

Response to House of Commons Business, Innovation and Skills Select Committee inquiry on the Industrial Strategy

September 2016

1. Introduction

- Balfour Beatty is a leading international infrastructure group. With 16,000 employees across the UK, Balfour Beatty finances, develops, delivers and maintains the increasingly complex infrastructure that underpins the UK's daily life. Delivering projects across transportation, power and utility systems, social and commercial buildings: from Crossrail and the Channel Tunnel Rail link, Heathrow T2b to the M25, M60, M3 and M4/M5; Sellafield and soon Hinkley C nuclear facilities; to the Olympics Aquatic Centre and Olympic Stadium Transformation.
- We also have significant experience and understanding of the links between infrastructure investment and regeneration and economic growth. Leo Quinn, Chief Executive of Balfour Beatty, is a member of the Department for Business, Energy and Industrial Strategy's Construction Leadership Council (CLC) and leads the work stream on skills. The CLC draws together a number of senior business people from across the construction supply chain to provide leadership to help transform the UK construction industry and position it as a driver of productivity across the economy.
- Fundamentally, Balfour Beatty supports the Government's renewed focus on a long-term industrial strategy and the decision to create, in the new Department for Business, Energy and Industrial Strategy (BEIS), a government department with the industrial strategy at the heart of its activities. We believe that, designed correctly, a strong industrial strategy can contribute to increasing economic growth and resilience, alongside a more balanced society. The key balance to be struck is between a healthy market economy and the right level of central intervention.
- Balfour Beatty also welcomes the Committee's inquiry. It is important that industry and other interested parties have the opportunity to input views and ideas in this way. However, we also hope that the Committee will examine the models employed by other countries as well as considering direct submissions, to learn lessons and make recommendations relating to what has worked particularly well elsewhere, as well as what has not worked. It is worth noting that in countries such as the US and China, the state plays a key role in driving growth by ensuring investment in areas such as innovation.
- Industrial policy is likely to be significantly impacted by the UK's decision to leave the EU. The impact of 'Brexit' will be felt in a number of key areas such as State Aid, trade policy and the labour market. A strong industrial strategy will be important in responding to these changes.
- Furthermore, a robust industrial strategy could prove particularly important following Brexit in helping the country build on its key national strengths and take advantage of opportunities that emerge during and after the negotiations.
- We hope our expertise and the responses provided in this document will add value to the Committee's deliberations.

2. Summary of key points

- a. The Government's industrial strategy should seek to establish stability and certainty in the political and policy landscape.
- b. Some industries should be used as cross sector enablers in the strategy. Infrastructure is a good candidate for this as it underpins productivity growth in many sectors and across the whole country. Innovation and skills are two other areas which share the same properties.
- c. Effective, reliable infrastructure should underpin Government's industrial strategy. Infrastructure has the potential to stimulate the economy in the short term, offset uncertainty and support productivity in the long term. Indications from the Prime Minister that delivery of infrastructure projects, increased house-building and devolution of powers to regions and cities outside London will be a focus of the industrial strategy are very welcome and have Balfour Beatty's full support.
- d. An industrial strategy must support sectors where the UK has genuine expertise and a strong competitive edge, enabling them to take advantage of opportunities as they emerge.
- e. An early and integrated policy response to what happens following the vote to leave the EU will be important. A plan both retain the skills of those who have migrated here and to ensure that the UK remains an attractive place for talented people to move to should be a key element of Government's industrial strategy.
- f. The industrial strategy should also seek to address the skills shortage in the UK directly, by continuing to support the upskilling of our own workforce. We therefore welcome the plans to increase the number of apprentices and introduce the Apprenticeship Levy.
- g. An industrial strategy should not see government intervene too much in the economy. Policies which ensure that the regulatory and tax systems encourage business to thrive are welcome for example, but too much state direction and policies which prop up inefficient industries are unlikely to help the economy in the long-term.
- h. There must be room for new sectors, especially those industries in which we will be internationally competitive going forward, to be supported by the strategy. These areas will provide growth in the future.
- i. The strategy should respond to the needs of all areas of the economy. This means it has to deliver across a wide range of geographic locations. It has also to support small and medium business opportunities as well as very large enterprises. And it should ideally be high-profile, with clear support from government, demonstrating their determination for it to succeed.

3. Responses to specific inquiry questions

What does the Government mean by industrial strategy, and what does the private sector want from one?

When Theresa May became Prime Minister, she announced that the UK government would develop an 'industrial strategy' to deliver a modern, innovative and competitive economy. Further indications from the Prime Minister that delivery of infrastructure projects, increased house-building

and devolution of powers to regions and cities outside London remain priorities and will be a focus of the industrial strategy are very welcome and have Balfour Beatty's full support.

In terms of what industry wants more broadly from an industrial strategy, above all, it must support sectors such as infrastructure and its component parts (including construction, architecture, design and engineering for example) where the UK has genuine expertise and a strong competitive edge, enabling them to take advantage of opportunities as they emerge. As these sectors are able to thrive, there should be a lasting impact in terms of growth, employment and key skills across the country, helping to achieve the aim of closing the economic and productivity gap between the South and the rest of the UK. Getting this element right is a precondition for the success of the wider strategy.

More specifically, Balfour Beatty believes that effective, reliable infrastructure should underpin Government's industrial strategy. Infrastructure has the potential to stimulate the economy in the short term, offset uncertainty and support productivity in the long term. Infrastructure investment delivers significant benefits, not only in terms of direct employment relating to the build and long term maintenance of a scheme and the spend that goes via the supply chains; there is also a well-documented multiplier effect. Economists estimate that every £1 spent on construction generates £2.84 in total economic activity¹ at least 90% of which stays in the UK².

Following the vote to leave the EU in June, it is important that Government retains its commitment to infrastructure. The Government's industrial strategy should seek to establish stability and certainty in the political and policy landscape. With private finance dominating the UK's planned infrastructure investment (69% of financing is from the private sector (worth £260 billion), whilst 19% is from the public sector (£73 billion) and 12% is from mixed financing (£46 billion)³) the strategy should ensure the UK is attractive and stable enough to maintain and even improve its position as a place for infrastructure investment.

Another key focus of the industrial strategy should, in our view, be the labour market and more broadly, providing a coordinated approach across areas such as skills and infrastructure. Approximately 2.2 million EU nationals work in the UK⁴. For industries such as the infrastructure industry, free movement of labour in the EU has allowed us to find the skilled staff we cannot currently source in the UK. Given the number of major infrastructure projects in the pipeline, uncertainty around the free movement of labour could cause the industry recruitment and staffing difficulties and may increase costs where demand for labour outstrips supply, and the subsequent risk of project delays. This will be particularly relevant for mega projects such as HS2 and the nuclear new build programme. An early and integrated policy response to both retain the skills of those who have migrated here and to ensure that the UK remains an attractive place for talented people to reside should be a key element of Government's industrial strategy. It will be important however, that BEIS works closely with the Department for Exiting the European Union and the Department for International Trade in considering this point. To this end, we welcome the establishment of the Cabinet Committee on Industrial Strategy, which aims to ensure that the industrial strategy has input from all the relevant departments, not just the business department.

The Government's industrial strategy should also seek to address the skills shortage in the UK directly, by continuing to support the upskilling of our own workforce. If we want a successful industrial strategy then we must invest in the people who will deliver it, so skills, the investment in

¹ LEK Consulting, Construction in the UK Economy, 2010

² CBI, Construction bridging the gap, June 2012

³ National Infrastructure Pipeline, July 2015

⁴ UK Labour Market Statistical Bulletin, Office for National Statistics, July 2016

human capital, must be a priority in the industrial strategy. In this vein, we welcome Government's plans to increase the number of apprentices by 3 million and introduce the Apprenticeship Levy. Balfour Beatty has taken the initiative in this area by being a long standing member of The 5% Club, an employer led organization set up by our Chief Executive Leo Quinn three years ago, aiming to address the skills gap by getting more young people into earn to learn opportunities, encourage businesses to take the lead on training and promote apprenticeships as a positive career decision. However, we do not believe that the apprenticeship levy alone will be enough to meet the shortfall in skilled workers the infrastructure industry needs.

What the approach looks like in reality is a clearly defined strategy designed through close interaction and genuine dialogue between government and industry – and with representative bodies, such as the Construction Leadership Council, which Balfour Beatty's Chief Executive, Leo Quinn, is a member of. Most importantly, the strategy should be adhered to over the long-term as we see in other countries such as Germany.

How interventionist in the free market should Government be in implementing an industrial strategy, for example in preventing foreign takeovers of UK companies?

This is a complex area and the exact balance that should be struck between an interventionist policy and a free market approach should, in our view, be driven by the industrial strategy: which means that any such strategy needs to have pin-pointed "strategic" industries, so that such decisions are made on a case by case basis. However, a policy which is either rigidly free market or recklessly interventionist is unlikely to succeed: a successful strategy is likely to involve a blend of the two.

What the UK does not need, in our view, is an industrial strategy which sees government intervene too much in the economy. Policies which ensure that the regulatory and tax systems encourage business to thrive are welcome for example, but too much state direction and policies which prop up inefficient industries are unlikely to help the economy in the long-term.

An effective strategy would see the Government adopt an approach where barriers to success are identified and removed, enabling innovation and investment. And where investment in infrastructure is undertaken strategically to support key geographies and industries and enable them to succeed. Balfour Beatty therefore believes that issue such as potential foreign takeovers should be considered on a case by case basis rather than there being a blanket policy. In our view, the three principles that should guide thinking in this area should be that:

- Successful and important industries should be recognised and supported. We support a sectoral approach. However, it should not be about "picking winners" – the overarching aim should be to create an environment in which all companies and sectors can thrive by supporting those industries where the UK has a genuine competitive advantage;
- There must be room for new sectors, especially those industries in which we will be internationally competitive going forward, to be supported by the strategy. These areas will provide growth in the future;
- The approach taken in the industrial strategy should be genuinely strategic: it should not be about propping up failing companies or sectors for the sake of it, but must assess the long-term requirements of the UK economy. For example, the failure to recognise the value of the domestic supply chain leaves us exposed to higher prices from overseas companies in areas such as steel, where the failure to accurately assess the economic benefit of buying

locally produced products contributed to the demise of the structural steel industry in the UK.

What lessons can be learnt from:

- Previous governments' industrial strategies?
- Other countries' attempts to develop industrial strategies?

Previous governments have had industrial strategies, both in the UK and elsewhere, from which many lessons can be taken.

Firstly, ongoing engagement and dialogue with industry is key to designing and implementing an effective industrial strategy. It will be of advantage to the new BEIS Department, in our view, that the 2010-2015 Government set up sector councils and other forums in its own approach to an industrial strategy. We recommend that these are maintained and built on rather than reinvented.

In terms of what can be learnt from previous strategies, Balfour Beatty believes it is important to achieve a balance between the future growth sectors (e.g. advanced manufacturing, bio medical, digital) and the core building blocks of industry (e.g. construction, manufacturing). Previous strategies have tended to overlook the less glamorous industries for which there is steady demand. Leaving the EU could be an opportunity for the diversification of the economy away from financial services and back towards industries such as engineering, construction and manufacturing, as the UK may no longer be bound by single market rules which restrict a more active industrial policy. This, in turn, would support the rebalancing of the economy more evenly across the regions and should therefore be supported by the industrial strategy.

There are many countries that can be learnt from, for example, Japan and the US, which have both used industrial policy to promote key sectors and industries with notable success. Examples include:

- Developments in the US science and innovation sector, which it has achieved largely by strategically supporting its defence industries;
- South Korea developed a strategy based around 17 future sectors as possible high-growth markets. Key capabilities common to these 17 sectors were identified for strategic support and strategies set for 7 of the common capabilities. The strategies include KPI targets and the support mechanisms required to deliver.

However, we believe the best model is perhaps Germany, which now has the largest share of global trade in manufactures ahead of China, Japan and the US. Germany has an active industrial policy focussing on inter-connected levers such as long-term planning; the emphasis on vocational training; the use of tax incentives to help industries grow; and the strategic use of public procurement around the use of key materials or technologies, or adherence to specific standards, which means that certain industries, companies or technologies can be stimulated and supported. The close relationships between banks and industry are another important element in Germany's success and indeed, the German model of collaborative public-private partnerships such as those found in Fraunhofer Institutes were recognised and used as models by the UK Coalition when it launched the Catapult Centres. However, rather than being a single, formal document, Germany's industrial policy is better described as a cross-government framework, embedded in all areas of policy, aimed at creating the right conditions for German businesses to thrive. Most importantly, there is universal support for the aims of the policy.

Balfour Beatty believes that infrastructure could be better supported by an integrated fiscal approach. Including taxes such as stamp duty for example, along the lines-proposed by the City Growth Commission and the London Finance Commission, could enable Combined Authorities to secure further infrastructure funding.

Should the industrial strategy have a broader objective, such as improving productivity?

We believe that an effective industrial strategy must benefit the whole economy and enable all industries to thrive. However, it is inevitable that there must be a sectoral approach to some extent, where key industries are identified for success, in order to maximise the benefits from the levers the Government has available to it. A sectoral approach would also enable the UK to play to its strengths in supporting those industries where it has a competitive advantage.

In our view, some areas should also be used as cross sector enablers and dealt with in their own right. Infrastructure is a good candidate for this as it underpins productivity growth in lots of sectors and across the whole country. Innovation and skills are two other areas which share the same properties. The new industrial strategy will therefore, require a combination of horizontal policies (aimed at benefitting the economy more broadly, for example, measures to support R&D and innovation, or changes to corporate tax policy) and those which support specific sectors (such as funding of certain technologies, or changes to public procurement rules).

In terms of other approaches, a sectoral and a geographical approach are not, in our view, at odds with each other, as areas of the country often have a specific expertise and an established supply chain relating to it. For example: the automotive industry in the Midlands and North East; the East London Tech City; or aerospace in the North West and South West. An effective industrial strategy must drive economic growth in different areas of the country. In order to ensure that the strategy is genuinely 'strategic' geographical impact and ensuring economic growth across the whole country is one of the key issues politicians should consider in designing it.

We recommend therefore:

- A strategy with an overarching objective of achieving growth across the economy, enabling all industries – and by inference, individuals and thus society - to thrive.
- The strategy would prioritise certain key sectors for support, ensuring a focus on benefitting the maximum geographic spread across the country by using cross-sector enablers such as the infrastructure industry.
- And the strategy would enable new, growth industries to emerge.

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