

Political Economy

On the 27th September, the Welsh Assembly Minister of Economic Development and Transport launched KB4B, a 'knowledge bank for business' which is to be a new mechanism for delivering support to high-growth Welsh businesses. The initiative has been devised in consultation with the private sector to tailor support across a wide range of sectors. While it is, of course, a new and untested concept, an initial impression is that it appears to disregard the notion that governments should only interfere where there is market failure.

The Western Mail on 12th October reported an anonymous letter from Welsh Development Agency (WDA) staff unhappy with appointments at KB4B. Their objections centred on whether there was really a need to appoint new staff at salaries of more than £50,000 per annum to 'manage accounts in the bank' at a time when alternative employment will be needed for many of the 1,700 WDA, Wales Tourist Board (WTB), Education and Learning Wales (ELWa) and the new economic development and transport unit (EDT) staff. While these apprehensions are inevitable on the part of the displaced, perhaps even more serious concerns relate to the fundamental structure and rationale of KB4B.

At its launch Andrew Davies used the example of Microsoft – employing only three people in 1975 – to illustrate the underlying principle for the new initiative. The idea of Wales as home to the next Microsoft is indeed an attractive one, but the link made between its phenomenal success and public sector support is somewhat incautious. Microsoft is a company that licensed other people's intellectual capital and formed an alliance with an existing dominant company (IBM) to achieve its astonishing growth. Being part of the nascent personal computer business in the 1970s and 1980s was also very fortunate. There can surely be no suggestion that Microsoft was successful because it received financial, procedural or training assistance from Washington State or any other public agency? But if it did not, it is a curious example to choose. To this challenge the Assembly Government might argue that business conditions were and are different in Wales from North Western US, which is true (though both are on economic peripheries). However, if KB4B is designed to enable growth of tomorrow's 'Microsofts' there must be a clearly understood and consistent process at work, especially when public money is being spent to achieve this.

A Case of Market Failure?

The golden rule of government intervention in business is that it should only occur in the event of market failure. The initial list of companies drawn up as potential recipients of Assembly support is diverse; from a well established Welsh pharmaceutical company, to offshoots of multi-national defence and aerospace contractors, an

insurance company and a UK-wide construction company. The basis for selection is apparently a wide one:

"SMEs with the energy to double turnover within a three to four year timeframe, and with a minimum turnover of £3 million, and larger businesses having significant growth prospects with local technology/design/management capabilities"

What is not yet clear is how such a variety of businesses can all be facing systemic market failure which ostensibly can only be solved through public sector intervention. Can the Assembly's appointed commercial managers really give such companies any guidance on how better to run their affairs? If they cannot, then KB4B activities may come to be considered subsidy by another name. The Minister's pronouncements at the launch of KB4B that Wales was fast becoming the best place to 'start a business... grow a business and... see that business prosper' would seem to rule out any such endemic market failure.

The Case for Inclusion?

The drawing up of the KB4B list of 50 companies may well be seen as a rejoinder to a number of previous attempts to pick 'winning' sectors by the WDA and others. Basing Welsh prospects on such work has proved problematic, being very demanding of data, and requiring a deep understanding of the sectors in question. Here now we have, in contrast, an economic policy that appears to depend almost entirely upon the combined 'gut instincts' of public sector and professional service firms in Wales (whose regional headquarters are in Cardiff) who together draw up the list which appeared in the Western Mail (October 12th 2005).

Currently absent (or not immediately obvious) is information regarding the nature of any objective economic analysis used to guide the choice of potential recipients for KB4B attention. Some of the cited companies are operating in burgeoning markets and face growing demand, while others are active in aging sectors showing little or no growth in the UK. Others may only be capable of competitive, cannibalistic growth within Wales as they are parts of companies that also have English

offices. It is also difficult to evaluate from the outside the nature of the market failure facing these companies given their apparent diversity.

Conflicts of Interest?

Another significant question that the Assembly has yet to answer relates to how potential conflicts of interest are going to be managed? The existence of KB4B presupposes that its services confer advantage to recipients, whether this benefit is directly through fast-track access to grants or to training and business consultancy. Hence, great care will have to be exercised to ensure that this public/private partnership initiative which is, in its way, groundbreaking, maintains the highest standards of integrity, avoiding the possibility of draining public sector funds into the 'service industry' firms of Cardiff.

Moreover, the prospect exists for firms to be included on initial or future lists because public sector account managers or private sector consultancy firms are too close to firms and individuals to make an objective decision regarding their potential for future growth. These possibilities make the need for transparency particularly urgent. So, will there be robust measurable targets, goals or actions qualifying firms for continued public support? It appears that there will be evaluation – but only in terms of whether it is working for the companies involved, not whether it is working for Wales.

Unclear Goals?

The apparent lack of any sort of measurable target for success is a flaw, illustrating a fundamental problem that underlies this strategy. Despite what the GM Chairman Charlie Wilson told the US Senate in 1955, what's 'good for General Motors' is not *always* good for America. If KB4B were to induce a competitive impact enabling beneficiary firms to make productivity gains while also increasing their employment, and if that employment were of high quality and the recipient firm was indigenous, then there would be little conflict between the taxpayer (to whom this bank is ultimately accountable) and the client firm. However, a government induced step-rise in the profits of client multi-regional and multi-nationals which are likely to repatriated to the home region would be less palatable.

Conclusion

Few development agencies have yet had significant success in 'picking winners' at the sector/industry level, to the extent that such identified activities have developed with public sector help to become significant drivers of regional growth. Yet the Assembly is seeking to do something even more difficult and speculative by picking winners at this highly visible micro/company level.

With refreshing honesty, the Assembly admits it is likely to see the vast majority of this investment produce no return, and this is perfectly acceptable and necessarily realistic providing that the pay off is positive. However, any

investment strategy should be clear to the ultimate investors – here, the taxpayers of the UK – and this is not yet the case for KB4B.

What is awaited with interest is an indication of the basis on which companies are being shortlisted, and reassurance that this selection methodology is robust, if KB4B is to become a credible agent of economic development. This is important also to transmit a market signal to aspiring firms in Wales. High on the agenda must be:

- The development of objective criteria for inclusion in the KB4B shortlist;

- Processes to ensure that financial benefits do not arise from recommending a KB4B target;
- A clear statement on the mechanisms whereby Wales is expected to benefit from the growth of targeted businesses;
- A set of targets and goals that are measurable and reflect the success of the project for the business *and* for Wales.

In its first years the Assembly made a clear commitment to an evidence-based economic policy with the creation of the Economic Research Panel. The KB4B initiative should then be evaluated within the robust framework that has been set in place.