INDUSTRIAL POLICIES AND NET ZERO

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WHAT THE PROBLEM IS, AND WHY IT MATTERS

Recent shocks, including the Covid-19 pandemic and the energy price spike induced by the war in Ukraine, led to both supply chain disruption and inflation. In Europe and the US, these shocks also exposed a lack of resilience in areas such as energy security and the supply of medical equipment.

Governments have reconsidered the role of industrial policy in (re-)building domestic manufacturing capacity to safeguard against future crises, to reduce reliance on China, and - critically - to get to Net Zero more quickly than the market seems able to manage.

As a result, industrial policy is back, and in a big way, although whether one policy can hit multiple targets is open to question, especially for a small open economy like the UK

The United States is the 'flag-bearer' for new industrial policy. President Biden's Inflation Reduction Act (IRA), and CHIPS and Science Act add up to over $2 trillion of industrial policy support for green manufacturing, reshoring and decoupling from China. These have provided a range of subsidies and tax breaks to foster investment in and take-up of low carbon technologies, such as battery electric vehicles (BEVs), heat pumps and carbon capture as well as semi-conductors.

The IRA alone has stimulated some $278 billion of new investment, creating some 170,000 new jobs. Not surprisingly, the European Union (EU) has grown concerned over the IRA's impact on the EU's own green manufacturing base, particularly in terms of diverting investment away from the EU, especially on battery making for BEVs. And looking East, the EU has launched an investigation into Chinese subsidies for battery electric vehicles. Yet China has of late re-emphasised its focus on industrial policy, while South Korea has just unveiled a $29bn boost for its EV battery industry.

In response,the EU has announced a €250 billion Green Deal Industrial Plan, along with a relaxation of EU 'state aid' rules to allow member states to use fiscal incentives to fast-track investment in green sectors, with an emphasis - at a high level at least - on skills, supply chains, funding and smart and simple regulation such as cutting red tape for new net-zero manufacturing projects and accelerated permitting rules for renewables.

This has all led to concern that a green subsidy race will stifle competition, raise global trade tensions, and reduce opportunities for developing economies to grow their own clean-tech sectors. New policies could also challenge the existing multi-lateral trade framework and WTO rules. Indeed, this could be a major moment for reset at the WTO, especially when both the EU and UK are introducing Carbon Border Adjustment Mechanisms.

But both the US and EU subsidy schemes should help accelerate a much-needed green transition. That will accelerate decarbonisation and the move to Net Zero. This is needed as the market, left to its own devices, is not moving quickly enough.

And what of the UK? The UK had several industrial strategies after 2010, with the most recent, developed by Greg Clark, scrapped under the Johnson government. In its place came a plan to 'Build back better' with a new focus on levelling up. Yet funding for local industrial strategies, in which Local Enterprise Partnerships (LEPs) and Combined Authorities had invested significant time and resources, was scrapped.

More recently LEPs were also culled in further institutional churn at the regional level. 'Build back Better' was followed by Liz Truss' short lived Growth Plan, and most recently Rishi Sunak's Growth Areas. At the time of writing there is no industrial strategy as such. This constant stop-start is indicative of the UK approach, in contrast to experience elsewhere, and has been criticised by a number of employers' associations such as MAKEUK.

In particular, there has been little in the way of a policy response to either of the US and EU subsidy schemes. Indeed, existing UK initiatives to net zero have generally lacked sufficient funding, been haphazard and sometimes conflict with other policies.

For instance, the Green Alliance has argued that there is a £14 billion shortfall in low carbon infrastructure investment in the UK. Moreover, the windfall tax on North Sea oil and gas firms oddly covers some wind and solar electricity generators, thereby discouraging investment in renewables. This is counter-productive as the UK has a competitive advantage in the generation, storage and low-carbon technologies and processes, especially in nuclear and offshore wind. Sadly, it has yet to leverage this into building a stronger supply chain in such areas, which has been something of a missed opportunity.

WHAT CAN BE DONE

Having a policy would be a start.

Jeremy Hunt said he would wait and see what the EU will do on its green industrial policy before responding. But why? One argument put forward for Brexit was that EU State Aid rules allegedly stifled the ability of the UK to support industry.

Yet the UK position since Brexit has been to largely scrap industrial policy and pretty much stand on the sidelines while the action unfolds elsewhere, for example on attracting investment to build battery giga-factories in stark contrast to the US and EU.

In 2023 the government did - finally - set out five 'growth areas' for the economy. This was followed up in late 2023 by extra support for the automotive industry (previous funding pots had been spent on Nissan, MINI and TATA). And there was the start of a much-needed battery strategy. But the sums on offer are a fraction of what is available in the US, EU and China, and there is a lack of an overall industrial strategy.

Labour had previously promised a £28 billion a year green transition programme - through a dedicated green investment fund - a proposal which was cautiously welcomed by climate experts. But in 2023 it rowed back on the policy, downgrading it to an aspiration over two parliaments and only if its fiscal rules allowed. Labour may also initiate a 'Buy British' procurement policy, though this could fall foul of existing WTO rules, and possibly the EU-UK Trade and Co-operation Agreement.

While Labour's fiscal caution is understandable in the run up to a General election, the UK needs substantial investment, for example to deliver energy security on the way to net zero. To do this, Labour needs a clear and credible plan that the money will be well spent if financial markets are going to finance borrowing.

Despite Labour's caution, there are some major opportunities for the UK to push forward on net-zero by capitalising on its existing strengths and capabilities, such as those in nuclear and off-shore wind. Progress depends on new investment in low carbon infrastructures - electric vehicle charging points, high-speed broadband and hydrogen technology - and working closely with local businesses to identify the best projects to support. This is not about 'picking winners' but rather nurturing the 'stables' from which winning low carbon technologies can emerge. Moreover, many of these opportunities reside in the North of England, and so an industrial policy supporting such sectors would also assist with 'levelling up'. Indeed, there are several 'shovel ready' low-carbon projects that could boost local growth.

In short, the UK needs to get serious about a 'Green New Deal' if it is to meet its own net-zero commitments, build low-carbon resilience in its own energy supply, re-shore critical manufacturing and compete with the US, EU and China.