

Ideas Wales: Economy seminars

Seminar Two: Andrew Davies A.M. on the economic future of Wales

21st October 2010

Review of Wales Current Economic Position

1. despite the efforts of successive Assembly Governments, Wales remains one of the weakest performing parts of the UK economy, against a range of indicators and issues. The strategy of pursuing inwards investment has shown a decline and indigenous entrepreneurship is yet to fill the gap. There are critical deficits in the skills, innovation and finance needed for growth.
2. part of the explanation can be found in the nature of debate about the Welsh economy at the Assembly itself, where Members generally show themselves more comfortable with debating the allocation of wealth than its creation – and certainly spend more time in discussion social policy, as compared to economic policy. Even in economic debates, jobs are generally seen as a welfare issue, not an economic one.
3. The conduct of economic policy at the Assembly Government inevitably takes place within the macro-economic context set by the UK Government. Since the Assembly came into being, until May 2010 (and possibly beyond), the key characteristics of UK economic management can be summarised as follows:
 - A preference for the modest and non-interventionist role of the state, consistent with the economically liberal ‘Anglo-Saxon’, rather than the social model of the European Union;
 - A market-led, light touch regulatory framework, e.g. FSA; Ofcom; Ofgem; Ofwat.

- Acceptance of long-term structural shift of economy from manufacturing to service industries, especially dominance of financial services with London global lead, but with sub-regional centres in Edinburgh, Leeds, etc – though not Wales.
- A monetary policy which led to high UK exchange rates over an extended period in recent years has also made exporting very challenging for UK and Welsh manufacturing companies
- Minimal or no UK regional policy (other than role of RDAs) and no manufacturing strategy
- Research & Development, both private and public sector (especially higher education) concentrated in ‘Golden Triangle’ (Cambridge, Oxford and London/South East England)

Much of this has the characteristics of metropolitan-dominated policy making, with little to say about large-scale market-failure (for example in telecommunications in Wales), or (at least until the 2008 crisis), the benefits of active government,

While the UK-level conduct of the economy produced conspicuous successes in, for example, sustained low interest rates, increased levels of public investment, rapid declines in unemployment and growth in employment rates, there were a series of difficulties which included:

- On-going problems associated with long-term structural changes in global economy. As Gerry Holtham pointed out In December 2008, after exchange controls were abolished in the 1980s, labour was weakened relative to capital as capital flowed freely to wherever it could find the highest profit, e.g. loss of manufacturing to emerging markets in eastern Europe, BRIC countries and Asia -*"a change reflected in the relative share of profits and wages"*.
- The central problem of the global economy - *"If profits and output rise persistently faster than wages, who will buy the output?"* e.g. decline in living standards in USA for those on middle/low incomes
- Tim Lankester, added that in the run-up to the crisis *"real wages were not growing fast enough to underpin final demand without excessive borrowing by wage earners"*.
- Historically low interest rates fueled consumption in ‘west’ largely paid for through capital transfers by China and sovereign funds, such as oil-rich middle east. Result was large balance of payments deficits in USA, UK, etc., but

low interest rates also encouraged banks to develop 'innovative financial instruments' and to pursue new and marginal markets, e.g. sub-prime housing in USA.

- Growth of inequality which, in turn, contributed to the borrowing spree and the post- 2008 crisis.
 - When the crunch came and the private sector cut back, tackling government deficits were the natural counterpart of the private sector's "de-leveraging". They still are. Cuts in public finances likely to have disproportionate effect in Wales, both in terms of public sector jobs and also impact on private and third sectors. 2010-15 Cambridge Econometrics (July 2010) forecast widening of north-south divide with in 'north', including Wales, showing slowest growth in GVA and higher rates of unemployment.
4. Against this background, and now not only without control over macro economic policy, but without much influence over it either, what is to be the role of devolved government in Wales? The starting point has to be a willingness to ask some fundamental questions about the purpose and nature of the Welsh economy, going forward
- Should our emphasis be defensive, focused on weathering the immediate economic storm - i.e. defending as many jobs as possible in the short-term - or should the focus be on the longer-term, pursuing clear long-term strategy to seek
 - With challenge of climate change should we be pursuing a strategy based primarily on economic growth? Won't a revival in economic activity across the world simply produce another oil price hike, triggering a further down-turn?
 - Does Wales' relative performance within UK matter? Wales is part of one of largest economies in world and once London is taken out of the figures, Wales' relative performance compared to other UK 'regions' not so marked. We know that, once a certain prosperity threshold is reached, higher economic standards of living do not produce increases in experienced well-being, either individually or socially. We do very well, but we don't feel the benefit. Doesn't the continual focus on relative performance just miss the most important policy points?
 - If we are entering a period of low (or no) economic growth, and we take a more mature attitude to relative performance, then should our focus be on 'quality of life' issues – making sure we get as much as possible out of the cake we've got, rather than just trying to make the cake bigger and bigger?
 - Is relative weakness of private sector an issue?

- Is the strategy of focusing on growth on indigenous SMEs mistaken? The vast bulk of private sector employment comes from a small number of large scale firms. SMEs, though numerous, have a much smaller economic impact. 1.8% of total of 190,000 companies in Wales (c. 3,500 with employees over 150) account for 54% of private sector employment and 70% of turnover. Should our focus be more on making sure that 'anchor companies' are attracted to Wales, and know that Wales is a place they are valued and supported?
- Is relative 'dominance' of public sector an issue? Why should it be?

What do we do?

- The first, and most fundamental point, is that the new economic context must force government/public sector to focus on what is most effective and what gives biggest return for public investment. A great deal of Assembly Government's economic policy, for example, has turned around debates about the nature of business support. It could be argued that we have ended with the worst of a number of worlds – we spend more per head than any other British nation or region on supporting business, but have managed to convey a message of not being business friendly.
- We must be honest about situation and performance - and stop doing things because we can, not because we should.
- We must make sure that the instruments available to the Assembly Government are made more effective. The Civil Service remains hamstrung in both culture and capacity - slow to respond, process obsessed and risk averse. The machinery of government must be reformed to ensure we have the culture, capacity and skills to be able to deliver on the policy. Civil service largely generalist and don't have necessary specific skills and expertise to be able to deal with commercial world. Business support must understand and have the skills to work with clients whether large global companies, sector specific or indeed mutuals.
- Higher education institutions have had a relatively marginal impact on the Welsh economy, being too fragmented and with insufficient critical mass. Reform of HE is inevitable and necessary, in order to raise performance and embed in economy.
- Stop rhetoric that doesn't match reality. Claims to be "world class", "ahead of the curve" and "cutting edge" are distractions from the much more mundane, but important, task of bringing about incremental but persistent improvements in the services which make a real difference to everyday life.

- We must focus on a few priorities **but** make them happen and align all policies and resources to deliver on those priorities. We cannot be all things to all people.
- Must address two main challenges, essentially twin track: 1) create higher value knowledge economy **and** 2) tackle large cohort of long term economic inactivity and long tail of low skills.
- We must will the means to deliver on our priorities. Danger of reacting to immediate pressures, especially public finance squeeze and lose sight of the longer term.
- Policies, including legislation, must be judged against contribution towards delivering strategic economic priorities. E.g., legislation must be seen as just one - and only one - of a comprehensive policy toolkit contributing to Government objective aims, and not in isolation and as an end in itself. At a minimum legislation and policies must have a very early Regulatory Impact Assessment.

An example:

Questions: (1) Which is largest single investor in Wales in next decade? Probably RWE/nPower

(2) Which is potentially the largest sector in terms of investment in the next 15 - 20 years? The Energy sector.

In this lies the possibility of optimism about the future of the Welsh economy, with potential investment in Wales and borders now standing in the region of £35 billion (on and offshore renewables - wind, wave and tidal, biomass, etc.); carbon such as LNG and clean coal; and nuclear. (Was £50 billion until this week's announcement on Severn tidal barrage!). There are real world examples, for example in Navarra in Spain, where whole new industries have already been created around the renewable energy agenda.

If we are to make the most of the prospect, however, the next Assembly term will need to see a more determined marshalling of the machinery of government, in order to focus on the *economic* impact of renewables, as well as the *environmental* benefits they bring. Drawing on the Scottish Government model, we need to be strategic in both policy **and** delivery. It means, for example, a revitalisation of the Energy Summit, so that its agenda is set jointly by industry and government, and through dialogue between them, and where there is a focus on energy generation, as well as on the social consequences of energy liberalisation – prices, metering, fuel poverty and so on.

So, while renewables offer a huge opportunity, we won't take advantage of it unless we prepare properly for it. If the Atlantic Array goes ahead, for example, it will be the biggest investment in renewables in the UK, with the output capable of meeting 90% of Wales' energy needs. Who, therefore, is acting now to promote possibilities of manufacture here in Wales? How will components be built and repaired? Where will the skills needed for the industry be found? Where will the research be carried out? All these ought to be questions in the here and now for economic policy-making in Wales, if we are to take maximum advantage of the new possibilities.