



John Mills
**Institute for
Prosperity**

UK ECONOMY

Manufacturing **Unlocked**

How to make a revival in
manufacturing a reality

“ This paper by the John Mills Institute for Prosperity is a reminder of the continuing importance to the economy of manufacturing. Having spent five years overseeing an industrial strategy in government, I recognise many of the supply-side problems which this paper identifies. Its suggestions are constructive and helpful.”

Rt Hon Sir Vince Cable

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John Mills is an entrepreneur and economist who has long been involved with political affairs. He is the founder and chairman of John Mills Limited (JML), which specialises in selling high volume consumer products, using audio-visual methods for promoting their sale both in the UK and in many other countries – about 85 at the last count. His main interests as an economist are the UK's relationship with the EU and the relatively poor performance of western economies compared with those in the East.

He was for many years a senior Labour elected member of Camden Council, the London Borough's Association and the Association of Metropolitan Authorities, and in the late 1980s he was deputy chairman of the London Dockland Development Corporation. He was chairman and then deputy chairman of Vote Leave, joint chairman of Business for Britain and the founder of Labour Leave, all campaigning for Brexit during the run-up to the June 2016 EU referendum. He is vice-chairman of the Economic Research Council and founder of both The Pound Campaign, Labour Future and The John Mills Institute for Prosperity, all concerned in different ways with the UK's economic and political prospects. He is a frequent commentator on TV and radio and he has a large number of published books, articles, pamphlets and blogs to his credit.

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FOREWORD

BY RT HON SIR VINCE CABLE

This paper by the John Mills Institute for Prosperity is a reminder of the continuing importance to the economy of manufacturing. It may account for only 10% of GDP but the positive contribution to productivity, innovation, and exports is disproportionate. Although our economy is now mainly services-based, there is considerable interdependence between digital and other services and the manufacturing which they serve. Moreover, with some traded service activities, as in the City of London, taking a hit from Brexit, a manufacturing revival would help to fill the gap and to do so in parts of the country that have been otherwise left behind.

Having spent five years overseeing an industrial strategy in government, I recognise many of the supply-side problems which this paper identifies and the Institute's suggestions are constructive and helpful. Because of the nature of fixed investment and manpower training, manufacturers usually operate on longer timeframes than other firms and also have to manage complex supply chains. Supportive government policies and a sense of long-term stability and continuity are important. It is essential therefore that there is cross-party consistency. This approach fits very well in that context.

Securing a sustained manufacturing revival will not be easy. John Mills' belief in the need for a competitive exchange rate is right but will be difficult to achieve in a world of free capital flows. Nevertheless, he has set out a practical plan of action to make that revival more likely.



Rt Hon Sir Vince Cable

Member of the Institute for Prosperity's Advisory Board

Former MP and Secretary of State for Business, Innovation & Skills

Former Leader of the Liberal Democrats

ABOUT RT HON SIR VINCE CABLE

The Rt. Hon Sir Vince Cable is a member of the Institute for Prosperity's Advisory Board. He was Secretary of State for Business Innovation and Skills and President of the Board of Trade (2010-2015). He was a Member of Parliament for Twickenham from 1997 to 2015; Deputy Leader of the Lib Dems from 2007 to 2010, and Shadow Chancellor between 2003 and 2010. He was the Leader of the Liberal Democrats from 2017 to 2019. He is currently a visiting professor at the London School of Economics, St Mary's University, and Birmingham City University, as well as a columnist for The Independent.

HOW TO MAKE A REVIVAL IN MANUFACTURING A REALITY

There are strong arguments, which the Institute for Prosperity has done its best to advance, for believing that no policy designed to get the UK economy to grow much faster than its current underlying very low rate of 1% or so per annum will work successfully unless the UK can implement an investment and export-led strategy. This requires a competitive base for a considerably wider range of manufacturing activity than exists at the moment. The first section of this pamphlet explains why this is the case.

However necessary it may be, however, a more competitive exchange rate on its own is not a sufficient condition for achieving a manufacturing revival and a transition to a considerably higher growth rate – the target being an additional 2% per annum added to the low underlying rate which is there already. This is why most of this pamphlet concerns a raft of complementary policies which are required. A more competitive pound will help to make investment in the UK more profitable and attractive to potential investors. This will not, however, be enough on its own. To enable our economy to respond positively to better demand conditions, and thus to make a transformative policy framework work, a number of other major complementary policies need to be put in train.

There is a reason for highlighting what these complementary policies are in addition to explaining why they are necessary and highlighting the advantages they will bring. Most of them are popular in themselves. They go with the grain and are, therefore, a relatively easy sell. The need for a much more competitive pound is unfortunately not in this category. Most people instinctively favour a strong pound even though this has – as we will see in the next section – all sorts of damaging consequences. If we are going to switch to having a much more competitive pound, therefore, it helps to know that this policy change will need, if it is to be successful, to be accompanied by a lot of other strategy shifts with which most people are likely to feel instinctively more comfortable. These include policies on education and training, taxation – especially investment allowances – directing finance to the manufacturing industry, discouraging short-termism, establishing priorities for infrastructure, avoiding excessive energy charges, facilitating planning consents for new industrial facilities and harnessing better than we have done for a long time the benefits from research and development.

The Need for a Competitive Pound

The reason why a more competitive pound is so crucial is that – as a raft of international experience and evidence shows¹ – economic growth depends very largely on physical investment in quite a narrow range of project categories, clustering round mechanisation, the application of technology and the use of power. Most other types of investment – in road, rail, schools, hospitals, public buildings and housing in the public sector and office blocks, shopping malls projects such as new restaurants, IT installations and housing in the private sector – however desirable they may be from a social point of view – contribute little if anything to rising output per hour and increasing productivity and economic growth. Investment in mechanisation, technology and power on the other hand, can deliver total – or social – rates of return to the whole community of well over 50% per annum, including not only a return to whoever put up the money to finance the investment but also higher wages, greater profits, a stronger tax base, and better and often cheaper products.

Our problem in the UK is that we spend much too little on these kinds of high-powered investments which generally entail rapidly falling costs as production volume increases, so that any initial competitive advantages are soon magnified. They tend to find their natural home in the internationally traded privately owned light industrial sector where competition is fierce, and competitiveness is crucial. Typically for manufacturing, about 30% of total costs are for machinery, raw materials and components for which there are world prices.² The remaining 70% covers all other costs – wages and salaries, all overhead costs, and provisions for interest and taxation. The 30% of costs for machinery, raw materials and components stays the same in world price terms whatever happens to the exchange rate but the rate at which all the domestically incurred costs are charged out to the rest of the world depends crucially on the strength of the currency. If it is too high, the consequences will be lost sales leading to lost share of world trade, deindustrialisation, balance of payment problems and slower and slower economic growth, leading directly to static or falling average incomes – exactly the experience which the UK has been through.

Judged by these criteria the evidence that sterling has for a long time been overvalued is overwhelming. In 1950, just short of one eighth of all manufactured exports in the world originated in the UK.³ Now they comprise less than 2%.⁴ Exports of services, where we have many natural advantages which do not apply to manufacturing – our language, geography, our legal system and universities and the skills orientation of our workforce – have done much better but not nearly well enough to fill the gap. Our total share of world trade in 1950 was 10.7%. By 1990 it had halved to 5.4% and it has now halved again to 2.5%.⁵ If you look at our industrial base, as late as 1970 just under one third of all our Gross Domestic Product (GDP) came from manufacturing. Now it is less than 10% and still drifting down.⁶ In the nineteenth century the UK was the Workshop of the World with a large export surplus in manufactured goods.⁷ Now we have a deficit on this account of some £90bn per annum – about 4% of our GDP.⁸ The result is that we cannot pay our way in the world, and – on top of everything else – we have a massive foreign payments deficit every year which we finance by selling off national assets and borrowing even more money, losing control of an ever increasing proportion of our economy in the process.

The case for a more competitive pound rests on it providing our economy with the opportunity to grow much faster. We need to shift about 4% of our GDP out of consumption and into investment with at least a 50% overall on social rate of return, as our own and international experience shows is eminently possible. $50\% \times 4\% =$ the extra 2% increase in GDP every year which a lower pound – roughly 25% lower than it is now (\$1.39 as of 19th February 2021), with £1.00 approximately equal to \$1.00 – would be able to produce. But – to repeat – a lower pound to achieve this result is a necessary but not a sufficient condition. The results we need to achieve won't materialise unless a wide range of other changes in the way the economy operates take place at the same time, and it is to this agenda that we now turn.

Education and Training

Complaints that the UK's educational and training system is not as good as those in other countries at producing a labour force appropriate for modern conditions, particularly in manufacturing, go back a long way. Scientific and technical studies have never had the same prestige in the UK as in many other countries, particularly those such as Germany

and Switzerland which are clearly more successful than the UK in manufacturing terms. The pressure in secondary school is strongly in favour of subjects and curricula which will lead to university rather than technical training. The result has been large numbers of graduates doing jobs for which a university education was not appropriate while there is a chronic shortage of people with technical skills at all levels.⁹

Sadly, the UK has a long tradition, which is still very much in evidence, in favour of a career in the professions and against trade generally, and against making and selling things in particular. The most able graduates from university do not usually go into industry, in contrast to what happens in other countries. The result is that not only are there skill shortages on the shop floor but that many companies in the UK lack top management with levels of competence and ability, technically and more generally, which are seen in other countries. The bias against industry goes back at least as far as the nineteenth century and it is surely partly a function of the difficulty suffered then by the UK as a result of the strength of sterling in the Gold Standard system. Long-standing lack of profitability in industry lowered its prestige, biasing social attitudes and pressurising students away from manufacturing and towards other career choices with far less to contribute in terms of raising general living standards.

In some key respects, these longstanding problems have got worse recently. While on education, international comparisons show that, starting from a fairly low position, we have done rather better generally on PISA tests than we did before¹⁰, the situation on post-school training has deteriorated markedly over the past decade, partly as a result of austerity measures which have impacted very heavily on this sector and partly because the ever-increasing pressure in schools in favour of academic university studies has weakened resistance to cuts in expenditure on technical training. The result is that over the past decade, expenditure on it has fallen by almost half, from just over £4bnn in 2008/09, to barely £2bn in 2017/18¹¹ to a level which is lower than in all other advanced economies. In the UK only one person in ten has a technical qualification whereas in Germany the ratio is one in five.¹² Government efforts to promote apprenticeships recently have been conspicuously unsuccessful.

The situation we are now in with COVID-19 means that lessons from the 1930s on making much better use of our labour force may be particularly apposite. In 1931 GDP fell by 5.0%¹³ as unemployment rose to 15% of the insured labour force – not so very different from where we are now, albeit from a different cause.¹⁴ As the UK abandoned the Gold Standard and devalued by about 25%, however, the economy began to stage a major recovery as new employment opportunities became available. Between 1932 and 1939, UK GDP rose at 3.7% per annum, faster than in any period this long in the nation's peacetime history.¹⁵ Unemployment fell to just under 8%¹⁶ as the total number of people in work rose by 24%.¹⁷ 1.3m of the new jobs were in manufacturing.¹⁸ A much more competitive economy made it more profitable to export than to import, because it became worthwhile siting new industrial facilities in the UK rather than overseas, investment in plant and machinery rose dramatically. It almost doubled between 1932 and 1938¹⁹, while manufacturing output went up by 55%²⁰ as manufacturing productivity soared, rising cumulatively by 28% in six years.²¹ Living standards rose three times faster in the 1930s than they did in the 1920s.²² By 1939 the UK economy was almost 30% larger than it had been in 1932²³ and we were in a strong enough position – just – to withstand the German onslaught in the Battle of Britain at the beginning of World War II.

An important precedent here is that the high levels of unemployment in 1932, caused by the inter-war depression, ensured that there was a highly fruitful source of skilled labour available to take advantage of the manufacturing revival which was then taking place. In the 2020s we need to use a combination of much enhanced and focused technical training and the skills available from the parts of the economy which have contracted, such as the aviation industry, which is shedding skilled engineers, to ensure that the manufacturing resurgence which the UK so badly needs is not held back by skill shortages.

Taxation and Investment Allowances

Before we were struck by COVID-19, about 40% of GDP passed through the state's hands every year, most of which was paid for out of taxation. Current government expenditure as a percentage of GDP is much higher but will probably fall back in due course. The big government revenue streams come from income tax, which in 2019/20 raised £195bn, VAT £134bn, and national insurance (£144bn), but taxes on companies, particularly Corporation Tax, which raised £52bn and business rates at £29bn, also made a significant contribution.²⁴ It is generally thought that it is fair and reasonable for companies to pay significant amounts of tax partly because they benefit directly from government expenditure on education, infrastructure and local government services and partly because it is better to spread the incidence of taxation as widely as possible, including on businesses, to minimise the distortions which taxation inevitably tends to produce.

If there is to be a significant increase in investment to support a large rise in manufacturing output, however, the money to pay for it will have to come from somewhere and retained corporate profits is clearly a major potential source of funding. Should the rate at which Corporation Tax is charged therefore be reduced to encourage more investment to take place?

The answer is likely to be "no". There is little evidence that reductions in Corporation Tax on their own increase investment and this is hardly surprising, not least because the categories of companies for which increased manufacturing investment is most likely and most needed are not necessarily the same as those most likely to benefit from lower Corporation Tax levels.²⁵ There is therefore a much stronger case for any tax concessions to encourage increased investment to be tied directly to the desired investment taking place. The way to do this is via investment allowances, which provide for accelerated depreciation on qualifying capital investment, with the reduction in the amount which the companies concerned have to pay being directly related to the capital expenditure which they incur.

Investment allowances have been available for many years but not comprehensively and not on a consistent basis. Partly because of relatively high exemption limits, only a small proportion of companies²⁶ – although this does include the largest of them – have been eligible and the percentage allowances available have gyrated substantially, thus diminishing their impact. To make them more effective, the ratios involved need to be stable and predictable some way ahead and sufficiently generous to make a real difference. Indeed, there is an arguable case for making them applicable to more than 100% of the capital expenditure sums involved as an

added incentive to encouraging expenditure on the sorts of high-powered investment which the economy so urgently needs.

Finance for Manufacturing Industry

The need for a favourable tax regime for the manufacturing industry shades into the requirement for finance to be available more generally for manufacturing on as easy and favourable terms as possible, to encourage capital expenditure and to supply the working capital needed for expansion.

Traditionally, banks have been expected to provide finance facilities to support the manufacturing industry, but for a variety of reasons, the flow of funds thus generated has been sparse and inadequate. Part of the problem has been that manufacturing businesses in the UK have acquired an unfortunately well-deserved reputation as being poor credit risks, leaving banks feeling much more confident and secure about avoiding bad debts and eventually being repaid on personal and property loans than on those concerned with companies involved in manufacturing.

Another problem is that the benefit to banks from lending for capital expenditure and working capital to support it is that the returns to banks are small while those to the economy at large – particularly of the most highly productive type – are potentially much greater. This inevitably produces a bias towards less than optimal amounts of funding taking place. Overarching these difficulties has been the unprofitable prospects for manufacturing capital expenditure flowing from a strong pound, thus undermining the case for more capital expenditure especially of the most productive type which tends to be particularly exposed to international competition.

An interesting and important example of what can be done to overcome these problems is provided by the experience of Japan during the decades following the end of World War II. No doubt part of the reason for the phenomenally high growth rate achieved by the Japanese during the decades following the end of hostilities was the very low and competitive exchange rate awarded to the Japanese by the occupying American administration.²⁷ It was the Japanese themselves, however, spurred on by Osamu Shimomura, the Japanese equivalent of John Maynard Keynes, who reorganised the way the banking system worked to provide almost unlimited sums of money on very favourable terms to industry, thus powering its expansion. As a result, for years on end Japan achieved a growth rate of about 10% per annum.²⁸ Japan's rate of expansion only slackened off – dropping to no more than what the UK is now achieving – as the yen soared in value in the 1980s²⁹ as the world choked on Japan's massive trade surplus and the yen's international value soared. As the profitability of industry plummeted, the Japanese switched from financing manufacturing investment to pouring money into property speculation – with predictably disastrous results.³⁰

Any system to support manufacturing investment needs to have some "skin in the game" – some risk – among those who stand to benefit from it. The sort of system which might work therefore could be one in which banks were obliged to lend a multiple of whatever investors were prepared to put up as loans on unsecured terms with repayments due over a reasonably long time period. Any scheme of this sort is bound to lead to some losses although they should be a small proportion of the total and, to make sure that they materialised, would probably largely, if not completely, be underwritten by the

government. A key requirement of a competitive exchange rate strategy is to get large volumes of investment happening quickly, to provide the resource for further expansion without depressing living standards. Making finance readily available would be a vital element of the policy to be pursued.

Short-termism

UK investors have a rather different view of the returns they expect than those in many other countries. In the relatively highly financialised UK environment, investment opportunities tend to be judged on a relatively short-term horizon. Success among the owners of many young thrusting companies is judged by how quickly they can sell out and cash in. Venture capitalists insist on current profitability at the expense of investment in the future, which may take time to pay off. The stock exchange looks for quarterly results on which management bonus payments often, in turn, depend. Banks are reluctant to lend on a long-term basis, preferring to keep loans repayable over a comparatively short period of time.

These characteristics of the UK market for finance are in sharp contrast to those in countries such as Germany, particularly in relation to the backbone of much German industry – the Mittelstand. This consists of often family owned firms with long-term perspectives, frequently supported by local or regional investment banks who are happy to provide long-term loans.³¹ Whereas in the UK the appetite for investment is determined mostly by the returns likely to come back to the investor, in Germany the investment climate is more inclined to be viewed with the interests of the whole community at heart. Clearly, this is an environment more favourable to manufacturing investment than the one which prevails in the UK.

Is there anything which can be done to move UK attitudes to investment away from the short-term to a longer perspective? In the immediate future, probably not. Other ways need to be found of making sure that the finance required for manufacturing investment is available need to be found. In the longer term, however, attitudes to a revived and much more buoyant manufacturing sector in the UK may change. Its prestige should rise, and more attention will therefore very probably be paid to its ongoing needs. Social attitudes take a long time to form and even longer to change but reindustrialisation on a reasonably substantial scale – raising the proportion of GDP accounted for by manufacturing from 10% to 15% in a much more rapidly expanding become – could make a big difference.

Priorities for Infrastructure

If the UK economy is to expand by something like 3.5% per annum – the recent world average – as this pamphlet proposes, the overall proportion of our GDP devoted to investment will also have to increase to something close to the world level – about 25%.³² Getting the growth rate up by 2% per annum needs to be achieved, as already explained, by switching 4% of GDP out of consumption and into the high-powered categories of investment which produce social rates of return averaging 50% per annum or more. $4\% \times 25\% =$ the 2% additional growth per annum which the policy described in this pamphlet is designed to achieve. Of the 8% difference there is between our current roughly 17% of GDP³³ devoted to investment compared to the 25% provision we really need, about 4% will therefore need to be pre-empted by high-return investment, mostly

plant and machinery in manufacturing industry, leaving the other 4% to cover increased investment on everything else.

Where should this go? The table below shows the breakdown of UK investment spending in 2019.

UK INVESTMENT EXPENDITURE IN 2019			
All financial figures in £bn			
		As % of total Investment	As % of GD
Transport equipment	20.7	5.3%	0.9%
Plant and machinery	59.8	15.4%	2.7%
Dwellings	85.0	22.0%	3.9%
Other buildings and structures	138.0	35.6%	6.2%
Intellectual property	83.6	21.6%	3.8%
Total	387.1	100.0%	17.5%

Source: ONS Times Series Dataset. London, ONS, September 2020

Expenditure on plant and machinery will need to more than double as a percentage of GDP, from 2.7% to a little less than 7%, which is still – incidentally – less than half the equivalent percentage in China, which is close to 15%.³⁴ This leaves roughly 1% of GDP each to be allocated to each of the other four categories of investment expenditure. Transport equipment includes aircraft where demand may be reduced for some time ahead. The need for more expenditure on dwellings is obvious but may need to be constrained initially because of the relatively low economic social rate of return that housing generates. Spending on other buildings and structures includes road and rail expenditure. HS2 is going to pre-empt a significant part of this budget over the next ten years, pre-empting anything up to about £10bn a year with a relatively low eventual social rate of return which will not start to materialise for another decade.³⁵ Its contribution towards enhancing the UK’s GDP on a discounted per annum basis is therefore unfortunately almost zero. Intellectual property includes research and development which needs to increase but where current expenditure takes time to gestate and to generate increases in GDP.

To get the overall growth rate up, the overwhelmingly high spending priorities need to be on increased investment on projects with not only a high social rate of return but also rapid pay off periods. Indeed, timing is of the essence. An investment which comes on stream in a year is twice as valuable in enhancing GDP growth as one with the same eventual return which takes two years to start producing new enhanced output.

Energy Costs

The UK has made a leading international contribution towards combating global warming and mitigating its consequences. This has been done, however, at considerable cost to our international competitiveness as a result of a substantial part of the cost of switching to renewable energy being charged to manufacturing industry. This is especially the case for industries such as the production of cement and smelting aluminium, both of which are highly energy intensive, both of which have now ceased production in the UK almost completely. We need to play our part in the world's climate change strategy but not at the expense of pricing our products out of world markets.

Part of what needs to be done is to recognise that it is an illusion to think that fighting climate change will create favourable business prospects which will generate enough profitable opportunities for there to be no net cost arising from all that needs to be done to slow the current rise in temperatures. The reality is, unfortunately, very different. Estimates vary but coalesce round a net cost to the UK economy over the next decade or two rising to about 3% of GDP.³⁶ These costs will partly take the form of higher levels of taxation to pay for the contribution towards climate change costs for which the state will be responsible. These will stretch from better flood defences to research and development into carbon capture. Action along these lines will need to be complemented in the private sector by higher prices for energy than would be the case if we continued to rely on fossil fuels, combined with other expensive changes to be borne by consumers and households such as scrapping vehicles with internal combustion engines and improving home insulation.

The policy pursued in the UK up to now has been to spread the additional costs to the economy from climate change policies by raising energy prices, and in particular those for electricity, by spreading them over consumers, commerce and industry by a combination of taxes, duties and levies. Fossil fuel taxes for petrol and diesel at garage filling stations in the UK are currently 57.5% per litre plus 20% VAT on the final price³⁷, resulting in total costs which are in line with those in most other developed countries, all of whom have experienced formidable political resistance to prices going any higher. In this respect, the USA is an outlier with prices running at about half those prevailing elsewhere.³⁸ On electricity prices for industry, however, the situation in the UK is much less favourable. Electricity prices to industry in the UK are much higher than in most comparable countries. They are about 50% higher than the EU average and more than twice those in the USA.³⁹

The lesson to be learnt from the figures is surely that if the UK decides to spend more than average on relatively expensive sources of renewable energy, the costs involved need to be borne by the domestic economy – by general taxation or higher prices to domestic residents – and not by adding to the cost of exports, or import substitutes, if they are already too high to be competitive.

Industrial Premises

If we are going to have a manufacturing revival, we will need a lot of additional production space to enable this to materialise. When almost a third of our national income came from manufacturing, factories were spread all over the country. Now many of them have been demolished or converted to other uses such as being converted to offices, showrooms, retail or residential purposes. If we are going to get manufacturing back from being 10% to 15% of our economy, to enable it to grow considerably faster than

it has been doing recently, the amount of industrial floorspace which will need to become available is going to have to increase by at least 50% and possibly more. This is going to be a considerable additional challenge, not only because of the new buildings required but also because the new facilities will need considerable back-up in other ways. In particular, we will need a road and rail system capable of handling additional volumes of traffic both to move goods from one place to another and to enable people to move from home to work and back again. We will also need to ensure that there are sufficient power supplies to ensure that expanded energy requirements can be met.

What can we do to ensure that there is adequate provision of buildings, transport facilities and power? We need to plan to make sure that it is all available. We need a national planning framework to ensure that sufficient planning consents are granted fast enough to keep up with demand, with sufficient power supplies available. We need a reassessment of how much investment in road and rail is necessary to make sure that we don't suffer from unnecessary bottlenecks and congestion. This is likely to involve shifting expenditure priorities away from London and the South East, where relatively little new industry is likely to be located to our erstwhile industrial heartlands where most revived industry is likely to be located.

Research and Development (R&D)

The proportion of the UK's GDP which is spent on research and development is well below the world average. According to the World Bank, in 2018 the UK expenditure on R&D as a percentage of GDP was 1.72% compared to a world average of 2.27%, and 2.58% for all OECD countries. The USA spent 2.74%, China 2.19% and the Euro area 2.21%. In ratio terms the UK was thus about a quarter below the world average and a third behind the expenditure levels in comparable OECD countries.⁴⁰

How much does this matter? In the short term, probably not very much at least in the sense that increasing R&D expenditure, especially of the fundamental long-term variety, will not help much in the immediate future. While some R&D has a very rapid pay-off much of it does not do so. If the current pressing objective is to get the proportion of manufacturing as a percentage of GDP up from 10% to 15% and the percentage spent on investment in plant and machinery increased by 4% of GDP over, say, a five-year period, most of the new production capacity needed will have to rely on technology which is already established. There will not be time for much fundamental research to make a significant contribution. There is a relatively weak case, therefore, for increasing R&D expenditure as opposed to relying on well-established technology and machinery, during the transition period to a higher growth rate.

In anything but the short term, however, it is an uncomfortable position for the UK to be in if it is making relatively little contribution to discovering and nurturing the products and services of the future. We will therefore need to get our R&D expenditure ratio up, some of which may happen naturally. Part of the reason why R&D expenditure in the UK is now comparatively low must be because so small a proportion of our national income comes from manufacturing. If this ratio increases by 50% – from 10% to 15% – R&D spending as a proportion of GDP is likely to rise with it, which should surely be encouraged though a range of measures such as tax breaks for qualifying R&D expenditure and support from our universities.

Another welcome change might be for more of the fruits from R&D to stay in the UK rather than for it to leak abroad. The UK has a relatively strong reputation for the innovation element of research and development but a considerably weaker one for carrying innovation through the development phase so that viable new products and services emerge at the end of the process. This is partly because too high an exchange rate can all too easily make it profitable to exploit new ideas with production facilities located outside the domestic economy and partly because of the tendency for start-up technically based companies to have short time horizons with their owners keen to cash in – often by selling out to foreign interests – as soon as they can rather than building up businesses for the long term.

Increasing expenditure on R&D over the next decade reflects part of the cultural change towards supporting manufacturing industry which the range of policies outlined in this pamphlet is aimed to achieve.

Conclusion

The conclusion to be drawn from all the considerations in this pamphlet is clear. Even if it is accepted that a considerably more competitive exchange rate is an unavoidably necessary condition for the UK economy to grow faster and to avoid being so unbalanced it on its own is not sufficient. There is also a wide range of other policies which need to be put in place at the same time to ensure that the necessary changes of circumstances and incentives all work together to make them successful.

Without shifting resources into manufacturing, investment and exports, we will never rid ourselves of the stagnation which is the consequence of import and debt led deflation. But getting this change to take place has a lot more to it than just enabling the UK to charge more competitive prices for our exports and to be rather less inclined to import a wider and wider range of goods. As this pamphlet has explained, we also need a wide range of complementary policies to be implemented at the same time.

It is a help that most of these policies are ones for which there is in principle wide-spread support. The reason why they are not being implemented more widely already is because there is unfortunately plenty of evidence that most of them would not work well – or at all – in an environment of very slow or non-existent growth. This is what has locked us into our current very slow rate of economic growth and stagnant productivity and incomes.

The problem is that the big change in policy which would unlock their vital contribution to economic recovery – making the pound more competitive – cuts the deeply felt feeling across the political spectrum in the UK that such a policy change should not even be considered. It is simply not on the policy making agenda. It is not that there are widespread discussions and a potentially lively debate about whether such a policy would work, leading to the conclusion that it might not do so. On the contrary, despite all the evidence from round the world to the contrary, there is almost no consideration of this option at all. This is mainly because there is a key overhang from monetarism and neoliberalism in the belief – in spite of contrary experience from all over the world – that any use of the exchange rate as a policy instrument is impossible or – which amounts to much the same thing – that, despite all the evidence to the contrary, it would be self-defeating if it were to be tried.

So, what we now need is a review of exchange rate policy to take place within the context of all the other desirable but relatively uncontroversial policy changes which would need to be implemented at the same time to make a competitive exchange rate policy work. If the reality is that none of these other attractive policies will bear much fruit unless the UK economy is made more competitive by an active exchange rate policy, we need even more urgently to face up to the need for a change of attitude which will make them possible.

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- ⁵ Tables in 1989, 2000 and 2018 editions of *International Financial Statistics Yearbook*. Washington DC: IMF, 2019.
- ⁶ Google data on manufacturing historically as a percentage of UK GDP.
- ⁷ Table UK.14 in *One Hundred Years of Economic Statistics* by Thelma Liesner. New York: Facts on File Inc, 1989.
- ⁸ ONS Times Series Dataset. London: ONS, September 2020
- ⁹ Numerous newspaper reports.
- ¹⁰ <https://www.oecd.org/pisa>
- ¹¹ Figure 4.4. page 46, in the Institute for Fiscal Studies 2018 annual report on education spending in England.
- ¹² Newspaper report November 2020.
- ¹³ Table UK.2 in *One Hundred Years of Economic Statistics* by Thelma Liesner. New York: Facts on File Inc, 1989.
- ¹⁴ Ibid, table UK12
- ¹⁵ Ibid table UK2
- ¹⁶ Ibid table UK.12
- ¹⁷ Ibid table UK.11
- ¹⁸ Ibid table UK.11
- ¹⁹ Ibid table UK.5
- ²⁰ Ibid table UK.3
- ²¹ Ibid tables UK.3 and UK.11
- ²² Ibid tables UJK.2 ND uk.9
- ²³ Ibid table Uk.2
- ²⁴ House of Commons Library Briefing Paper CBP 8513 *Tax statistics: an overview*. London: September 2020.
- ²⁵ HMRC Policy Paper on Corporation Tax published March 2020.
- ²⁶ <https://www.gov.uk/capital-allowances/annual-capital-allowance>
- ²⁷ As part of the Dodge-Line measures adopted in 1948 at the instigation of the US authorities the Japanese exchange rate was fixed at 360 yen to the US dollar which gave the Japanese an extremely competitive exchange rate.
- ²⁸ Successive editions of *International Financial Statistics Yearbook*. Washington DC: IMF
- ²⁹ Pages 586 and 587 in *International Financial Statistics Yearbook*. Washington DC: 2000 IMF
- ³⁰ Wikipedia entry on the Japanese asset price bubble 1986 to 1991
- ³¹ [www.ft.com/Bankers keen to court Germany's small businesses](http://www.ft.com/Bankers-keen-to-court-Germany's-small-businesses), 10th April 2014 as an example of press comment.
- ³² Page 81 in *International Financial Statistics Yearbook 2018*. Washington DC: IMF, 2018.
- ³³ Ibid
- ³⁴ Data from Chinese national statistics
- ³⁵ www.hs2.org.uk
- ³⁶ Estimate of the annual cost of climate change produced by BEIS
- ³⁷ ONS data on International Energy Prices
- ³⁸ Ibid
- ³⁹ Ibid
- ⁴⁰ OECD statistics on international R&D expenditure.



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