

STRONG FOUNDATION INDUSTRIES

How improving conditions for core material producers could boost UK manufacturing

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60-SECOND SUMMARY

The foundation industries – manufacturers of core materials that supply other manufacturing and construction firms – have had a tough post-crisis period. Despite pockets of stronger than average investment, productivity and pay compared to the economy as a whole, these industries have experienced a deeper contraction, and been in recessionary territory for longer, than both the rest of manufacturing and the economy as a whole.

Although partly the result of increased competition from emerging markets, globalisation isn't the whole story: the foundation industries in the UK are smaller, and have contracted faster, than has been the case in other developed countries facing the same challenges. This reflects a broader weakness of the UK's economy: our manufacturing diversity has been lost over the last 40 years, and we remain an anomaly among advanced economies in having so few industries with comparative advantage. This is a key reason for our large and longstanding trade deficit.

Our analysis suggests that EU competitors support their industries in ways that the UK does not, which warrants investigation. Evidence on public and private research and development (R&D), productivity and investment performance shows that the UK performs relatively poorly, and that there is a role for government and industry in terms of helping firms to improve. With transitional support, the UK's foundation industry firms have the potential to supply advanced manufacturing firms, such as those in aerospace, automobiles and pharmaceuticals, to a much greater extent than they do currently. Building on our areas of existing comparative advantage would be a low-risk way to diversify our production capacity; this is, therefore, where the government should focus its efforts.

The government's response should have two phases. First, it should ease the pressure on those industries in acute distress by ensuring that UK firms are not unfairly disadvantaged by tax, energy costs or subsidised imports. Second, it should look to strengthen the institutional support available to the foundation industries, in line with other EU countries, in order to help them adjust their production to better integrate into domestic supply chains. This could include providing firms with more patient forms of finance, improved collaboration and innovation systems, and more life-cycle-costing forms of public procurement for the goods the foundation industries produce.

KEY FINDINGS

UK foundation industries have performed poorly relative to other developed economies. The UK has one of the smallest foundation industry sectors relative to GDP in the OECD. Since 2000 its share of GDP has shrunk by 43 per cent, compared to an average decline across the OECD of 21 per cent.

Foundation industries contribute to regional growth. Most firms within the foundation industries are located outside the south east. Productivity and pay in the chemicals and basic metals sectors are generally higher than for both the rest of manufacturing and the non-financial sector as a whole.

There is demand for foundation industry goods from key strategic sectors. A large proportion of domestic demand for basic metals and fabricated

metals comes from UK strategic industry with revealed comparative advantage, including motor vehicle manufacture and aerospace.

International suppliers are increasingly meeting this demand. Domestic firms in chemicals, fabricated metals and basic metals manufacturing have come under increasing competitive pressure as global production has increased. At the end of the 1990s imports constituted 40 per cent of domestic consumption of basic metals, but that figure is now 90 per cent. Import penetration has also risen for chemicals and fabricated metals.

European co-ordinated market institutions offer greater support to their foundation industries. Co-ordinated market economies have institutional characteristics that supply more patient capital, stronger vocational training and industry-specific

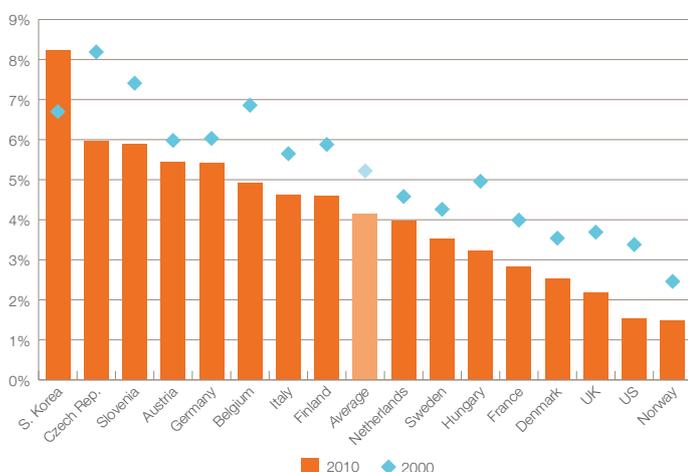
learning, and dense inter-firm networks that foster an innovative ‘industrial commons’. Together these institutional features help form competitive advantages in differentiated, niche modes of production over the UK’s liberal market model.

There are significant benefits to better embedding foundation industries in domestic supply chains.

We estimate that one percentage point of demand for domestic output from fabricated metals, basic metals and chemicals is worth an additional £2.3 billion in gross output and around 19,000 jobs in affected industries and further down the supply chain, with UK firms well placed to capitalise.

Between 2000 and 2010 manufacturing as a proportion of the total economy fell faster in the UK than in most comparable countries

Foundation industry output (GVA) as a proportion of total economy (GVA), OECD countries, 2000 and 2010 (%)



Source: IPPR analysis using OECD 2015a, ONS 2015b and ONS 2015c.

Note: All OECD countries included for which data was available. No OECD data was available for UK manufacturing output at the second digit; UK data was sourced from the ONS.

KEY RECOMMENDATIONS

Although recent years have been turbulent, certain parts of the foundation industries – particularly those that supply existing strategic industrial clusters – have the capacity to better integrate themselves into these supply chains. This would help them become more resilient and help diversify British manufacturing as a whole. To give firms a chance to do this, and provide time for institutional reform to embed itself, a series of immediate steps should be taken to ensure a fair playing field on trade and energy costs. At the same time, government – both national and local – should take a series of steps to overcome barriers facing the foundation industries.

Boost clusters

BIS should **create a ‘cluster leadership team’** responsible for promoting brands of clusters, and improving connectivity within clusters. **Foundation industries should be eligible for support from a renewed and expanded advanced manufacturing supply chain initiative**, with applications from advanced manufacturers that integrate foundation industry firms considered favourably above equivalent bids that do not. Similarly, **foundation industries should be better integrated into the Catapult network**. Existing centres should encourage bids for co-ordinated research activities where applied science, foundation industries and advanced manufacturing firms can align their interest and conduct joint projects.

Improve access to more patient forms of finance

To help provide more patient finance targeted explicitly at nurturing stronger manufacturing clusters, **we propose restarting and repurposing the underspent regional growth fund (RGF)**. Government should use powers for emergency funding, or delay the expiry of any existing underspend, so that new or surplus budgets can be targeted **specifically** at supporting innovation and clustering in the **supply chains of strategic industry**, such as aerospace, automobiles and pharmaceuticals.

Introduce more strategic model of public procurement

Stronger standards guidance for public procurement would help support a market for high-quality British foundation industry goods without falling foul of EU state aid rules. We recommend the **use of more stringent standard regimes – including product quality and social and environmental impacts – in public procurement guidelines**. More strategic procurement would better account for the cost of a product over a life cycle, and help the UK transition towards a low-carbon economy by reducing our reliance on high-carbon foundation industry imports.

Spread ownership

Government should **introduce an employee right to buy whereby employees are given the opportunity to take ownership of firms that are planning to close or are being sold off**.

For the full report, including all references, data sources and notes on methodology, see: <http://www.ippr.org/publications/strong-foundation-industries>

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