

DEVOLUTION AND INNOVATION: THE FINANCING OF ECONOMIC DEVELOPMENT IN THE UK'S DEVOLVED ADMINISTRATIONS

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INTRODUCTION

This article explores an important policy field, economic development, for which the territories and administrations of Northern Ireland, Scotland and Wales can be characterised as being in more or less permanent economic policy crisis since devolution. This is not unconnected with higher level economic governance as the UK government from 1997 onwards pursued a strong sterling policy outside the Eurozone that, supported by globalisation effects, has devastated manufacturing employment. As firms decamp to cheaper labour zones in Eastern Europe, North Africa, India and China, to these woes are added pressures for new industries caused by the end of the Internet stock market bubble from March 2000, and the ensuing global economic recession. So serious is the haemorrhaging, estimated at 100,000 manufacturing jobs per year in the UK since New Labour came to power in 1997, that the Department of Trade and Industry raised its 'bail-out' fund from £2 billion to £6 billion in early 2003.

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The title refers to a generic policy response to contemporary job-loss, namely to promote policies that build regional innovation capability. This is something to which the **Wales for Innovation** (2002) plan aspires, as does Northern Ireland's **Think, Create, Innovate** (2002) consultation paper, and the Scottish Executive's **Smart, Successful Scotland** (2001) strategy commits economic policy. However, this apparent policy convergence masks distinctive underlying policy regimes. This is reflected in three kinds of economic governance and policy formation, the first *visionary*, the second *constrained*, the third *precautionary*. They refer to policy styles evident in Scotland, N. Ireland and Wales respectively. Each is a variant on governance under limited sovereignty, a condition all governments find themselves in to some degree, but which sub-national systems experience most, being near the bottom of the multi-level governance stack. It is intended as a simple distinction that nevertheless captures complex reasons why policy systems do or do not branch out from 'path dependence' (Arthur 1994) despite roughly comparable initial conditions within their state. It will be argued that, on the input side of economic governance, Scotland has enacted a *visionary* economic development policy, Northern Ireland a *constrained* approach, while Wales has adopted a *precautionary* one. It is too early to be definitive on the output side but some suggestive evidence is presented that points to difficulties, indeed intra-territory barriers, that counteract policy ambitions to some extent.

INNOVATION AND THE KNOWLEDGE-BASED ECONOMY

Each administration's economic policy documentation refers to innovation in the knowledge-based economy as a guiding strategy; hence there is consistency in that aspiration up the multi-level governance ladder to the UK's and EU's espousal of the Lisbon Agreement of the European council to pursue 'Innovation in a Knowledge-Intensive Economy' to compete globally. Scotland, it will be shown, has implemented economic policies that seek to transcend old, and even not so old, path dependencies. Northern Ireland is constrained to taking policy steps to build from an anachronistic industrial base that, as it erodes, exacerbates inter-ethnic tensions, in a context where the cushion of increased public employment is impossible due to its 'bloated' state after decades of armed political conflict, and its embryonic 'new economy' is assailed by the global technology downturn. Wales, faced with a legacy of 'smokestack' deindustrialisation, and rapid erosion of Asian

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transplants that brought semi-skilled alternative employment, unlike Scotland but less so Northern Ireland takes precautions against strategies that require exercising foresight to embrace possibly 'faddish' abstractions like the Knowledge Economy. To be clear about the nature of the Knowledge Economy phenomenon to which Scotland is reconciled but to varying degrees Northern Ireland and Wales are less so, our definition of the Knowledge Economy at regional level is 'an economy in which more than 40% of employees are employed in high technology manufacturing and knowledge-intensive services'. Evidence is provided elsewhere of the positions of the three territories on an EU comparative canvas.

MANUFACTURING MELTDOWN

Each of the three devolved parts of the UK has suffered substantial manufacturing employment decline in the 1997-2003 period, often in what were thought to be propulsive 'knowledge economy' sectors. Table 1 summarises the broad sectoral data.

Table 1
Manufacturing Jobs in the Devolved Territories Since Devolution

Territory	2002	2001	1998
N.Ireland	93,530*	103,220	105,750
Scotland	336,000	337,000	375,000
Wales	206,000	220,000	250,000

Source: ONS & DETINI

* 2003

Throughout the UK, large firms accounted for two-thirds of the losses, and these have run at an approximate rate of 100,000 per year since 1997. Clearly, the devolved territories, in losing between them 95,000 manufacturing jobs in the first three years since devolution alone, have borne a disproportionate share of about one third of the total. Since a not insignificant portion of this was relatively new foreign direct (and indirect) investment, represented in the likes of Asian investors such as Hitachi, Aiwa

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and LG Electronics in Wales, many denizens of Silicon Glen in Scotland, and Bombardier (acquirer of Short's aerospace of Belfast) in N. Ireland, the necessity was acute for major policy re-thinks as established inward investment began to close or relocate and the pipeline for new projects dried up considerably.

Devolution also coincided with the ending of the UK Chancellor's self-imposed budgetary clampdown on public expenditure. Statistically speaking the increases in health and education expenditure since 1999 have more than made up for manufacturing job-loss in Scotland and Wales, though for reasons connected with past civil unrest in N. Ireland this avenue of employment growth has been constrained, as Table 2 shows. Most of this job growth is accounted for by increases in employment in health and education, but government and other public agency employment has also risen. Of course, the persons recruited into new public administration jobs are unlikely to share the same skills or labour market networks as those made redundant from manufacturing.

However, interviews with economic development civil servants in Wales revealed research evidence suggesting a 'capillary' labour market effect of such changes according to the following. New public administration opportunities attract persons from existing service industries, including private, the new opportunities perceived as less vulnerable and better paid. In cities, the vacancies arising from this shift are taken by formerly economically inactive persons. In former heavy industry sub-regions the latter remain inactive and their labour markets import labour from nearby catchment areas, including the aforementioned cities (Clark 2003). As much of the old industrial areas outside cities in Wales also housed much of the new, but now disappearing, manufacturing, they are doubly affected by these induced changes in public expenditure from the UK government. That is, little reduction in economic activity and an increase in manufacturing job-loss without significant take-up of new opportunities in public administration or, needless to say, innovative start-up businesses.

Table 2
Public Administration Jobs in the Devolved Territories Since Devolution

Territory	2002	2001	1998
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N.Ireland	243,300*	296,170**	291,530
Scotland	690,000	671,000	635,000
Wales	415,000	368,000	348,000

Source: ONS & DETINI

** 2003; ** 2000.*

The broad statistical measure of post-devolution public administration change shows Wales and Scotland's combined total rising by 122,000, a 4.8% increase compared to a Great Britain rise of 1.6%. Wales accounts for 3.4% of the joint total of 4.8% above, and now has 31.8% of its employment in public administration compared to a GB figure of 25.7% and Scottish share of 28.6% (Cooke 2003). The official civil service view of this is that it reflects the Welsh Assembly Government's efficiency in transforming new block grant receipts into jobs, something that has hitherto been questioned in Wales as elsewhere, especially in education, where insufficient of the amounts allocated appeared to reach schools and teacher numbers accordingly.

By contrast, N. Ireland is embarked upon a politically necessary downsizing of public administration consequent upon the peace process. This has resulted in a 48,000 employment decline since devolution. Hence the N. Ireland authorities, varying between the Executive and Westminster, according to the suspension or not of the Assembly, are constrained in the important dimension of expanding public administrative employment, unlike Scotland and, especially, Wales. It was shown that manufacturing employment had declined by over 12,000 during the same period. Thus economic revival in N. Ireland is inordinately dependent upon continued attraction of inward investment, and stimulation of academic entrepreneurship in telecommunications and Internet software, both difficult markets given prevailing global trading conditions.

POLICY EXPERIMENTATION

Scotland's 'Visionary' approach to engaging the knowledge economy

Even before devolution in Scotland some thought had been given in piecemeal ways to the demands of creating a 'new economy' in the face of a second deindustrialisation. This had involved developing early a pilot business 'clustering' programme for biotechnology, ICT, Food and Energy sectors and loosening up control by Scottish Enterprise of its venture capital arm, which was privatised. In the second half of the 1990s there was also a new kind of enterprise support initiative, namely 'Proof of Concept' funding in support of academic entrepreneurship. The rate of start-ups from universities increased above the EU norm and the number of venture capital firms with a presence in Scotland increased to some 27.

Scotland's new deindustrialisation hit earlier so that although it lost a lot of manufacturing jobs 1998-2002, its share was lower and fewer were lost than in Wales if not Northern Ireland. Nevertheless the situation caused the Scottish Parliament to commission **Scotland's Science Strategy**. This reviewed basic scientific research, costed it, assessed it in relation to world-class benchmarks, and prioritised three fields for which extra resources and attention would be forthcoming. The fields are Biosciences, Medical Science and E-Science. Activities were begun to develop closer networking among university, public and private research laboratories, and to stimulate technology transfer *from* the Scottish health system into the economy, and to promote a science-based economy.

Regarding the last, the Scottish Executive then produced an economic strategy document charging Scottish Enterprise and economic actors generally, to espouse their vision of a 'Smart, Successful Scotland'. This emphasised the need to position Scotland to exploit to the full the Knowledge Economy and proposed actions to: enhance knowledge inputs and outputs among global businesses in or relevant to Scotland; hasten the rate of spin-outs from scientific research; make Scotland's 'talent' base more 'sticky' and augment it by stimulating a more cosmopolitan image.

Briefly, three examples of each are summarised in what follows. First, foreign owned firms now *planning to leave* are targeted to encourage them to replace production jobs with R&D. This has resulted in some success, one reason being that Scotland's science base is excellent, producing 28% of UK

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biotechnologists and 20% of medical doctors with only 9% of the UK population. Pharmaceuticals firms spend, at 17.5%, twice the amount on R&D than other sectors average; hence knowledge linkage around healthcare makes sense. A second example, concerning spinout firms, is the ambition to enhance an already successful cluster programme by establishing new Technology Institutes (ITIs) that will take basic research from universities, patent it as appropriate, transform it into near-market innovations and commercialise it by license, sale or new spinout. Three ITIs in Life Sciences, ICT and Energy were envisaged. Curiously, this was an idea first mooted in Wales but, although under review by the Assembly Government and the Welsh Development Agency it has yet to be acted upon.

The formal establishment of the envisaged ITIs was announced in September 2003 with a budget of £450 million over a decade, 10% of Scottish Enterprise's planned expenditure. Such was the acrimony with which this and other forms of public intervention was greeted by the neoliberal part of the Scottish media in the run-up to the announcement that the Scottish Enterprise chief executive, Robert Crawford, resigned. A further twist in the tale is that Scottish Enterprise sought university support in its efforts to build up this important feature of a Regional Innovation System only to be rebuffed by the more status-conscious universities being expected to rub shoulders with newer universities in the process. Accordingly the ITIs were designed to operate independently of universities. Predictably, when the ITIs programme was announced the universities complained of not having been consulted. Finally, to enhance knowledge inputs and outputs, an extranet linking the Scottish business diaspora has been constructed, is functioning successfully and will be expanded externally and adapted as an internal knowledge management system first for all Scottish Enterprise staff and then for the Scottish 'knowledge economy'¹. A diaspora database is one idea the WDA has emulated, commissioning the Institute of Welsh Affairs to find the expatriates.

¹ It is worth noting that the *Financial Times*, 3 December 2004, reported Scotland as having Europe's leading economic development agency, winning the *fdi.com* prize for enterprise.

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Post-Devolution Wales: a developmental state?

In Wales, building a knowledge economy has proven to be a hard nut to crack. A number of disparate initiatives were launched, variously listed under the enlarged and centralised bureaucracies of the WDA and (until April 2003, when it was partly dismembered) ELWa, the Assembly Government's education and training agency. These emerged as disparate measures, mostly dependent upon the designation of much of north and west Wales, plus the former coalfield in the south, as qualifying for EU Structural Funds Objective 1 status. Not experienced in managing transfers of the £1.2 billion scale plus match-funding that this designation released, the Assembly Government cast around for methods of spending and managing expenditure. Here the *precautionary* principle overwhelmed any pretence at a more *visionary* alternative.

A Task Force to consider a 'national economic development strategy' and the Objective 1 Single Programming Document was established to design the financial structure for programme expenditure. The process of drawing up the priorities on which the money was to be spent had been complex and not entirely successful. Participation by representatives of local government, business and the voluntary sector had led to deadlock with the voluntary sector complaining of being out-manoeuvred by the other parties. Accordingly, Rhodri Morgan – the new First Minister elected after Alun Michael, the Blair government's preferred candidate, had resigned over Objective 1 criticism in the Assembly – dismantled the administrative machinery set up by his predecessor and handed the task to the civil service. Time was short as the final submission deadline to Brussels was looming, and so they simply allocated the funding in the same proportions as it had been divided in the old Objective 2 programmes.

Some of the resulting imbalances resonate still in the painfully slow manner in which funding is allocated for project proposals that have to be adjusted many times to fit criteria not well-suited to needs and interests of project partnerships, in committees dominated by WDA nominees, and avoid imputed overlap with existing programmes run mostly by the WDA. With the Assembly Government spending lavishly on public administration the two were acting as a developmental state but while criticism of efficiency and effectiveness was loud, critique of the interventions from an ideological viewpoint was mute. Formal assessments of performance regarding Objective 1 funded initiatives such as the Entrepreneurship Action Plan (EAP),

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Knowledge Exploitation Fund (KEF), Finance Wales (FW) and the *Technium* incubator programme are infrequently published. However, each has been shown to have failed to meet targets and largely to operate independently; KEF until recently was managed by training agency ELWa, itself closely tied to Further Education colleges that received most of the project funding despite having little knowledge worth exploiting. A picture of multiple disconnects rather than joined-up governance prevails.

Such was the perception of chaos by the Assembly Government that on Bastille Day, July 14th 2004, First Minister Rhodri Morgan astonished the world of Wales and a few places elsewhere by announcing the termination and closure of Wales' three leading economic development agencies: the Welsh Development Agency, ELWa (the Welsh Training Agency) and the Wales Tourist Board, in a 'bonfire of the quangos.' Their functions will, by April 2006, be absorbed into the Assembly Government's Ministry of Economic Development. Motivation for this is much debated, though about the method there is unanimity: it was Stalinist in its 'plug-pulling' *sans* public debate, debate in the Assembly, discussion with the Chairs or other Senior Executives of the agencies, and least of all involvement of the poor bloody infantry who will find themselves transformed into mainstream civil servants in the aforementioned April 2006. Bizarrely, the Chief Executive of the WDA resigned almost immediately on precisely the grounds that he hadn't re-entered public service from the failed, privatised Welsh Water company *Hyder*, to end up as a civil servant.

The motivation for this *coup* is much-debated. The First Minister had expressed a view in favour of rejecting the Richard Commission recommendation that Wales should receive equivalent powers regarding legislation and taxation enjoyed by the Scottish Parliament on grounds that he did not wish to see the Assembly subject to permanent reorganisation and associated instability for a decade. Now, by decree, he had committed it to precisely that in absorbing two elephants and a giraffe in the form of the three re-nationalised, formerly arm's length agencies up to and, with teething troubles, undoubtedly beyond 2006. Why did he do it? Relations between the WDA, in particular, and the Assembly Government had never been cosy. From the beginning, what WDA saw as the theft of the International Trade Division by the Assembly Government, and its apparent removal from any democratic scrutiny, strange as that may seem, was a shot across its bows. The astonishing decision was made in order to beef up the responsibilities of

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the Assembly Government and make a possible case for implementing the Richard recommendation to increase the number of AMs to handle the new menagerie. Supported by a grumpy Minister of Economic Development, this was a response to opposition to the Richard Commission recommendations from the Welsh MPs who would become, in effect they thought, decommissioned, and indeed from Blair himself, who is alleged to have told Rhodri 'it's not on'. The new, internally appointed Chief Executive who will oversee the transition is a close acquaintance of the First Minister and former Director of WDA West Wales region in which the Minister for Economic Development's constituency lies. It has been announced that the impending internal reorganisation of the WDA has been suspended until further notice.

Northern Ireland: innovation under constrained policy scope

The most immediate economic governance consequence of devolution in N. Ireland was the establishment of an integrated economic development agency, Invest Northern Ireland (INI). This arose from re-thinking Northern Ireland's plethora of administrative bodies and excessive public administration expenditure in light of the Belfast ('Good Friday') peace agreement. Until suspension of the Assembly, there was a marked degree of what was referred to as 'Competitive Governance' surrounding devolved decision-making in the Assembly. Thus Sinn Fein were considered to have trumped the other parties by opting to administer the relatively staid portfolios of Health and Education while others opted for more high profile, but significantly lower budget, fields like Economic Development, Transport, and Culture. Innovation in economic development meant adopting a more entrepreneurial outlook. Thus INI perceives itself to be more concerned with building *capability* than *capacity*. This may seem a fine distinction but the contrast is between pre-devolution days when the emphasis was on *capacity* through large-scale, capital-intensive, often foreign investment projects, and *capability* building among indigenous businesses, particularly start-ups. In this respect, but with different language INI is no different from Scottish Enterprise or WDA – they all have to face the intractable reality that 'capacity' has diverted to Eastern Europe and China.

INI sponsors selective financing and partners venture capital businesses that invest in start-ups. It was noted in interview that INI executives believe taking preference shares in new businesses might be a superior vehicle to venture capital, especially for start-ups a long way from enabling venture capitalists to earn the typical seven-year return for their investment

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syndicates and themselves. But INI is also more firmly involved in the burgeoning incubator system put in place and evolving in recent years. Particular interest and aspiration is placed in the 'immediately global' start-up, by-and-large high technology in nature. Prior to the global Internet slump, Northern Ireland had developed a platform of up to a hundred such incubator businesses and fledglings that had moved as they had grown, mostly in Internet and telecommunication software (e.g. MineIt, 8over8 and Kainos). This was stimulated by the certainty that the Assembly, in comparison with Whitehall tradition, would demand faster results from policy directives. This might be thought a narrow economic front on which to base future policy, but such are the constraints it is not a simple matter to shift from this hitherto small but successful policy sphere.

However, new instruments to finance support for building *capability* now involve detailed discussion with the Northern Ireland Department of Finance, especially in respect of what had been perceived as a bulldog-like Assembly Audit committee questioning what kinds of instruments of 'new public finance' might be democratically acceptable. Urgency was also given to this by the precedent of Enterprise Ireland, the Republic's new market-facing, small firm enterprise support agency. The key question is 'if, as a public agency you invest heavily in the risky, high growth category start-up and experience failures, what are the rules regarding public service requirements to exercise due stewardship of public finance?'. How is due diligence defined in regard to public risk? There had been much serious cross-examination of civil servants by the Assembly Public Accounts Committee on this financial governance issue, so much so that it was acting as something of an obstacle to public enterprise. A similar role is played by the Northern Ireland Audit Office. The position reached politically was that, provided appropriate growth parameters were derived and abided by from the outset, and judgements of risk made accordingly, acceptable public investment risk management would be deemed to have been observed. Needless to say, the vagueness of such a determination and the colander-like nature of possible legal interpretations were not helping overcome the inherent risk-averseness of public officials.

This was, in essence, why the approach adopted up to and including the devolution era in Northern Ireland had been to assist in the establishment of arm's length investment companies operating in the market, examples of which include Equity Enterprise, Crescent Capital and Meridian, the last-

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named established post-devolution. Now, however, special, selective INI investment vehicles like NITEC with ('institutionally borrowed' from Scotland) 'Proof of Concept' and Seed Capital (£3 million fund) instruments, outside the scope of normal risk capital firms such as those mentioned, are in place or under consideration as the elaborate requirements of the innovation support system are becoming more fully appreciated. Devolution, with locally sensitive Ministers and audit committees, has meant that such relatively sophisticated instruments are carefully and slowly arising simply from greater attention being paid to the economic development requirements of the future Northern Ireland economy. These are among the difficulties of transition towards a more public enterprise, market-facing investment agency scrutinised by an especially hawkish Assembly Audit committee.

CONCLUSION

While referring to Scotland's experience of economic development policy experimentation as *visionary* in comparison to that of Wales as *precautionary*, and N. Ireland's as *constrained*, it is clear that more autonomy rather than less is required to mobilise serious efforts to restructure the nature of financial support for enterprise and innovation. More broadly, the kind of limited devolution Wales and, to a lesser extent, Northern Ireland received and the ensuing limitations in implementing sometimes ambitious but ill-thought through policies, suggests such experiences are likely to be more generic if such powers are applied in, for example, English regions. This prognosis was amply fulfilled by the North East of England referendum in November 2004 which returned a resounding 'No' vote on precisely these grounds. Scotland's fuller settlement, while also experiencing difficulties in building 'Triple Helix'-like (Etkowitz 2003) innovation linkages, has given the Executive and its key economic governance agency, Scottish Enterprise, greater freedom to press ahead with possibly more controversial but also more *visionary* economic governance institution and policy formation.

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