
Economic Perspective 1

THE DEVOLUTION DEBATE: IS THERE AN ECONOMIC CASE?

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During the 1987 general election, the main political parties, save one, were committed to some form of constitutional change for Scotland. Various degrees and kinds of "self-determination" were offered to the Scottish electorate by those parties. The exception was the Conservative Party. Its Scottish representation in the House of Commons was much reduced as a result of the election, yet it retained its United Kingdom parliamentary majority by a substantial margin.

Scotland is, therefore, governed by a minority party in recent electoral terms. It is a party which has not always opposed constitutional change but that is its current policy position. This phenomenon has given rise to speculation on the likely course of behaviour for the other political parties in Scotland.

Under the generic title of the "Domesday Scenario", a number of suggestions have emerged to the effect that the lack of representation of a pro-devolution view in Government will cause a realignment of non-government parties and/or voting patterns towards substantial constitutional change.

Underpinning at least part of this scenario and the rest of the devolution debate is an assumption that economic powers under a devolved constitution would deliver to the Scottish electorate a higher level of economic growth and a lower level of unemployment. That assumption can be challenged by examining what action might be taken by a devolved government in Scotland.

The result of this reasoning casts doubt on whether devolution could deliver the hoped-for

benefits. If accepted, these arguments remove economic management objectives from the devolution debate. The debate must then centre on arguments for or against legislative devolution's effects on other policy issues.

What are the objectives?

Economic development in Scotland is the process which produces more or bigger trading enterprises. To survive, these enterprises have to profitably service customer needs. It can also mean the process which results in existing activities becoming more efficient, again in terms of supplying markets and that efficiency gain provides more added-value in the economy.

This apparently simple proposition, stated in these terms, involves a wide range of action in marketing, product and service design, production, training, education and finance. All involve the nurturing of essential skills, the advance of knowledge and the co-operation of individuals in the realisation of business objectives. Having the right people in Scotland is critically important.

The Centralisation Problem

Since the 1950's, there has been a headlong rush of industry and commerce into formation of conglomerate enterprises with concentrated, centralised management functions. That centralisation of business organisation within the United Kingdom carried with it a geographical

centralisation on the South East of England. The same region of the United Kingdom which enjoys the benefits of centralised government (the biggest business) became the headquarters location for much of the country's industry and commerce. The process continues.

The concentration of senior executive opportunities in the South East of England robs Scottish industry and commerce of the talented people who are the instruments of industrial change. The presence of qualified and experienced people is critical to making advances in marketing, design, production engineering, training and finance. Those advances are indispensable to the process of economic growth.

These people who have been withdrawn from the employment pool in Scotland, or were never in Scotland in the first place, are the people who also contribute, outside of business life, through their involvement in voluntary bodies and community organisations, including political activity.

The same phenomenon is also apparent in the public sector's higher management echelons. Even the few examples of government office dispersal which have been won for Scotland, have created little or no opportunity for the qualified and ambitious Scot who seeks a career as a senior civil servant. Quangos, agencies and other forms of public sector employment have not been distributed evenly in the UK.

Except insofar as it would have created a limited number of opportunities for politicians and administrators, the 1979 Scotland Act provisions would have made no direct contribution to solving the problems of centralisation. At worst, the act of establishing legislative devolution would reduce the scope for relocation of government functions because more of these functions would be defined as servicing England and Wales only. At best, its effects on business centralisation would be indirect through improvements in companies' operating environment. It is difficult to envisage an Assembly allocating public expenditure in a way which would be directly beneficial. The scope for special public expenditure provision would have been small because of obligations to provide obligatory social and other services to national standards. The Assembly as previously proposed could have had no substantial effect on centralisation.

Industrial and Commercial Devolution

While efficiency gains are also possible, growth in the Scottish economy is mainly dependent on identification and exploitation of new market opportunities in the United Kingdom and overseas. Relative to the Pacific Rim countries, there are only modest prospects for growth in the UK economy. Considerable emphasis must therefore be placed on overseas exports. Most of the opportunities for export growth cannot be realised by increasing inward investment: the trade performance of companies which are already here has to improve. This is dependent on companies' innovation of products and techniques and the competence of the workforce at all levels in actually producing the goods and services required by their potential customers.

New business growth can include an occasional useful contribution from subsidiaries of overseas companies, new to Scotland. But it is now widely recognised that international technology transfer and market exploitation can be achieved by other means and the flow of mobile investment (to the more developed countries) is very limited.

The instruments of these changes in how markets are supplied are companies, although they can be aided and abetted by supportive institutions. This means that the critical industrial issue for Scotland is the same today as it was during the last devolution debate - the ability to generate and originate new enterprises and to keep and develop indigenous companies. Without innovative management functions in Scotland, economic activity becomes wholly dependent on allocation of work conceived elsewhere. In that, literally, subsidiary role it is much more difficult to innovate.

Not all multinational companies with Scottish subsidiaries involve that dependency problem. Several multinational/ multiregional subsidiary companies in Scotland have benefited from decentralised forms of corporate organisation. But they have been the exception, rather than the rule: the closure of the Caterpillar plant provided the extreme illustration of a subsidiary with no control over its own destiny.

Regional industrial policy has been mainly concerned with manufacturing industry and with production per se. The various systems of grants to fixed investment have a valuable impact on

restructuring the capital stock of Scottish industry but have not particularly favoured the development of headquarters functions. Nor have the many infrastructure improvements in Scotland resulted in location of headquarters functions. Indeed, the aforementioned process of concentrating industrial and commercial control has consistently acted against development of headquarters functions in Scotland. It is not well appreciated how few companies with operations elsewhere in the United Kingdom or overseas, have their headquarters management in Scotland.

The separation of innovation and manufacturing is a worrying phenomenon. The eventual result of starving a manufacturing operation of its ability to change must be its demise. Therefore, if the emerging division of those functions were taken to its logical extreme, little manufacturing would take place in Scotland. With that ultimate erosion of the industrial base, the *raison d'être* for much of the service economy would disappear also. There is no conceivable trading pattern for non-manufacturing activities in Scotland which could support the population at a tolerable standard of living.

Since these locational and organisation factors affecting innovation functions have been moving against Scotland, some new form of regional industrial policy or some new additions to existing regional industrial policy must be found to redress the balance. To what extent can devolution contribute? Or, can the necessary industrial devolution be pursued independently from constitutional change?

To attempt an answer to these critical questions, the three key influences on economic growth must be examined - exports, innovation and competence. A scenario for supporting and supportive institutions is suggested (for discussion purposes) and followed by a commentary on the relevance, or otherwise, of devolution (as currently conceived, i.e. along the lines of the 1979 Scotland Act).

Exports

A decentralised range of services to promote Scottish-made goods and services would ideally involve executive devolution of central government discretionary spending, viz. a separate Treasury allocation of funds to the Industry Department for

Scotland and direct access to the information services of United Kingdom commercial representation overseas. Separate overseas representation could not be justified as cost-effective. The support to companies from the overseas posts is an information service on markets which has no need to differentiate its sources and coverage according to distinctively Scottish interests. The only Scottish dimension is the identification of the goods and services with Scotland, not with the customers.

There can be no institutional substitute for companies' individual marketing and selling activity overseas but supporting services, primarily information services, can enable smaller companies to address markets which would otherwise be beyond their staff resources. Also, travel grants for new export marketing and selling effort enable limited budgets to be stretched over more export destinations. Co-operative, or collaborative promotion under a "Made in Scotland" banner has been contemplated in the past but no private action has been taken in the absence of public sector support. Invidious comparison has been made with the promotional activity of the Irish Export Board.

The principal United Kingdom government agency concerned with export promotion is the British Overseas Trade Board (BOTB). Its annual budget for supporting promotion of goods and services overseas is very modest by international standards at about £27M. per annum. This figure excludes the cost of commercial officers stationed in embassies and consulates overseas. They are employees of the Foreign and Commonwealth Office (FCO) and their cost has been estimated at £53M. per annum.

Access to BOTB Services, including the overseas posts, for companies in Scotland is primarily via the Export Office for Scotland. This institution is part of the Industry Department for Scotland and acts as the local agent for BOTB services which are centralised in London.

The Scottish Council Development and Industry and to a minor extent Chambers of Commerce, are the actual instruments by which co-operative ventures, e.g. export selling missions, are mounted from Scotland. The Council's activity is primarily directed to assisting companies not well established in markets i.e. it aims to improve market coverage by assisting marketing research

and initial sales activities in markets which would not otherwise be tackled by the companies involved.

In addition, the Scottish Development Agency (SDA) under its inherited powers from the Council for Small Industries in Rural Areas (COSIRA), takes part in consumer goods exhibitions and store promotions overseas, thereby assisting the further export development of smaller companies already established in these markets.

The Scottish Council and the SDA have agreed to co-operate, employing start-up funding from the latter to increase the provision of computerised database information on overseas markets to smaller companies. This service is supplementary to the BOTB/FCO information services.

Hence, public and private sector action has already been taken on decentralised export services in the Scottish interest. While the scale of expenditure has been modest, the scale of national, United Kingdom, support for export marketing is itself modest.

Devolution could contribute to gearing up such services and expenditure if it permitted a re-allocation or increase of public expenditure, in support of such services. Increasing public expenditure to fund export assistance to Scotland alone is inconceivable except under federal arrangements. And re-allocating expenditure is an unlikely priority of an assembly with very limited scope for discretionary expenditure. The proposal for an elected Scottish Assembly is therefore not relevant to increasing exports.

Innovation

Innovation improvement is a very wide subject involving aspects of the non-built infrastructure as well as direct assistance to companies. In the 1986 report by the Scottish Tertiary Education Advisory Council (STEAC) it was, amongst other things, recommended that funding of the Universities in Scotland be transferred from the responsibility of the Department of Education and Science to the Scottish Education Department. But there is no necessary association between the funding of university courses and research, and the innovation needs described earlier. Companies' needs require a response with some combination of the following components:

- a) marketing support (subsidiaries and assistance in kind) for product innovation:
- b) incentives/subsidies to company-sponsored or conducted product research and development:
- c) assistance in investigating and implementing process innovation:
- d) medium and long-term finance (equity and loans) to fund innovation projects.

Elements of these components already exist.

The Better Business Services Schemes and Enterprise Initiative grants subsidise consultancy studies on all four aspects of innovation. The two public agencies, the HIDB and SDA can further provide advisory services. However, the subsidy scheme and the advisory services are very limited in scale, viz. £550 and days rather than weeks of free advice per case for BBS.

Within the Universities and Colleges, Industrial Liaison Officers, or equivalents, act as intermediaries to make higher education resources available for appropriate industrial and commercial applications. However, there is no comparable service provided to companies within Scotland, vis-a-vis appropriate expertise which is located elsewhere in the United Kingdom or overseas. Self-sufficiency in technological or other expertise is unattainable and, for reasons discussed shortly, undesirable.

To recap, the objective of adding an explicit innovation policy to regional policy in Scotland would be to make Scotland an attractive location for siting headquarters functions and a favourable location for start-up and growth of indigenous firms. However, the resources of the United Kingdom, let alone Scotland, for funding original research and subsequent applications are small by international standards and likely to remain so for the foreseeable future. It has been, and will continue to be, necessary to specialise, just as industry and commerce must to some extent specialise. Developing special expertise in technologies, like specialisation in production, necessitates trade. By trading, access can be obtained to other areas' specialisations, and vice versa. To attain some technical or other edge in any field of industrial and commercial activity, it will be necessary to recognise that only a few subject areas should be addressed. This line of

reasoning raises the question of whether there should be a different set of specialisations in Scotland, relative to the rest of the United Kingdom.

If it is agreed that Scotland should specialise, this is tantamount to claiming the need for distinctive industrial and educational strategies for Scotland. Is it possible to have a distinctive development strategy for Scotland without legislative devolution?

The status quo provides for two major development agencies in the public sector and a variety of voluntary organisations in the private sector, not least the Scottish Council, which allow for research and debate on what such a strategy might be. Indeed, it could be argued that a strategy already exists. The SDA/HIDB specialisation in certain sectors, viz. electronics, health care and advanced engineering does represent such selectivity.

Elements of innovation policy are therefore in place, and this has been achieved without devolution. Would devolution *per se* increase the scale of original research and also the commercial application of research and would it cause funds to be available according to new criteria? The 1979 model of devolution offered no scope for either.

Competence

It would follow from development of a distinctive Scottish Industrial strategy that there would also be distinctive manpower needs. Insofar as the Scottish economy is already specialised, there are already distinctive requirements in personal competence. Further development of Scottish specialisation that is already in place, e.g. electronics, will tend to give further emphasis to distinctive manpower policy. This was one of the central considerations of the STEAC report: that the increasing requirement for advanced technical knowledge and skills would be a source of rising employment opportunity in the manufacturing sector. This growth in qualified labour demand is likely to happen despite overall employment in manufacturing industries declining.

While electronics manufacturing may be an extreme case (25% of employees being graduates by the end of the century), the technological competence

required of employees in all sectors of manufacturing is rising. This is a direct consequence of ensuring a competitive cost structure of moving towards higher value-added products in existing or new markets.

As well as an expected trend towards growing demand for technologically-qualified employees in Scotland, it is to be hoped that some progress on indigenous growth and relocation of headquarters functions will be achieved because the availability of qualified manpower in Scotland and the congestion costs of the South East will prove irresistible. This should substantially increase demand for employees with business and related qualifications. Such qualifications would also be highly pertinent to new business formation and the expansion of smaller and medium-sized companies which should accompany their growing involvement in overseas markets.

The desirable trend in composition of the workforce is towards acquisition of higher skills and preferably skills which are transferable within companies and between sectors. While this is the pattern for much of the industrialised world, the United Kingdom has had poor record of vocation training, particularly in recent years. The two-year YTS programme has been a welcome move in the right direction but it pales relative to the coverage of certified and qualified skills in the German economy, for example.

Is it possible for Scotland to create and maintain a distinctive approach to manpower competence without similar progress being made in the rest of the United Kingdom? Would devolution help?

The existing responsibilities for manpower competence in Scotland are divided. As indicated earlier, supervision and finance of the tertiary education sector is split between the Scottish Office and the Department of Education and Science. The Department of Employment's executive functions were exercised by the divisions of the Manpower Services Commission (MSC) whose separate identity in Scotland was a chimera. It remains to be seen what authority will be allocated to Scottish Enterprise in this regard.

While the Scottish Education Department (SED) had been wholly responsible for Central Institutions (technical and other colleges) and for the primary, secondary and further education sectors' contributions to manpower competence, this has

been eroded through a reallocation of funds through MSC. In Scotland, the Technical and Vocational Education Initiative (TVEI) and the TVEI Related In-Service Training (TRIST) are the major contributions of secondary and further education to steering students towards more technological and vocational education. Both are funded centrally through the Department of Employment and its Manpower Services Commission.

In vocational education there is a substantial measure of executive devolution despite the recent erosion of SED responsibilities. The Scottish Vocational Education Council (SCOTVEC) can be seen as an institutional vehicle through which more recognised courses and qualifications may be added. Also the introduction of Local Employer Networks in Scotland should ensure that training facilities are demand-driven by prospective employers.

However, there remains centralising tendencies in training provision because of the emphasis on application of national, United Kingdom policies. The industrial training boards (which have survived) are essentially United Kingdom institutions and the main thrust of policy implementation, the Youth Training Scheme, has no particular Scottish dimension other than its local lines of management.

Some extension of education and training effort in Scotland would therefore be within the competence of a Scottish Assembly while other critical areas would remain dependent on United Kingdom institutions and funding.

Decentralisation of executive control of higher education and training to Scotland is a possible response within existing constitutional arrangements. The differential effect of devolution would be dependent on the extent to which an elected Assembly would be prepared to redirect public expenditure in this direction.

The 1979 proposals gave no indication that extra public expenditure would be forthcoming and it must again be doubted whether an elected Scottish Assembly would wish to make choices in favour of this area of expenditure. However, it is possible to imagine circumstances under which a restoration of the traditional Scottish priority for investment in "human capital" might be restored. Devolution is therefore a potential contributor to

increasing personal competence.

Conclusion

This commentary on devolution as it might affect economic growth is necessarily subjective. As it has not happened, there is no objective way of assessing the concept's likely impact. Also, there may be unforeseeable changes in the world trading environment which will radically alter this present view of the main determinants of industrial change.

With these caveats, the conclusion of these thoughts must be that the case for devolution in terms of economic development, is not proven. Those who espouse the idea of devolution would be better served by presenting other aspects of their case. Likewise, their detractors have no basis for rejecting the concept on economic development grounds unless some definite disadvantage to industry and commerce can be demonstrated. Such disadvantage was not apparent in the 1979 model of devolution.

Notes

1. R Craig Campbell is Chief Economist of The Scottish Council Development and Industry. The views expressed are personal and do not necessarily reflect those of the Scottish Council.