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Smart Specialisation

# “Smart specialisation” done smarter: the hub-and-spoke model

## Summary

Regional inequality in the UK is very much a tale of two Britains. In London and the South East, growth, productivity, and wages largely outperform other regions, particularly those in the North of England, the Midlands, and North Wales.

Rather than viewing these successes with envy, the hub-and-spoke model emulates them. It creates conducive market environments to tackle anaemic growth and investment, and unleashes entrepreneurial ambition in our most deprived areas by challenging citizens to find their regions’ *raison d'être* in our dynamic, globalised world.

This policy would appeal to a wide range of political persuasions by building on cross-party consensus in favour of further regional devolution and improving the marginal economic benefits enjoyed from existing regional infrastructure.

This novel application of long-standing classical economic principles will give purpose to regional development, seeing individuals as more than just contributors to GDP. It is the much-needed shot in the arm for left-behind Britain and therefore merits serious consideration by policymakers.

## Economic Rationale

Classical economic theory<sup>1</sup> posits that all regions have a ‘comparative advantage’ over others in a narrow range of industries as they are endowed with resources that allow them to operate at a lower cost. As a result, regions specialising in their respective comparative advantages and exporting surplus output increases economic efficiency and boosts regional economic growth.

The long-run sustainability of this model hinges on regions moulding their specialisations around the dynamism inherent in all market economies – industries fall in and out of favour, and consumption patterns jolt at even the slightest provocation. To this end, capitalism provides a spontaneous discovery process of ‘creative destruction’<sup>2</sup>, wherein long-standing industries decline to make way for new, innovative ones.

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<sup>1</sup> Although Adam Smith and David Ricardo’s theories of specialisation and comparative advantage originally applied to individuals and nations respectively, these concepts follow through for regions.

<sup>2</sup> As the Austrian economist Joseph Schumpeter explains, creative destruction is the “process of industrial mutation that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one.” Joseph Schumpeter, *Capitalism, Socialism and Democracy* (Routledge, 2006).

In London and the South East, this indeed takes place as predicted. London boasts an established history as the world’s financial capital after centuries of facilitating entrepreneurial activity, and Britain’s “arc of innovation” (see Figure 1) encompassing Oxford, Cambridge<sup>3</sup>, and Milton Keynes has long received international acclaim as a centre for research and ideas.



Figure 1: UK Innovation Hotspots<sup>3</sup>

Parts of Oxfordshire and the Midlands epitomise how free-market capitalism aids the spontaneous discovery of new regional specialisations. During the Second World War, their location made them a central hub for manufacturing and servicing aircraft. When the war ended, aerospace engineers saw a lucrative opportunity in turning from producing fast, lightweight aeroplanes to building nimble track cars and racing them at RAF Silverstone and other disused airfields. Ever since, the so-called “Motorsport Valley” has cemented its dominance in hosting and supplying teams in Formula 1 (see Figure 2) and Formula E.

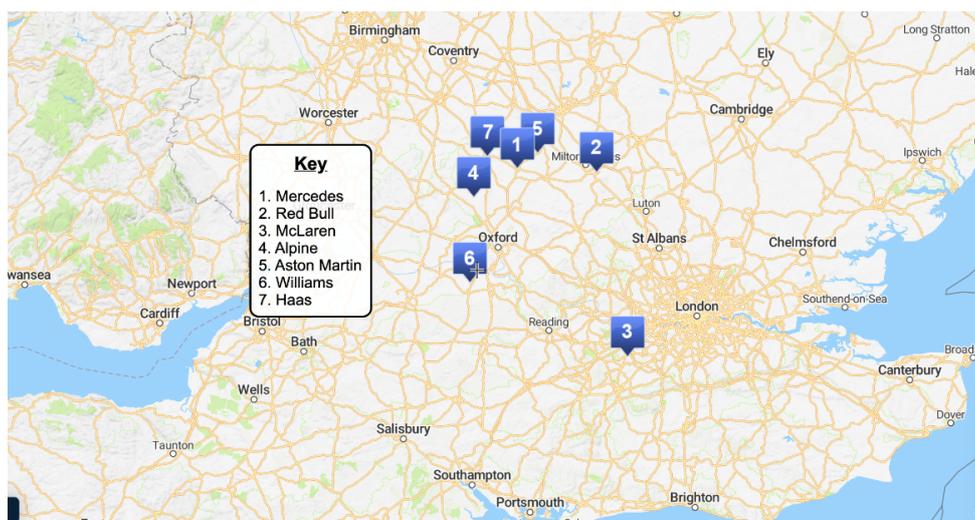


Figure 2: 7 out of the 10 Formula 1 teams are based in South East England<sup>4</sup>.

<sup>3</sup> The universities of Oxford and Cambridge were the first two to be founded in the English-speaking world.

<sup>4</sup> Formula 1. “F1 Teams 2021” Accessed April 3, 2021. <https://www.formula1.com/en/teams.html>

These decisions to specialise have reaped immense economic benefits. London and the South East capture the lion’s share of both domestic investment<sup>5</sup> and inward FDI<sup>6</sup> flows (see Figure 3) as firms are enticed by existing pools of specialised workers, established supply chains, and the opportunity of accessing productivity-enhancing knowledge spillovers from industry competitors nearby<sup>7</sup>.

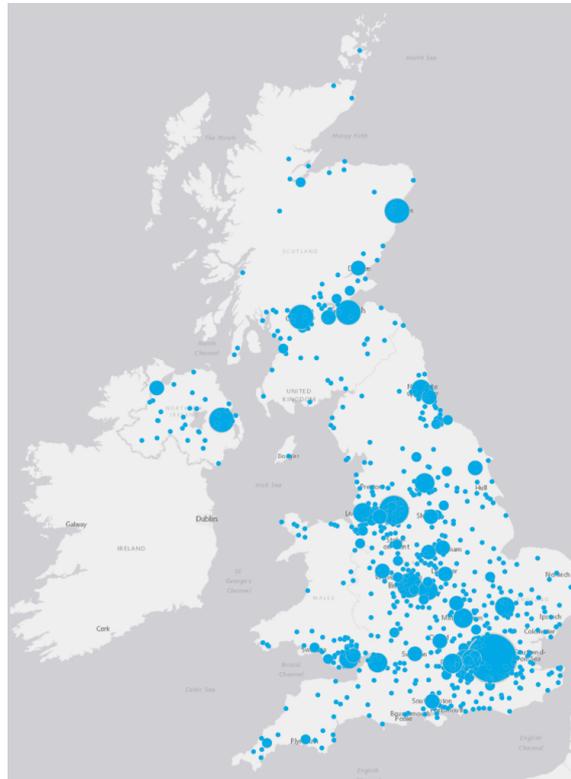


Figure 3: Distribution of greenfield FDI projects across the UK, year average 2003-18<sup>6</sup>

Export levels in these regions also eclipse those in the rest of the UK, with highly specialised SMEs dominating global markets. For example, as former Top Gear presenter Jeremy Clarkson notes<sup>8</sup>:

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*“All IndyCar racers, every Dakar winner since 2009, 35 of the 56 starters at this year’s Le Mans, including the car that won it, the Marussia Formula 1 car and the Pagani Huayra – all of them have gearboxes made [by Xtrac] on this little industrial estate in Berkshire.”*

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<sup>5</sup> Measured by Gross Fixed Capital Formation (GFCF) – the value of new fixed capital expenditure by UK-based firms. Office for National Statistics, “Regional Gross Fixed Capital Formation,” [www.ons.gov.uk](http://www.ons.gov.uk), December 21, 2017, <https://www.ons.gov.uk/economy/regionalaccounts/grossdisposablehouseholdincome/adhocs/007897regionalgrossfixecapitalformationnuts1andnuts22000to2016>.

<sup>6</sup> Foreign Direct Investment. The Greater London area alone attracts nearly 40% of greenfield FDI projects in the UK. Ilona Serwicka and Nicolo Tamperi, “FDI in UK and Brexit: Are There Regional Patterns?,” UK Trade Policy Observatory, 2019. Accessed April 8, 2021. <https://blogs.sussex.ac.uk/uktpo/2019/02/19/fdi-in-uk-and-brexit-are-there-regional-patterns/>

<sup>7</sup> Also known as ‘economies of agglomeration’ – cost savings arising from the geographical concentration of firms in regions.

<sup>8</sup> Jeremy Clarkson, “Top Gear”, BBC. (August 4, 2013). Series 20, Episode 6. Time: 53:13 - 53:40

As a result, specialisation has galvanised these regional industries, strengthening the brand images of the regions in which they reside and thus bringing long-run economic development.

Although regional specialisation is prevalent across the UK – all regions are to some extent defined by their involvement in a narrow range of industries – its translation into economic success has been considerably more muted in left-behind Britain. The reason behind this is psychological: rather than making rational decisions based on all available information, most investors submit themselves to herd behaviour when investing. This makes regional ‘brand images’ crucial attractors for investment – just as advertising lures customers into buying a product, regions in a free-market economy with a strong brand image of operating in an industry attract industry-specific investment and overseas demand. By contrast, investors and firms are unaware of the potential that lies in left-behind areas due to a combination of long-running misconceptions<sup>9</sup> and failures to modernise regional specialisms.

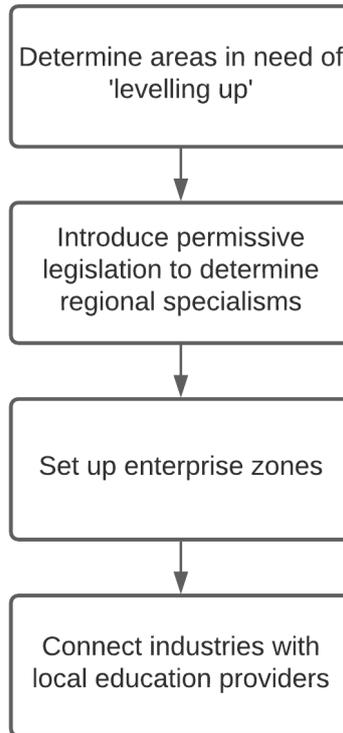
The hub-and-spoke model tackles these issues by catalysing the spontaneous discovery process. Its time-tested success in bringing regional development makes it a promising policy tool for supercharging living standards in left-behind Britain.

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<sup>9</sup> Strathclyde Regional Council: “We're living with an image that is ten to fifteen years out of date”; namely “the tail end of heavy industry”. Andy Griffiths and Allan M. Williams, “Culture, Regional Image, and Economic Development in the United Kingdom,” *World Futures* 33, no. 1–3 (April 1992): 105–20, <https://doi.org/10.1080/02604027.1992.9972274>.

## The Proposal

This proposal is comprised of four main stages:



### 1. Determine areas in need of 'levelling-up'

The term 'left behind' is still mired in ambiguity despite its prevalence in recent political discourse. Since government time and resources are highly scarce, an objective<sup>10</sup>, comprehensive indicator of socioeconomic underperformance should be devised to quantify the extent to which regions are left behind and therefore highlight areas most in need of regeneration<sup>11</sup>. One such 'left-behind index' created by the Institute for Fiscal Studies demonstrates how this could work in practice (see Figure 4).

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<sup>10</sup> Since this measure would determine the priority with which individual regions are considered for regional specialisation, the task of formulating it should be kept out of the hands of Westminster. This avoids political bias which could undermine the benefits of this policy for all left-behind regions.

<sup>11</sup> Existing indices of social deprivation can form a basis for this indicator. One widely used measure is the Index of Multiple Deprivation (IMD), which folds over 40 measures including crime statistics and access to housing into a single score. The main issue with the IMD is that its derivation is devolved, meaning levels of deprivation in Liverpool cannot be directly compared to those in Rhyl, for example. As this is a setback to levelling up areas nationwide, the main task for statistical agencies would be to develop a UK-wide indicator.

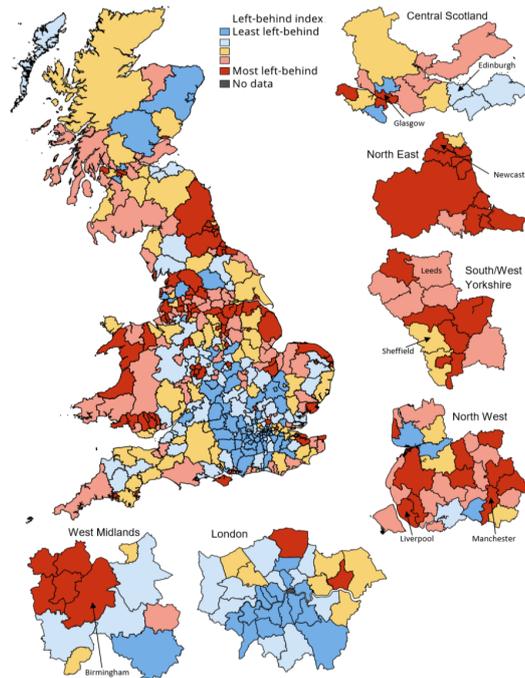


Figure 4: IFS Left Behind Index<sup>12</sup>

## 2. Introduce permissive legislation to determine regional specialisms

Once priorities are established, the specialisation of each regional ‘hub-and-spoke’ unit must be determined. The central government takes a hands-off approach in this stage by introducing permissive legislation that asks a simple question:

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*“What industry or industries should your regional economy specialise in to make the most of its values, skills, and potential?”*

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This would give workers, firms, education providers and local authorities, among others, the opportunity to harness their dispersed, tacit knowledge<sup>13</sup> of their regions to suggest more promising sectors to specialise in.

<sup>12</sup> Alex Davenport and Ben Zaranko, “Levelling Up: Where and How?” (2020): 12-17, <https://www.ifs.org.uk/uploads/CH7-IFS-Green-Budget-2020-Levelling-up.pdf>

<sup>13</sup> Friedrich Hayek, “The Use of Knowledge in Society,” *The American Economic Review* 35, no. 4 (1945): 519–30, <https://www.jstor.org/stable/1809376>.

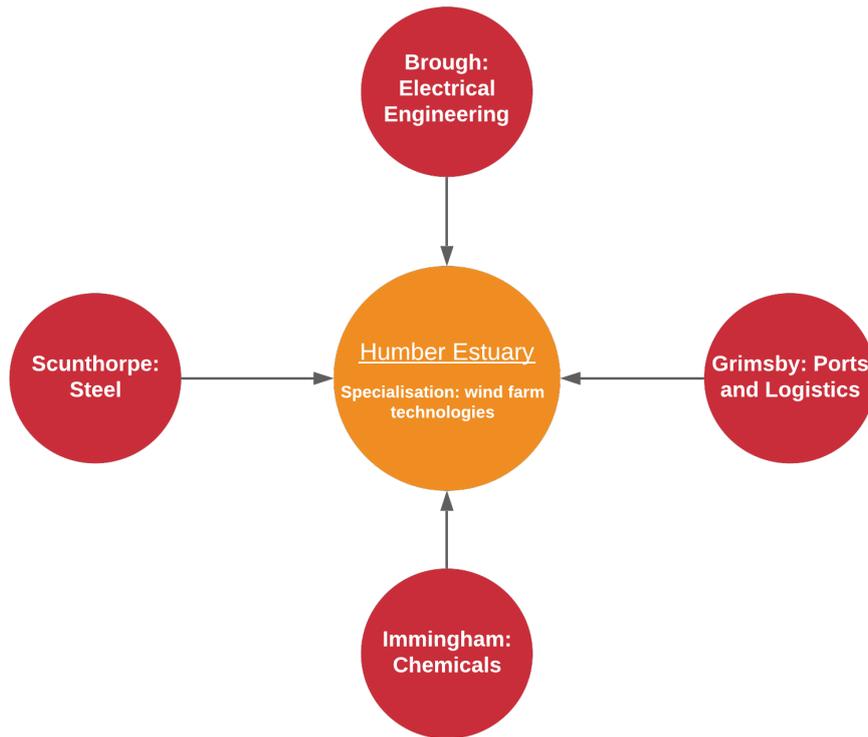


Figure 5: an example of how the permissive legislation process can be used to develop a hub-and-spoke model of regional specialisations

For example, the development of the Humber Estuary into a hub for wind farm technologies was driven by local towns’ existing industry specialisations which fed into different stages of the production process<sup>14</sup>. This cohesive approach set the region apart from over 200 potential sites across Europe<sup>15</sup> for a new Siemens wind blade manufacturing facility. The project has since created over 700 local jobs and has made the region a renowned destination for clean energy innovation.

A region’s historical involvement in specific industries would likely serve as inspiration for determining new regional specialisations; this would help to promote a region’s history whilst exploiting long-standing comparative advantages (see Figure 6). For example, the North East could specialise in advanced manufacturing and robotics to pay homage to its past dominance in shipbuilding whilst cultivating internationally competitive engines for growth and long-term employment.

<sup>14</sup> Each turbine could be made with 400 tonnes of Scunthorpe-made steel, and the process of installing it in the North Sea could be managed by logisticians from Grimsby.

<sup>15</sup> House of Lords Select Committee on the EU, “Brexit: Environment and Climate Change” (December 8, 2016), <https://www.parliament.uk/globalassets/documents/lords-committees/eu-energy-environment-subcommittee/Brexit-environment-climate-change/Brexit-Environment-Climate-Change-Written-Oral-Evidence-Volume.pdf>.

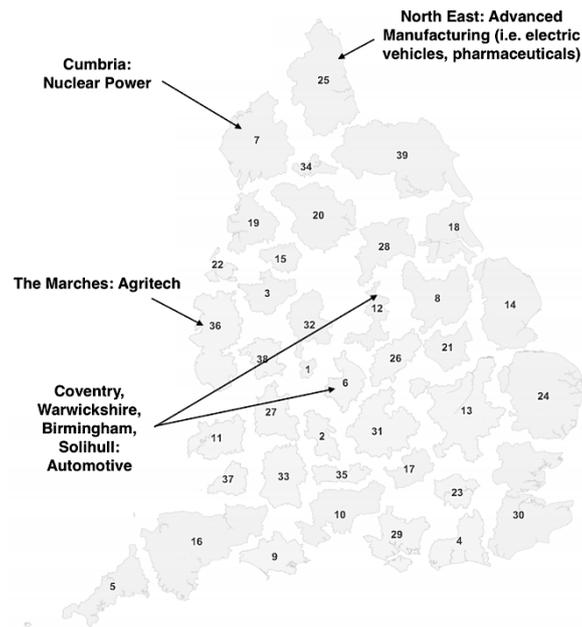


Figure 6: potential targets for regional specialisation hubs based on historical precedents

This bottom-up approach is not limited to ex-industrial areas. Rural, agricultural regions such as the Welsh Marches could learn from highly productive food exporters in the Netherlands<sup>16</sup> to make strides in the agri-tech sector, improving agricultural productivity and food security in Britain. Minette Batters, President of the National Farmers’ Union, suggests that this is indeed the direction British agriculture wishes to take<sup>17</sup>:

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*We now have a clear opportunity for British farming to become a global leader in sustainable, climate-friendly food production.*

*Agriculture and horticulture are dynamic, forward-looking industries. Farmers and growers are ready to adopt new technology to become more productive while [...] contributing to the country’s collective ambition to become net zero.*

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### 3. Set up enterprise zones

Creating enterprise zones in each regional hub would provide the financial nudge necessary for left-behind areas to entice foreign investors in an increasingly competitive market for FDI.

<sup>16</sup> Despite it being around 6 times smaller than the UK by land area, the Netherlands’ extensive use of hydroponics, vertical farming, and other agri-tech innovations have allowed it to become the world’s 2<sup>nd</sup> largest agricultural exporter after the US. The UK ranks 12<sup>th</sup> in this area.

<sup>17</sup> National Farmers’ Union, “Levelling up Rural Britain” (2021), <https://www.nfuonline.com/nfu-online/news/nfu-reports/levelling-up-rural-britain/>

Alongside the business rate relief and capital allowances that feature in existing enterprise zones, they should liberalise planning regulations that choke site development from the outset. More precisely, waiving planning permission requirements for projects contributing to a region's specialised brand images would be a welcome intervention for all stakeholders.

#### 4. Connect industries with local education providers

Enterprise zones in isolation may not maximise long-run regional development as they create incentives for businesses to merely relocate their production and jobs to areas within an enterprise zone<sup>18</sup>, with few marginal benefits for workers and regional development.

Although this cannot be prevented, encouraging human capital development amongst local workers will maximise the job-creating potential of these enterprise zones. Local education providers such as universities, FE colleges, and apprenticeship training providers should play a central role in upskilling workers. Doing so means that local workers are the main beneficiaries when job opportunities arise<sup>19</sup>.

Continually upgrading the workforce also avoids the risk of specialised regions suffering from endemic structural unemployment if hit by sector-wide shocks from global innovation and footloose capitalism<sup>20</sup>. This is because the local stakeholders that influence and maintain a region's specialisations are the first to foresee such threats to industry, allowing them to innovate accordingly to minimise any potential economic impacts.

Providing young people from the local area with ample training and employment opportunities in well-paying industries gives them the option to fulfil their ambitions without having to move elsewhere. Energising workers' pride in their hometowns and local industries in this way is crucial to reversing the regional brain drain that has kept left-behind areas on the back foot.

This stage also addresses concerns from deficit hawks as the cost of foregone tax revenues will be significantly outweighed by the economic benefits and fiscal multipliers associated with lower unemployment and a more skilled workforce. This is even before considering the immeasurable societal benefits of greater social mobility for students and trainees.

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<sup>18</sup> "Evidence from previous Enterprise Zones suggest that up to 80% of the jobs they create are taken from other places" Andrew Sissons and Chris Brown, "Do Enterprise Zones Work?," 2011, [http://www.cooscountywatchdog.com/uploads/8/7/3/0/8730508/do\\_enterprise\\_zones\\_work\\_february\\_2011.pdf](http://www.cooscountywatchdog.com/uploads/8/7/3/0/8730508/do_enterprise_zones_work_february_2011.pdf).

<sup>19</sup> The existing specialised workforce in the Humber estuary has meant that more than 97% of the 1,000+ jobs created by Siemens' investment in Hull have been filled by workers from within a 30-mile radius of the factory.

<sup>20</sup> Andrew Sissons, researcher at the Work Foundation, alludes to this being an existing problem with the current enterprise zones: "Enterprise Zones do very little to promote lasting economic prosperity. Most Enterprise Zones create a short-term boom, followed by a long-term reversal back into depression" Ibid., (Sissons and Brown 2011)

## “Smart specialisation” done smarter

The hub-and-spoke model makes multiple improvements on the current regional policy of “smart specialisation”.

### Reduced centralisation

The UK’s implementation of this European concept involves Westminster sharing power with 38 Local Enterprise Partnerships (LEPs) - business-led partnerships between local authorities and private sector businesses tasked with encouraging regional growth and employment.

Although this begins the process of devolution, LEPs are far from taking full advantage of the highly localised, dispersed industry knowledge held by firms and workers on the ground. A 2017 survey found that although 75% of LEP boards comprised members outside of big business and local government, only 33% of these had voting power<sup>21</sup>. The hub-and-spoke model’s permissive approach to discovering regional specialisations avoids the mistake of keeping decision-making power in Whitehall.

### Realigning priorities

LEPs have a remit to stimulate economic growth rather than to revitalise areas of dereliction<sup>22</sup>. Their fixation on achieving short-term returns has irked local communities whose requests have been sidelined by pre-approved, ‘shovel-ready’ projects<sup>23</sup>.

Regional brand images cannot be improved with short-term patches. This proposal prioritises the needs of local communities as it recognises that improving their economic prospects underpins the long-run economic development and investment attractiveness of left-behind areas.

### Providing support for rural areas

LEPs have often overlooked rural and coastal areas due to the assumption that business is predominantly driven in cities. Such an approach ignores hidden potential in semi-urban and rural areas. By contrast, this proposal begins with a rural focus. Given that many of Britain’s critically left-

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<sup>21</sup> CPRE, “Next Steps for LEPs How Greater Transparency and Accountability Would Help Local Enterprise Partnerships to Support a Thriving Countryside” (June 2018), [https://www.cpre.org.uk/wp-content/uploads/2019/11/LEPs\\_report\\_final.pdf](https://www.cpre.org.uk/wp-content/uploads/2019/11/LEPs_report_final.pdf).

<sup>22</sup> BBC, “Government Growth Plans ‘in Danger of Failure,’” *BBC News*, August 8, 2011, sec. Business. Accessed April 21, 2021 <https://www.bbc.co.uk/news/business-14388183>.

<sup>23</sup> National Audit Office, “Local Enterprise Partnerships,” 2016, <https://www.nao.org.uk/wp-content/uploads/2016/03/Local-Enterprise-Partnership-Summary.pdf>

behind communities are rural, they would be among the first to receive much-needed support to turn the tables on their past deprivation.

## Moving up the value chain

For decades, successive governments have failed to proactively offset the impacts of modern-day globalisation. As a result, what is in theory an efficient process of offshoring lower value-added<sup>24</sup> production to low-cost emerging economies has in practice become a driving force behind rising inequality, structural unemployment, and disillusionment with a seemingly apathetic political system.

The hub-and-spoke model puts moving up the value chain at the heart of efforts to supercharge regional economies in left-behind Britain. It would foster innovation-led growth in higher value-added industries, creating well-paying, resilient jobs for local workers<sup>25</sup>. Significant labour market shocks amid the uncertain economic climate of the past year only heighten the need for this intervention.

## Reducing barriers to entry

Regional specialisation reduces barriers to entry for entrepreneurs looking to set up in an industry as moving to a regional hub with a related specialisation surrounds them with the base infrastructure needed to set up. This will stimulate regional clusters of industry competition and bolster a robust brand image that will help to shine a light on the untapped economic potential in left-behind areas.

## Rekindling an entrepreneurial mindset in left-behind regions

Suggesting to left-behind communities that future-proofing their key industries can mitigate threats posed by globalisation would fuel an ambitious mindset. In effect, this proposal calls on all local actors to think like entrepreneurs, considering how their line of work fits into the broader structural picture of their region's economic future and how that future could evolve given existing regional talent. Small businesses form the backbone of the UK economy – rekindling entrepreneurship will strengthen it, delivering improved growth and living standards to left-behind Britain in the process.

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<sup>24</sup> The term 'value added' refers to the differential between the cost of a good or service and the price that can be charged for it. Higher value-added industries include pharmaceuticals, advanced manufacturing, robotics, and renewable energy development. Lower value-added industries include manufacturing, textiles, and call centres.

<sup>25</sup> An OECD study notes that firms and sectors closer to the technological frontier tend to be more 'resilient to shocks from international competition and technological change' (OECD, "Boosting Innovation-Led Growth in Regions in Industrial Transition," [www.oecd-ilibrary.org](https://www.oecd-ilibrary.org/sites/e511754c-en/index.html?itemId=/content/component/e511754c-en), November 14, 2019, <https://www.oecd-ilibrary.org/sites/e511754c-en/index.html?itemId=/content/component/e511754c-en>).

By contrast, less productive industries have borne the brunt of unemployment spikes due to the Covid-19 pandemic (Nicholas Bloom et al., "Which Firms and Industries Have Been Most Affected by Covid-19?," Economics Observatory, May 28, 2020. Accessed April 15, 2021. <https://www.economicsobservatory.com/which-firms-and-industries-have-been-most-affected-covid-19>.)

## Political Feasibility

The hub-and-spoke model is inherently a bi-partisan policy – it would draw support from left-wing parties by tackling the root cause of social inequalities whilst championing blue collar Conservative values by transferring decision-making power from Westminster to working people.

Since 1997, devolving economic power to regions has taken multiple forms under governments from both sides of the aisle. Given the strong demand for adjustments to the current top-down system of “picking winners”, this proposal would ride the wave of political momentum towards further regional devolution.

Uncertainty around any policy proposal often encourages political inertia that stops bills in their tracks. This is unlikely with the hub-and-spoke model as similar variants have already been tested in areas such as the Humber Estuary and Liverpool, with great success<sup>26</sup>. Furthermore, this proposal does not require a paradigm shift in regional policy - it can quite easily complement existing regional infrastructure. For example, the freeports unveiled in this year’s Spring Budget could become regional hubs to supercharge left-behind coastal regions, and infrastructure projects such as the rollout of full-fibre broadband nationwide could help to link regional hubs digitally, benefiting firms with multi-industry production processes.

This proposal could also facilitate the progressive economist Mariana Mazzucato’s desire for nationwide, cross-sectoral collaboration to solve multifaceted problems such as the climate crisis<sup>27</sup>. As industry hubs would be located in regions nationwide, inter-industry collaboration also becomes geographical collaboration, unifying the country in the pursuit of common objectives. This could assuage discontent in the devolved administrations which have long felt detached from Westminster and excluded from the national conversation. As a result, this policy could also serve to unite the country at a time when the Union is under mounting tension<sup>28</sup>.

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<sup>26</sup> Recessions in the 1970s flattened Liverpool’s shipbuilding industry, creating structural unemployment and stoking social unease. The then-Environment Secretary Michael Heseltine created an enterprise zone in the city centre which helped to attract private capital back into the city, and the 1988 opening of Tate Liverpool helped to showcase Liverpool’s industrial past. Today, the city’s revival is a model of how reviving regional brand images is critical to any plan to level up left-behind areas.

<sup>27</sup> Mariana Mazzucato, “Mission Economy: A Moonshot Guide to Changing Capitalism,” (January 29, 2021), <https://www.lse.ac.uk/Events/2021/01/202101291600/economy>.

<sup>28</sup> Tony Blair notes, “There’s definitely a real challenge for the Union [...] for sure in Scotland, for sure in Northern Ireland, there are some rumblings in Wales” (ITV News, “Tony Blair Admits ‘Weaknesses’ of Devolution Failed to End Calls for Independence,” YouTube, April 27, 2021. Accessed May 2, 2021. <https://www.youtube.com/watch?v=gOfKJ0wabtY>)

## Conclusion

In a perfect world, free-market economics would largely rule out geographical inequalities: all regions would be recognised for their economic capabilities and positive feedback loops of investment and prosperity would be felt across the nation.

The hub-and-spoke model recognises that this doesn't apply in practice. To cope with information overload, most investors settle to be followers and satisficers, not rational maximisers. As a result, a vast basin of potential in left-behind Britain has remained untapped for decades.

Rather than hijacking the system by dictating regional development plans from Whitehall, this policy is a liberating alternative. It calls on the localised knowledge of communities to determine new regional economic pathways and primes the pump to set inward investment and the market discovery process in this direction.

At a time when aspirations for the future are at an all-time low, especially amongst poorer households<sup>29</sup>, the need for a strong, inclusive economic recovery from Covid-19 has never been higher. The hub-and-spoke model fits this bill with ease, setting out an ambitious long-term plan to finally turn the tide on regional inequalities and supercharge economic prospects in left-behind Britain.

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<sup>29</sup> Prince's Trust, "Pandemic Highlights 'Aspiration Gap' as Young People Lose Hope," [www.princes-trust.org.uk](https://www.princes-trust.org.uk), September 29, 2020. Accessed May 1, 2021 <https://www.princes-trust.org.uk/about-the-trust/news-views/aspiration-gap-research>