

THE DAVID HUME INSTITUTE



**Establishing Competitive Economic
Advantage in the Scottish Economy**

Alf Young

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Establishing Competitive Economic Advantage in the Scottish Economy

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Foreword

In the Autumn of 2001, The David Hume Institute ran a series of seminars aimed at addressing the problems of creating comparative advantage in the Scottish Economy. An effort was made to seek out speakers who could bring an outside view of the situation. While there is a good supply of high quality analysis produced in Scotland about Scotland, it was felt that it would be a helpful contribution to present the views of people who are in a position to comment in an expert way on the challenges that exist for Scotland but to do so based on experience gained in other economies.

To this end we were fortunate to have Sir Geoffrey Owen from the London School of Economics who drew on his experience both as an academic and as a former editor of the Financial Times to speak on "British Industrial Performance – An Historical Perspective". This was followed by a transatlantic perspective from Mr Lawrence Fish, President and CEO of Citizens Financial Group, Inc., and main board director of the Royal Bank of Scotland Group who spoke to the title of "Establishing Competitive Economic Advantage – with emphasis on the Experience of New England". The third and final seminar in the series was given by Ms Marianne Neville-Rolfe, who is Director of the Business and International Division for the South East England Development Agency (SEEDA). She spoke on "Establishing Competitive Economic Advantage – an English Perspective".

Each of these seminars was chaired by Mr Alf Young, Policy Editor of the Herald and a recognised expert commentator in the area of economic policy, particularly in Scotland. Alf led the discussion in such a skilful and successful manner that it was felt that it would be a useful contribution if The David Hume Institute published his own summary of these three summaries. The Hume Occasional Paper presents that summary. While it is somewhat after the event, the topic has not receded in importance and, indeed, both the recent slow down in the Scottish economy and the forthcoming elections to the Scottish Parliament bring the issues very much to the top of the policy debate.

The David Hume Institute is delighted to be able to publish this *Hume Occasional Paper* and is grateful to Sir Alan Peacock who sponsored the original seminar series. As always in our publications, it is necessary to make clear that the Institute holds no collective view or opinion upon the issues raised, the views expressed being those of the author alone.

Brian G M Main
Director
January 2003

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Establishing Competitive Economic Advantage in the Scottish Economy

Autumn Seminar Series 2001

By Alf Young, Policy Editor, The Herald

1: Introduction

How to establish sustained competitive advantage for Scotland's economy is the one issue that has really dominated the policy debate for most of the post-war period. The question's urgency has been driven by a persistent and widely-shared perception that Scotland's economy has under-performed both the UK as a whole and rival, benchmark economies in the rest of Europe and further afield for most of that time.

As early as 1954, in the introduction to a statistical account of the Scottish economy he was editing Alec Cairncross, then a Glasgow University academic, later to become the government's chief economic adviser, wrote: "The picture that emerges is one of an industrial economy that shows signs of lagging behind the rest of the country."¹ That view has persisted, with only occasional respites, for most of the half century that followed.

Since it was, like the rest of industrial Britain, the pioneer in that great 18th and 19th Century revolution in making things, so heavily dependent on primary industries and manufacturing as it entered the second half of the twentieth century and more exposed than the UK as whole to export markets, Scotland's economy was particularly susceptible to structural change, industrial evolution and the fast changing post-war competitive environment, with all the consequences that entailed for sustaining economic growth and generating work for all who wanted it. Dark clouds of doubt started gathering very quickly after war ended. During the 1950s and 1960s more than half a million people left Scotland for good, lured by better wages, more plentiful jobs and fresh opportunities in England, America and the countries of the old Commonwealth.

As Tom Devine puts it in his recent history of Scotland, “The economic boom was now seen to depend on the temporary conditions of replacement demand after 1945 and the virtual absence of international competition while the ravaged economies of Europe and the Far East recovered from the devastation of war. There had still been precious little industrial diversification. Indeed the heavy industries were more dormant by 1958 than they had been in the later 1930s. In the west of Scotland, core of the traditional industries, the rate of entry of new companies in the 1950s was about half that of the 1940s. Ominously, indigenous enterprise was also much less in evidence. Before the Second World War, most companies in the region were Scottish-controlled. By 1960, over 60% of all manufacturing firms employing more than 250 people were owned by non-Scottish interests.”²

Successive governments, both Tory and Labour, addressed these threats by indulging in more and more state intervention. Failing industries were nationalised, starting with coal, rail and electricity in the 1940s. More and more concerted efforts were made to lure new industrial investment from overseas, starting with branch plants of US multinationals like Honeywell, IBM, Goodyear and Caterpillar which all arrived in the immediate post-war period. British industry had its arm twisted and its palm greased to locate new productive capacity in the emerging regions of economic distress. Scotland – with a new steel strip mill at Ravenscraig, a pulp mill in Lochaber, aluminium smelting on the Moray Firth and car and van assembly at Linwood and Bathgate respectively – got its full share of the mounting largesse. Government was putting more and more of its own resources behind such intervention. According to Harvie, government expenditure on industrial assistance grew nine-fold between 1964 and 1973 alone.³

The state also created new agencies of its own to mastermind future economic strategy. The Highlands and Islands Development Board was established in 1965, the Scottish Development Agency ten years later. At the start of the 1990s, despite more than a decade of Thatcherism, neither body had been abolished by the Tories. Instead, transformed into Highlands and Islands Enterprise and Scottish Enterprise, both were given an expanded remit (taking in skills and training) and increased funding. By the start of the Thatcher era, many of the industrial transplants of the 1960s, like the Linwood car plant and the Invergordon smelter, were unravelling.

Undaunted, government and its agencies targeted foreign direct investment in the newer industries of the information age. Silicon Glen came into its own, with ministers regularly boasting how Scotland was an increasingly significant source of European production of personal computers, workstations and silicon chips. In the second half of the 1990s, as the technology and telecoms bubbles began to deflate and major plants closed or failed to materialise, that strategy also began to unravel. Other strands of this kind of replacement thinking – like attempts to lure call centre and back-office financial services activity to Scotland – have scored short-term successes. However now that India, in particular, is targeting UK call centre and software development activities from a much lower cost base, it remains an open question how long these particular strategies will continue to reap rewards.

As early as 1993, Scottish Enterprise was beginning to make a more dramatic shift in its strategic thinking. First its business birth rate strategy, which focussed on evidence of a comparative dearth on indigenous enterprise and entrepreneurship in Scotland and what could be done to remedy it, was launched. Later a second front was opened up on the comparative failure of our universities and colleges to commercialise the fruits of their research. Intertwined with both was a growing conviction that, to compete in much more integrated global economy, Scotland would have to invest more in – and exploit more fully – the skills of its own people. In an increasingly knowledge-driven world, brains would prove a more reliable long-term asset than brawn. With the advent of devolution, such thinking crystallised in the new Scottish Executive's Smart, Successful Scotland agenda document for its enterprise network.

With even comparatively recent inward investments being mothballed or closed down (Motorola, NEC, Hyundai, Chunghwa) officials belatedly began to acknowledge that the days of winning large, job-rich investments from the ITC or other sectors overseas were behind us. The political deficit in the new approach is that it offers no quick fixes. Indeed when Scottish Enterprise put its business birth rate strategy out to independent scrutiny at the start of the new millennium, its impact – in terms of additional new indigenous businesses created – was found to be negligible. The commercialisation agenda had several false starts before it began to hit its stride.

Now Scottish Enterprise's chief executive Robert Crawford is warning that even the new focus on exploiting research and development opportunities faces growing competition from some emerging economies. Crawford has cautioned that SE's plans to create three or four state-funded technology institutes will take a decade to deliver results. Worse, there is growing evidence that major American and European multinationals are not only relocating cost-sensitive assembly and manufacture to Eastern Europe and the Far East. Corporations like General Electric, Intel, Siemens and Microsoft are also investing heavily in R&D in China. "Whether it is in low tech electronics assembly, call centres or high-end research and development, we are now competing in a cruelly global marketplace and no business – no matter how traditional it may seem – can be excluded from this reality," Crawford has warned.⁴

So the Scottish economy's competitiveness challenge is long-standing and, in large measure, remains unresolved. There are some encouraging signs of a revival in indigenous entrepreneurialism. Some of that progress has been in traditional sectors like transport and milk supply where deregulation and privatisation have opened up fresh opportunities. One of our best known self-made men has made his fortune from retail and property. Some of the advances are in the newer technologies, although progress there has been restrained by adverse market sentiment since the global technology and dotcom bubbles burst. Scotland's stock of indigenous businesses with a stock market listing has been on a declining trend over the past two decades and some of those newer companies that have raised funds in the capital markets are presently sitting at very low ratings. Scottish-headquartered businesses that build a genuinely global reach remain rarities, the oil-services Wood Group being the most-widely quoted contemporary example.

If we are to better understand the roots of that challenge in one small northern European nation, we must set the experience of the Scottish economy over the last fifty years in a wider, comparative context. Is Scotland's post-war industrial and commercial history radically different from the experience of the United Kingdom as a whole or from experience in other parts of these islands? What lessons can we learn from the way post-war competitiveness has evolved in other parts of the world? As a way of starting to address these questions, The David Hume Institute convened a series of three seminars in the autumn of 2001 on the theme of "Establishing Competitive Economic Advantage in the Scottish Economy". I had the pleasure of chairing all three sessions.

Our first speaker was Sir Geoffrey Owen, Editor of the Financial Times between 1981 and 1990 and, since 1991, senior fellow in the Institute of Management at the London School of Economics. In 1999 Sir Geoffrey published *From Empire to Europe*, his acclaimed account of the decline and subsequent revival of British industry since the Second World War. Between 1967 and 1972 he was first an executive in the Wilson government's Industrial Reorganisation Corporation and then an executive with British Leyland.

The second seminar was addressed by Mr Larry Fish, chairman, president and CEO of Citizens Financial, the fast-growing US regional banking operation first acquired by Royal Bank of Scotland Group in 1988. From the fifth largest banking operation in the smallest state of the Union (Rhode Island), under Royal ownership Citizens has already become, through a series of acquisitions, a top twenty American bank. Mr Fish offered us insights into why this particular transatlantic relationship has flourished and an American, or rather a New England perspective on how to create competitive advantage through public/private collaboration and targeted tax incentives.

Our final speaker was a native of Edinburgh, Ms Marianne Neville-Rolfe, Director of the Business and International Division at SEEDA, the South East of England Development Agency. The new network of English regional development agencies was only 30 months old when Ms Neville-Rolfe, a career civil servant on secondment from the Department of Trade and Industry, addressed us. However her experience of government intervention in pursuit of competitiveness in what is already the most prosperous region of the United Kingdom promised to add another dimension to understanding of the challenges Scotland faces.

In the next three sections, I will attempt to summarise the arguments each speaker deployed. I will also try, in each case, to draw some general conclusions from the discussions that seem to me to be relevant to the issue we set out to address – that of establishing competitive economic advantage within the Scottish economy.

2: An Historical Perspective

The central thesis of Sir Geoffrey Owen's book, *From Empire to Europe*⁵, reiterated in his Hume Institute seminar, is that Britain's relative industrial decline in the decades immediately after the Second World War was not simply the continuation of a longer-term drift that had started way back in the 1870s. What happened after 1945 – three decades of further comparative decline before the tide began to turn again in Britain's favour in the 1980s and 1990s – was much more about choices made by successive British governments in the immediate post-war period. Two choices, in particular, shaped our post-war destiny. "The biggest single mistake was to opt out of European integration in the 1950s," he writes. The other error was to give insufficient priority, until the Thatcher years arrived, to competition as the principal driver of higher productivity. Instead industrial policy in the 1960s and 1970s focussed on creating national champions and preserving jobs. "Britain needed a pro-European Margaret Thatcher in the 1950s," is how he encapsulated this strand of his analysis for his Edinburgh audience.

Owen regards the cultural thesis developed by authors like Correlli Barnett and Martin Wiener – that British manufacturing ran out of steam because the offspring of the great entrepreneurs of the industrial revolution lost interest and turned their minds to country pursuits instead – as "vastly exaggerated". He accepts that British industry lost ground to American and German competitors between 1870 and 1914, but mainly because of "the timing and character of industrialisation in the two follower countries, not to deep-rooted and persistent institutional or managerial deficiencies." He argues that the deficit was partially made up in the inter-war years and that, during that period, there was no lack of entrepreneurial vitality evident in the newer industries in Britain.

That longer-term legacy did leave Britain, post-1945, with a deep commitment to older industries like cotton textiles and shipbuilding our manufacturers had once dominated and a predisposition to trade with the old Empire rather than continental Europe. However the superior performance of the French and West German economies up until 1979 was at least in part due to their starting from a lower base of industrialisation pre-war; the availability of pools of surplus agricultural labour; a willingness to completely rethink policy on everything from promoting market competition and controlling inflation to placing labour relations on an entirely new

footing; and a growing commitment to tariff-free trade within Europe. Owen's study of how various industries evolved leads him to conclude that neither the financial nor the education and training system let British industry down in the early post-war years. Yes, both systems exhibited various flaws. But these were not core causes of our manufacturing decline. He gives much more weight to the importance of poor labour relations and industrial unrest in becoming a serious drag on productivity and damaging Britain's image abroad. "However...the decline of industries such as machine tools and semiconductors cannot be blamed on strikes, demarcation disputes or overmanning. Even in cars and shipbuilding – both badly affected by strikes – labour relations were only one element in the collapse of these industries, and probably not the most important."

Britain had won the war. There was no real stimulus for national renewal, no widespread questioning of the institutions which had helped deliver victory. The priority, as far as economic policy was concerned, was to prevent any return to the high unemployment and social distress of the 1920s and 1930s. The way to do that was to encourage tripartite partnerships involving employers, trade unions and government. Anything that might challenge that consensus barely registered on the political radar. So, when additional steel-making capacity was needed and both Scotland and South Wales staked their claims, the answer was to split the investment in two and keep both locations happy. The price was two sub-scale plants which would not survive, in an increasingly competitive market, for very long.

As someone who had been involved, briefly, in the early 1970s, Owen reserves his most withering analysis for Britain's attempts to remain internationally competitive in car production. He calls it "an avoidable disaster". In 1960, he reminds us, the British Motor Corporation was one of the world's leading car makers. It had nearly 40% of the UK market and produced more vehicles each year than anyone else in Europe other than Volkswagen. "Fifteen years later as the largest constituent of British Leyland it was on the brink of bankruptcy and taken over by the government. Fifteen years later still, having changed its name to Rover, it was taken back in the private sector as a subsidiary of British Aerospace, but too weak to survive without an alliance with a larger car manufacturer. In 1994 Rover was sold to BMW of Germany, but this proved to be no long-term solution." As we all now know, BMW abandoned the venture six years later.

Indeed the main reason Britain still has a thriving car industry has been the willingness of major Japanese corporations – Nissan, Honda and Toyota – to invest in new production capacity in Britain, all of it south of the border. Earlier inward investors from America – Ford and General Motors – have since retrenched. Why did the Japanese come? Owen is in no doubt. “Britain benefited from this (globalisation) process because, thanks to Margaret Thatcher, it had become a more attractive location for investment.” This was part of a process which ensured that labour productivity in manufacturing in the UK, which had lagged both France and Germany between 1960 and 1979, decisively outstripped both of them between 1979 and 1995. That’s what Sir Geoffrey Owen means when he says the tide turned.

The Thatcher years brought the wholesale privatisation of state-owned enterprises, an end to the tripartite consensus and a monetarist emphasis on creating a low inflation environment in which business could flourish. New Labour, under Tony Blair, bought into that same message. Sir Geoffrey approvingly records chancellor Gordon Brown’s words to an audience of business people. “Today we know that in a global economy greater competition at home is the key to greater competitiveness abroad; we know that it is the openness of the economy, not its closed nature, that is the driving force in productivity growth.” Far from reversing the pro-market tide which had been running since 1980, Owen notes, “the Labour government looked for ways of increasing competitive pressures in the economy.”

It is certainly true that finding ways of narrowing the remaining productivity gap between Britain and its main competitor economies has been a constant preoccupation of Labour’s current chancellor. It is also true that few, if any, of his Tory predecessors would have dared to pursue the work-shy with such relentless determination as Gordon Brown. However other economic forces are currently at work which raise some tantalising questions about the Owen analysis of the roots of national competitive economic advantage. Neither his book nor the timing of Sir Geoffrey’s seminar allow for the full consequences of what we have come to call 9/11 to sink in. He spoke just two weeks after the terrorist attacks on Manhattan’s twin towers. He could not be expected to account for the market turmoil which has followed on from these cataclysmic events.

In an internet article addressing country-specific factors shaping the future of the global telecommunications industry written before 9/11, Sir Geoffrey says this. “According to a recent American study, the UK currently offers a more

favourable environment for the development of the internet and of e-commerce than, for example, France or Germany. One of the UK's advantages, the authors argue, is a much more liberal regulatory framework – a consequence of the Thatcher government's liberalising policies which have not been reversed under New Labour. If, as the US study suggests, internet and e-commerce grow faster in Britain than in other parts of Europe, this will create opportunities for Marconi to build up its business in switching equipment." Few predicted how rapidly some of the hype surrounding dot-commery would dissipate and no-one, as far as I am aware, foresaw Marconi's remarkably swift relegation, from major industrial corporation to penny stock. However the pace and depth of the turmoil, which has plunged the entire UK manufacturing sector into a protracted recession, does mean the trend of improving competitiveness of the UK economy in the 1980s and 1990s may not be as readily sustainable in the present decade.

One of the most striking features of the turnaround in the UK's fortunes in the last two decades has been our growing attractiveness as a location in which globalising multinationals wanted to invest. They came because the UK represented a cost-effective entry point to the wider EU marketplace and because of Britain's growing reputation for labour flexibility and competitive wage rates. Many of these global companies are now retrenching and Scotland, like other parts of Europe, has suffered a spate of plant closures as a result. Even if there is a pick-up in activity levels, the longer term threat is that future investment will choose even lower cost locations, notably in the emerging former-communist economies of Eastern Europe. By 2004 eight of these economies, including Poland, Hungary and the Czech Republic, could be full members of an expanded EU, further enhancing their attractiveness to inward investors. Meanwhile Britain's continued ambivalence about joining the eurozone appears to be a significant factor in recent figures showing our share of foreign direct investment is, once more, falling behind both France and Germany.

Sir Geoffrey Owen's historical analysis explains much about the challenges facing Scotland as we try to improve the competitiveness of our economy. In particular Owen's emphasis on the braking effect of having been the first economy in the world to industrialise, the nostalgia associated with traditional manufacturing sectors like shipbuilding and the consequences of placing jobs before profit, consensus before competition are all very relevant to the Scottish condition and how we deal with it. Whether his central thesis

– that the entire UK economy and, by implication, Scotland’s was no longer in inexorable decline in the final two decades of the 20th century – remains sustainable in the new realities of today is a much more open question.

3: A New England Perspective

Having first opened its doors in 1828 Citizens remained a small mutually owned savings bank until the 1980s. “Extraordinarily ordinary for most of its history,” is Larry Fish’s own description of the story. When it demutualised in 1986, its assets were worth less than \$1bn. It demutualised at a time of significant consolidation in the US banking industry. Its board decided that, to generate the capital it needed to expand, it must find a larger parent with deeper pockets. Two years later it became part of the Royal Bank of Scotland Group.

A year later the US economy was plunged into recession and banking in New England experienced its deepest slump in a hundred years. However Citizens never lost money between 1989 and 1992. It didn’t make much. But it survived while many other small banks were going bust. Its survival – and the fact that there were so many failed banks around – opened up a period of considerable opportunity. Fish put his plans to the Royal’s chief executive Sir George Mathewson. He wanted three things: \$500m of fresh capital; freedom to run the bank as a largely autonomous operation; and a clear acknowledgement that, since compensation scales in US banking are materially higher than in the UK, the Royal would pay what it took to attract the best people.

“The Royal has remained true to its word on capital, decentralisation and compensation from that day on,” says Fish. In return Citizens made 17 acquisitions, digesting each before moving on to the next, culminating in the acquisition of Mellon Bank in Pennsylvania last year. The \$1bn institution had become a \$50bn institution with 12000 staff and 800 branches, making more money in a week than it had in the whole of 1992. Growth by acquisition has continued into 2002.

Fish is emphatic about the simplicity of his business model. "We are a bank bank," he says. "We make loans but we love deposits. We are not in financial services. We don't process things for third parties. We don't do merchant banking. We don't have a retail brokerage business across the country. We open the doors every morning and we happily accept your deposits. Later in the day we make some loans." Citizens aspires, he adds, to three key objectives – to being an absolute leader in "hugging the customer" and making them feel good about the service they experience; to being a great place to work; and to being on everyone's list of the 100 most admired companies in the United States on ethics and community involvement. "We believe fundamentally that a great company makes a lot of money and behaves with integrity," he adds.

It would, however, be a mistake to assume that, in trying to build that widely admired business, Americans necessarily start with the advantage of less red tape and fewer government and other regulations to observe. Larry Fish surprised some in his Edinburgh audience with his description of the regulatory environment within which Citizens has to operate. "We don't have a single work day that we don't have a regulator somewhere in Citizens Bank examining something," he says. "So we have much, much deeper government involvement." The Mellon purchase agreement had been signed on 17 July, 2001. Because of the weight of regulatory approvals required across a number of states – submissions running to three or four feet thick – the deal couldn't be closed until 1 December 2001, a month after his Edinburgh address.

However, while the red tape and regulation his bank faces is significant, Fish identifies some other, cultural differences in the way business is conducted in Scotland compared with New England that might help explain America's competitive edge. These cover the way people in business communicate with one another, the significance accorded to process in businesses here and the prevailing mindset about economic prospects on both sides of the Atlantic.

"You are very indirect. In fact I'm never entirely sure what you're saying," he reported, recalling instances where even after years working with senior Scottish executives he had rarely heard them utter a direct "No". Fish also emphasised a Scottish preference for understatement. All the UK companies he had encountered were very big on process. To elaborate the point he

focussed on the emphasis on the process of taking and confirming of minutes. As a formal process this seems to assume a markedly more prominent role than it does in the USA. And, he might have added, a role that is so generative of internal red tape.

Speaking, as he was, only weeks after the cataclysmic events of 9/11, Larry Fish also dwelt on the economic prospects facing the United States. His assessment was gloomy. He suggested a deep recession now looked unavoidable. The only real question was how long it would last and how deep it would bite. His warning carried added weight as he serves on US Federal Reserve Advisory Board. Yet there was a matter-of-fact, reasoned tone to his analysis that contrasted quite sharply with some of the more hysterical language that can attend equivalent economic debate here in Scotland. During questions he had something to say about that too. "I don't know why you're so hard on yourselves," he observed. "You tend to be tough on each other. I don't think you've done so poorly in the last ten years." Fish contrasted that prevailing mood with his experience of the Irish whose mood and approach he regards as altogether more upbeat.

When he turned to what wider economic development lessons Scotland might learn from New England, there were further surprises. But first Larry Fish emphasised the impact of education reforms and tax cuts. After the 1989/92 recession, the state level response in Massachusetts was dramatic reductions in both personal and corporate taxes. State personal taxes were cut from 7.5% to 5% and major corporate tax breaks were focussed not on attracting inward investment but, for example, on two of the state's largest existing employers, Raytheon and Fidelity. "The theory was that money would be much better spent keeping and building what we already had rather than trying to attract new industry to the region," he explained. The results, claims Fish, were dramatic. Growth of 4% to 5% became commonplace year after year in the 1990s. Unemployment plummeted. And the state ran up large enough fiscal surpluses to accumulate a \$2bn rainy day fund.

With technology hardware companies like Digital, Data General, Computer Vision and Prime disappearing from the regional map, another decision was not to back high tech manufacturing but to focus instead on what Larry Fish calls "high tech brainpower". As a result there are now 3700 software businesses in the greater Boston area. There are some surprises in all of this, notably the idea of American policymakers, in an avowedly market driven

economy, putting tax breaks the way of major established corporations, like the mighty Fidelity, rather than trying to lure the next new thing.

However the biggest surprise of all is the nature of the forum within which this strategy was thrashed out and implemented. Sir Geoffrey Owen may be correct in arguing that the scrapping of tripartite structures under Margaret Thatcher was one of the key turning points in the UK economy beginning to narrow its competitive gap with Germany and France. In Massachusetts, at around the same time, they were breathing new life into that tripartite approach by forming the CEOs of the top twenty companies in the state, the leaders of the five biggest labour unions, the state governor and other leading state officials into an Economic Policy Forum which met, at 7.30am, every month to thrash out that tax-cutting, support-what-we've-got agenda. "There's no point," argues Fish, "just talking among yourselves in the private sector. If we were going to get anything done we had to do it together." So seriously is the Forum's role taken that no one is allowed to send alternates to the meetings. It's for top decision makers only. If you don't show, your company or labour union doesn't get to have its say.

Now that a debate about a corporate tax-cutting agenda is beginning to get off the ground in Scotland, thanks to the SNP, the Massachusetts experience of tax cuts and their economic impact is clearly worth deeper study. However, for me, the most striking feature of Larry Fish's contribution to this series was what he had to say about some of the cultural and structural differences in the way we do business and formulate economic strategy here, compared to how these things are done in New England. Changing aspects of a prevailing national culture – for instance, trying to turn ourselves into a more direct, confident society, less preoccupied with process – is surely a challenge well beyond the capacity of political power alone to deliver on. Yet the need to address some of these issues simply will not go away. We desperately need some fresh thinking on what realistically can be done to shift attitudes.

We also need to reflect on the power of concerted, collaborative action by all key interest groups in an economy to deliver meaningful improvements in performance and unlock fresh sources of economic advantage. We are awash in Scotland with structures that all claim to be trying to make a difference in Scotland's economic performance. But are they the right structures? Compared with the Economic Policy Council Larry Fish describes, many of them seem utterly redundant.

4: Lessons to be Learned from an English Development Agency

When Marianne Neville-Rolfe made the final contribution to this seminar series the English network of Regional Development Agencies or RDAs was still in its infancy. These bodies were first vested in April 1999 and were still, when she spoke, developing the programmes and outcome measures which would characterise their mature role in promoting regional competitive advantage. Ms Neville-Rolfe has direct experience of two English regions. Between 1994 and 1999 she served as Regional Director of the Government Office for the North West. Her home remains in Manchester. However she is now Director of the Business and International Division in SEEDA, the South East of England Development Agency. SEEDA covers an area with a population of some 8m people and supports a £120bn economy which consistently ranks second after London within the United Kingdom in its level of GDP per capita.

She started her talk by endorsing the view that one of the prime movers in English regionalism has been the role of regions of around 5m people as the optimal base for developing and delivering any economic development strategy. The median population size for the world's top 40 knowledge-based regions, against which the South East benchmarks itself, is 6m. The Scottish experience was, she added, "the inspiration for much of what has been attempted in some of the English regions and, it has to be said, the focus of considerable envy." Part of that envy is directed at higher levels of government spending in Scotland compared with English regions, like the North West, which exhibit similar levels of disadvantage.

Of the twelve nations and regions that make up the UK, Scotland enjoys the second highest level of overall government expenditure per head, yet produces the fourth largest GDP per capita and ranks only fifth in the incidence of deprivation. The North West ranks a notch higher in deprivation but is only ninth in GDP per head. Yet it is only sixth in the level of government spending it attracts. The South East, which enjoys the lowest level of per capita government expenditure, ranks second in GDP per head and twelfth on the deprivation index.

On the face of it, the South East's treatment appears much more rational than Scotland's or the North East's. However Ms Neville-Rolfe then articulated a case for more, not less, government investment in the UK's second richest region. "In the South East we are focused on the disturbing fact that, benchmarked against the world's 40 top performing regions, we sit at 34th in GDP per capita and 35th in productivity. Is perpetuating, or even worsening this really the right way to achieve national economic success?" she challenged. She acknowledged that government, in setting up RDAs, had explicitly seen them as a means of closing the GDA per head gap between the worst and best performing regions. "The fear is that because this would require the worst performers to grow so much faster than the best, the only way to do it is to, in effect, hold back the best, increasing the skewing of public investment which already exists, failing to support and build on success, and letting externalities such as congestion take an even greater toll."

In the absence of much higher levels of public investment in the South East, Ms Neville-Rolfe characterises the region's existing sources of competitive advantage as location, a rich knowledge base and the relative vigour of its entrepreneurial culture. Without even trying – an inward investment agency was only established in the past five years – the South East region has captured around half of all the US investment coming to the UK. Given the proximity of London and its international airports, it is the leading European region for HQs of international companies and one of the leading regions in Europe for research and development activity, including a clutch of government-supported R&D establishments and the powerful research capability of Oxford University. Nearly 10% of the 8m population are employed in knowledge-based activities. Nearly a fifth of the UK's entire stock of software engineers are to be found in Surrey and the Thames Valley.

So why bother investing in a regional development agency in such a richly endowed area at all? The equivalent question has sometimes been raised about the point of Scottish Enterprise devoting a significant slice of its resources in a local enterprise company that covers booming Edinburgh. Ms Neville-Rolfe argues that the productivity gap with other top-performing regions world-wide remains. "The South East success story could be even more productive for the benefit of the whole UK, if its weaknesses can be addressed," she argues. In addition, the success achieved to date is not guaranteed, given the "extraordinary mobility of the factors for success in

the knowledge economy and the speed of change in the fortunes of the most successful global enterprises.” In support she cited one survey showing that a third of companies located in Surrey and employing more than 250 employees were thinking of moving out of the area. So, in her words, “why kill the golden goose?”

On the other hand, what can a government-inspired RDA actually do to address some of the challenges Ms Neville-Rolfe describes? SEEDA has an annual budget of roughly a fifth of what Scottish Enterprise spends. And, in contrast to Larry Fish’s powerful endorsement of the work of that elite Economic Policy Forum in Massachusetts, she confessed that, in South East England, businesses tend to see all levels of government as “more likely to be a hindrance than a help to their success.” Outwith business lobbying groups, general business consciousness of the work of the RDA was, she suggested “low to non-existent”.

A related issue is the wide-ranging operational remit given to all RDAs covering a social justice as well as an enterprise agenda. SEEDA is charged with raising the run rate of regional GDP per capita over the next decade and with closing the productivity gap with high-performing comparator regions around the world. It is also charged with increasing the level of entrepreneurial activity and new business creation in its area. However another clutch of responsibilities means attempting to reduce deprivation in the 119 local government wards in the region that fall within the bottom two deciles of deprived communities across England as a whole. That programme is targeted at some 700,000 people, in areas to the east of London, along the south coast and in the former Kent coalfield.

The objectives in these parts of SEEDA’s remit still have a strong economic dimension. For instance they include raising employment rates among the working-age population in such areas to the regional average of 80%, reclaiming 75 hectares of derelict land and buildings each year and ensuring 60% of new housing is built on previously developed land, and securing more sustainable jobs in rural areas. However addressing some of these social justice issues in an otherwise rich and successful region poses its own set of problems, including the possibility that, through alienation, these problems may be more intractable than they might otherwise be in traditional inner city environments.

There is an obvious tension here between government intervention designed to improve the lot of the least fortunate in society and government intervention designed to generate step change in the competitiveness of the whole economy. It is an enduring conundrum that remains largely unresolved. The very fact that a single agency is charged with both missions is surely a less than satisfactory outcome. But that is where we are, not just with the English RDAs but with the enterprise network in Scotland too. These three seminars did not answer all the questions of how Scotland can put its indifferent recent economic history behind it and unlock fresh sources of competitive advantage. But the three contributors, from their very different perspectives, did stimulate a lot of new thinking in my mind about the role of corporate tax breaks in stimulating enterprise, about the deep cultural factors that may, at times, hold us back, and about how governments balance competing policy priorities. It was a real pleasure to be able to chair such stimulating debates.

Notes

¹ A. K. Cairncross (ed.), *The Scottish Economy: A Statistical Account of Scottish Life* (Cambridge University Press: 1954), p.1.

² T. M. Devine, *The Scottish Nation 1700-2000* (Allan Lane The Penguin Press: 1999), p. 570.

³ Christopher Harvie, *No Gods and Precious Few Heroes: Scotland 1914-1980* (Arnold: 1981), p.149.

⁴ Speech to Lanarkshire Chambers conference October 25 2002

⁵ Geoffrey Owen, *From Empire to Europe: The Decline and Revival of British Industry Since the Second World War* (Harper Collins: 1999).

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