



ECONOMICS
of PROSPERITY



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Trading Up: New Ideas for UK Exports

by Emily Redding

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CONTENTS

About the Author	2
Foreword	3
Executive Summary	5
Introduction	9
What Should the Government be Trying to Achieve and Why?	10
Productivity Gains	10
Fundamental Questions	11
What Do We Mean by a 'UK Export'?	11
Goods v. Services	13
What Does the Data Show?	15
Volume v. Value?	17
A Government Strategy?	19
Key Policy Areas	21
Export Targets	21
A Multi-Sector Approach	23
Exploiting Clusters, Global Value Chains and Inward Investment	25
Barriers to Trade	28
Gateway UK	30
Aid and Trade	31
Trade Missions and Envoys	33

ABOUT THE AUTHOR



Emily Redding

Emily Redding is a Research Consultant studying UK trade and export policy. She has previously written a report on CSR in banking for the British Bankers' Association. Prior to this she ran the Business Forum at Policy Exchange for four years, leading on their engagement with existing corporate donors. Alongside this she wrote and published *Board Rules: Improving Corporate Governance*, a report that looked at how to drive up standards of corporate governance among UK companies. She has co-authored another Policy Exchange report titled *Privatising the Banks: Creating a New Generation of Shareholders*.

Emily has a breadth of private sector experience, including four years at KPMG, firstly in Corporation Tax and later in Government Advisory. A qualified Chartered Accountant, she read Law at the University of Bristol.

The views expressed in this paper are those of the author and not necessarily those of the Legatum Institute.

FOREWORD

by Sian Hansen, Executive Director



This paper is the first in a series of international trade papers that the Legatum Institute's Economics of Prosperity team will be launching this year. Emily Redding has begun by mapping the UK's actual export interests by interviewing key people in UK businesses, and providing an analysis of the fundamental aspects of the UK's overall export picture. The paper then asks what the government (and companies) could be doing to improve the UK's exports.

KEY INSIGHTS

This paper offers several key insights, and raises some major issues at the heart of the difficulties that UK exporters face. The success of UK exporters is an incredibly important component in determining the success of the nation, and if this aspect of the UK's economic policy is given the centrality and importance it deserves, this could go some way towards boosting the UK's overall productivity.

The World has Changed

The first key insight is that the way in which trade negotiations and ministries were set up has fundamentally changed. We are no longer in a world where a firm makes product X in country A and sells it to country B. Today's world is one of competing global supply chains. It is a world where most trade is intracompany trade—i.e. trade within companies themselves. It is a world where border trade barriers have come down, but inside the border distortions have increased, and where efficiency is the benchmark of a successful supply chain.

The Role of Services has Increased

Services play a much larger role in the overall export picture. Services and goods are also inextricably linked for many firms. It is here that the UK has a potentially large competitive advantage. The role of financial, legal, consulting and other professional services is a huge component of the overall UK export market, and it is in services where some of the most difficult barriers lie. Many of the barriers highlighted by UK exporters are distortions put in place by governments to favour particular firms, or that limit competition. Often they are not discriminatory in the classic trade sense, even in its widest application, but these significantly and disproportionately harm UK exports over and above the exports of other countries.

Government's Role in Helping Exporters

Government plays an important role in helping exporters to achieve their goals, but should be mindful to act only where appropriate. For example, the government should vigorously attempt to remove trade barriers where they damage the UK's export interests and help facilitate companies and sectors



Above: Cargo operations on the River Thames, London.

working together for a more efficient, collective drive to export. However, we do not advise government to engage in subsidisation of particular favoured technologies or to engage in picking winners.

Changing the Government Structure to Deal with the New Reality

Governments have to catch up with the reality of trade in the 21st century. The importance of the trade and exports agenda needs to be recognised throughout government with a systematic whole-of-government approach embedded in all areas. The UK government has taken some steps towards this but, as this paper demonstrates, there are many practical areas where this approach could be furthered for the benefit of the export agenda.

EXECUTIVE SUMMARY

The UK government wants to ‘trade their way out of the deficit’ and find ways of boosting UK economic growth in an area where the UK has traditionally been outperformed by its peers. Only one in five UK companies export compared to one in four of their German counterparts.

The government set the very ambitious target of increasing exports to £1 trillion by 2020 and boosting the number of exporters by 100,000, and yet, despite this focus and the many accompanying government initiatives, export growth has been slow. While the world economy may be heading into difficulty and with recession hitting countries like Brazil and Russia, there are other, long-standing reasons behind the UK’s ponderous export performance.

Common factors often cited are: a cultural reluctance to export, especially among smaller companies; a lack of ambition; an over-reliance on the domestic market, particularly because of the long years of growth preceding the financial crisis of 2008; producing the ‘wrong’ types of goods; a lack of infrastructure; access to finance; a lack of skills, especially language skills; and maintaining adequate levels of R&D investment.

However, there are export areas where the UK performs very well. The UK is the second biggest exporter of services in the world and enjoys a large services surplus of £15.4 billion with the EU alone. We can also boast of world-leading, advanced manufacturing companies in the aerospace and defence sectors.

Despite these successes, the needle on exports has not shifted enough in recent years. This report argues that the UK needs to think beyond the many small initiatives offered by UK Trade & Investment (UKTI) and consider some more far-reaching questions on what it wants from its export strategy and how best it can exploit the opportunities and advantages it does have.

The rhetoric surrounding and created by such ambitious targets runs the risk of creating a discussion around exports and trade that is far too superficial and fails to recognise some of the different issues that feed into a successful export policy. This report provides a brief look at some of the more fundamental questions, and even assumptions, currently at play.

Our research highlighted twelve areas that are important to discussions about ‘where next’ for UK exports. These included a look at how we classify UK exports in a world of shifting borders and jobs and how this feeds into the ‘volume versus value’ debate. The hefty targets set by government are looked at in this context as well as how they could be better tailored to help boost exports.

The changing reality of exports is also looked at in relation to the breakdown between goods and services and how the UK could take advantage of its head start in the latter. We look at the attempted pivot to emerging markets and how we can build on the advantages the UK already holds in exports. These include a growing link between aid and trade—increasingly important given the scale of the international development budget and reach of the Department for International Development (DFID)—the British ‘brand’; how foreign companies can see a benefit in promoting links with the UK; and our significant lead in the EU on inward investment.

However, the UK's disadvantages cannot be ignored. Most significantly, our research showed a weakness in collaboration across different industry sectors as well as a concern that a new whole-of-government approach to this area would be difficult to implement at the same time as maintaining momentum on the exports agenda.

These key areas are being discussed because they were the ones that arose out of the many interviews we held with exporters, officials, academics, trade envoys and related trade associations. We asked what their biggest priorities were, which areas needed more thought from government and business, and where the opportunities were to try something new.

With such a large policy area this report cannot possibly cover all the many drivers of exports; areas such as the skills pipeline, infrastructure and trade finance have also been amply covered in other reports. Instead, we offer quick policy recommendations and analysis on those areas of discussion that have perhaps been overlooked or are only just starting to gain importance.

THREE KEY THEMES

There are three main themes that filter through this report:

Firstly, exports have an important role in increasing UK productivity and efficiency. Multinationals are the most productive of companies followed by domestic companies that export, and only then by domestic companies that operate solely in their home market. Opening a company up to another layer of competition in a foreign market forces that company to either become more productive, or to fail. There has been some recognition of this in the government's new 'Productivity Plan', however, despite it being of paramount importance, exports are rarely looked at through a productivity lens.

Secondly, this is an area that needs a long-term approach from government. As many companies pointed out, the UK is trying to change in a few years what other countries, notably France and Germany, have been doing for twenty-five years. A preoccupation with 'quick wins' can often come at the expense of a longer-term, deeper relationship with new markets that, in the long run, will yield far more value in exports.

Finally, this is an area that needs to become more unified. It is starting to happen with the new attempt at a whole-of-government approach and the 'Prosperity Fund' but success for exports will only really come when all government departments feel some responsibility for export numbers. Similarly, an efficient multi-sector approach by the government and companies across sectors is vital for exports to progress to the next level.

TOP FIVE POLICY RECOMMENDATIONS

1. '100,000 new exporters' target should be amended to focus on having a high percentage (80%) of new exporters still exporting after five years

Currently, a lot of UKTI's work seems to involve identifying and persuading Small and Medium Enterprises (SMEs) to begin exporting, tying in to the '100,000 new exporters by 2020' target. Yet, nearly half of UK goods exporters stop exporting within six years. This suggests that merely helping companies, in particular SMEs, to start exporting does not lead to a huge change, or improvement, in the eventual numbers of exporters. Where UKTI could really add value is through moving towards a more sustainable, long-term

approach to helping smaller companies export, and aiming to build customer relationships with SMEs predicated on years rather than months.

A better target would be a reduced number of new exporters but a higher number of those that start and are still exporting after five years. This would require both government and companies to think more long term about where they should plan their export strategy, target SMEs that have the resilience to successfully start exporting and encourage them to diversify and increase their chances of building viable, permanent export streams.

2. Make UKTI/Minister of State for Trade and Investment a Cabinet position

Despite many changes to UKTI this is still an area that is driven by the personality of the minister and the priorities of 10 Downing Street. Although exports have received more attention under the current government, and the willingness of the Prime Minister and Chancellor to lead trade missions has helped with this, there has been little structural change to root this focus. A constant churn of UKTI ministers (five since 2010) and the switch between businessmen and politicians in the role has made it harder to implement the long-term strategic and structural changes that are needed.

Not only does there need to be an attempt at increasing the length of tenure of trade ministers but the trade portfolio also needs to be placed on a par with other areas of government and elevated to a Cabinet position. In almost all other countries, Ministers of Trade and Commerce are very senior positions, and a role that cuts across many other departments, including the Foreign & Commonwealth Office (FCO) and DFID, needs to have that visibility at the highest level. Not only would this raise the trade profile but it would also make it more likely that concrete structural changes would have a greater chance of becoming embedded.

3. Use large UK multinationals' signings to trigger an automatic trade mission promoting other sectors and companies

If the UK could present multilayered packages to countries with input from many sectors it is more likely that deals will be signed, and that they will have a higher total value. Currently, trade missions are planned, and then government representatives proceed to ask larger companies if there is a deal that can be signed during the mission. This can be frustrating for companies that may have to rush a signing they have been working on for a while. Similarly, companies often do not proactively encourage the government to help them with a particular market but will instead express an interest only once the government has decided to send a trade mission there.

We recommend that the government builds automatic trade missions around large overseas contract 'wins' as and when they are secured by the private sector. The government can springboard off these and use them as the entry point to a new market for many other businesses and sectors. Not only would this approach be private-sector led but it would also provide a soft entry point to sell a package of goods and services rather than having to make separate inroads for each sector and company in a country where UK companies have already established that there is a market. It will also change the signing of a big deal by a UK multinational to being the start of a long-term relationship rather than the end result, all of which helps to implant a longer-term approach to exports.

4. Exploit UK industry clusters formed around large public projects and export the IP and technology

The UK has one of the most open economies in the world and is the EU leader in attracting inward investment. It has also created successful clusters in places such as the North Sea and exported the knowledge gained there around the world.

Large taxpayer-funded projects such as Crossrail and the decommissioning of nuclear power stations are at the forefront of technology and innovation. This design and knowledge will be valuable to other countries planning similar projects. Instead of seeing these projects as sunk costs to the Treasury, the IP created could be monetised. We suggest that a 'wrapper' is created whereby it is written into contracts governing the work that the IP generated is to be collected by a third party and packaged up to be sold on the international market, with royalties filtering back to both the public and private sector.

Not only would this provide more value for money for the taxpayer from costs that were to be incurred anyway, but it would then make it easier for the UK companies involved to offer their services to other governments. Other countries are using investment in the UK, e.g. China in the nuclear sector, to boost their expertise and credibility which they will then be able to export elsewhere and the UK should follow suit.

5. Take advantage of the openness of the UK economy and its international reputation to become a 'gateway' for other countries' companies

Already, other countries are seeking to work with the UK and form partnerships on projects that can then be exported to a third country. For countries that wish to boost their own exports but may lack the history or apparatus, this is a good way for them to grow their exports under the umbrella of the UK.

Much like the 'strategic relationship' initiative set up in 2011, the UK should proactively reach out to smaller, high-growth companies from countries the UK would like to target for stronger trade links and ones that would benefit from a UK company registration. The government could offer these companies advice and help them as they try to build links with countries and regions the UK has strong ties with, such as the EU and the Middle East. Not only would this improve relations with the companies' origin countries by directly helping their multinationals of tomorrow, it would boost links and cement longer-term ties with the target countries, outside of the products and services the UK can offer.

INTRODUCTION

The last UK government set a hugely ambitious target to increase exports to £1 trillion by 2020. Recently described by the previous UKTI Minister as a 'stretch target' it will be missed by a wide margin. The target, ambitious though it may be, does however indicate the increasing importance exports and trade have for a government looking to boost economic growth against a backdrop of lowered GDP growth forecasts (to 2% in the recent Budget).

Exports, therefore, are a vital part of any discussion about how the UK is to prepare itself for the challenges and opportunities in an increasingly connected and global world. Exports and trade also form a crucial part of other important discussions currently occupying both government and companies, including questions of productivity, aid, data, foreign direct investment and how to pivot towards, and benefit from, the rise of new emerging markets.

In the course of this research we interviewed companies of all sizes from start-ups to large multinationals. We spoke with all the major UK exporters and canvassed their opinions on what they believed was holding UK exports back. We also interviewed officials working in the FCO, UKTI and DFID, trade associations, trade envoys and academics who all had extensive experience in working in trade and exports. All interviews were given 'off the record' to ensure that this report could present as honest a picture as possible.

Through these interviews we were able to establish key areas of importance, all playing crucial parts in the jigsaw that makes up export policy. We have aimed to provide a brief analysis of each area, any problems as well as new policy recommendations.

The report also looks at some of the more fundamental questions that should form the basis of any strategy or policy discussion in this area.

This report is not intended to provide a detailed look at all government policies and initiatives in this area, nor is it a detailed look at some of the wider questions that feed into business policy and have been comprehensively covered by other reports. However, it is intended to collect the big topical issues affecting trade in one space and offer some thoughtful new policy ideas that take these into account, providing further discussion for policy-makers and businesses alike.

WHAT SHOULD THE GOVERNMENT BE TRYING TO ACHIEVE AND WHY?

There are three key themes that should form a continuous strand through UK export policy. Firstly, there needs to be a greater understanding of why exports are so important and the link between exports and productivity, competitiveness and growth.

Secondly, the UK's trade policy should be orientated around creating a long-term strategy that looks to horizons of ten and twenty years rather than the next change of government or the next short term target. A common plea from companies in the course of this research was for the government to be patient with the export agenda and in building trade relationships and winning projects which can take years, not months.

Finally, a long-term strategy and 'whole of government' approach combining government departments and different industrial sectors needs to be truly embedded in both government and business.

PRODUCTIVITY GAINS

Increasing UK exports should be a priority for the government because companies that export are more productive, and because export-based jobs tend to be higher paid. In the US it has been estimated that exports, on average, contribute an additional 18% to workers' earnings in the manufacturing sector.¹ There is evidence to suggest that the most productive companies are multinationals, followed by domestic companies that export and only then followed by domestic companies servicing the domestic market.

In the March 2016 Budget, the main driver of the reduced GDP growth forecasts was a lower forecast for potential productivity growth. The government has itself identified that 'a large and widening productivity gap exists between the UK and leading advanced economies'.² The exports element of the government's 'Productivity Plan' includes references to the new whole-of-government approach, amongst other things, but as the BIS Select Committee commented "we question whether the document has sufficient focus and clear, measurable objectives to be called a 'plan'".³

Increasing UK exports is one way that the government can boost UK productivity and therefore should form a core part of any productivity strategy and not be seen as something separate carried out by UKTI. For example, recent government support has mainly been focused on large corporations or SMEs and start-ups, often leaving out medium-sized businesses (MSBs). Productivity gains are more likely to occur in MSBs as they have reached a critical mass and moved on from mere survival, so it would be worthwhile for the government to look more closely, outside the MSB programme, at the different needs of MSBs and their crucial role in increasing UK exports.

1. International Trade Administration: "Do Jobs In Export Industries Still Pay More? And Why?" by David Riker, Office of Competition and Economic Analysis (July 2010)
2. <https://www.gov.uk/government/news/productivity-plan-launched>
3. Para 1: http://www.publications.parliament.uk/pa/cm201516/cmselect/cmbis/466/46606.htm#_idTextAnchor138

FUNDAMENTAL QUESTIONS

WHAT DO WE MEAN BY A 'UK EXPORT'?

Firstly, what do we even mean by a 'UK export'? Technically, goods produced in this country are considered UK exports when they physically cross the UK border. Services exports are recorded differently and are discussed later. In reality though, this basic definition does not accurately convey the complexity of UK exports and, by default, the targets based around these figures will also be compromised. How can government create an effective strategy for exports when there is not a well-developed idea of what a UK export is or, indeed, what the UK wants from its exports?

For example, the final export that physically leaves the country will often include other, smaller, companies' products within a supply chain. A BAE Systems export will contain many different components from their supply chain, from large and small manufacturers, and yet only BAE System's final product is counted. Technically this is accurate but there is an increasingly popular view that there is an artificial line drawn between big and smaller companies and that all suppliers feeding into the final export should be viewed as exporters themselves, with the larger firms acting as an umbrella company.

How can government create an effective strategy for exports when there is not a well-developed idea of what a UK export is or, indeed, what the UK wants from its exports?

There would be value in recording the different company components in that final export to give an accurate picture of all the different companies involved in exporting; without this information the government will struggle to target their support.

These export statistics will also not always accurately take into account the contribution of those companies that retain their headquarters and IP in the UK but manufacture the product elsewhere. Companies should retain their IP in the UK and relegate the manufacturing of the product overseas when it yields a competitive advantage to the business to do so. A product built using UK design and technology, with sales remitted back to the UK but manufactured in Malaysia, for example, will count as a goods export for Malaysia rather than the UK. However, it could easily be argued that the value of this export, in both design and HQ jobs, sales and taxes, remains in the UK despite the physical product never touching these shores.

US-based Apple is a good example of a company that manufactures its product outside the US in a global supply chain, but which retains much of the value in the US.⁴ Traditional export reporting would classify iPhones as Chinese goods because they are assembled in China; however the IP, software design,

4. P19, IMF: "Trade Interconnectedness: The World with Global Value Chains" (August 2013)

marketing etc. is all done in the US and Apple supports over a quarter of a million supply-chain jobs there as well. The US has moved further up the value chain but this should not reduce its value as a typical US export. The value to China, by contrast, is relatively limited with estimates being put at just \$10 or less per iPhone in direct labour wages.⁵

Similarly, what about products made here in the UK but by a company with a foreign owner? Jaguar Land Rover accounts for 5% of total UK exports⁶ but has been a wholly-owned subsidiary of Tata, an Indian-based company, since 2008. Can we really count it as a UK export if the ultimate profit goes to a company based overseas? We would argue that such products should be considered UK exports because they are responsible for jobs here in the UK. All of which highlights the fact that exports are an increasingly complicated matter, especially when taking into account the global footloose nature of supply chains and multinationals. Export data, as it is now, is not helpful in understanding how much value the parts of the supply chain which are located in the UK generate for the UK economy as a whole.

A better question would be to look at where and what the value of the export is. If goods are produced in the UK and are therefore creating jobs then that is valuable to UK Plc, regardless of who the ultimate owners are. If, on the other hand, the value to the UK is in the revenues remitted back in the form of sales and tax on goods produced overseas then that value should also be clearly counted, in addition to the sale of the IP.

Looking at the focus of trade missions or the current prioritisation of attracting inward investment, jobs would appear to be the primary measure of success. Whilst job creation is important, this focus can detract from the other value exporting provides.

This will become more pertinent the more developed emerging markets become. Already, UK companies wishing to export or set up a business in countries such as India have to agree to move key sections of their manufacturing to those countries. As emerging markets become more assertive these demands to move production (and jobs) will only become more frequent.

Reframing the value of exports with wealth creation, and tax revenues being seen on a similar level of importance as jobs, should help to shift government focus and therefore its support towards policies that reflect this changing nature of world trade.

Policy Recommendations

1. Record all components in the supply chain that contribute to a final export in order to accurately reflect the number of companies and jobs involved in exporting as well as the complete value of the final export to UK Plc.
2. There should be a clear recording of products made and sold elsewhere in the world using IP and design based here in the UK to demonstrate the importance of R&D as well as emphasising the advantage the UK has in this area and the value, outside of jobs, that exports bring.

5. P6 "Capturing Value in Global Networks: Apple's iPad and iPhone" by Kenneth L. Kraemer, Greg Linden and Jason Dedrick (July 2011)

6. Grant Thornton UK LLP, Submission to the Cole Commission (February 2015)

GOODS v. SERVICES

Services account for 79% of the UK economy⁷ and yet export discussions tend to focus on the goods, we produce. The UK is the world's second biggest exporter of services, only behind the US, whereas we are ranked tenth in world merchandise exports. In 2015 the surplus on UK trade in services was £88.7 billion, a surplus that has increased by £39.4 billion in the five years since 2010.⁸ In comparison, the deficit of UK trade in goods in 2015 was £125 billion. Services are also where UK companies overwhelmingly use domestic firms in supply chains. UK car manufacturers only source about 40% of their components from UK companies whereas for services 90% of demand is supplied by UK companies.⁹

Given the success of UK services, does this continued focus on goods skew policies and government support away from the areas that are likely to provide the most growth? And with many high-value manufacturers nowadays seeing sometimes half the value of export contracts comprising services, is it worth asking whether the export distinction between goods and services is still relevant? We would argue that it is a distinction that should be phased out.

A commonly cited belief from our research with companies was that services were of less interest to the government partly because they do not provide as easy a photo opportunity on a trade mission that a new airplane or building would. This attitude will hinder the creation of a long-term, sustainable export drive that plays to the UK's strengths, especially when considering that many of the markets the UK is targeting with trade missions will soon be at the stage where they will require services more than goods.

The UK is the world's second biggest exporter of services, only behind the US, whereas we are ranked tenth in world merchandise exports.

For example, in China, we should not be creating a government trade strategy based around goods exports that they will not want or need in a few years at the expense of putting efforts into the areas where we already have a leading advantage but have not fully capitalised on yet. Germany, a country that UK politicians continually talk of trying to emulate, does well because it focuses on what it does best (advanced manufacturing of key goods that no one else produces to their standards). It could, therefore, be argued that the UK would be better placed if it were to home in on those areas in which we already have a strong advantage. The danger of not doing so is that we squander the lead we have already built, chasing after artificial export opportunities.

The reporting of services exports also undermines their status. The measurement of services is in its infancy with the Office of National Statistics (ONS) using the International Trade In Services (ITIS) Survey to collect information covering approximately fifty different services and their trade worldwide. This annual survey uses a sample of 14,500 UK businesses of varying sizes, and asks them how much income they have received from exports and how much they have spent on imports for each of the different services.

7. ONS Release "An International Perspective on the UK—Gross Domestic Product" (24 April 2014)

8. ONS Statistical Bulletin "UK Trade: January 2016", released 11 March 2016

9. P13 Department for Business, Innovation and Skills "Strengthening UK manufacturing supply chains: An action plan for government and industry" (February 2015)

This is then supplemented by information collected for the Annual Business Survey. This data is therefore not particularly timely or accurate. Without accurate data it will be harder for the government to plan a strategy that supports services or allocates resources effectively.

This is an opportunity to cement the UK's world leadership in this area. The UK should be at the forefront of the development of the measurement of services as one of the world's biggest providers. It should in particular continue to focus on the creation of a single market for services in the EU, with whom the UK had a £15.4 billion services surplus by 2014.¹⁰ Trade barriers (which are discussed later) affect services far more than goods so the creation of a single market is crucial. Playing a leading role in the measurement and development of services will assist with this.

Companies also have a responsibility to boost the importance of services exports by seeing themselves as exporters. Whilst big manufacturing companies (that also happen to export services) have, for decades, seen themselves as exporters, this is often not the case for companies such as those in the financial and professional services sectors. If these companies begin to think of themselves as exporters and advocate, where appropriate, on that basis, they will be better able to keep the importance of services central to the export agenda and also provide the government with a better understanding of the support they need.

Policy Recommendations

1. Services exports need to be seen by government as of equal value to goods exports with trade missions and government strategy being organised around this idea.
2. Export data should explicitly and comprehensively cover services trade without relying on surveys.
3. The government should aim to become a leading player, an influencer, in the global development of the measurement of services, especially given its position as the second largest exporter and particularly in the creation of a single market for services in the EU.

¹⁰ ONS Release "How important is the European Union to UK trade and investment" (26 June 2015).

WHAT DOES THE DATA SHOW?

So where is the UK in terms of exports? Total exports have increased from £497.1 billion to £512.4 billion since 2011, an increase of 3.1% or £15.3 billion in real terms. Whilst any increase is to be celebrated, year on year the average annual growth in UK exports since 2011 was 1.1%.¹¹ In comparison to Germany, which recorded an increase of 6.5% in exports in 2015 alone, it is a rather weak increase.¹²

The pivot towards more emerging markets and, in particular, the BRICS, has been a constant in government plans and rhetoric but how much has it really happened?

In 2010 the top ten markets for UK exports were the US, Germany, the Netherlands, France, Ireland, Belgium & Luxembourg, Spain, Italy, China and Sweden. In 2015 the only change to this list was that Switzerland replaced Sweden. The total share of UK exports going to the EU in 2014 was 44.6% and whilst this is falling (down from 54.8% in 1999) it is still the main market for UK goods and services.¹³

The extent of the challenge facing the UK in boosting exports to the BRICS rather than its more traditional trading partners can be seen in the fact that in 2015 more UK exports went to Germany alone than all the BRICS countries put together (10.7% of total exports to Germany compared to 8.6% to the BRICS). The value of exports going to Germany in 2015 was £30.6 billion whereas to the BRICS it was £24.4 billion.¹⁴

China may be the UK's 6th biggest export market but India has dropped in one year to from 11th to 17th and Brazil, Russia and South Africa were at 27th, 24th and 25th respectively. These things do take time but the dominance of established EU export markets does show that a significant cultural and actual shift is required to pivot UK exports more towards emerging markets.

For services exports there is even less of a presence in emerging markets. In 2014 China was the 14th biggest destination for UK service exports with India at 24th.¹⁵ This is in part due to a lack of development of services markets in those countries as well as extensive trade barriers, but it does put into perspective the challenge facing all UK exporters.

The data is also indicative of a general pattern of export for UK SMEs. UK exporters have a tendency, when starting to export, to limit themselves to one or two markets, often in the EU. As many as four-fifths of the top ten export destinations for SMEs are in the EU.¹⁶ Emerging markets are a much higher risk to smaller companies, not only because the EU's regulations are easier to navigate and more familiar, but because there are often significant other expenses such as translators and visas. Additionally there is the worry about corruption and falling foul of the Bribery Act, both of which would prohibitively add to the cost of exploring a new market.

The government could encourage more companies to look at emerging markets by de-risking some of the elements of expanding into them. Key amongst this would be for UKTI to assist companies to initially navigate these more complicated markets by providing an approved (and continually updated) list of

11. BIS Select Committee Inquiry, Submission of evidence from the Rt Hon Lord Maude of Horsham, Minister for Trade and Investment on behalf of Her Majesty's Government (January 2016)

12. Germany Federal Statistic Office, Foreign Trade figures <https://www.destatis.de/EN/FactsFigures/Indicators/LongTermSeries/ForeignTrade/Irahl01.html>

13. ONS Release "How important is the European Union to UK trade and investment" (26 June 2015)

14. ONS Statistical Bulletin "UK Trade: December 2015", released 9 February 2016

15. Table 9.12 Trade in goods and services, United Kingdom Balance of Payments—The Pink Book (30 October 2015)

16. http://www.newsroom.barclays.com/r/3303/exporting_on_the_up_for_uk_small_businesses

reputable and able distributors and agents in-country. Currently, some in-country teams will provide lists of, for example, local law firms, but on the understanding that their services have not been vetted or approved. An approved list of potential business partners would both reassure UK companies and also make it easier for companies to gain a toehold in a new market.

Increasing exports to emerging markets would also be more likely if the government were to take a closer look at MSBs. Currently, large companies who need very specific government-to-government assistance and SMEs are the main focus of government policy in this area. However, we would argue that MSBs are actually very well placed to be the ones to enter emerging markets. Large companies are usually in the riskier markets already, either through historic reasons or because they are large enough to bear the higher business risk.

Given that the lead time to set up and start doing business in emerging markets is generally longer than in the EU, and comes with more risk, MSBs have the capital and cash to invest in the years it takes to build the right network, navigate the different barriers and finally win projects and customers. This sort of initial outlay in time and resource is beyond most SMEs. Therefore in the government's drive to boost exports to emerging markets the focus should perhaps be more on supporting MSBs with targeted help into these particular markets.

Data can also play an increasingly important role by helping the government's and companies' export strategy at a more granular level. A lot of UKTI's work is very resource-intensive and often the first interaction a company will have with UKTI will be with a person. This is incredibly expensive and unnecessary when the strategic deployment of information and data might be more helpful. Government can play a vital role here in collecting data on who is exporting, what goods they export, how long they take to break into their first market, when they are likely to move onto a second market, and at which point most companies stop exporting, breaking it down into different-sized companies and sectors.

In this way they can form a map that other exporters can use to see likely pitfalls for a company in their sector, realistic lead-in times before sales are realised, and the best target markets based on the experiences of others. This would help UKTI by reducing the need for face-to-face interaction for many of the earlier stages of advice but also, in analysing the exporting journey, they will be able to direct their resources to the most in-demand areas, helping to reduce obstacles for exporters.

Policy Recommendations

1. UKTI to provide an approved and updated list of reputable and able distributors and agents in-country for UK companies to partner with.
2. Government to focus on the support they give to MSBs, in particular how to help them open up emerging markets when looking to increase exports.
3. Government to collect, analyse and disseminate data on the typical export 'journey' for different-sized companies and sectors to help with the planning of resources and export strategies.

VOLUME v. VALUE?

The two headline targets throw up a dichotomy at the heart of government goals in this area; is the goal to increase the value or the volume of exports? This dual aim could explain why there is a competing focus on SMEs (for the 100,000 target) and large companies (for the £1 trillion target). Are they mutually exclusive or can the two aims successfully run in parallel?

This conflicting approach has been acknowledged by UKTI, who want their services to be 'more closely focused on the export targets' while also acknowledging that driving up the number of exporters, and also the value of exports will require different approaches.¹⁷

The UK has been very successful in a few key high-value exports such as those typically found in the defence and aerospace sector. The aerospace industry alone exported £10.5 billion worth of goods in 2014.¹⁸ It makes sense that the UK would wish to continue to focus on the high value-areas where it already has an advantage. Boosting these high-value exports will also shorten the time taken to reach the £1 trillion figure.

The £1 trillion target should, therefore, be amended to better aid the drive for increasing the value of exports. Rather than an all-encompassing target that no one sector or department feels responsible for there should be a public target that breaks down the overall ambition into more discrete areas.

The UK has been very successful in a few key high-value exports such as those typically found in the defence and aerospace sector. It makes sense that the UK would wish to continue to focus on the high value-areas where it already has an advantage.

For example, if the government set an overall target of an increase of 5% year on year solely in high-value exports, such as advanced manufacturing, they could then look at what is within their power to help achieve that very specific target. They could look at their trade missions, at the skills pipeline, at R&D expenditure and tax relief and think about how each of those feed into and affect these specific exports.

On the other hand, if one of the main benefits of UK exports is considered to be their ability to create jobs for UK workers, as discussed earlier, then it would make sense for a high-volume target to take priority. The more UK companies that export, the more jobs those exports are supporting. This is particularly true for SMEs that will often already be operating at full capacity and therefore any extra business in the form of exports will necessitate a rapid need for more employees.

However, there is a risk that by focusing too much on boosting SME exporter numbers, it exacerbates the tendency of UK companies to export to one or two close markets rather than help them build a long-term more expansive export strategy. This approach also makes it unlikely that a surge in the number of individual exporters would lead to any significant increase in either the value of UK exports or the number of new markets being reached.

17. P9 BIS Select Committee Inquiry, submission of evidence from the Rt Hon Lord Maude of Horsham, Minister for Trade and Investment on behalf of Her Majesty's Government (January 2016)

18. House of Commons Library, The aerospace industry: statistics and policy SN/EP/00928 (5 March 2015)

The cost per pound exported in a mass volume export market is much higher and therefore this type of target can have a significant negative impact on both efficiency and productivity. In Germany they tend to have a smaller number of exporters that tend to individually export more. Such an approach means that companies are better placed to absorb any downturns or local market difficulties because they have better targeted their export markets with a longer-term approach rather than a scattergun, one company/one market strategy.

At present nearly 50% of UK companies that start exporting goods will have stopped within six years, indicating that merely boosting the number of exporters does not necessarily lead to a permanent improvement in the numbers of companies exporting.¹⁹ The danger is that exporting becomes something that hinders smaller UK firms rather than being the means by which they grow, especially if they are not diversified.

As it is, only 10% of small UK businesses export compared to 40% of large companies.²⁰ Consequently a large part of UKTI's work seems to be identifying and then trying to persuade more SMEs to begin exporting. Recently the government launched the 'Exporting is GREAT' campaign to raise awareness amongst potential exporters and direct businesses to advice. However, exporting is hard and requires a serious commitment and we would argue that if a company has to be persuaded to export then they perhaps do not have the drive and resilience to really see that through, which would be borne out by the numbers stopping exporting within six years. UKTI should continue to provide information on how to start exporting but they should not aggressively target and try to persuade non-exporters to start.

Where UKTI could really add value and boost the numbers of exporters is by shifting the emphasis towards a more sustainable, long-term approach to helping smaller companies export. Like with large companies, UKTI should aim to build customer relationships with SMEs predicated on years rather than months. SMEs, and in particular start-ups, interviewed for this research felt that it was usual to receive an early burst of support from UKTI but that this was rarely maintained and they often lost all contact.

A better target would, therefore, be a reduced number of new exporters but a higher number of those that do start to still be exporting after five years. This would require both government and companies to think more long term about where they should plan their export strategies, target SMEs that have the resilience to successfully start exporting and encourage them to diversify and broaden their chances of building viable, permanent export streams.

Policy Recommendations

1. The headline value target should be broken down into separate, realistic targets for high-value exports and sectors that can help government target specific support towards the different kinds of exporters.
2. Resources should not be spent on cold-calling and trying to persuade SMEs to start exporting but rather on building long-term relationships with those that want to export already.
3. The 100,000 new exporters target should be amended to shift focus and government support onto having a certain percentage of new exporters still exporting after five years.

¹⁹ BIS Select Committee Inquiry, Submission of evidence from the Rt Hon Lord Maude of Horsham, Minister for Trade and Investment on behalf of Her Majesty's Government (January 2016)

²⁰ ONS Release "Exporters and Importers in Great Britain, 2014" (12 November 2015)

A GOVERNMENT STRATEGY?

With a whole-of-government approach being implemented in this area, there would appear to be more of a strategy now than in previous years. UKTI sector teams are being moved out into the relevant departments and all departments will now take responsibility for exports with UKTI remaining a central hub. There is also greater involvement and interest from 10 Downing Street in this area.

The willingness of the Prime Minister and Chancellor to lead high-profile trade missions and host leaders here in the UK indicates top-level support for exports but businesses are concerned that this influence has not yet translated into the long-term structural changes that make exports important, even when leadership inevitably changes. How does this area become less personality-driven?

The constant changing of trade ministers (five since 2010) and the switch between businessmen and politicians in the role has not helped to embed change or make this area less about the personality of the minister responsible. It also makes it harder for UKTI and the export agenda to assert itself in the face of influence from other departments.

The trade portfolio therefore needs to be placed on a par with other areas of government and should be elevated to a Cabinet position. In almost all other countries, Ministers of Trade and Commerce are very senior positions and a role that cuts across so many departments needs to have that visibility at the highest level. If international development is a Cabinet-level post then trade should also be. Not only would this raise the trade profile itself but it would send a clear message that the government as a whole sees this agenda as important and build in a structure that gives the trade minister more clout.

The willingness of the Prime Minister and Chancellor to lead high-profile trade missions and host leaders here in the UK indicates top-level support for exports but...how does this area become less personality-driven?

Serious consideration also needs to be given to the length of tenure of trade ministers. This is a policy area that needs a long-term approach but under the previous thirteen-year Labour government there were eleven trade ministers, none of whom served longer than two years.

This turnover of ministers makes it impossible to truly drive through any change and embed it in the civil service. In comparison, William Hague's longer tenure at the FCO has meant that the strategic push for 'commercial diplomacy' has had a chance to take root. Many businesses report that under Hague's leadership, ambassadors have become more trade orientated and that FCO civil servants, on the whole, have become much more aware of the need to increase exports and have realigned their work accordingly.

More recently, the whole-of-government approach can be seen in the plans for UKTI 'sector teams' to be moved into the relevant individual government departments. This is likely to benefit departments such as the Ministry of Defence (MoD) where government involvement with defence procurement and

exports (and the industry) is already well established and closely intertwined with the private sector. However, it is possible that in moving sectors out into separate departments, exports will actually become more isolated as they move away from the multi-sector hub of UKTI.

There is also the very real risk that in many departments exports will not be considered a priority, but more of an added bonus. When there are many more pressing areas, will improving export numbers have any priority at all? The Department of Energy and Climate Change's (DECC) 'Single Departmental Plan: 2015 to 2020' does not mention exports once. The sector teams in some departments are also likely to be very small which will have a bearing on how much influence they can expect to have.

Businesses have also spoken of their concerns that whilst this change is taking place, any momentum on the export targets will be lost and that without ministerial buy-in (and with a change in the leadership at UKTI this becomes more of a risk) there is little chance that such embedding will successfully take place.

The Export Implementation Taskforce, which has the responsibility for driving the UK towards the two export targets, is there to monitor export policies. To embed exports, once the UKTI teams are established, they should be included in each department's Single Departmental Plan with key deliverables such as the amount of direct resource supporting exports, e.g. how many ring-fenced full-time members of UKTI staff are employed within the department. The minister responsible should have to provide the Export Implementation Taskforce with an annual account of their performance against these.

Policy Recommendations

1. Trade minister role should be made a Cabinet-level position.
2. Government should aim to secure a lengthy tenure for trade ministers so that changes have time to embed in and to encourage long-term planning.
3. Each department should include a plan for boosting exports in their Single Departmental Plan and report to the Export Implementation Taskforce, once the sector teams have time to get established on the Export Drive with real deliverables and benchmarks.

KEY POLICY AREAS

Whilst the above questions are discussions that need to form a part of any export strategy planning, there are also key discrete areas that interlock together to form strands of that same strategy. The below section offers a look at those different strands and how they fit into the key themes of building a long-term strategy that is embedded into both UK government and business culture. These were areas that our interviews highlighted as the most important.

EXPORT TARGETS

As discussed above, export targets are the highly visible part of the UK's '2020 Export Drive'. But what is the point of targets, especially if they become unrealistic so early on? A number of the people interviewed for this research were in favour of retaining a target, no matter how unrealistic, as a way of giving the export agenda impetus and to reinforce its importance. Perhaps the question, therefore, is not whether the targets should be scrapped but how they can be improved upon and grounded in reality and thus a tool in trying to boost exports.

In order for these targets to be seen as having some basis in reality and not as PR gimmicks, they must be constructed in such a way as to hold the government to account. A target can only really be useful, or valid, when there is some rationale behind it or it contains a measure of achievability. What was the science behind the £1 trillion figure or the 100,000 businesses? From discussions it would appear that there was no real grounding to the numbers. And it is not just these headline targets that have such weaknesses. There are smaller targets for bilateral trade with individual countries that the government has also been setting.

For example, a UK-UAE trade target was set in 2009 to increase trade to £12 billion between the two countries. This was reached by 2013. The target was then reset in 2015 to £25 billion in bilateral trade by 2020.²¹ Behind this target, however, there was no real guidance on how the government felt it would be achieved or how much each key sector would contribute. Therefore, there have been some frustrations in the business community that targets are set with little thought to the actual planning of how to meet them.

A good country or sector target should aid planning and that is why it needs to be rooted in reality. To this end the best people to contribute to these targets are in-country UKTI and FCO officials (who carry out this role already) as well as the companies already based in the region that will have first-hand experience of the opportunities there. At the moment, companies feed in indirectly through their general dialogue with the different government departments. We would argue that in-country companies should have a more direct role in setting bilateral targets. Considered targets will also compel officials and companies to give honest appraisals of the situation facing them on the ground, which can then be filtered into realistic policies and objectives in the UK.

21. <https://www.gov.uk/government/world-location-news/uae-uk-business-council-sets-new-bilateral-trade-target-for-2020>

A target can only really be useful, or valid, when there is some rationale behind it or it contains a measure of achievability...A good country or sector target should aid planning.

Targets should be broken down by sector to increase credibility but also so that companies, civil servants and others can see how such a figure was reached. For example, if in that £1 trillion figure, UKTI could specify that they expected £100 billion of that to come from defence exports then the MoD and defence companies would have a good idea of what their goal was for the next five years. If there is not a specific (and public) number correlating to a discrete area of policy influence then it is nearly impossible to hold ministers and departments to account. They should be linked into the Single Departmental Plans (discussed previously) to cement their importance.

Similarly, more specific targets could take into account the different business cycles that various industries have. Many of the sectors that the UK is a world leader in, such as defence and pharmaceuticals, have long business cycles and therefore setting targets based on short-term horizons is counter-intuitive.

In general, the 2020 horizon of the main targets feeds into a short-term attitude that runs counter to the need to build long-term strategies in this area. Whilst it is understandable to predicate some targets around the end of this government, it might also be useful to have overarching longer-term targets stretching out for fifteen years that could assist in embedding exports into government.

This would be especially useful when looking at new emerging markets where there may not have been long-term strategies in place before. Including longer-term targets would also create more of an incentive to build policies around a longer-term outlook which is what this area needs and businesses want.

As the targets currently stand, they are largely ineffective either as a goad or as a tool, but by altering them to help focus policy-makers' attention and assist in building a long-term strategy, they could add considerable value.

Policy Recommendations

1. Companies should be involved in setting bilateral trade targets to ensure that such targets are both realistic and achievable with a concrete foundation to the numbers.
2. Government targets should be broken down into discrete sectors so that different government departments and ministers can be held to account for them, so that they have a scientific basis and to take into account the different business cycles of various sectors.
3. The government should consider setting additional longer-term export targets that will provide an incentive to build policies around a fifteen-year outlook as well as a shorter one.

A MULTI-SECTOR APPROACH

To have a successful whole-of-government policy there needs to be a true multi-sector approach. Breaking targets down into sectors should not hinder this, but a working multi-sector approach would involve having, for example, an energy company working with a financial services firm, with government, to take advantage of multiple opportunities in a new market.

Currently, such an approach is not in place. This is partly due to a cultural resistance from companies; UK businesses generally choose their supply chains and partners based on what makes the best business sense rather than out of patriotism, and persuading companies to work more collaboratively in this area has not met with huge success in the past. It is absolutely right that companies base their investment and market decisions on what is good for their business but there are ways that the government, in a convening role, can take this into account but still help build a more collaborative and efficient approach.

Not only does a lack of collaboration lead to duplication of effort by UKTI and the wider government, it is a waste of resource to focus on and build relationships with new markets and opportunities for one 'quick win' instead of wider longer-term gains. It also means the value of the total amount exported is likely to be less.

If the UK could present multi-layered packages to countries with input from many sectors it is much more likely that more deals will be signed, and with a higher total value.

If the UK could present multi-layered packages to countries with input from many sectors it is much more likely that more deals will be signed, and with a higher total value. The UK could learn from the French, where approaching exports in this way has been a key strength for years now. For example, in January 2016 the French government played an important role in securing a deal with a state-owned public company in India (Engineering Projects (India) Ltd.) and nine different French companies. There is no reason why the UK cannot follow their example if we can overcome the lack of coordination between departments and sectors.

To a certain extent, UKTI is already attempting to do this with their High Value Opportunities programme. UKTI will identify projects overseas, with a total value of over £500 million, and help companies of all sizes bid for them with knowledge-sharing, support and business contacts. However, this scheme is more about the government identifying opportunities for companies than consistently joining together multiple sectors when looking abroad.

A way to change this would be to approach the signing of a big deal by a UK multinational, as the start of a long-term relationship, not the end result. At the moment a trade mission will be planned and then the government will ask companies if there is a deal that can be signed whilst they are there, often to the

frustration of those companies that will sometimes have to try and quickly complete a signing they may have been working on for a while.

Instead, the government should build a type of automatic trade mission around these large 'wins' as they are secured by the private sector. The government can springboard off these and use them as entry points to new markets for other businesses and sectors. For example, a big oil pipeline project could be signed with a large UK multinational in a key emerging market and that project could then be used to trail in many other different sectors. Other businesses that could potentially benefit would include hotels, caterers, professional services firms etc.

This will require UKTI to be aware of when such deals are being signed and help coordinate the different companies with the different sectors that might stand to benefit. UKTI generally have been good at spotting business opportunities for UK companies but the advantages of this approach would be that it is led by the private sector, when it has been established that there is a market there, and it also provides a soft entry point to sell a package of goods and services rather than having to make separate inroads for each sector and company.

Day-to-day, a multi-sector approach is also hindered by the rather siloed reality of Whitehall. There is perceived to be a lack of information across government about which departments are assisting which companies, with email being the only way of linking up the different areas. Companies reported that whilst Whitehall can feel joined-up if you are one of the big 'strategic' companies, and are involved in monthly meetings with senior officials, for the vast majority it is not joined-up at all.

A more practical approach would be to have a central repository of the different contacts linking in with government from a particular company, deal or sector and who is working with them from the government side. That way the civil service would be able to see who the key contacts were and also be able to act on bringing in new companies that could already be seeking help from other departments. Whilst to a certain extent it is a company's responsibility to ensure that they are known to government, if they wish to have their support, an easy-to-access database on exporters and their links would make the process much more efficient. This is particularly true considering the rapid rate at which civil servants move roles and departments.

Policy Recommendations

1. Government should use the signing of a large project with a UK multinational as an automatic trade mission to pull in multiple sectors to a new market rather than organising a trade mission and then looking for a deal to sign.
2. A central repository should be created that contains the different contacts, projects and proposals for different sectors; their companies and export opportunities to ensure the whole government is joined-up.

EXPLOITING CLUSTERS, GLOBAL VALUE CHAINS AND INWARD INVESTMENT

The UK has been very successful in achieving one of its core export aims—to lead Europe in attracting inward investment. In 2014/15 the UK is predicted to have increased its inward Foreign Direct Investment (FDI) by 50% despite global FDI flows decreasing 11% in the same time period. The total value of UK inward FDI stock has been estimated by the OECD to have reached £1 trillion for the first time and the UK significantly outperforms its closest rivals in Europe.²²

Inward investment plays a direct role in boosting exports and it is good that the two are being linked under the Export Implementation Task Force. A good example of the role it can play is the revival of the UK's car manufacturing sector. In 2008, Jaguar Land Rover was bought by Indian company Tata who proceeded to invest heavily in its operation, eventually doubling their annual sales. Other foreign owners also moved in and invested in the auto industry with the result that as a whole, the industry now generates an annual turnover of £69.5 billion.²³ But, crucially, nearly 80% of the cars manufactured in the UK are exported with the industry making up 11.8% of total UK exports. This demonstrates how inward investment can lead directly to export growth.

Prioritising inward investment also makes sense in the context of the increasing importance of global value chains (GVCs). Trade in intermediate goods now makes up more than two-thirds of total world trade, so any discussion of exports has to be placed in the context of this new reality.²⁴ Attracting more FDI and thereby increasing the UK's share of GVCs should ultimately lead to the UK gaining a higher share of world trade.

GVCs also help drive up productivity and efficiency. If the same product can be produced more cost-effectively and more efficiently in another country, then production will transfer there.

Furthermore, attracting GVCs is important because smaller companies will often get their first taste of 'exporting' from belonging to the supply chain of a large multinational. 10,000 SMEs operate within advanced manufacturing supply chains alone.²⁵ Therefore, GVCs are crucial in any attempt to get SMEs exporting or to build the next generation of exporters.

The encouragement of GVCs and inward investment also helps in the creation of clusters, "critical masses—in one place—of unusual competitive success in particular fields."²⁶ Prime examples of this would be the 'clusters' of companies that have grown up to supply, for example, Rolls Royce in its UK locations.

In terms of exports, the North Sea oil industry is a great example of where a cluster has been created and then gone on to be exported. Over the past forty years, UK companies have been at the cutting edge of developments in the oil and gas industry and have subsequently been able to export that knowledge and their personnel around the world.

We would argue that there are a number of other projects currently underway that could be used to build clusters, leading to direct exports and the development of further industry opportunities.

22. Corporate Report, "UKTI Inward Investment report 2014 to 2015" (17 June 2015)

23. The Society of Motor Manufacturers and Traders "Motor Industry Facts 2015" (21 May 2015)

24. IMF Trade Interconnectedness: The world with global value chains (August 2013)

25. Lord Green of Hurstpierpoint speech on "SME Exporting: the national challenge" (10 November 2011)

26. "Clusters and the New Economics of Competition", Michael E. Porter, *Harvard Business Review* (November–December 1998)



Above: Section of new rail tunnel under construction for the London Crossrail Project at North Woolwich, London, 2015.

Public projects such as Crossrail and nuclear decommissioning provide a great opportunity to create a cluster similar to that of the North Sea oil industry, which will lead to exportable goods and services. Instead of viewing these big public projects as large sunk costs to be borne by the UK taxpayer, they could instead be framed as a way to create practical know-how that UK companies can then sell abroad.

We would suggest a model whereby it is written into the public contracts governing the work that any IP created (for example any innovations arising from tunnelling in Crossrail) be captured by a third party and then placed in a form of wrapper. This IP could then be offered for sale on the international market as a package of technology. The 'royalties' from the sale of this IP would then revert back to both the public and private sectors.

Crossrail already has INNOVATE18 which partners with Imperial College and aims to capture the many new ideas and processes created by the project, but this 'wrapper' would find a way of effectively monetising them and other processes

developed. Not only would this raise revenue directly from the creation of IP but UK companies involved in the projects would then be very well placed to follow-up with other governments looking to buy the IP to provide their services directly.

Likewise, the Catapult Centres set up under the coalition government seek to help commercialise the UK's research and academic communities' work, and one of their aims is to support businesses in accessing overseas markets and attracting inward investment. This 'wrapper' would be a practical way of doing this.

Inward investment into key industries such as the nuclear sector has been a thorny issue in recent years. There is a risk that other countries, such as France and China, are showcasing their expertise in this area and will use their investment in the UK to then market this knowledge and experience and go on to increase their share in the global market. Not only would UK companies not have benefited from the initial procurement but they will have missed out on the longer-term benefits of being able to export know-how.

We are not suggesting that inward investment should not be allowed in these areas, more that where large public contracts occur and have UK companies supplying them, there should be a mechanism in place to extract as much value as possible for UK Plc. This is also about ensuring that the UK, which has based a lot of its export success on its R&D and innovation, is not exporting away its IP and any future trade advantage.

Policy Recommendations

1. Government should take advantage of industry clusters formed around large public projects and write into the governing contracts that all IP created be captured by a third party in a form of a wrapper and sold on the international market.
2. The royalties from this technology 'package' should go to the private and public sectors.
3. UK companies should follow-up this sale of IP by using it as a soft entry point to advertise their products and services abroad.

BARRIERS TO TRADE

The ease with which companies can locate their supply chains also depends on the existence of any barriers within the UK. Likewise, the ease with which UK companies can export abroad also depends a lot on the barriers they find in those markets.

For large companies, the barriers to export are generally more at the government and regulatory level whereas for smaller companies they tend to be more market-based, however, they all impact on UK companies' ability to export.

A good example of a market barrier is the import restrictions in place on pharmaceutical goods in Algeria. Effective from 2009 the Algerian government prohibited the importation of pharmaceutical products that competed with similar locally-made products. This means that as soon as a local supplier can claim to manufacture the same product as a UK pharmaceutical company, the UK company is not allowed to sell it in Algeria, even if in reality there are differences between the brands. Not only does this prevent UK products reaching that market but it can also negatively impact on the health of those depending on the drugs because the quality is often not comparable.²⁷

For large companies, the barriers to export are generally more at the government and regulatory level whereas for smaller companies they tend to be more market-based.

A lot of these types of market barriers are imposed by local government and therefore this is an area where the UK government takes the lead because it is at the government-to-government level that such tariffs will be eliminated. At the moment the FCO, with guidance from UKTI and the companies they deal with, will take advice on those barriers that are causing UK companies problems and will, with in-country staff, create a strategy that will target the local government in an attempt to reduce or eliminate the barrier. This does, however, rely on companies reporting such barriers to the government, and it then being pushed through.

In the US, the Department of Commerce's Office of Trade Agreements, Negotiations and Compliance runs an easily accessible website that offers an online form for any company to complete if they believe they are being hindered by a trade barrier.²⁸ The European Commission also operates a similar 'Market Access Database'. This makes the system much more transparent and easy to access and we would argue it is far more likely to lead to smaller companies registering when they come across difficulties rather than having to rely on establishing a relationship with someone in UKTI. Despite there being an EU website we would recommend that a similar UK website be set up and run by UKTI to make it clearer for UK businesses and be more responsive.

The second type of barrier with the potential to damage UK companies' chances of exporting are anti-competitive market distortions (ACMDs). These are domestic regulatory barriers that distort the market into which UK companies wish to trade or invest. They are different from the market barriers mentioned

²⁷ P115 Pharmaceutical Research and Manufacturers of America (PhRMA), Special 301 Submission 2014

²⁸ http://tcc.export.gov/Report_a_Barrier/index.asp

above because they apply equally to both domestic and foreign firms and distort the market for both. They are a particular problem for UK companies because they disproportionately affect services and IP-intensive industries, two vitally important areas for the UK.

For example, China has introduced new 'standards' that distort the market and heavily favour domestic companies. In 2009 they introduced the TD-SCDMA 3G wireless standard and assigned it to the Chinese company, China Mobile, that controls most of the Chinese wireless market. Foreign companies wanting to access that market must therefore develop new versions of their existing products so that they comply with the 'standard'.²⁹ This is a huge cost to big companies such as Apple that are likely to have the resources to invest in adapting their product, but it would disbar smaller companies from even attempting to access that market.

While the European Commission does have responsibility for trade and trade negotiations, there is nothing to prevent the UK government from vigorously defending the interests of its own companies. Many ACMDs relate to domestic regulatory issues and thus go beyond the narrow trade agenda.

In the US, for example, there is a Market Access and Compliance Assistant Secretary in the Department of Commerce who "advocates for US business interests abroad by identifying and working to eliminate foreign barriers to trade, and monitors and enforces foreign compliance with trade agreements".³⁰ This could be added to the remit of the Competition and Markets Authority (CMA), that already looks at restrictions on competition and would be well placed to appoint someone to take on the trade role, perhaps in conjunction with UKTI.

The advantages of appointing a central person to focus on such issues would be to have a focal point for the elimination of these barriers and increase their importance. As discussed later, this role could also play a prominent part within trade missions and help to increase the mission's longer-term impacts and benefits.

Policy Recommendations

1. Create a UK website where any company can easily register, with the government, a market barrier or ACMD that is hindering their export efforts to improve access, particularly for smaller companies.
2. Add the elimination of barriers to trade to the Competition and Market Authorities' remit and appoint someone from there to focus on this agenda.

29. P7 "Freeing the Global Market: How to Boost the Economy by Curbing Regulatory Distortions", Shanker Singham, Council on Foreign Relations (October 2012)

30. <http://trade.gov/press/press-releases/2010/michael-c-camunez-confirmed-as-commerce-assistant-secretary-for-market-access-and-compliance-091710.asp>

GATEWAY UK

The UK is one of the most open economies in the world, as evidenced by our success in attracting inward investment. Not only is the UK constantly improving its business environment, with the recent Budget, further lowering corporation tax to 17% in 2020, but we are one of the only countries where foreign investors are treated exactly as UK companies once they invest here.

In addition to this openness, the UK is also seen as a 'gateway' to Europe, particularly by US companies, because of our membership of the EU and physical closeness to other EU markets. Companies often set up offices here and use the cover of UK companies to expand into Europe, in both goods and services. For goods exports they can assemble products in the UK and cut down on freight costs whilst benefiting from the UK's business environment and reputation abroad when exporting the final product to EU markets.

This is a model that does not need to be limited to the EU but could be used for other countries or regions with strong ties to the UK. Already, other countries are seeking to work with the UK and form partnerships on projects that can then be exported to a third country. The UAE-UK Business Council has explicitly stated its intention to look at "collaboration between British and Emirati companies in third markets such as Egypt" and it is a good example of the demand there is to work with the UK.³¹ For countries that wish to boost their own exports but lack the history and apparatus, this is an ideal way for them to start to grow their exports under the umbrella of a country that they trust and which has extensive experience.

The UK should proactively reach out to firms from all over the globe that would benefit from a UK presence or UK company registration. Much like the 'strategic relationship' initiative set up in 2011 that provides eighty-three of the top companies, many of them foreign multinationals, with access to 'buddy' ministers, the government should reach out to smaller, high-growth companies from countries the UK would like to target for stronger trade links.

The government could then offer advice and help to those companies as they try and build links with countries or regions the UK has good links with, be that Europe, the Middle East or countries such as Chile. Not only would this improve ties with the companies' origin country by directly helping their businesses but it is also another way of boosting links with the targeted markets and cementing long-term ties between them and the UK.

Policy Recommendations

1. UK government should seek out a group of high-growth companies in target emerging markets to 'buddy' and help them to export out to countries or regions where the UK already has close ties to build stronger trade links with both markets.

³¹ <https://www.gov.uk/government/world-location-news/uae-uk-business-council-sets-new-bilateral-trade-target-for-2020>

AID AND TRADE

Increasingly, aid and trade are intertwined and DFID has a significant role to play in the trade and export agenda. The ring-fenced nature and size of DFID's budget means that it also has substantially higher resources than other government departments to direct towards this.

The main obstacle to the combination of the two agendas is the strict (and strongly adhered to) rules surrounding the definition of spending as 'Overseas Development Assistance' (ODA). The UK is stricter than other countries in ensuring that what DFID do fund is for the benefit of the aid recipient. This is a very different approach to the Dutch, who have a combined trade and aid ministry. They manage to comply with the ODA rules by assessing each project to see if there are any potential conflicts of interest and, if there are, basing any decision on what would offer the best chance for 'sustainable inclusive growth'.

Even though in the UK there is nothing to prevent an indirect benefit to UK business, there is often a disconnect between what UKTI wants and what DFID does. DFID is more focused on local businesses in developing countries, and how to assist them and the people living there, rather than on creating markets for UK companies or subsidising UK exporters. In-country there is more of an overlap between the two departments and DFID staff will highlight opportunities to their counterparts in UKTI, however, as a general rule, exports are not a DFID priority.

Companies have also suggested that DFID is not very welcoming to UK business, or at the very least, does not operate on a preferential basis towards them. However, a 2012 assessment had 92% of DFID's contracts being awarded to UK-registered companies so this would suggest that in terms of direct business, UK companies do benefit from the DFID budget.³²

However, collaboration between DFID and the trade agenda is going to become more important going forward. The nature of aid is changing and the number of countries relying on aid assistance as their main source of revenue has dropped significantly. For example, Rwanda has reduced aid from making up 85% of government spending in 2000 to 45% in 2010.³³ This drop in dependency is becoming increasingly common and demonstrates the potential 'aid' countries have to become new markets, relatively quickly. Whilst DFID does work in many of the most fragile states, at some point, those states will shift from aid recipients to trading partners. A recent example of this is Vietnam, where DFID is withdrawing from this year, but where a more trade-based relationship should be starting to take shape instead.

There is also a lot of overlap between what DFID does and what UK businesses need. It has gradually become accepted by most of the world's governments that creating good business environments by cutting red tape, increasing transparency and combatting corruption, is crucial to economic growth and prosperity; all work that DFID provides funds to achieve. DFID acknowledged as much with its development of High Level Prosperity Partners in Africa that were discussed at the time as a way for DFID to work with UKTI, the FCO and UK businesses to address these challenges.

DFID's work on Aid for Trade and with the Trade Policy Unit (a joint team combining civil servants from DFID, BIS and the FCO) has also focused on trade for developing countries by assisting them to gain access to richer markets; working on standards and harmonisation to increase the likelihood of local exporters

32. <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmintdev/1680/1680we10.htm>

33. P8 Action Aid "Real Aid: Ending aid dependency"

being able to take advantage of this access; helping with cross-border barriers; and trying to reduce unfair subsidies that penalise those trading in some of the poorest countries.

Whilst DFID focuses on these because they are the means by which developing countries will eventually build up their economies, there is an indirect benefit for UK businesses and specifically UK exporters. These are all areas that need to be addressed before those countries can become sustainable export markets for the UK. In particular, DFID's work to reduce the cost of intra-Africa trading through the elimination of border barriers will reduce the costs and obstacles for the UK businesses that will eventually export to that region.

In a sign that the whole-of-government approach is extending to this area, the new Prosperity Fund will be key in helping knit together the two agendas. With £1.3 billion at its disposal and sitting within the FCO, the fund attempts to bring together the different strands of promoting economic growth in emerging markets and will involve the work of a few departments.

It is understood that the detail of how the Prosperity Fund will work has yet to be finalised but a crucial element should be the creation of a mechanism that plans and provides for a continuous link between the UK and other countries through aid dependency all the way up to becoming trading partners.

With increasing numbers of countries graduating from aid dependency—as Vietnam is now—it is vital that the UK capitalises on the strong links DFID has built and has a system in place to transfer these effectively to the FCO as new emerging markets for exporters. The Prosperity Fund should invest funds in coordinating this and plan a cross-government long-term strategy that looks ahead five, ten and fifteen years, analysing how the UK can build prosperity but also identifying the next steps for those countries and how to be best-placed for that development. This analysis and strategy could be tied into the longer-term targets proposed earlier for UKTI, to bring the different areas of government together.

There is also a direct place for DFID in the promotion of UK business, however. In 2013 Justine Greening led a high-level business delegation to Tanzania in a new market-led approach to development. This has been the only such delegation so far. We would suggest that DFID should become more involved in UKTI trade missions and consider leading missions to countries where they have a strong presence but which have been overlooked by UKTI previously.

This would have the dual benefit of addressing the perceived cultural reluctance in DFID towards helping exporters but will also be an effective way to start building trade relations with countries that have not reached a stage where they would be considered by UKTI as a target.

UK companies do, however, need to take some responsibility for this disconnect between DFID and business. The work DFID undertakes in the poorest countries, which are often the riskiest for UK businesses to try and operate in, will ultimately help create conditions more conducive to foreign firms. However, DFID's work is not to de-risk those markets for UK companies. There will still be considerable business risk in exporting to more fragile countries and this needs to be taken into account.

Policy Recommendations

1. The new Prosperity Fund should create a detailed mechanism through which a country rolls up from aid recipient to a new market to an established trading partner with a continuity of relationship.
2. DFID to lead trade missions to frontier markets where they have a presence and which have traditionally not been a target for UKTI.

TRADE MISSIONS AND ENVOYS

The UK is now far more engaged in trade diplomacy than it was; for example, since 2010 there have been five high-profile trade visits to China, compared to just four such visits in the thirteen previous years. However, there is a concern that the government can put too much emphasis on high-profile trade missions, in a world where trade no longer follows the flag, at the expense of building the long-term relationships that trade missions should augment, not replace.

The structuring of missions around deliverables and having a big announcement and photo opportunity at the end, can frustrate companies who have been working on a particular business deal separately and are then asked by government for a completion date and a press release (although trade missions can sometimes help nudge a deal over the line).

The quality of trade missions is also inconsistent with some being very well-executed and others failing to convene the right people or make the most of their time in the country. It was felt that the quality of a mission mainly depended on in-country staff. Likewise, due to demands on ministers' time, visits are sometimes cancelled or curtailed at the last minute which can cause offence to the host country. Often the relevant minister is not able to visit a country more than once in a few years.

The really valuable relationship-building, particularly for larger companies, is done away from the trade missions. In particular, many companies felt that the PM-led missions were too big to be effective and were repeatedly attended by many of the same companies. However, for smaller companies, being on a plane with the Prime Minister and being extensively briefed about the country was of significant benefit and many were keen to be granted a place on them. The drawback to this is that, in reality, only a tiny portion of businesses will ever be invited onto them.

However, coordinated trade missions to a region can really move the needle in a trade relationship. For example the 'Gulf Initiative', unveiled in 2010, had led to over 230 outward visits by ministers to the Gulf States, including four by the Prime Minister, by 2013.³⁴ The UAE has moved from 16th to 11th biggest export market for UK exports,³⁵ whilst arms deals worth more than £4 billion have been signed with Saudi Arabia.³⁶ This demonstrates their potential to add real value to a trade relationship but are there changes that could be made to make missions more effective in general?

Companies should be given more advanced notice of trade missions and the planned programme. At the moment, delegates are often not able to use their time as effectively as they could because they are tied into a schedule revealed at the last moment for security reasons. The French and German governments let companies know far earlier what their ministers will be doing and when and who they will be meeting. The lack of notice restricts how useful the missions can be as a chance for companies to create business opportunities themselves and meet useful people.

Junior ministers should be expected to lead more sector-specific missions, especially now that UKTI teams are to be posted to their departments. Every effort should be made to prioritise missions and not cancel at the last minute.

34. <http://www.publications.parliament.uk/pa/cm201314/cmselect/cmfaff/88/8806.htm>

35. ONS Monthly Review of External Trade Statistics August 2011/ONS Statistical Bulletin "UK Trade: December 2015", released 9 February 2016

36. <http://www.theguardian.com/world/2015/oct/13/uk-saudi-arabia-relationship-under-growing-strain>

Trade missions should have a public dedicated trade barriers aspect, with attendance by the appointed person from the CMA (see earlier recommendation). This is common practice for the US and there is no reason why a similar tactic could not be employed by the UK. The barriers most hampering British companies should be analysed before each trade mission and targeted as part of talks while there. Given that very few businesses will make it onto a trade mission, helping to dismantle barriers that affect them is of far more value, long term, to companies.

Trade envoys complement trade missions by providing another senior government figure to lead visits. A new, low-cost, initiative introduced in 2012, it expands the number of people the government can deploy for trade purposes. A common observation was that the UK's competitors, for example, the French, had ministers who do not have parliamentary demands on their time and who therefore visit target markets far more than their UK counterparts, which gives them a distinct advantage. The network of cross-bench trade envoys, appointed by the Prime Minister, increases the number of people able to visit target markets. Originally a small group, it has been expanded in this year to twenty-three envoys covering a range of different countries from Mexico and Indonesia to Jordan and Iraq.

The peer or MP responsible for a country or region is expected to build a network and assist UK companies with connections and local knowledge, playing a big part in any potential trade mission and visiting at least once a year. They are particularly valuable where they have previous experience in that country or region, or in the country's leading sector.

However, it was reported that they have limited resources and their ability to market themselves to the wider supply chain rather than a handful of companies is not quite there. It is also a significant, unpaid commitment for people who are already short of time. In addition, the spread of countries is rather piecemeal, and misses some key markets that are in the government's strategy.

With this in mind the trade envoy network should be expanded and put on a more formal footing. It should remain at the appointment of the Prime Minister to give them prestige and a high enough profile but there should be a more systematic approach, including more clarity on their role within Whitehall itself. If the UK is to build longer-lasting, deeper relationships with the emerging markets of tomorrow then they need to establish a presence in that country that will hopefully outlast changes in government and allow the representative to become really embedded.

The expansion of the trade envoy network should not just apply to emerging markets. There is no reason why trade envoys could not help UK-US exports. There is a common perception that UK officials tend to focus on New York and Washington, DC. at the expense of other parts of the country. With such a diverse and large economy, a trade envoy for California or the Mid-West, for example, would be very beneficial for UK companies, especially given that so much business and trade in the US is conducted at state and local levels.

Likewise there is nothing to prevent envoys being appointed to different countries in the EU. The popularity of the EU as a trading destination for UK business and the extent of our trading there already means that envoys to the less well-known EU markets could be highly beneficial. It is not just to emerging markets thousands of miles away that they can add value.

Similarly, the government should look at appointing senior trade envoys to their big BRIC targets such as China and India. By having a senior figure as a trade envoy, for example, for China, the momentum can be carried forward by them through successive governments. It will also provide a coordinating trade point for these important markets.

We would also suggest that envoys receive some remuneration beyond expenses for the role to recognise the work and time involved and add to the status of the role.

Policy Recommendations

1. Government should give companies more advanced notice of a trade mission's schedule so they can plan their time more effectively.
2. Junior ministers should be expected to lead more sector-specific missions with a commitment made to prioritise missions and avoid cancellations at the last minute.
3. CMA appointee should be included on all trade missions to highlight trade barriers.
4. The trade envoy network should be expanded to include envoys for different parts of the US and EU to take further advantage of the UK's biggest markets.
5. Trade envoys should be appointed for big export targets such as China and India so there is a trade focal point that remains even when governments change.



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