, and automation threaten to widen outcomes and entrench inequalities further. Economic diplomacy, as a matter of foreign economic policy, can play a role in solving for these problems; however, this must come hand-in-hand with updates to the domestic components of the UK's policy agenda, so that the underlying challenges may be addressed as well. As one witness put it, "Economic diplomacy opens up economic opportunities, but only if we address issues of skills, education and infrastructure can those opportunities be seized in more deprived areas."

Regional, or spatial, divides in the UK are by now commonly understood phenomena. Of the ten cities in the UK with the highest unemployment rates, for example, [eight](#) of them are in the North of England and Scotland. This is in part a consequence of the dynamics of that recovery (austerity policies contributed to asymmetric outcomes across the UK), as well as certain global and national economic trends around de-industrialisation, which have been exacerbated by COVID-19. It is also due to the regional allocation of affected industries. Such issues are increasingly present in the data:

- In Northern Ireland, the claimant count (those seeking unemployment insurance), [increased by 90%](#) when the pandemic began. Over the course of the year, the total percentage of Northern Irish members of the labour force receiving such unemployment insurance increased from 3.2% in January to 6.8% in August.

- In Wales and Scotland, [8%](#) of the labour forces now receive support from the state—up from 3.9% and 4% respectively.
- In the North West, [8.5%](#) of the labour force now receives support from the state—up from 4.2% in January.
- In the North East, it stands at [10.1%](#)—up from 5.8%.

Regional disparities are also deeply intertwined with sectoral disparities:

- Since the pandemic began, those who were previously employed in the Accommodation & Food Services industry have seen unemployment rise from 4.8% to [6.7%](#), the greatest slump in any industry since the summer of 2016.
- Long-term unemployment in Manufacturing now stands at 10.7%, up from 8.7% in the previous quarter.
- Long-term unemployment in Construction stands at 14.8%, up from 11.4% when the pandemic began.
- By contrast, unemployment in fields such as Financial Services have seen only modest increases in recent months, holding at 3.0%. Long-term unemployment rates in Financial Services have in fact *decreased* from 7.1% to 6.8% in recent months.

However, it is important to note that as far as wage disparities go, researchers attribute divergent outcomes in the UK to [sorting not to area effects](#). That is to say, wage disparities across the UK are driven more by the occurrence of different workers in different areas (accounting for 70% of disparities) than by the specific attributes of the areas themselves (accounting for only 30%). Area ‘targeting’, e.g., driving infrastructure investments to specific locations, may be a viable policy path given the high correlation between sorting and area effects, but it will also be important to direct attention to sorting problems—namely, skills and education.

There is much work to be done on both front. Recent [research](#) has found that the South East (London in particular) “receives a disproportionate share of investment in infrastructure,” which contributes to sluggish productivity and job growth in those areas. The [skills mismatches and absences](#)—13% are overqualified for their current job, 28% of UK workers are underqualified for their current job, and some 7 million people (20% of workers) will be “*significantly* under-skilled” by 2030—also add to the UK’s economic problems and disparities. A range of policies to address both area effects and sorting problems, and to allow regional authorities to take the lead on both, are outlined below.

Given these challenges, witnesses also discussed the prospect of re-balancing the UK’s economy—pursuing a course of [re-industrialisation](#), having already gone through industrialisation and de-industrialisation in the last two centuries. To do so would be a difficult task. Manufacturing accounts for only 8% of jobs. It is important to note as well that strengthening the UK’s manufacturing sector may increase output, however it is not guaranteed to provide a similar boost to [employment](#) due to

the growth of automation. Given the importance of [‘advanced manufacturing’](#) in the 21<sup>st</sup> century, the UK’s relative advantage in high-tech industries, and the potential it offers to accelerate some rebalancing of the UK economy, upskilling workers, as discussed below, is worth considering.

## PROPOSALS

A refined economic diplomacy agenda can better address some of the differential regional and sectoral impact from trade, investment and other foreign economic policies, witnesses argued. Such an agenda should strive to achieve better distributed growth across the UK. Achieving this requires not just policy change, but also institutional change, such as those set out below.

1. **National Infrastructure Commission** – One proposal, which cuts across the diverse sector- and region-specific challenges the UK is facing, is a revamped and sustained infrastructure policy. Witnesses proposed empowering the [National Infrastructure Commission](#) (NIC) to be able to execute and oversee infrastructure policy and strategy as an independent body in the model of the Bank of England. At present, the NIC, created in 2015, helps to study and explore various infrastructure policies, proposals, and investments for the purpose of advising the government. Witnesses argued that granting the NIC meaningful authority and independence, as well as re-expanding its remit to include necessary components of a state’s infrastructure such as housing, will be needed to prioritise greater infrastructural development and innovation going forward.
2. **Decentralising Foreign Direct Investment Policy** – Attracting investment, securing export markets, and developing stronger commercial and people-to-people ties for the purpose of trade and tourism are important national policies but also have regional dimensions. This is a challenge that was discussed by regional public servants in previous [evidence sessions](#); the need for greater devolved authority on these matters was echoed in this evidence session.

To do so, witnesses encouraged the government both to build “devoted regional investment funds” (such as a proposed ‘Southwest Gateway Investment Fund’) and to permit existing ones (such as the [Northern Powerhouse Investment Fund](#)) to operate with greater independence. In effect, such regional bodies should be granted more significant oversight of and responsibility for their region’s inward and outward foreign direct investment.

3. **Learning from Others** – One stated priority of this government is to ‘level up’ communities that have been ‘left behind’. Given the long-term difficulties many of these communities have faced, the new problems posed by the current crisis, and the lack of preparedness for the

changing global economy, witnesses expressed concern about the government's capability to achieve meaningful and lasting economic recoveries in some of these communities. However, success stories in other locations—from Boston to Leipzig to Chongqing—provided a measure of confidence. For this reason, witnesses noted the importance of studying and, where advisable, emulating the institutions created and policies pursued by countries that have been able to regenerate growth where it has been lost, namely by decentralising economic statecraft. The government should therefore consider the creation of an internal or external study group that may evaluate successful regional investment strategies that have been adopted in the United States, Germany, and China, among others.

4. **Advanced Manufacturing** – As many witnesses noted, advanced manufacturing is key to the UK's industrial strategy and economic future. There have been notable regional successes in advanced manufacturing, with witnesses encouraging the 'agglomeration of expertise' that exists in this field outside of London, particularly in the Midlands. It is also an area that has benefited from strong and well-executed coordination by the government, particularly in research and development. However, witnesses also argued that there is more to be done on establishing advanced manufacturing as a 'strategic concept' for domestic and foreign economic policy. Noting the vast linkages between and opportunities for the advanced manufacturing and services sectors, as well as the current absence of an overarching government policy on this issue, witnesses encouraged policymakers to develop a larger strategy for this fast-growing, cross-sectoral industry that may enhance its development at home and export success abroad.
5. **Upskilling & Income Share Agreements** – Running throughout the challenges outlined above is a deficit of in-demand and forward-looking skills. As one witness reported, 50% of wage disparities in the UK are driven by skill disparities. The importance of training and re-training the labour force is well established in UK policy, with distinct [career skills and training](#) programmes operating for those seeking work in [England](#), [Scotland](#), [Wales](#), and [Northern Ireland](#). However, these programmes are limited in scope, offering only application information, CV support, free online and vocational courses, and generalised advice. Meaningful 'upskilling', direct training for good jobs and the next generation of work, remains a rarity. In particular, witnesses noted the absence of electrical engineers in the UK's labour force. More broadly, they worried about the UK's readiness for changes within the advanced manufacturing and industrial landscape with respect to digitalization and electrification.

A new upskilling drive is needed as the UK's current career services infrastructure has failed to provide the desired outcomes. One possible path that policymakers should explore is subsidising the creation of regional 'Income Share Agreement' (ISA) training academies. Such programmes, a Silicon Valley outgrowth that is now being pursued on a larger scale by the US Department of Education, invite young and out-of-work individuals to apply for

specialised job training programmes, compensate the accepted students for the duration of their enrolment, and subsequently receive or 'share' some fraction of former students' future income for a limited period of time—if, of course, that income emerges within a pre-arranged timeframe. ISAs have been hailed as credible, self-funding alternatives to traditional state training services. Moreover, following witnesses' worries that new arrivals to the labour force are ill equipped for the jobs of the future, ISAs provide a unique alignment of skills training with the interests of private sector actors.

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