

SUBMISSION TO THE SELECT COMMITTEE ON SCOTTISH AFFAIRS

THE ATTRACTION OF INWARD INVESTMENT TO SCOTLAND

It is desirable to maximise the inflow of investment to Scotland. Over the next few years indigenous investment will not be sufficient to prevent a considerable rise in unemployment.

To ameliorate this increase, the attraction of inward investment ought therefore to be a prime target of policy. This paper addresses the question of whether the present institutional structure ensures that the aim of maximising this inflow of capital is achieved.

Before addressing this topic in detail, two preliminary remarks are in order:

1. during this decade it is unlikely that the amount of 'free floating' investment available in the world will approach the levels of the sixties - a time when Scotland achieved considerable success in attracting foreign capital. Substantial uncertainties with respect to future demand coupled with currency instabilities which began to develop during the seventies have made businessmen extremely cautious about expanding capacity, particularly in new locations. Therefore, because Scotland is bidding for a slice in a smaller cake, competition in the next few years from other areas can be expected to be more intense than it has been in the past.
2. because of our membership of the EEC and its avowed intention of encouraging free competition between industries in the member countries, certain constraints have been placed on the maximum amount of financial assistance which can be offered by way of an incentive to invest in a particular area. In Scotland, the maximum grant which can be offered under EEC rules is 30% of the total cost of a project. In Eire and the South of Italy 75% can be made available. Therefore, however effective industrial promotion is, Scotland will continue to be at a severe disadvantage relative to those areas in terms of the financial package which can be offered under present EEC rules. Further, this situation is likely to worsen in the future when membership of the community is extended to Mediterranean countries who have more acute regional problems than the United Kingdom.

Now consider the particular problem of ensuring that the structure of industrial promotion and development in Scotland is the best which can be achieved. One can examine this question in three different ways:

1. examine recent trends in investment in Scotland and, by comparing periods in which the institutional structures for promotion differed substantially, try to make deductions about the effectiveness of alternative forms of organisation.
2. on the basis of a priori reasoning and such fragmentary evidence as is available, try to determine how the various bodies involved in industrial promotion in Scotland interact with one another and with potential investors.
3. compare experience in Scotland with that in other regions or countries which have broadly the same characteristics but differ in respect of their institutions for promotion and development.

While the first of these options is certainly a desirable line of enquiry to follow, severe statistical problems rule out any conclusive results. Nevertheless it is useful to assemble such limited evidence on trends in inward investment in Scotland as is available in order to provide a background for further discussion.

The amount of foreign investment in Scottish manufacturing industry is shown in Table 1 overleaf for selected years.

Unfortunately, investment by ALL non-Scottish firms is not distinguished in the statistics. Nevertheless, the following points can be made:

1. Investment by foreign enterprises in Scottish manufacturing industry makes up only a relatively small proportion (less than 20%) of the total.
2. In real terms, during the early seventies, capital spending by foreign enterprises in Scotland was more or less constant. In contrast, there was a fairly rapid rise in foreign investment in the UK as a whole.
3. As a proportion of total Scottish capital formation, the foreign component declined during the early seventies.
4. In contrast, both in Scotland and the UK as a whole the proportion of workers in manufacturing who are employed by foreign firms has tended to increase. While total manufacturing employment fell during the last decade in both areas, the numbers working for externally controlled enterprises actually rose.

The available evidence does not suggest that Scotland was particularly successful in attracting new foreign investment during the last decade. Those already here may have consolidated their position and expanded their workforce. Unfortunately, their employment growth was insufficient to offset the appalling rate of decline of indigenous manufacturing industry - just over 10,000 jobs per year during the period 1970-1979.

TABLE 1 INVESTMENT IN MANUFACTURING INDUSTRY IN SCOTLAND
1971-1975

		1971	1973	1975
£ million	By Foreign Companies	30.9	39.2	54.1
Current Prices	By UK Based Companies	147.7	190.6	371.5
£ million	By Foreign Companies	58.3	58.5	54.1
Constant (1975) Prices	By UK Based Companies	278.7	284.5	371.5
Foreign Investment as % of total Investment				
	Scotland	17.3	17.1	14.6
	UK	15.9	15.8	16.4
Employment in Foreign Firms as % of Total Manufacturing Employment				
	Scotland	12.7	15.3	15.8
	UK	9.5	10.8	12.4

Source: Census of Production, Summary Reports

The second means of assessing the success of the present structure development is to take a more direct approach. The following points concerning the current system can be made:

- (i) There are a large number of bodies concerned to promote Scotland or particular areas thereof. Not all of these have substantive financial powers. Control of finance is largely vested in bodies who have less direct contact with promotion and development.

The fact that many different bodies are involved is not necessarily detrimental to the overall effort. It may extend the choice available to potential investors - a different type of assistance may suit one industrialist more than another. Neither, of course does the existence of a large number of bodies guarantee success. Indeed it may lead to fundamental problems of co-ordination, consistency and clarity. Consider these in turn:

- a. when a number of different authorities need to be consulted regarding different aspects of development - such as financial incentives, planning consent, assistance in finding workers etc., problems of co-ordination of effort between authorities will inevitably arise. Communications and meetings between interested parties are necessary and inevitably slow down the rate at which decisions are taken.
 - b. without a formalised control structure there is a danger that the level of competition between agencies reaches too high a level. Now, of course, since the bulk of financial aid is non-discretionary, competition between authorities is largely of a non-price form. Thus agencies seek to attract investors by offering them a modern infrastructure, skilled labour, a pleasant environment etc. Again, such competition need not be necessarily detrimental - but there must come a point where diminishing returns set in to additional promotional effort. When promotional activity INCREASES the level of investment then it should be encouraged providing that it is not too costly. When additional effort simply REDISTRIBUTES around Scotland capital spending that would have occurred anyway, then no net gain occurs. An important point following from this argument relates to the encouragement of firms who have already made their locational decision and established themselves in one particular area. Then, if the relevant local authority succeeds in encouraging the firm to expand its plant, the whole of this additional investment ought properly to be considered a net gain. For once the location decision has been made, there will be no duplication of effort if the local agency encourages further expansion
 - c. overseas companies cannot be expected to immediately grasp our exceedingly complex political structure. Neither is it reasonable to expect them to appreciate the complicated administrative process which must be undertaken before a new plant can be commenced. (Even indigenous firms, particularly small businesses, find it an arduous task to comprehend the workings of officialdom). Therefore the approach by a promotional agency may lack clarity in the sense that the potential investor becomes confused as to the assistance which the agency is able to render. He may conclude that it is an inconsequential authority with little real power and therefore ought to be ignored. On the other hand, there is a danger that he ascribes greater powers to the agency than it is capable of delivering and subsequently becomes discouraged when he discovers it is necessary to contact many other agencies before his plans come to fruition.
- (ii) Promotion and development activities cost money. It is possible, given the intense political pressure to create

employment, the cost of such activity, like Topsy, will just grow. Of course, EEC rules present an obstacle to the amount of subsidy which can be given directly for investment for investment. They do not, however, preclude agencies from other ways of assisting firms to expand. For instance, market intelligence centres can be used to indicate potential new sales areas to firms. In fact, EEC rules on direct investment are likely to encourage the creation of such facilities by forcing authorities into new ways of thinking about development. Costs will inevitably rise. At present, little is known about the cost-effectiveness of existing development policies. In future, as new areas are explored the situation is likely to become even more confused.

- (iii) One must bear in mind that politicians of all levels are likely to involve themselves with the process of promotion and development. Now it can be argued that recent changes in promotional structure have greatly improved the co-ordination of activities between the regional authorities and the Agency. However, internal contradictions are inevitable in a system where the officers of the regional authority simultaneously try to meet the requirements of the SDA and those of local politicians. Further clashes of interest may occur at other levels - for instance between the new towns and the regions or the regions and the districts. Wherever officials believe that the aims and objections of their agency differ from those of another official body with whom they are dealing, possibilities for conflict arise. If such conflicts do occur, then surely the burden of proof must lie with those who would claim that the present structure is adequate and that internal conflict does not damage the level of inward investment in Scotland.

As a final means of examining the structure of promotion and development, consider comparisons of the Scottish experience with that of other, similar, areas. The comparison which has been made, almost ad nauseum, is that of the SDA with the IDA (Irish Development Authority). Unfortunately, the relative success of the IDA has been frequently taken to reflect badly on the performance of the SDA. There are at least four reasons why a simple comparison of IDA and SDA performance is invalid. These are:

- (1) as stated in the introduction, EEC rules limit the amount of financial aid which can be offered to a potential investor in Scotland. Because of Eire's relatively underdeveloped condition, the EEC does not limit the amount of assistance which can be offered by the IDA to the same extent. Thus it is the case that, other things being equal, the IDA can simply offer a more attractive financial package than can be offered from Scotland.
- (2) the SDA must further operate within the constraints of UK industrial policy. The Department of Industry is obviously concerned to ensure that each of the UK development regions receives equal treatment.

- (3) The IDA is the ONLY development agency in Ireland, while although the SDA is the most important agency promoting Scottish industry, it is not the only one and certainly does not have the autonomy of the IDA.
- (4) The IDA has accumulated a quite wide experience of development and promotion, much more than the SDA could be expected to collect in its relatively short existence.

Having said that, it is still worth pointing out that Scotland's so called advantages over Eire - skilled labour, access to institutions of higher education and well-developed infrastructure - in no way can be said to equalise the advantages which the IDA holds over the development agencies in Scotland. Most overseas firms in Scotland are US owned. In its submission to this committee the SDA claimed that in the period 1964-1979 26,000 jobs were created by US firms in Scotland. Compare this figure with the number of jobs generated by overseas companies in Eire over the last few years as shown in Table 2.

TABLE 2 OVERSEAS INVESTMENT IN EIRE

YEAR	TOTAL INVESTMENT (£m)	JOBS CREATED
1975	98.1	6,843
1976	51.1	7,493
1977	331.4	11,703
1978	150.1	13,590
1979	219.2	15,854

Source: IDA

Eire has managed to attract a far larger volume of employment from overseas than Scotland in the last few years. The idea that Scotland's supposed superiority in certain aspects can offset the massive financial assistance which Eire can offer is plainly fallacious. Indeed it is questionable whether some of the items frequently mentioned are real advantages at all. The vast majority of the unemployed are unskilled. There is no great pool of labour in Scotland from which skilled employees can be drawn without having negative effects on existing employers. Indeed employers have recently expressed concern regarding attempts by foreign governments to attract skilled labour out of Scotland. Further, the existence of centres of higher education is likely to be of only marginal benefit to most incoming enterprises. Graduates are a highly mobile section of the population, and are likely to become even more so as their employment opportunities diminish. Although there are a few instances of beneficial direct contact between universities and businesses, these take time to build up and an incoming firm is unlikely to assume that the mere existence of universities and colleges in the area in which he intends to locate guarantees that

useful co-operation will develop.

Perhaps a more fruitful line of comparison is to review the performance of other development regions in the UK in relation to Scotland. The major differences which cloud the comparison of the SDA and the IDA obviously are not relevant to comparisons within the UK. Unfortunately data on inward investment are only available up to 1975. These are shown in Table 3.

TABLE 3 OVERSEAS INVESTMENT IN GB DEVELOPMENT REGIONS

CAPITAL EXPENDITURE (£m)				
	WALES	NORTH	NORTH WEST	TOTAL
71	38.8	39.2	36.5	114.5
73	39.7	19.9	34.9	94.5
75	64.8	56.1	71.7	192.6
	SCOTLAND AS % OF TOTAL		SCOT. MANUF. EMP. AS % OF TOTAL	
71	27.0		34.9	
73	41.5		35.0	
75	28.1		35.1	

Source: Census of Production, Summary Reports

Although the figures are somewhat outdated, they certainly do not demonstrate that Scotland substantially outperformed the other main development areas in Great Britain over the period in question in terms of attracting foreign investment. Between 1971 and 1975 Scottish manufacturing employment averaged 35% of the total number of employees in manufacturing in Wales, the North West and the North. Yet capital expenditure in Scotland by overseas companies averaged only 32.2% of the total for these same regions. Unfortunately, because more recent statistics are not yet available, it is impossible to compare the present structure of promotion and development in Scotland with that in these other regions. In particular this means that the impact of the SDA cannot yet be assessed. One cannot ascertain whether the virtual collapse in new openings which occurred in the latter half of the seventies in Scotland was mirrored in the other development regions. On the basis of this discussion of the factors affecting promotion and development in Scotland we would summarise and conclude our arguments as follows:

- (1) whatever method one uses to try to assess the success of the present structure of promotion and development, lack of data preclude the formation of definitive judgements.

- 2) Scotland, has not performed well in terms of attracting investment in recent years. While this poor record may be attributable to factors other than current methods of attracting capital, it certainly leaves no room for complacency. It may be too easy to blame these other factors.
- (3) the large numbers of authorities who are involved in promotion and development seems likely to lend to certain organisational difficulties because of what seem to be internal contradictions in their structure. Nevertheless it may be the case that a harmonious relationship exists between the authorities and they are able presently to co-operate to their mutual advantage.
- (4) it is useful to distinguish between promotional activity which simply redistributes investment within Scotland and that which genuinely adds to the existing capital stock. Once the location decision has been made, local organisations ought to try to encourage further investment, providing that such encouragement is not too costly, since such activity will lead to a genuine increase in capital spending.

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