National Assembly for Wales

Enterprise and Business Committee

Inquiry into the Welsh Government's approach to the promotion of trade and inward investment

Evidence from Dr John Ball – TII 12

**NATIONAL ASSEMBLY OF WALES**
**Enterprise and Business Committee**
**Inquiry – Welsh Government's Approach to the Promotion of Trade and Inward Investment**

Memorandum from Dr John Ball
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**Preamble:**

May I first of all thank the committee for accepting this late submission to its inquiry on the Welsh Government's Approach to the Promotion of Trade and Inward Investment. The terms of the inquiry are wide ranging although clearly the central theme is inward investment and it is within its generic meaning, that this submission is presented. I note that the inquiry is not asking for ideas or alternatives, simply to comment on activity. A recurring theme in the submissions thus far received is reference to past success with inward investment coupled with regret at the demise of the WDA; this submission takes a different view.

**Regional Policy:**

Before addressing the experience, relevance and usefulness of inward investment so far as it applies to Wales, it is worth re-emphasising the aims of regional policy, of which inward investment is one instrument. The *regional problem* is conventionally associated with the terminal decline of traditional industry found in the regions and is invariably referred to by one of its principal characteristics, that of unemployment. It is attributed to two fundamental weaknesses. The first is *structural*; many regions have inherited an unfavourable industrial structure as a result of the industries upon which regional economies grew. In addition, the problem is seen as *locational*. The regions do not provide suitable locations for new industry and firms attracted to the regions are often subject to cost and other disadvantages. Of the two, the inherited industrial structure has been seen as the important determinant in the lack of economic growth.

To address the above problems, the main aims of regional policy since its inception with the Special Areas Acts of 1934 have been twofold: the p*rovision of employment* and the *diversification of the existing industrial structure to encourage self-sustaining growth*. In reality, policy instruments, notably used by the WDA, have mainly been aimed at the former, to the detriment of the latter. It is this emphasis that has led to criticism of the policy's main instrument, inward investment. In employment provision terms, active regional policy has indeed been successful, without it, the situation in Wales would have been worse in terms certainly of unemployment.

### The Role of Inward Investment

There are questions about the long term success of inward investment in resolving the continued decline of the Welsh economy and it is worthwhile repeating the perceived advantages of the policy. Incoming firms are a major source of employment, introduce new skills and technology to the receiving region, have a substantial multiplier effect through the encouragement of local suppliers and provide a long term strategic asset as a basis for economic growth.

### Inward Investment Assessment

Although successful in creating employment (which became and to some extent remains, the over-riding motive), inward investment as a major instrument of regional policy, has failed both in in the perceived benefits noted above and the second aim of regional policy – *the diversification of the inherited industrial structure.* Success in employment provision has served to reduce the possibility of long term growth that inward investment is supposed to provide.

Almost half a century of attracting inward investment had resulted in large employers providing much needed employment, thereby fulfilling to some extent one aim of regional policy. But wealth creation and economic development do not arise solely from the provision of employment. In reality, success in creating employment has served to depress longer-term development because the skills required have not always been appropriate. An important policy assumption is that inward investment has a substantial multiplier effect in encouraging local businesses to supply goods and services, thus increasing the effectiveness of the original investment – the so called *propulsive* theory. The reality is that this often does not happen, managerial functions, especially purchasing, inventory and product development, remained outside Wales. Suppliers existed, but in *economic* space not in *geographic* space.

Many of the investing businesses attracted to the regions diversified the industrial base but did little to encourage the technical, managerial or skill base; a pre-condition for successful economic growth. Many products aimed directly at the market were at the end of their life cycle, a position driven entirely by cost, whilst many others were derived demand products subsumed into other products. Financial inducements – invariably grants – have been the main instrument used and on occasions have supported projects with limited employment prospects, or which would have been undertaken in any event without subsidy. Fundamentally, no attempt was made to differentiate between efficient and non-efficient firms, or those with products in a growth sector or on the quality of employment offered.

The over-riding major criticism was that Wales became a "branch plant" economy; inward investment became synonymous with external ownership, low skilled employment, standard end of life cycle products, mature technologies and restricted management opportunities. In 1998 I wrote an article for the Western Mail entitled “How Inward Investment is Failing our Economy” questioning the on-going policy based on inward investment. It led to letters from irate local government economic development staff questioning my arguments and listing their successes. No doubt these same staff are today enjoying their pensions while the businesses they so quickly defended have long since disappeared.

More recent industrial policy in Wales is a repeat of the past with a focus on products in sectors such as motor vehicles and consumer electronics. These are not growth sectors and for which there is *derived* demand; products incorporated into other manufactured goods sold under a variety of international brands; suppliers capable of supplying components invariably compete on price since the end use customers are extremely price sensitive.

## The Reality of Evidence

I noted above that there is no question in my mind that the role and “success” of inward investment into Wales has been exaggerated and consequently shown it in an entirely false light, I would respectfully refer the committee to the submission I presented to an inquiry by the Select Committee on Welsh Affairs in 1998 *Investment in Industry in Wales* and which I think is relevant to this current inquiry.

In 1997 at the height of its powers and influence, the WDA was asked to provide a list of inward investment projects for the period 1986-1996, as part of research conducted for a master’s degree at Swansea Business School. The list provided 208 "new" projects which it was claimed had created 38000 jobs and safeguarded 25000 others. A further request for these firms to be identified individually resulted in a list of *all* firms known to the agency since its inception in 1976, irrespective of start date which totalled 391. A yet further request resulted in the names of the firms for the first list (the period 1986-1996) eventually being provided. A comparison of the two lists showed *just 95 firms* appeared on both lists. When asked to explain this anomaly, the WDA showed admirable imagination in suggesting three reasons. The first was that the original list of 208 “new” projects comprised "announcements" and the agency had no way of knowing which, if any, had come to fruition. The second explanation was even more imaginative, that some projects may have been announced in one name but gone ahead under another and that the Agency had *assumed* the projects had progressed. Finally, that some projects might have gone ahead under the names of British subsidiaries. It was clear that claims of success by the WDA were at best questionable and at worst highly inaccurate, especially when other published statistics were examined. The (then) Council of Welsh Training and Enterprise Councils, commissioned research on the south Wales corridor and that particular report made reference to a claim by the WDA of no less than 434 inward investment projects in <u>this geographic area alone</u> for the five years from 1991 to 1996.

Of those inward investment organisations that completed the subsequent research questionnaire, fully 30 per cent were actually acquisitions of or joint venture with existing Welsh firms, but were nevertheless still claimed by the Agency as inward investment successes.

In its consequent report in 1998, the Welsh Affairs Committee expressed concern not only with the accuracy of these statistics, but with what the WDA actually termed as inward investment. (Inward investment, according to the Oxford English Dictionary, is “investment within a country from outside”). Although traditionally seen as investment from overseas  any UK based business counts, as does expansion by any organisation already established in Wales and in some circumstances, even a Welsh owned company expanding its operations. Thus for example, Tata Steel’s recent expansion and modernisation of its facilities at Port Talbot steelworks is classed as an inward investment success even though it started life as the Steel Company of Wales and presumably the 3,500 or so employees now count as “inward investor” employees.

I find it worrying that the fixation with the success of inward investment continues. According to Ernst and Young, inward investment projects into Wales in 2012 numbered just 31, claiming to have created 2051 jobs. This was immediately seized upon by government and the media as success in inward investment with an increase of 244% on the previous year. Mathematically correct perhaps but certainly misleading as to the "success" of inward investment.

Much of the criticism thus far is arguably historical, although the fact remains that a great number, indeed the majority of former investors have left. My concern is that the enthusiasm for inward investment continues, but in a different vein. Large externally owned factories are now being replaced with large, externally owned service sector employers; financial services, call centres and retailers. Employment is being provided and the mistakes of the past are being repeated; the lesson *that no successful economy was ever built on external ownership* has not be learned. The significance of economies dominated by large, externally owned organisations cannot be over emphasised. In an interesting analogy, Checkland (1976) likened the one large single employer in an area to the legendary Upas Tree of Java. This tree was reputed to grow to a mile across and killed everything that attempted to grow in its shadow. This has been the weakness of the Welsh economy and is a weakness that is likely to continue with present policies.

**The Alternative**

I am aware that this inquiry is not directly concerned with policy alternatives, although a comment is require. Part of this current inquiry is concerned with exports and although Wales is reasonably successful in exporting goods, these tend to be from large employers, steel for example. A policy is needed to encourage indigenous businesses capable both of growth and consequent export potential; indeed some Welsh businesses have been successful (mainly in food and beverages) and indicate – in a small way – what is possible.

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