



CREATING A POSITIVE BUSINESS ENVIRONMENT FOR WALES

IWA response to the Welsh Government's
economic renewal consultation

May 2010

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Sefydliad Materion Cymreig
Institute of Welsh Affairs

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Introduction

Given the well-catalogued decline in Wales' economic fortunes, the Institute of Welsh Affairs welcomes this review of the Welsh Government's economic development policy. The IWA's response draws on the views of providers of business support, business representative organisations and academics, on the extensive experience of its own Economy and Finance Study Group, and on the outcomes of the IWA National Economic Conference, held in Cardiff on 19 February 2010.

In arriving at its recommendations the IWA has taken the view that it could make a more valuable contribution to this crucial debate by eschewing small, incremental changes in favour of a more radical vision that not only takes account of the likely pressures on public expenditure, but can also galvanise both the public and private sectors in a joint endeavour to transform the shape and size of the Welsh economy.

Our recommendations to the Welsh Government fall under four themes:

- Create the optimum conditions for private sector investment.
- Mobilise the public sector in support of private sector growth.
- Support development of growth-oriented cultures in private enterprise.
- Refocus the role of the Welsh Government on policy creation, adopting a predominantly private sector-led arm's length delivery model.

Each of these themes is subject to detailed discussion in our response. The key recommendations arising from this discussion are set out below.

Summary of recommendations

Create the optimum conditions for private sector investment

- As a priority, work closely with the education and skills department to ensure that all school leavers achieve adequate basic skills levels.
- Hold local education authorities accountable for meeting these standards.
- Develop east-west rail and road links to promote expansion of markets beyond Wales' borders.
- Work closely with the West of England to lobby for the earliest possible electrification of the western rail corridor from London, and for more effective links to London Heathrow.

- Continue work to extend broadband coverage to the entire population, lobbying UK Government to cover the exceptional costs involved.
- Improve the clarity of planning guidance and speed up the decision-making process.

Mobilise the public sector in support of private sector growth

- Establish a permanent "Welsh business embassy" in London to promote Welsh exports, encourage venture capital and inward investment, and lobby for Welsh business interests within UK Government.
- Radically improve procurement practices, including increasing the number of CIPS qualified professionals to best practice levels.
- Integrate procurement with other business support functions to capture long-term benefits from public sector procurement contracts.
- Develop a Welsh capital fund in line with the Rowlands recommendations.
- Use the Welsh business embassy to interface more effectively with UK Government economic programmes.
- Streamline business support and remodel financial assistance along the lines of the Innovation Voucher Scheme.
- Use Business Rates and Single Investment Fund monies to encourage reinvestment by Welsh firms and foster innovation.

Support growth-oriented cultures in private enterprise

- Create an industry-led export association to develop an export culture in Welsh businesses.
- If sector-specific support strategies are developed, create a clear, consistent policy and ensure that funding is allocated strategically.
- Re-conceptualise the largest part of innovation policy as belonging to the business support function and allocate funding and support accordingly.

Refocus the role of the Welsh Government on policy creation

- Formulate a strategic plan for the Welsh economy incorporating rigorous goals for future performance, towards which all economic development effort will be marshalled.
- Create a new policy delivery structure, based on a hub and spoke model, to separate policy creation and delivery and to increase the use of private sector expertise.

The need for change

The Welsh Government has identified the need for a new direction in its economic development policy, and for good reason. The catalogue of our economic woes is long and familiar.

The Welsh economy has an unhealthy and unsustainable dependence on the public sector, and on current trends that is set to get worse. Manufacturing has declined from nearly a third to less than 20% of our output. After a period when unemployment in Wales had reduced sharply, it is now back to its traditional position of being higher than England, Scotland or Northern Ireland. Our per capita Gross Value Added continues to decline relative to the rest of the UK, to the point where it is now 25 per cent less than the UK average. The most recent UK Competitiveness Index¹, which incorporates performance across a total of sixteen input, output and outcome factors, shows Wales dropping to the bottom of the regional rankings. Comparison with 1997 figures shows that, whilst Wales has shown a slight improvement relative to the UK average, it has nevertheless slipped one place from eleventh to twelfth over the past thirteen years.

This unhappy picture exists despite a long period of general economic growth within the UK, despite Wales spending more per head on economic development than any other UK region², despite the availability of two massive programmes of European assistance, and despite the 2005 abolition of the WDA and subsequent departmental restructuring. The case for a radical overhaul of the Welsh Government's overall approach to economic development – particularly the formulation and content of economic development policy and its means of delivery – is, therefore, overwhelming.

In its defence, the Welsh Government is entitled to make two arguments: first, that the situation might have been a lot worse had it not been for its policies and, second, that the real determinants of these economic outcomes are macro-economic conditions outside its control. In the main these are the impact of globalisation and of UK economic policies that have been orientated more towards the financial sector than manufacturing, together with an unwillingness to countenance any obstacle to the growth of London and the south east of England.

The first argument does not absolve us from a need to examine policies afresh, especially since we have no means of telling whether the

¹ Huggins, Robert and Piers Thompson, 2010, *UK Competitiveness Index 2010*, Cardiff, UWIC.

² Upton, Stevie, 2010, 'Opaque funding streams', in *Agenda*, Spring 2010, pages 47-8.

proposition is true. The second argument simply reminds us that we may need a much more robust engagement with the UK Government to ensure that UK economic development policy and initiatives are designed to benefit all parts of the country. In this sense the aftermath of a worldwide financial debacle provides Wales and other disadvantaged regions of the UK with a powerful moral and economic case as well as an unprecedented opportunity to reshape policy to our benefit.

For all these reasons the IWA welcomes this review. In formulating its own response it has consulted with providers of business support, business representative organisations and academics, as well as drawing on the extensive experience of its Economy and Finance Study Group. The IWA also convened its first national economic conference in Cardiff on 19 February 2010 – addressed by the First Minister, Carwyn Jones – and many of the issues and themes raised at the conference are reflected in this document.

In arriving at its recommendations, the IWA has taken the view that it could make a more valuable contribution to this crucial debate by eschewing small, incremental changes in favour of a more radical vision that not only takes account of the likely pressures on public expenditure, but can also galvanise both the public and private sectors in a *joint* endeavour to transform the shape and size of the Welsh economy.

We argue that there is an urgent need for steps which end the tension between the Government's economic development objectives and its apparent suspicion of the private sector when discussing the future of public services. These mixed signals can be a significant deterrent to business development in Wales, even where they are not already an explicit barrier to private sector involvement.

Our recommendations to the Welsh Government fall under four themes:

- Create the optimum conditions for private sector investment.
- Mobilise the public sector in support of private sector growth.
- Support development of growth-oriented cultures in private enterprise.
- Refocus the role of the Welsh Government on policy creation, adopting a predominantly private sector-led arm's length delivery model.

1 Create the optimum conditions for private sector investment

The primary task for Government in the field of economic development is to ensure that public policy as a whole can deliver the appropriate human and physical infrastructure to allow business to flourish. Everything else is secondary, and that fact should be central to informing the Welsh Government's priorities. Without the right physical

infrastructure and a well-educated and skilled population, other business support will struggle to deliver positive benefits. Spending on skills and infrastructure must therefore remain a priority as now-inevitable public sector spending cuts begin to take effect.

Skills

In 2008, only 58% of Welsh pupils reached the Level 2 threshold at Key Stage 4, a figure which falls to 45.6% with the additional requirement of A*-C GCSE passes in English or Welsh and mathematics. Over thirteen percent of pupils failed to reach the Level 1 threshold in that year³. That a large minority of the Welsh population is reaching working age without basic literacy and numeracy skills is a serious problem for the Welsh economy.

As CBI Wales has emphasised⁴, ongoing implementation of the National Basic Skills Strategy is imperative if we are to increase economic activity rates. The Department for the Economy and Transport should, as a matter of urgency, work closely with the education and skills department to ensure that all school leavers in Wales achieve adequate basic skills levels. There is a need for simple and clear national strategies to guarantee adequate literacy and numeracy, and a determination that local education authorities be held accountable for their effective delivery within their own schools and colleges. We must do everything possible to eliminate the wide variations in performance in schools across Wales. The IWA is currently researching this issue, and we look forward to sharing our conclusions with the Government later this year.

The IWA welcomes the all-age approach of Basic Skills Cymru to tackling illiteracy and innumeracy, and reinforces the message that strategies for addressing basic skills deficits in the adult population should be vigorously pursued. We anticipate that the arm's length delivery model set out below will help to facilitate the necessary closer interaction between government departments.

With respect to the specific skills needs of individual employers, it should be clear that no government can easily anticipate future demand. Skills requirements should be articulated by businesses and provided by a training system that is structured to respond rapidly to changing needs. Where non-basic, specialist skills training is provided by the public sector, there should be an expectation that beneficiary industries will contribute to the costs.

At the higher skills level, we need to increase sharply the output of scientific and technological skills, although care must be taken that this does not damage the teaching of the humanities. Whilst their value can

³ Welsh Assembly Government, 2008, *Assessment and Examination Performance in Wales: Comparison with England and its Regions, 2008*, Statistical Bulletin SB 36/2009.

⁴ CBI Wales, *Agenda for a growing economy: Wales' priority of priorities*.

sometimes be measured in economic terms, the humanities have a far broader value in our society. The inspiring story of the creative industries in this country in recent decades has been the result of the marriage of both cultural and technological creativity.

The latest remit letter to the higher education funding council suggests an increasingly instrumentalist agenda. However, research indicates that a lighter touch approach is more likely to produce desirable economic and social benefits from higher education⁵. Universities make a range of contributions to society, and must be allowed greater freedom to pursue these according to their particular strengths.

Infrastructure

One of the principal economic development capabilities of the Welsh Government is its ability to provide or facilitate the provision of suitable infrastructure. In this field it is Government's most important function, alongside skills development. Well-functioning infrastructure is an essential prerequisite for attracting and sustaining high quality businesses. Welsh business organisations repeatedly highlight a number of areas for improvement in relation to both transport and digital infrastructure, and in terms of the planning system.

Improvements are urgently needed and, given the likely sharp reduction in capital expenditure through public funds, there will be a need to find ways to draw in very substantial amounts of private capital if we are to make progress with the urgency that the situation demands.

Transport infrastructure

Business organisations stress the significance of the road infrastructure to the functioning of the Welsh economy. Whilst ongoing modernisation of the road network is clearly critical, the IWA supports the Welsh Government's clear commitment in its National Transport Plan⁶ to the development of sustainable transport options. For these to have a desirable impact on employment and economic development, they will need to be designed with the projected requirements of private sector interests firmly in mind.

These requirements dictate the need to prioritise the improvement of east-west links in south, north and mid Wales so as to encourage the necessary expansion of markets beyond Wales' borders. We say this despite also seeing the value of improved north-south links in drawing north and south Wales into a more effective unity.

The priority in south Wales must be to improve capacity in the M4 corridor, especially in the vicinity of Cardiff and Newport, and to ensure

⁵ Upton, Stevie, 2009, 'Combating the culture of numbers', in *Agenda*, Winter 2009, pages 60-1.

⁶ Welsh Assembly Government, March 2010, *National Transport Plan*.

that ill-sited local developments do not turn the most important strategic artery in Wales into an over-crowded local road. The Government needs to formulate and publicise clear objectives for each of these east-west transport corridors, in terms of road and rail. In order to improve our international connections, such objectives must also include the development of more effective rail links direct to Heathrow.

On rail, the Welsh Government should make common cause with regional authorities in the West of England to lobby for the earliest possible electrification of the western rail corridor out of London. Such a joint campaign might be more effective than the separate pursuit of this objective by Wales and the West.

On air transport, we have to recognise that Wales faces considerable obstacles. It is one field in which provision in north Wales – via Manchester – is better than in the south, where airports – both Cardiff and Bristol – are in sub-optimal locations. It is now nearly 10 years since the UK Government published its review on the future development of air transport in the United Kingdom. At the time the IWA expressed its disappointment that this refused to contemplate a more rational development for both south Wales and the West of England, by locating a single airport on Severnside. The Welsh Government should be alert to the possibility of reviving this option in the context of any barrage development on the Severn.

Digital infrastructure

The development of a high speed broadband network across Wales will be crucial to Wales' economic future. The Government deserves credit for the investments it has made to bring the current network to as much of Wales as possible. In recent months the Hargreaves Review of the creative industries in Wales has again highlighted the importance of broadband infrastructure, not only for the digital media sector but also for other sectors and for the population as a whole. Given the large proportion of the Welsh population living in areas that are rural or otherwise isolated from the existing infrastructure, the Government will have to work with private sector providers to ensure that coverage is extended as soon as possible to the entire population.

Wales will have to ensure that the criteria for roll-out do not disadvantage large parts of Wales, as they can so easily do. The point also needs to be made that a commitment to a universal service obligation for high speed broadband across the UK will be immensely costly. It is an exceptional cost that should be borne by the UK Government, not by devolved expenditures.

Planning

Whilst planning authorities must clearly balance the demands of individual applicants with a longer term concern for the best interests of an area and its people – demonstrating the importance of detailed

regional plans to inform planning decisions – every effort should be made to improve the clarity of planning guidance and to speed up significantly the decision-making processes. This is another area where there is too much variation between the performance of different local authorities in Wales.

CBI Wales has indicated that improving the planning system in Wales would probably require the drawing down of additional powers from Westminster. If achieved, a more responsive planning system would benefit the Welsh economy by reducing the time and cost to development for successful applications. Given that unsuccessful applications would also incur a lower cost, this might additionally be expected to have a positive effect on firms for which the current time and cost investment poses too high a risk for an application to be submitted.

2 Mobilise the public sector in support of private sector growth

We have already noted that provision of the human and physical infrastructure that allows business to flourish should be the principal goal of economic development policy. This notwithstanding, there are a number of direct interventions that can further assist private sector growth, as well as mitigating the effects of the squeeze on public sector budgets. These fall into the following four areas:

- The pro-active use of public sector procurement to benefit as far as possible existing Welsh businesses, and to generate new business capacity.
- The creation of a positive and productive relationship with the venture capital community to increase its involvement in business creation and development in Wales.
- The attraction of private capital in as many spheres as possible to replace lost public sector capacity.
- The reduction or rebating of business rates, specifically targeted at incentivising business growth.

In addition to the above the IWA proposes the establishment of a "Welsh business embassy" in London, quite separate from the Wales Office. Its purpose would be:

- to be a visible focus for Wales and Welsh business interests in a world capital;
- to promote Wales to venture capitalists as an investment location;
- to promote Welsh exports, and the wider internationalisation of the Welsh economy;

- to target businesses seeking inward investment opportunities in the UK; and
- to lobby for Welsh interests at the UK level.

Closely related to these functions, and therefore potentially also to be incorporated within this organisation, is the promotion of Wales' cultural and tourist attractions.

In serving business, rather than political interests, a business embassy would have a function quite distinct from the Wales Office. However, with the potential for the future incorporation of Wales Office functions within a department for constitutional affairs, establishing a business embassy could also serve to ensure an ongoing Welsh presence close to the heart of UK Government.

Procurement

The Economic Renewal Programme represents an exciting opportunity for the Welsh Government to pioneer innovative new models of public service provision, using public sector spend to procure goods and services from the private sector. Public procurement should be regarded as *the* principal way in which the Government can directly promote business and employment growth. Currently standing at £5bn per annum, the Welsh public sector procurement budget is a significant resource that has hitherto remained underused.

Under EU regulations, public contracts must be awarded according to the principles of transparency, non-discrimination and value for money. Achievement of these criteria need not militate against the securing of direct benefits for local people and economies. Following a European Court of Justice ruling in 2002, quality can be taken into consideration alongside cost in determining value for money. And in respect of non-discrimination, while it is the case that bids from outside the area in which the contract is being awarded must be considered, even here there are ways of ensuring local benefit.

The Arbed programme is just one example of good practice that could be considered for replication across Wales. The scheme is funding social housing providers in Strategic Regeneration Areas to undertake energy efficiency projects or renewable energy retrofitting in their housing stock. Arbed is designed to reduce environmental impact and fuel poverty, but also specifically cites the need for successful bids to deliver economic benefits. This is most likely to be delivered through targeted recruitment and training (TR&T) of local people. Since TR&T does not require the successful bidder to be local to achieve local benefits, it avoids potential litigation over lack of equal treatment of bidders.

For procurement to be used more effectively as a driver of economic development, two key policy changes will be necessary. Firstly, a critical need has been identified, by Professor Kevin Morgan of Cardiff University, for more Chartered Institute of Purchasing and Supply

qualified professionals. There are approximately 130 CIPS qualified managers in the Welsh public sector at present, just 45% of the required minimum under the best practice guideline of one qualified professional for every £15 million of procurement spend⁷.

Without an adequate number of CIPS qualified staff, procurement will tend to be fragmented and less cost effective, failing to deliver best value across the whole-life cost of a product or service. This is currently apparent in many of the Welsh local authorities, where procurement responsibility is often scattered throughout departments, without any high-level management oversight. The current failure to accord public procurement a political status commensurate with its economic power – what Professor Morgan terms the procurement paradox – limits the ability of the power of purchase to secure gains for the wider Welsh economy. The good practice exhibited by local authorities such as Caerphilly and Carmarthenshire should be made the rule, rather than the exception.

A second area requiring attention is the need for *long-term* benefits to be captured from procurement contracts. Where contracts have been awarded to Welsh companies, those companies should be directed towards appropriate business support. In particular, they should be actively encouraged to engage with the export and innovation associations described below. This would allow companies to use a Welsh public sector procurement contract as a springboard for further opportunities and future growth. Although export will not be a relevant opportunity for all companies, those with the potential to provide goods and services more widely – and particularly across the English border – should be identified and supported to do so.

For employees trained under TR&T provision in a procurement contract with a non-Welsh company, there might exist limited potential for those employees to start a company to fill the market gap. The scale of this potential should not be over-estimated but, again, procurement professionals should be alive to the possibilities and must maintain good links with the various business support mechanisms. Good communication between procurement professionals and providers of business support will therefore be paramount. A "hub and spoke" model for the delivery of economic development functions is described below. It is envisaged that this delivery mechanism will be crucial in providing fully integrated support.

Benefits in terms of cross-departmental working are also anticipated. It is self-evident that public procurement as an activity occurs across all departments, encompassing everything from school dinners and new buildings to digital media projects, and that the power of the public purse – even as budgets become increasingly constrained – is therefore strong. It should be apparent that effective delivery of procurement policy is also a cross-departmental issue, incorporating at a minimum

⁷ Morgan, Kevin, 2010, 'The power of purchase', in *Agenda*, Spring 2010, pages 36-7.

departments for the economy, education and skills, and public service improvement, and that it would therefore benefit from the existence of a non-departmental delivery organisation which could serve to integrate the interests and resources of multiple government departments.

Private equity and venture capital

As pointed out by Lord Griffiths of Fforestfach in his April 2010 speech to Cardiff Business Club⁸, civil service structures promote prudence and caution; a necessary high tolerance of uncertainty in the provision of business support does not sit easily with this approach. The people best placed to realistically assess risk are those with direct commercial experience, and one area where their involvement becomes an absolute necessity is in financial support for business start-ups.

Speaking at the IWA's National Economy Conference, Chris Rowlands, author of the Growth Capital Review, indicated that a gap in business finance for investments between £2 million and £10 million is apparent in Wales, as at the UK level⁹. Rowlands' recommendations to the UK Government include creating a regionally-distributed commercial fund to fill this gap. Wales should follow the Scottish Government's proactive response to the Review by establishing its own regional fund without delay.

Three steps are proposed to implement the Rowlands recommendations. Firstly, the Welsh Government must consider how to attract London-based and international venture capitalists who have location-agnostic new ventures. An initial approach should be made to a small number of VCs, to establish what key attributes would persuade them to back Welsh-based ventures. A Wales proposition – most likely based on factors including our universities and skills, logistics, proximity to London and Europe, and the attractiveness of Wales as a place to live – will then need to be developed and promoted to VCs. Existing VC-backed businesses in Wales could act as advocates and as a source of positive reference in this process. Establishment of a Welsh business embassy in London will also be crucial to the promotion of Wales in this context.

Secondly, the recommended regional fund, with a target size of approximately £200-250m and a 3-4 year investment period, should be established. The natural fund manager for this is Finance Wales which, as the IWA has previously recommended¹⁰, should operate at arm's length from Government. The sole, but nonetheless critical, role for the Welsh Government would be to provide high level persuasion to attract investors. A fund of this target size should be expected to attract institutional capital, with individual investments of between £10m and £25m. Early commitment from three or four Welsh-based cornerstone investors, such as Local Authority or University Pension Funds, will help

⁸ See <http://www.clickonwales.org/04/three-key-challenges-for-wales/>

⁹ See 'Wales needs a delivery plan', in *Agenda*, Spring 2010, pages 41-3.

¹⁰ IWA, 2006, *Time to deliver: the third term and beyond, policy options for Wales*.

to secure credibility during the fund-raising process. Risk can be reduced through a portfolio effect of investment in a broad range of sectors.

Thirdly, the Welsh Government must do its utmost to attract large scale private sector investment in order to accelerate the improvement of the physical infrastructure and to facilitate the improvement of the housing stock. It is true that some early PFI schemes did not provide best value for public services, but the public sector outside Wales has learnt much from those early experiences. By now it is possible to construct funding schemes with a far better balance of risks and benefits.

Infrastructure assets – e.g. road, rail and housing – would be attractive asset classes for investors seeking long-term yield from long-term off-take agreements or operating franchise. Establishment of a Welsh Infrastructure Fund could provide capital alongside infrastructure investors such as Macquarie, 3i Infrastructure plc and international pension and other funds. This would be geared by long-term debt/bonds from the debt capital market, according to well-established models.

Business support

Plugging into the UK

In addition to drawing on its own economic development funds, the Welsh Government should consider how it might interface more effectively at the national level with UK Government programmes including Nesta, the Carbon Trust and the Innovation Fund. In order to ensure that Welsh companies benefit from these funding streams, expertise should be developed and maintained within DE&T for the purpose of promoting the schemes and advising on applications to them.

The Welsh Government should also seek to develop its relationship with the Department for Business, Innovation and Skills. The establishment of a permanent Welsh business embassy in London should be used as an opportunity for the promotion of Welsh interests at the UK policy level and to ensure that Wales is in the vanguard during development and implementation of UK-wide programmes. Greater engagement with UK policy makers for this purpose should not, however, prevent the Welsh Government from exploring international examples of good practice, emanating, for instance, from Finland and Singapore, to inform its own economic strategies.

Local business support

Comments made by Cardiff web developers Cube Interactive to the Hargreaves Review highlight the particular importance of rapid innovation in the creative industries, but the notion that "time to market is critical to avoid being left behind"¹¹ should be borne in mind when dealing with any company seeking support. Attention should be given to

¹¹ Cube Interactive, 2009, *Cube's contribution to the review of Wales' Creative Industries*, www.cubeinteractive.co.uk/review

streamlining business support, focusing provision in those organisations with the greatest business expertise, preferably in the private sector, and allowing day-to-day operations to be free from direct intervention by Government.

There is a need to review the provision of business support services by the Welsh Government and local authorities, to ensure the elimination of duplication and to clarify the role of each.

Although Wales has attracted criticism for fostering a grants culture, there remain circumstances in which grants can be a useful tool for the attraction or retention of companies. Nevertheless, there should be an expectation that larger, more established companies will not rely on grants as an ongoing source of support. Smaller firms often have a greater need for support and can obtain more lasting benefits from it. Provision should be focused on those small firms where a need for funding to accomplish a discrete activity is identified.

As described below, a need has been identified to re-conceptualise innovation support as an integral part of the business support function. With this in mind, we envisage the provision of financial assistance for business support operating along similar lines to the Innovation Voucher Scheme currently effective in England, Northern Ireland and Scotland. Whilst the Scheme was initially designed to facilitate interaction between SMEs and universities, it has recently been extended in the Yorkshire and Humber and North East regions to allow certain pre-approved companies to share expertise with client firms. The model adopted in Wales should allow this broader range of interactions.

As far as possible, the decision-making process for the awarding of funds should be devolved to the approved providers of support. Moving away from the current system of civil service coordination of provision will ensure that responsiveness is maximised and bureaucracy limited. Providers should be trusted to make well-judged decisions about the appropriateness of providing business support in each case. To ensure that business support funds are spent effectively, use of imaginative performance indicators should be incorporated into the system. Whilst it is not necessarily possible to assess the potential impact of support before it is received, analysis after the fact should be used by providers to refine their future provision and to allow the Government to determine, on a periodic basis, whether a particular provider should continue to be approved.

A new role for business rates

In 2006, the IWA made the following recommendation on a new role for business rates:

Although major tax breaks are not an available policy instrument, it might still be possible to create incentives for businesses to reinvest profits to promote innovation and

support future growth. This could involve targeting RSA grants and local Business Rates on further investment to ensure that profits are ploughed back into business growth. For example, Non-Domestic Rates (the Uniform Business Rate) raise almost £750m per annum in Wales. Part of this could be targeted on growth businesses, so that businesses that succeed in expanding sales revenues by, say 20 per cent, will be eligible for 50 per cent reduction in the rates they pay.

Companies must be encouraged to make profits and to re-invest these in Wales. This is a prime mechanism for boosting business investment and hence productivity. The Assembly Government has few levers of economic power but everything it does should be focused on supporting those companies that reinvest their profits in the Welsh economy. In this way, without having to identify growth sectors, the Assembly could reward successful companies and encourage innovation and research. Other policy tools such as Regional Assistance could support this by being focused away from just safeguarding jobs to encouraging further capital investment. This may take the form of incentives to invest in skills or product and process innovation.¹²

The Institute continues to believe that Business Rates and elements of the Single Investment Fund could be effectively targeted in this manner.

3 Support growth-oriented cultures in private enterprise

Exports

As a small nation on the periphery of Europe, Wales should not develop its economic policy without giving significant attention to Welsh companies' export performance. Government statistics analysed by Professor Dylan Jones-Evans of the University of Wales¹³ show a reduction of 15.4% in the value of Welsh exports between 2008 and 2009, from £10.6 billion to £9 billion. The global economic climate has undoubtedly contributed to this but, worryingly, the decline in Wales was greater than in all but three other UK regions. Scottish export performance improved over the same period.

In spite of this recent decline in fortunes, there is clear potential for expansion of Welsh exports. Output from biotechnology and pharmaceuticals and from telecommunications fell in Wales between 2008 and 2009, but rose at the UK level, implying that these are export markets that Wales is failing to fully exploit. Meanwhile, agriculture and the creative industries saw rising output, albeit from a low level, even as

¹² IWA, 2006, *Time to deliver: the third term and beyond, policy options for Wales*, page 139.

¹³ See <http://dylanje.blogspot.com/>

output fell at the UK level, suggesting a particular strength in these areas in Wales.

The role of IBW and UKTI as facilitators of international trade activity is an important one, and should not be underestimated. However, this function only comes into play once Welsh companies have decided that they wish to export. Exports are likely to remain subdued for the foreseeable future because of the recent or proposed closure of a number of important export-intensive Welsh firms. Going forward, the Welsh Government should consider how an export culture among *all* Welsh companies can best be promoted. An industry-led export association might reasonably be developed to lead on this. Encouraging exports should not focus exclusively on export overseas; the UK market is also an important one, particularly for SMEs. The South Wales Chamber of Commerce has acknowledged the importance of exposing Welsh businesses to UK competition, and has emphasised the need for appropriate east-west transport infrastructure to facilitate this, as recommended above.

Wales would benefit from establishing a closer relationship with Whitehall with respect to export and inward investment. We need to place ourselves in a far stronger position in relation to the securing of higher-level functions as and when a new wave of FDI begins. A permanent presence in London, in the form of a Welsh business embassy, would support the targeting of businesses enquiring about inward investment or trade partnerships at the UK level. It would also facilitate lobbying to promote Welsh businesses and to develop opportunities that favour the Welsh economy. The latest figures on regional competitiveness in the UK, published by UWIC in April¹, underscore the large disparities between UK regions. Wales cannot redress this imbalance in isolation, and the Welsh Government must be more active in its efforts to influence UK-wide policy in this regard.

Sector-specific support and the role of innovation

The question of whether, and if so which, specific sectors will be selected to receive targeted support is likely to be a political decision. Whatever the approach ultimately taken, it is critical that it is clear and consistent and that, once it is adopted, the temptation to spread support more widely as additional needs arise is avoided. It is not possible to meet every funding need, and funding streams should be allocated strategically rather than on an ad hoc basis.

Whatever decision is taken on the provision of sectoral support, it is essential that the concept of innovation is far better understood than is often the case at present. There has been a tendency to equate innovation with advances in science and high technology. However, as Dr John Ball of Swansea University has discussed, 'innovation' derives from the Latin for novelty, renovation or modification, and tends to be

more mundane than radical¹⁴. Innovation can occur not only in large R&D facilities, but also in small, non-technical SMEs. Given that SMEs account for 99% of all businesses in Wales, attention to their needs should therefore represent a key part of innovation policy.

In much the same way as we need to develop a stronger culture of export among Welsh firms, there is also a need to support innovation in all companies, in whatever form it takes. The production of radically new knowledge has its function, but it is not as a near-market activity. We should not be seduced by the promise of high returns from large investments in R&D infrastructure. Instead, it would pay to focus far more on the economically valuable commercial development of existing ideas.

Competition is an acknowledged driver of innovation, and so support for the creation of sustainable SMEs will in part drive innovative behaviour. Nevertheless, the Welsh Government should also consider supporting companies to think creatively about *how* innovation might be brought about in their particular case. To develop a culture of innovation, Ball recommends that companies be encouraged to think about:

- developing different, perhaps simpler or more interesting, products;
- developing different way of doing things – of making products or delivering services;
- putting existing technologies to new uses in light of new trends and demands; or
- meeting existing demand through new delivery systems.

Understood in this way, as an integral part of companies' own development rather than as an externally-driven process that trickles down to them, support for the development of innovative ideas can be largely reconceived as one strand of the business support function, as opposed to being part of a distinct science policy. The Welsh Government is not best placed to be the provider of innovation support, but should instead consider making resources available to facilitate others in the sharing of good practice. In addition to the commercial arrangements for business support described above, provision should be made for business-to-business engagement on an informal basis, for the specific purpose of promoting and supporting innovative behaviour. Evening networking events hosted by Cardiff University's Innovation Network provide a good model for such engagement.

¹⁴ Ball, John, 2010, 'Improving what we already do', in *Agenda*, Spring 2010, 49-50.

4 Refocus the role of the Welsh Government on policy creation

The absorption of the WDA into the Welsh Government's civil service has been the most controversial change in the management of economic development in the first decade of the National Assembly. It was perhaps inevitable that the Welsh Government, as a new institution, should have wanted a clearer role in policy making, but we note that no attempt was made at the time to distinguish between the demands of accountable policy making and the requirements of effective delivery of key functions.

There is widespread belief in the business community that any gains in terms of policy formulation have been outweighed by a poorer and slower service delivery, a massive loss of brand value, and sharply reduced transparency and accountability. International Business Wales has not yet been able to generate the capability, the confidence or the profile of its predecessor.

We do not urge that the clock be turned back to create the former institutions, but we do believe that Wales needs to establish a clearer separation between policy making and service delivery in this field. In particular the department needs to address the speed of decision making in all areas.

It should not be acceptable to the public, to the business community or even to the National Assembly's own committees that it is currently impossible to derive from publicly available data a clear understanding of how, in detail, economic development budgets are spent.

We believe that every Welsh Government department, including the Department for the Economy and Transport, should be required to publish a year-end annual report that accounts in detail for expenditure under each programme heading and sub-heading, along with a clear statement of the outcomes achieved through this expenditure. Programmes should also be time-limited and subject to regular external evaluation.

Developing a realistic strategy

Underpinning each of the strategies detailed above should be a clear strategic plan for the Welsh economy. The Government must accept that the economic levers available to it are limited. Without medium- to long-term planning at the national level these cannot be used to best effect, and nor can priorities be effectively coordinated. The Welsh Government should ensure that the ERP consultation results in the production of such a strategy.

Policy documents emanating from the Welsh Government have tended to suffer from a preponderance of 'visions' for the future of the Welsh economy, without sufficient regard to the need to lay down clear and

precise plans for effective delivery. In particular, insufficient attention has been paid to ensuring that all economic development effort is marshalled in support of a single set of clearly defined goals.

This is not necessarily about 'picking winners' or about over-detailed action plans, but we must surely move beyond loosely defined aspirations to include far greater detail on the specifics of future economic development activity.

- The strategy should work back from clearly identified goals for Wales' future economic performance, benchmarked against other regions and nations, to a core set of strategies and associated targets that will move Wales towards those goals over a defined time period.
- It should include a realistic and critical evaluation of Wales' current and potential strengths and weaknesses, and identify not only where resources will be directed but also where they will not.
- It must develop a clear strategic direction for the economic development of the nation as a whole, whilst also taking account of the needs of each of the regions of Wales. It must be honest where tension exists between the two.

Separating policy creation and delivery

The IWA believes that creation of one or more arm's length bodies, combined with outsourcing of certain delivery functions – particularly in relation to business support – to private sector-led organisations, is central to the effective implementation of the strategies detailed above. The purpose of this would be threefold:

- Firstly, in operating at some remove from day-to-day politics, these bodies would be better placed to respond rapidly whilst also planning for and engaging over the longer term.
- Secondly, they would more readily facilitate the incorporation of private sector expertise into the delivery of services, and would also provide a much-needed mechanism for that expertise to advise on the development of future policy. That there is appetite for such involvement has been confirmed by both CBI Wales and the South Wales Chamber of Commerce¹⁵.
- Thirdly, these arm's length organisations would be required to produce annual business plans and reports that would contain sufficient detail to allow external scrutiny of performance, including, but not exclusively, by the appropriate National Assembly committees. At present, publicly-available information on Welsh economic development spending does not reach the

¹⁵ See CBI Wales, *Agenda for a growing economy: Wales' priority of priorities* and South Wales Chamber of Commerce, January 2010, *National recovery plan for Wales*.

levels provided by the English and Scottish RDAs, nor indeed those that were available under the WDA. This is a serious retrograde step, not only in terms of public accountability, but also because it fails to enable detailed evaluation of economic development programmes. Without an adequate understanding of past successes and failures, new policy is highly unlikely to set the Welsh economy on a progressively upward trajectory. In reinstating an adequate level of benchmarking and strategy review, accountability, and hence confidence in the effectiveness of economic policy, could be renewed.

A potential model for achieving these ends has already been described in relation to the creative industries, in the Hargreaves Review "The Heart of Digital Wales". Hargreaves describes the experiences of the stakeholders interviewed for the Review thus:

"[They found] the Assembly Government and its related agencies confusing and inhospitable ... [and received] irrelevant or ill-judged advice"¹⁶.

Whilst the Welsh Government might find this a harsh assessment it must not be ignored, coming as it does from the viewpoint of those at the receiving end of policy. In place of this, the Review envisages a hub and spoke arrangement for the planning and delivery of policy relating to the creative industries.

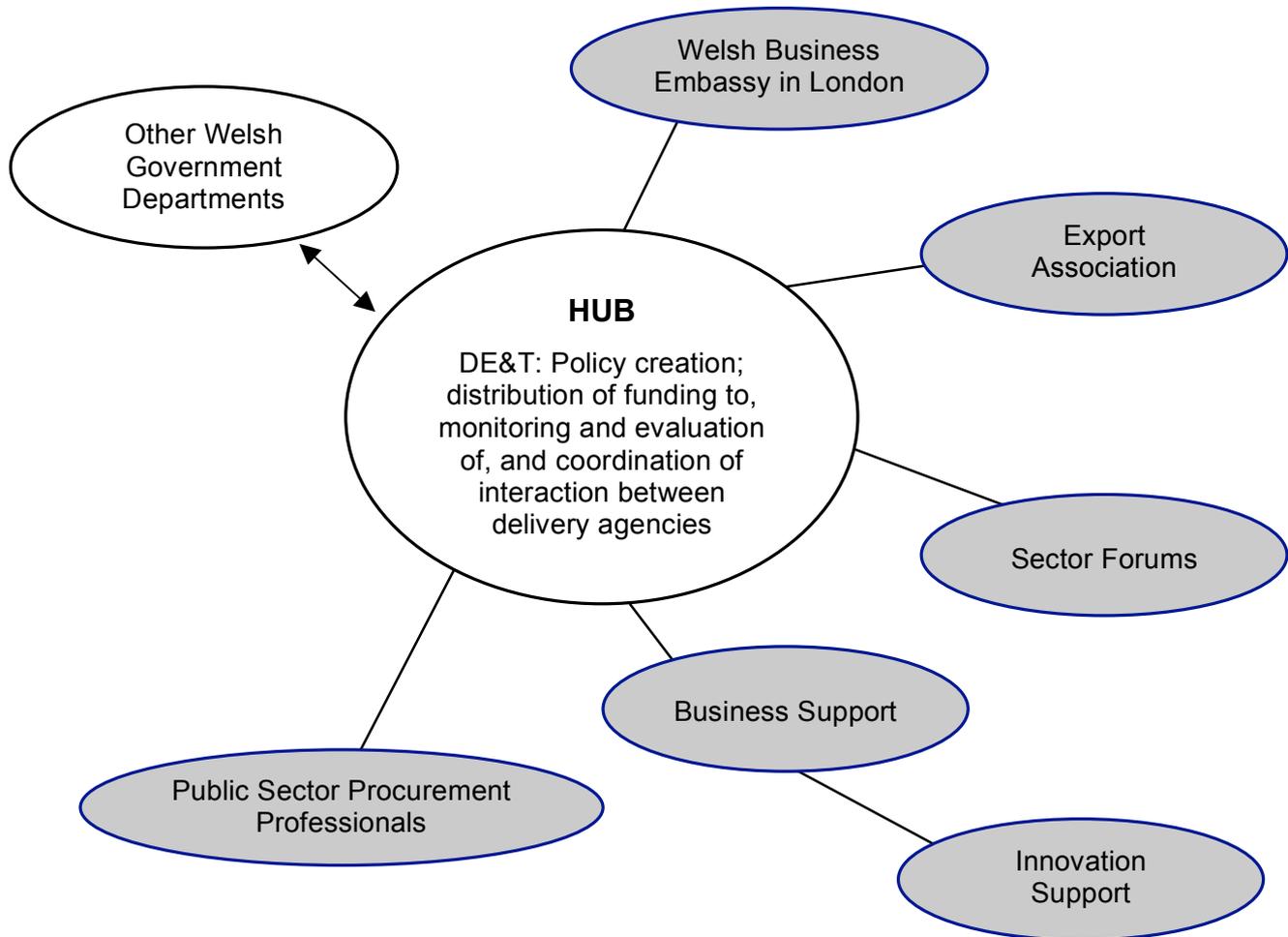
This model could readily be adapted for application across other areas of the economic development portfolio. As depicted in the accompanying diagram, an economic development 'hub' would be constituted for the purpose of:

- policy creation;
- distribution of funding to the delivery agencies;
- monitoring and evaluation;
- coordination of interaction between the delivery agencies.

Many of these functions would be undertaken by a slimmed down civil service, but input from the private and third sectors would be fed in through a board comprising the heads of each of the sub-boards that oversee activity in the 'spokes', together with senior DE&T civil servants. A limited number of agencies, many of which are already in existence in one form or another, would be devolved greater power in order to become full delivery agencies. These would include both public sector (as in the case of procurement) and private sector (for example for business support) organisations. Each 'spoke' might be expected to comprise a number of delivery agencies, and activity in each area would therefore be overseen by a sub-board. When finalising board membership, emphasis should be placed on maximising private sector expertise.

¹⁶ Hargreaves, Ian, 2010, *The Heart of Digital Wales: a review of creative industries for the Welsh Assembly Government*, page 20.

In sitting outside DE&T structures, although remaining accountable principally to that Department, these bodies should also facilitate more ready interaction between portfolios across the Welsh Government. To ensure widespread buy-in to the work of the delivery agencies, heads of all Welsh Government departments with an interest in economic development should sit on the 'hub' board.



It will be necessary to give the delivery agencies the autonomy to function independently on a day-to-day basis. Contact with civil service structures should focus on interaction through the 'hub' board, with monitoring and evaluation undertaken periodically to ensure ongoing accountability and effectiveness of spend.

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