

Episode release date: 12 January 2022

Host:

- **Bart van Ark**, Managing Director of The Productivity Institute and Professor of Productivity Studies at The University of Manchester (BvA)

Guests:

- **Diane Coyle** Bennett Professor of Public Policy at the University of Cambridge (DC)
- **Andy Westwood** Professor of Government Practice at The University of Manchester (AW)
- **Philip McCann** Professor in Urban and Regional Economics at the University of Sheffield (PM)

BvA: How do we level up regions in a sustained manner? Raising productivity and living standards and reducing inequalities? Why do institutions matter? And what's to change to make it work? We're going to find out. Welcome to Productivity Puzzles.

Hello, and welcome to the 11th episode of Productivity Puzzles, your podcast series on productivity, brought to you by the The Productivity Institute and sponsored by Capita. I'm Bart van Ark and I'm a Professor of Productivity Studies at the University of Manchester, and I'm the Director of the Productivity Institute, a UK-wide research body on all things productivity in the UK and beyond.

Welcome to this new episode of Productivity Puzzles, a new episode and a New Year. Happy New Year and we are looking forward to bringing you another series of productivity puzzles to solve in the New Year. Today's episode is particularly a tricky one. As we are waiting for the long promised Levelling Up white paper by the Government to be revealed any time soon, what will we find in it? Or what do we hope to find in it?

There has been no shortage of suggestions in recent months on what to do to advance economic and social progress across the UK in regions and cities and devolved nations, and how to reduce inequalities between places and groups in the population. We need more money. We need more investment in health and transport and infrastructure. We need to give local and regional governments more say in what to do, and yes, we need more investment in the drivers of productivity, research and development, innovation and skills, so that we can create what we sometimes call the virtuous cycle of improving life standards across the nation.

But at The Productivity Institute we stepped back a bit from those critical needs and we asked ourselves the question on how policy institutions and physical mechanisms should become less centralised, better coordinated and more long-term oriented to support productivity in a national and

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

regional context. I'm therefore pleased to welcome three of my colleagues in The Productivity Institute who are overseeing three of our thematic areas. First Diane Coyle, who's a Professor at the Bennett Institute of Public Policy at the University of Cambridge. And also a Director at The Productivity Institute overseeing our Knowledge capital theme. And Diane is a co-author of a paper with Adam Muhtar titled the *UK's Industrial Policy Learning from the Past?*

Diane, I always like to start with a short opening question which this time is really that if you would have to think of a good title for the upcoming Levelling Up white paper that we'll hopefully see soon what would be a great title from your perspective?

DC: I struggled with this because it's more of a slogan than a policy, isn't it? But I've come up with something like: *We are one nation, honest.*

BvA: Ah, good one. Okay, that's a good start. Our second panellist is Andy Westwood who's a Professor of Government Practice and fighting for social responsibility at the University of Manchester. And he's the co-lead of our Institutions and governance theme at The Productivity Institute. And Andy co-authored recently a paper with Marianne Sensier and Nicola Pike titled *Levelling Up, Local Growth and Productivity in England.*

Andy, the same question to you, your favourite title for the Levelling Up white paper?

AW: Well, Bart, I struggled also with this. So I, like Michael Gove, sought inspiration from the music industry and I came across a song by somebody called Ciara, and it's a song and it's called Level Up. It's apparently a song about empowerment and growth. And I thought the chorus would make a very good title, and if you bear with me the chorus goes: "Level up, level up, level up, level up, level up, level up, level up, all this on me, so yummy, all this, oh so yummy." And I think that would be a good title.

BvA: That's a great long title and will definitely get some attention in the media I'm sure. Good advice.

Last but not least of course we have on our podcast another encore, that's Philip McCann also, Chair in Urban and Regional Economics at Sheffield University Management School. Philip has led the Productivity Insights Network, our network proceeding TPI, and he's now overseeing the Geography and place theme at The Productivity Institute. And Philip is the author of the third paper that we are discussing today, which is titled the *Fiscal Implications of Levelling Up and UK Governance Devolution.* By the way, all these three papers as well as a short executive summary are of course on our website at productivity.ac.uk. And we'll also show the links in the show notes to the episode of *Productivity Puzzles*. So Phil, the same

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

question to you, let's get the Government going on this, your favourite title for the Levelling Up white paper?

PM: Well my initial response was the title should be what we should have been doing 30 years ago. And that was how I thought about it. Because I think also if you read the three papers that we're discussing this morning, these are so deep, these issues are so deep, they're so multi-faceted but they're not things which have happened over night. They're things which have happened incrementally in a complex manner over a very, very long period. And turning things around is going to be a long, long time. So: What we should have been doing 30 years ago.

BvA: Yeah, and they may add to that, what should definitely be done in the next 30, because it will take some time before everything happens. So well, that's a good start. So we'll let the Government know and see what they do with this.

So the format of this podcast is pretty simple. We'll start with a discussion of the assessment of the situation according to the three papers that you've been writing and some of the common themes. Because there are a lot of common themes here. And then we'll talk a little bit about what this all means for productivity and what are the solutions and the recommendations that you would advise the Government to include in the Levelling Up paper.

So Diane, let's start with your study on the *UK's industrial policy: learning from the past?*. You've been close to the fire on how to do industrial policy, not only as a scholar, you also were a member of the Industrial Strategy Committee which was disbanded earlier this year. You not only provide a great historical perspective of industrial policy in the UK but you also have a comparative perspective between countries, which of course really leads me to ask two questions, how has our thinking about industrial policy changed and does the UK reflect that thinking? And what does the UK do really different from what other countries do?

DC: The historical perspective is really interesting because there've been cycles in thinking about industrial policy. And those have been political cycles but also I would say cycles in economic ideas and in parallel with that. Mrs Thatcher came to power in the UK in 1979, Ronald Reagan in the United States in 1981, with a free market philosophy based on Hayekian economics and the Mont Pelerin Society. And in the mainstream economics profession, that perspective of deregulation, free markets went alongside the political swing.

But the tide intellectually turned some time ago I would say. People like Dani Rodrik pioneered this and have been doing so for many years. But I think now the centred ground of opinion among economists is that deregulatory free market perspective overlooked coordination problems,

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

public good problems and had gone too far. So intellectually the centre of gravity has changed.

But anyway, if you look at the history of UK industrial policy over the period since the mid-1960s there have been just an extraordinary number of changes. And one of the messages that I think leaps out of the work that we did for the paper is simply how many industrial policies there have been. There have been three in Conservative administration since 2015. There were three in the Coalition Government. They all leave a legacy of different kinds of institutions that don't get abolished. They stumble on in zombie fashion. So there's an incredibly complex landscape of policies, organisations, entities that make it a really confusing and inconsistent policy framework. I think it's quite hard to call it a policy framework at all. It's just a collection of things that have been done and abandoned.

And then, when you pick up on the comparison with other countries, that's when the contrast that really stands out. And I think even with the United States, which has some longer lasting institutions that are able to experiment, learn from their mistakes, evaluate what they did. And so our main message in the paper is that in the UK we don't have that mechanism for evaluation and learning and taking onboard lessons that we ought to have learnt, as Philip said in his introduction, many times over in the past 30 years.

BvA: Just go back a minute on the changes in industrial policy, because I think some people might think oh, we're not going to go back to the old style industrial policy of the 70s, right? Which is backing the winners, or frankly backing the losers most of the time. So what is the new thinking...just very briefly what is the new thinking in industrial policy that you think really matters?

DC: It's about coordination. So it's not so much the Government putting money on the table and backing individual companies. It's about coordination to give the market a framework within which it can confidently invest. So to give a current example, it would be de-risking investment in green technologies by guaranteeing that there will be a market for battery technologies or whatever it might be, and that technical standards will be set and that there will be cut off dates beyond which people can't buy internal combustion engines. So those coordination policies are very much at the heart of the new thinking.

BvA: Andy, why did the UK miss all this, or why did we move around so often from one place to another in industrial policy?

AW: I think it's partly as Diane says, it's gone in and out of fashion. Both the language and the reality of actually doing and planning and sticking with an approach. And a lot of that really is a feature of lots of policy in this area, and we'll talk about this throughout the podcast. Whatever those different

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

ideas are, they come and go very quickly. And Government finds it very hard, not just in an overarching sense, to stick to a particular approach over time. The different component parts, which have to be coordinated for any of this to work. The different component parts also find it difficult to stick to a long-term coordinated approach. So, you have that fragmentation at many levels and that churn along different timescales, poorly connected to each other. And so, it multiples and magnifies, if you like, throughout Government.

BvA: So we have two terms here already that we need to halt at. Short termism, fragmentation or lack of coordination comes back all the time in our conversation. The nice thing, Diane, about your paper, is the comparative perspective that you provide to other countries. You have great comparatives with Japan for example, it has a long history, of course, of industrial policy, but even the United States. But all these countries are quite different. So do you think that there are differences in the institutional setup of these countries, the way that their political system and their democracies are organised that can make a difference in how countries go along with this industrial policy making?

DC: They all have long lived institutions with responsibility for industrial policy. We had one, NEDO, National Economic Development Office, which Mrs Thatcher downgraded and John Major abolished in 1992. So we don't have any institution. And for many countries, for most countries, there's some degree of independence about these, also. Even the United States as you say has DARPA (Defense Advanced Research Projects Agency) and they have buy-in across the political spectrum, and have now...they're incredibly well established and it would be astonishing if anybody in the US political scene thought about abolishing DARPA and its ability to back research and make quite large investments in technologies.

And for other countries there's just a bigger acceptance that there is this coordinating role for Government, which I think the UK uniquely gave up on for the past 30 or 40 years. If you look at pretty much any other country they have a long-lived institution and some degree of independence for that institution from political ups and downs.

BvA: Phil, you have done a lot of comparative work between the UK and other countries. What is your favourite example of a country where you say - that's an example the UK, given its constitutional setup could really follow and do. I mean adopting the Japanese example is probably not going to be easy. But there may be some other countries where you say, that's a country you can learn from.

PM: Well I mean I can think of several examples, but one that you'll probably be quite pleased to hear, obviously because I worked there, I would say the Netherlands is an example. It's a small country geographically, but population densities, city sizes and so on are not that different to the UK.

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

Obviously we don't have...there's no ultra-large global city. But Randstad, the system of cities, plays a similar role. The reason I say the Netherlands is because one of the things I learnt from the Netherlands is everything's planned. Of course not everything works out, as you know. But you have a culture where you develop strategies, you build plans.

I mean at the University of Groningen where I was and obviously where you are, I remember teaching a course on Environmental and Infrastructure Planning. And every now and then I'd give a guest lecture, and I would start off by saying well, in the UK we don't have a spatial plan, apart from a pseudo spatial plan in Scotland and London. And all the students start laughing, because they think it's a joke. And I say no, it's true.

And the fact that you've got one course with 200 Masters students or 100 Masters students on every year, and I can't think of an equivalent course anywhere in the UK. It tells you something. Exactly as Diane said, coordination, strategy in the sense of coordination, long term, incremental, big picture, linking details to big strategies, it's not something which has been central in UK political economy for decades. And I think Diane's right. If you go back to the '80s these things moved away to a point that it's hard to think how to bring them back. And now we're struggling with this 30 years later, we're thinking how do we build institutions that can allow these crucial coordination processes to take place. And also in a manner which is not driven by party politics. That's really important, because markets and investors have to be convinced and it's a critical element of the political economy of the UK that somehow needs to be rediscovered.

BvA: Yeah, I mean this is a bit cheeky but one of the reasons the Netherlands can do a lot of planning is because they've got a common enemy, which is sea level, which is about six metres higher than where people live. So maybe we're creating some common enemies here in the UK and that might help. But as I said, that's a bit cheeky. And there's obviously a lot more going on here.

Andy, let's move onto your paper titled *Levelling up, Local Growth and Productivity*, really looking at the institutional setup of regional and local policymaking in the UK. Diane already pointed out how the policy churn is affecting industrial strategy. But you have widened this to two other critical areas for productivity, which is regional policy and education, particularly for vocational education. So take us through a couple of examples on why these policy areas are really affected so much by the struggle that we've been having in really driving a good devolution agenda in the UK.

AW: Sure, Bart. I mean the first thing to say is that there's a great report that the Institute for Government did a few years ago in 2017 where they picked out these three areas, industrial strategy, vocational education and training and regional policy as the three most egregious examples of churn and change and chopping and reforming the arrangements in all three across the whole

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

of Government. So they sit together in our discussion of this particular problem.

I think to take the regional policy part of that first, if you unpack it, it's a sea of acronyms as Diane mentioned. You can almost start at any point, but in our paper we start in the mid-1990s when arrangements go from Training and Enterprise Councils to Regional Development Agencies and Learning and Skills Councils. And then to LEPs, Local Enterprise Partnerships and Combined Authorities. And along the way we also have the creation of the Northern Powerhouse and the Midlands Engine. So that's over a pretty short period of time.

And it doesn't just show a changing set of arrangements between different political regimes or different ministerial periods in office. I think it also shows a disregard for institutions. So here we are saying how important long-term stability and local and regional institutions are, and coordination between them. But what I think it really shows is that ministers come into office and there's also a disregard for that. And acknowledgement at the centre, and this stretches into the Civil Service and into other national institutions too, that you can do this stuff. Because this stuff doesn't really matter. The capacity of institutions or the durability of institutions isn't going to be an issue. So churn away. And inevitably that's what they do.

So it's a cultural mindset issue about the lack of importance as well as the actual detail of what they do to institutions, which in some cases might be very sensible. But they just don't...whatever arrangements are introduced end up being changed very quickly. And skills, vocational education and training, which is another case study that we look at in our paper is a clear example of that. It's the arrangements to oversee it as well as to deliver it are very centralised. The bodies overseeing them are changed all of the time.

And just to give you an example of my time in government when I worked in the Treasury in the later years of the last Labour Government, we were doing a bit review of skills as many governments do, and as many governments do we went to visit these countries that we talk about. So we did go and try and learn the lessons of stability. And I remember being in Germany and the German part of Switzerland looking at the apprenticeship system and the German and Swiss ambassadors who were hosting us basically said it's very easy to get the apprenticeship system right. You take employers, you take training providers, you take trade unions, you put them all together and you leave it alone for 100 years. Which is something you will never do in the UK. And that stuck with me for a very long time.

BvA: Diane?

DC: It's the example that shocks me most actually, the churn in FE, because here are governments asking individuals and often those who are not from

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

comfortable backgrounds to make decisions that will affect their lifetimes, the course of their earnings of the rest of their lives. And then they change it two years later or three years later and it's absolutely shocking disregard for voters.

BvA: So let me be the advocate of the devil here a little bit. I get this. But you could argue, Phil gave the example of the Netherlands, you could take the example of Germany as well, yes, we plan better, but we also stick to things for a very long time, even if they do not always work all that well. And you could argue and you hear that a lot in the Netherlands, we should experiment more. We should be willing to try things out, see if they're working, if they don't work we'll change them in order to make them work. What's wrong with that? In a way you could argue that's what the UK is exactly doing. So what are we then not doing right if we are experiment with stuff?

DC: Well, I'll give one answer which is that I think experiments are great but they're usually done at small scale. If you're experimenting at national scale with a whole policy affecting everybody in the country, that's not an experiment.

BvA: Fair point. Phil?

PM: Yeah, I mean linking back to both Andy and Diane's points is that yes, we do experiment but then we tend to abandon the experiments. If you get a new administration in or a new minister or whatever, and by the way, this is not party political as in a particular party, this is a culture that goes across all politics. What tends to happen is those experiments are then lost and if you're going to do it at scale and longevity then experimentation has tremendous potential, but if you do it with neither then basically it just disappears in the wash.

BvA: Yeah, I think you both, Diane and Phil, your papers are very much arguing for this bottom up learning effect, right? So we do not have systems in place where we learn bottom up what works and what doesn't, and then try to translate it into adjusting... I mean my answer to my own question would be it's not so much that we wouldn't want to experiment. It is that if you experiment it doesn't mean that you throw everything away that you've done in the past, you try to improve on it and build on it rather than say let's get rid of it. Let's abandon the Industrial Strategy Committee and then do something completely different. Instead of well, how can we perhaps make it work better?

Andy, you had another point to add.

AW: Well just two points really. One is that you could call it experimentation but it's constant experimentation at every level. And we don't really evaluate it in the way that you might experience to, so that we can learn lessons from

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

those experiments. The second is think of the accumulative impact of that on an important institution at the local level, like the further education college that has to cope with all of that constant change, whether it's experimentation or otherwise. And it becomes very, very difficult for an important local institution to actually build its relationships with other institutions in a particular place or with employers in a particular place, when they're constantly being directed by the centre for a whole set of new reforms facing in different directions all of the time.

So I think it's not just that the change happens and that we don't learn lessons from that change. But it distracts the organisations and the people that are there to knit together and work with big players at the local level. And it just completely curtails their ability to function as they should be at the local level.

BvA: So before we go to Phil's paper, and actually it's a good segue into Phil's paper, you make a big point of the fact that there is fragmentations in the sense that some policies...geographically some policies have very different coverage. So some policies are large areas, some policies Combined Authorities, some policies at local councils. They're not aligned to democratic or political accountability. Again, you could say well, policy dossiers differ and sometimes you need to have a higher skill than a lower skill. So what are we doing wrong in terms of these, what you could call a mish-mash of geographical coverage of our various policies?

AW: I think again, there's a disregard element to this, that this doesn't matter. And again, there's a coordination point. If you're constantly working at different geographical boundaries it's much harder to coordinate activities and to join up at local or regional levels. And so I think that's the key problem, that again, if you're an institution on the frontline of those policies, whether it's a college or a university, or a local authority, or an employer working in a particular place or region or locality it's really, really difficult to bring those different elements of the economic development world together.

And that is problematic in and of itself, you don't join up those policies where actually you need them to become more than the sum of their parts, rather than less. But also if you're an employer who's looking to invest, somebody who might be looking to come into a region, it's very, very difficult to know who leads, who you go to, who you ask for advice or support. So it's a problem within government and how it coordinates itself. But it's potentially an even bigger problem for firms and for organisations trying to understand how these things fit together, because for most of the time they don't fit together.

BvA: So as I said, this accountability is a really nice segue into Philip's paper on fiscal decentralisation. But before that let's take a quick break where you can hear a little bit about what else is happening at The Productivity Institute.

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

M1: The Productivity Puzzles podcast is sponsored by Capita, a strategic partner to UK Government that designs and delivers public services that increase productivity for the public sector and improve the lives of the citizens who use them. For more information visit us at capita.com.

M2: The UK's regional productivity divide is stark by international standards. To investigate why, The Productivity Institute commissioned agenda setting deep dives into productivity across all English regions and the devolved nations of Wales, Scotland and Northern Ireland. Led by our eight Regional Productivity Forums, these insight papers provide unique analysis of the UK's longstanding productivity puzzle and will be published alongside an easy-to-read executive summary. Together, this research highlights where local and national policymakers can make a positive difference to productivity in their area and help contribute towards increased living standards and wellbeing everywhere.

Make sure you follow us on social media at [TPIProductivity](https://twitter.com/TPIProductivity) on Twitter and on LinkedIn to find out when the insights for your region of the UK are published. The Productivity Institute aims to pinpoint why UK productivity has flat lined since the 2008 financial crisis and create the foundations for a new era of sustained and inclusive growth. The Productivity Institute is a UK wide research organisation funded by the Economic and Social Research Council.

BvA: Welcome back to my discussion with Diane Coyle, Andy Westwood and Philip McCann on Levelling Up, productivity and what we need to do in terms of governance and institutions to make it all work. We're discussing three papers by The Productivity Institute authored by my panellists which you can download from our website, productivity.ac.uk and you will find the links in the show notes to this episode.

Now, Phil, we discussed Diane's paper on industrial policy, Andy's paper on regional institutions. Your paper is on fiscal implications of levelling up and UK governance devolution. And you make some really critical points there. And I think your key point here is if you're going to devolve powers, that's all good and well. And it's all fine that, of course, has to go with some kind of fiscal decentralisation. But don't think about it too lightly because...and I quote you here, changes in fiscal relationships between central and subcentral government either narrow or exacerbate into regional productivity inequalities depending on the form and implementation. Or in other words, it depends on how you do it.

So why did the UK in your point of view so far not do this very good?

PM: Well I think part of the issue is that...again, these are things which have happened incrementally over decades in different contexts. We build our system, we add onto it, we modify it, and the issues around Levelling Up,

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

let's call it that, have simply not been mainstream discussions for decades really. So when the fiscal system has been adapted or altered or adjusted, those levelling up productivity, and I come back to the fact that I view Levelling Up primarily in terms of productivity, that's how I'm thinking about it, that they're just not being part of the discussion really.

And then of course when we then try to retrofit, we look backwards and say my goodness, we've got really big productivity differentials here, many of which are accelerating and we've got to try and turn the tide a little bit. Then again, we tend to overlook a lot of these fiscal implications. We don't talk about them. We think about okay, we could potentially devolve these powers or have these people being elected as mayors or whatever. That's the discussions.

Whereas of course any industrial structure or political institutional structure, where there's funding involved then there's the financial and the fiscal analogue, as with every market structure there's a financial and monetary analogue of how the market works. And looking at the questions from that perspective then the UK has a series of characteristics through its central, subcentral fiscal system, which are well, unusual. In the OECD they're unique. There's no country that looks like us. And these are very, very deeply embedded. And then that makes it very, very difficult to start thinking about okay, what is the financial and the fiscal issues associated with levelling up?

So one way that I would come at this for example, I would think if I'm some sort of subcentral authority, whether it's a city regional government or whatever, and I'm thinking about urban redevelopment schemes, we've got to turn our city around for better living, better carbon neutrality, et cetera, but I don't just pay for that out of tax payers' money. We don't just put our hands in our pockets and pay upfront. The world doesn't work like that. You start thinking about how the private markets can get involved, who are the investors, what kind of public, private partnerships are going to facilitate these kind of developments. This is what you want.

Because fundamentally you have to find ways to make your place attractive to investors. That's the crucial thing, that markets have got to get interested in a place again. But then what you are able to do is so heavily constrained by the fiscal system and the legal underpinnings of it. To an extent that I really was... I found quite remarkable. I hadn't realised how constrained decision makers are and therefore if we really do want to affect Levelling Up, particularly to get markets and investors interested in places again, it would seem to me you're going to need some really substantial and very profound changes to the system or maybe on a selective basis in certain places. So you've got to give the decision makers locally the financial and the fiscal powers to get that interest again in those places by the private investors. And tweaking one or two things is not going to happen.

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

BvA: So just to be clear, because what I find interesting about your point is just don't think lightly about how you do this. Because I mean there has been devolution of fiscal powers in the UK. Your point is to a limited extent. But I don't think it's just the size of it. It's also...I mean you make nine points in the paper that are critical, we can't go through all of those. But what in summary are the things that you think really went wrong in the devolution that we've done so far fiscally?

PM: Well I think two main things. I think the subnational government needs to be released from the straight jacket in terms of their ability to borrow. I mean the idea that the city regions...it should be part of the culture to be able to go to the markets independently. Because then you're developing processes of due diligence, getting market makers and investors interested in a place. That's all about knowledge and capacity building. This should be fairly mainstream.

As it is, borrowing, securitised finance by subcentral authorities in the UK is absolutely tiny. And tiny in comparison to other large countries including unitary countries. So I think that's a big part of the mix, but also as you restructure the fiscal system to allow much more flexibility, innovation, creativity, experimentation, also financially, you've also got to think about the stabiliser system. The underlying stabiliser system also has to be redesigned to make sure that it encourages and allows for this kind of financial innovation, in a good sense financial innovation, as in doing what everybody else in the markets are doing. And the strange thing of course is that in the UK, in the last 40 years, competition, proliferation, multiple actors has all been part of all aspects of our political economy, except when it comes to finance in terms of these kinds of issues. It's like we suddenly reduce everything to a dimension of zero. It's so bizarre.

BvA: Diane?

DC: I completely agree with Philip about this point about borrowing. It's really hard to understand why major cities are not allowed to issue bonds against secure income streams like rents on accommodation if they want to build housing. And it's genuinely bizarre that there is this fear in central government about what would happen, the sky would fall in, if some borrowing were permitted. And one could start small scale and build up and experiment, as we were discussing.

The other point is that we have this incredibly centralised system of financial control on public spending, but it's highly incompetent. And I'm currently working with other colleagues in Manchester and Sheffield looking at the way that Treasury fiscal control is refracted down to local authority spending on things like homelessness or special educational needs. And the idea that the money is tracked and the outcomes are evaluated and we know that we've got value for money. That's for the birds. We can't even tell properly what gets spent on what.

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

So it's centralised, it doesn't give people who've got to plan for five-year horizons any visibility about their budget, even for the current year. You don't find out in a school what your current year's budget is until part way through that year. And the idea that you're asking school governors to plan over a five-year period, when actually they don't know what money they've got this year is just...it's an incredibly bad system.

BvA: Andy?

AW: Yeah, I think this is something to really look out for in the detail of the white paper. I think there'll be lots of announcements about how things might be reorganised and which new institutions will be created. But to really understand what's going to happen over the next few years or a decade or so, it's looking for these kind of details. And I think it's very likely that those conditions will remain in place, that organisations on the frontline, whether they are schools or colleges as I've talked about earlier, will be shifted from those kind of budgetary decisions or systems. And whether behind that, reading between the lines, the Treasury want to move to those kinds of arrangements. So definitely one to mine the detail of the white paper when it comes.

BvA: Yeah, and again, a good segue into recommendations and solutions. We don't want to be accused here of complaining and only lamenting. So let's make sure that the last ten minutes of this podcast we're going to talk a little bit about what should be in that white paper. What are important ways that we can do...what is realistic in terms of what can be changed? This is a long road, as we said earlier, it might take 30 years, but you can start somewhere. So let's start again at the high level of industrial policy and then we'll dive a little bit more into the regional components of this. So Diane, in your paper what is a good starting point for better industrial policy at this point in time?

DC: Well it follows from the weaknesses that we were talking about earlier, and so the two key points I would say are an ability to learn. So evaluation and taking the lessons that you learn from what's tried and implementing those. And alongside that and to help sustain it, a degree of independence for the institution. We look at examples like sovereign wealth funds or statutory bodies in other countries. There are many different models, and we have models here, such as the Office of Budget Responsibility, Areas of Independence and Policy. And one can find a balance between the accountability that's necessary and the longevity that you need for the learning to take place. So not at all an impossible task.

BvA: Yeah, that's what I find interesting, right? You're basically saying that there are actually some things in place, I think what you're asking for is just more commitment to that. And make sure that you give these kind of initiatives a

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

longer lifetime and not continuously dangle political pressure above their head. That it may be chopped or whatever way.

DC: Yes. So the most important solution if you like may be not to keep changing things every two or three years. And if you think about it why on earth should you politically want to change things like, I don't know, the technical standards for batteries in the electronic vehicle sector.

BvA: Can you talk...maybe one minute, because a couple of really interesting ideas again I would recommend listeners to look, go to these papers. One is sovereign wealth fund or Sovereign Development Agency that you have in there. Can you talk one minute about what you have in mind there? And again, how we can build on existing institutions that we already have?

DC: So many countries and often these are thought about in Asian countries, have development institutions. So they think about the economic challenge or problem facing the governments as improving living standards over the long term. So exactly what we're talking about, raising productivity and hence living standards. And embedding the learning mechanisms with just a real focus on that long-term development. So it's about embedding long termism.

And there are different ways of doing this. So you can have a wealth fund that has a long term investment mandate, and there are many examples of those. Or you can think about agencies, we give the example of the Caisse de dépôt in France. So it's an investment agency in a non-Asian country. So there are many examples of these and you can focus on long-term returns. And we have institutions. We've got investment bank institutions. We've got all the companies that the Government's taken stakes in during the pandemic. So there's definitely a seed there and an institutional basis there for building a framework where you embed the learning of the long term development perspective.

BvA: So going to the regional and local level, Andy, you've got a lot of interesting observations in your paper. One thing that's really interesting about your work is that you make these comparisons between different regions and how institutions are organised. And there are differences here. I mean you're looking at the North West and Greater Manchester, I think you argued that actually Greater Manchester, that might work reasonably well. Then you look at the Midlands for example where you say it's a big mish-mash of LEPs and Combined Authorities doing all sorts of different things.

So what will make it work well? Give us one or two examples in the UK where you see that works well and it is something that we could transpose to other regions in the nation?

AW: Yes, well, I think, Bart, you're right to pick out...and we pick out in the paper the example of Greater Manchester. And that's not just because we're

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

based here, but because if you look at the geographies that different powers relate to and that different institutions function within, they're pretty coherent. So in Greater Manchester it's the collection of the ten local authorities that together make up the Combined Authority. There's one Local Enterprise Partnership, there's one Chamber of Commerce, and a whole range of other powers relate specifically to those ten.

You go to the North East or to the West Midlands and it's a much, much more complicated picture. In the case of the North East, two combined authorities, gaps in-between that might be subject to new county deals, different arrangements with LEPs. In the West Midlands there are three LEPs within the Combined Authority area, and a whole bunch of different arrangements across different local authorities.

So I think there is a lesson from Greater Manchester that actually some kind of coordination of geographical boundaries does help.

BvA: But to some extent, if I may, to some extent that's also related to the fact there's political and democratic accountabilities organised along the same lines. Is that critical in your point of view that it has to be organised along the same lines? Or are there ways to deal with different geographical boundaries compared to your political boundary?

AW: I mean there are always going to be some different levels, particularly democratically. So for example, the relationship between a local authority and a combined authority and a mayor. Particularly the city region mayors. I mean we have other systems for mayors as well, unsurprisingly, given this conversation. But I think that democratic accountability is really, really important. The hard thing to plug into that of course is the role of constituency MPs that are also critical. But I think seeking stability, long term institutional stability along both political and economic grounds I think is something to look for. And I think alongside that I think a regard for the capacity and just the importance of those institutions, whether they're political institutions like the mayoralty in a city region, or the economic institutions that come alongside that. A greater regard for that, really, really, really matters.

But I think to return to a previous conversation, the way we fund these institutions also matters. So it's not just about the funding of the Combined Authorities or mayoral budgets, it's about the funding for organisations and institutions on the frontline, the colleges, the schools, the universities, the local authorities, and so on. And I think there's a problem about the level of funding. So to take FE as an example again, it's barely at the levels the sector had pre the financial crisis. So there's a problem in that.

But there's also a problem in how the funding that does exist is allocated. It's partly that annual rather than long-term approach but also as we've seen over the last few years, which undermines both the coordination and the

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

legitimacy of local political institutions, is the keenness for Government to run things on competitive arrangements. So competitions for Towns Fund or Levelling Up deals, this has also become a hallmark of how we deliver cash, but also how we undermine the institutions at local level. It's a centrally designed set of programmes, it's a centrally awarded set of programmes. And that is also a problem. So I think that would be a critical area where I think we should also look for change over the long term.

BvA: So Philip, a really interesting concept in your paper, is that what you're saying, what's missing in the UK is basically what you call this meso level of governance, right? Lots of other countries have provinces or other...in-between local and national levels. We have the Combined Authorities of course in the UK which is a bit of an example of that nature. But you think, it's my impression, that we need to think much more structurally about this to get this meso level in, right?

PM: Yes, in this paper obviously I talk about it in terms of fiscal perspectives. But I think it's actually...it's a knowledge problem. And the way I describe it is the UK looks like this, it's a pyramid. And everybody's at the bottom, these are the citizens. And decision making goes right up to the top almost straight away. So what happens is that you have automatic congestion at the top, there's just almost a bottleneck. And so only a very, very small number of players and actors ever get a hearing at the top. They're the ones that overly influence policy making, independent of who's in power. But that's because of how the system works. So certain companies, certain think tanks and institutions all based in London, strong media presence which is centralised and so on.

So what tends to happen is that citizens, locally based individuals or groups make no effort to try and to engage with government, because they know it's basically pointless. Because a system like that, a pyramid system like that maximises the degrees of separation between everybody by definition. And leads to this bottleneck congestion problem at the top. So the problem is that the centre has a lot of, if you like, high level expert knowledge but no granular knowledge of anything going on beyond, well, a couple of miles outside of Westminster basically because it doesn't get any representation and feeds into it on an ongoing basis. So there's no possibility of the centre learning because nothing comes up through the system.

And so it's a unidirectional decision making system, whereas governance systems to work have to be two directional all the time. And so the way to solve this, one solution is to collapse the pyramid and that's the Alesina argument about a country being small, that reduces the degrees of separation and that incentivises people at the bottom to engage higher up with decision making. And therefore higher echelons in the decision making and governance system are learning all the time from the locals. So you get a two way process.

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

And the other solution in a big country is to de-centralise. Either to federalise, which would be the German case, or really fundamental de-centralisation among unitary states. That's the Japanese and the French cases. And we've done none of those things at the moment. So we're talking about Levelling Up, but fundamentally our governance system still looks like that. So in terms of the white paper itself, you were asking what we're looking for, I view the white paper as a very important moment. And I think everybody in this arena does. But it's not the end, for me it's a stepping stone towards a much longer process, it has to be, and a much bigger process.

But for me I would be looking at how do the changes in the white paper address this problem of the degrees of separation, because that's intrinsically related to trying to find the optimum level for power and decision making to take place. And you want some sort of meso intermediate structures which following everything that we've discussed this morning are long term, are stable, are largely independent, are focused on coordination, all the things we've been talking about. But you also need proper fiscal and financial powers that reflect those institutional and governance roles that we want them to play.

So those are the things I would be looking for. Are we taking serious steps in those directions?

BvA: Diane?

DC: I think Philip's making a fundamentally important point here about knowledge. You can't from the centre have the granularity of information that you need about what's happening around the country to be able to learn about what works and what doesn't work. And so we have a system that just throws away all of that information. And it's not surprising that the consequences have been so disappointing.

BvA: And one important point in your paper also, Phil, is that let's be careful not just to talk about devolution of powers, but let's talking about building of institutional capacity. And a lot of that is actually happening at this meso level. The other point in your paper, I'm going to put this question to Andy, but you do make this early on that there's a lot of issues that we discuss, but one issue is also a certainly level of trust between central and local or regional governments. And as long as that trust isn't there, and I think that's an important issue to compare with other countries, where I just see more trust between central level and local level governments.

So Andy, what is it that can help to, also it's part of this paper actually that we're waiting for, to really restore the trust level between regional, local governments and the central government?

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

AW: I think you're right to pick out trust as a problem. I think this is part of the cultural disregard as I described it earlier between the centre and the local or the regional. There's a fundamental mistrust in the ability or the capacity for local and regional institutions to be able to handle power. Whether it's fiscal or any other. And I think that is a big, big problem for England, my report concentrates mainly on arrangements in England. But it's also a fundamental problem about the centre. Can the centre trust anything when it functions in the way that it does?

But I think the only way you can build that trust between the local and the centre, but also going back to your democratic point with local people, and local businesses, is to leave things in place and build stability and capacity over time. Now you can do that in a series of small steps, but it has to be... You have to learn from those steps, both locally and nationally. And I think this builds on Diane's point. You have to keep those channels open, which again, that's what's Philip's been talking about. And you have to constantly look to build that trust and to look to build that experience and capacity. And I think you can only change that over time.

But you have to want to start to do that. And I think that's one of the cultural problems. It's not clear that the white paper is going to necessarily change that, that mistrust if you like between the centre and the local. That they're always somehow less good or less able to deliver some of the things that matters, whether that's to local people or nationally.

BvA: Yeah, we'll hopefully see this soon, the long awaited Levelling Up paper that's been delayed a couple of times. I guess when you listen to this podcast we'll be closer to it. A great conversation, you reminded me, Andy, of apologising to some of our listeners, this was a bit of a discussion about England, of course there are interesting experiments in the devolved nations that we should look at. And we do have separate podcasts on this. We did one on Northern Ireland recently, we'll do one on Scotland very soon and on Wales also later this year. So tune into those. But for now Diane Coyle, Andy Westwood, Philip McCann, thank you so much for this conversation and I hope to see you again soon on one of our podcasts.

Our next episode of Productivity Puzzles will be on a really puzzling topic, which is business start-ups and productivity. During and since the pandemic we have seen a surprisingly large number of new business registrations in various sectors of the economy. And it's not a pure UK phenomena, we've seen this in other countries as well. So what are these start-ups? Will they survive once the economy gets really past the pandemic? And how can we leverage the opportunity to make these businesses productive for the future. Our speakers at this point are still a little bit of a surprise, but stay tuned and you will hear from us soon about this next episode.

You can sign up for the entire *Productivity Puzzle* series through your favourite platform to make sure you also don't miss any future episodes. If



Ep. 11 Productivity Puzzles podcast transcript

Levelling Up and Productivity: The Role of Industrial Policy, Institutions and Fiscal Mechanisms

you would like to find out more about upcoming shows or any work by The Productivity Institute please visit our website at productivity.ac.uk or follow us on Twitter and LinkedIn. *Productivity Puzzles* is brought to you by The Productivity Institute and sponsored by Capita and this was me again, Bart van Ark at the Productivity Institute. Thanks for listening and stay productive.

End of transcript