Guest Editorial

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In April 2015, the Learned Society of Wales[1], with support from Bangor University, organised an International Symposium on Economic Policy for Peripheral Economies. The symposium, held at Portmeirion, brought together specialists in the field of regional development; both economists and economic geographers. These two groups have active research programmes that do not always interact as much as they might and an aim of the symposium was to achieve cross-fertilisation of ideas. There were notable and distinguished contributors from the United States and Continental Europe, as well as from the United Kingdom, and with a substantial representation from Wales.

Following the Symposium, the presenters were invited to submit a paper to the Welsh Economic Review, based on their contributions. Those received are contained in this volume. The format of the symposium was for each main presentation to be followed by another that provided brief comments and observations on the main paper. Some of these comments have also been received, and follow the relevant main papers in this volume.

The intention of the Symposium was not merely to review the current state of the academic field but also to stimulate a discussion with a direct bearing on policy. The issues covered have widespread relevance but are evidently pertinent to Wales. The country is geographically peripheral in Europe and since the decline of the heavy industries in which it had specialized, and indeed had helped to launch during the industrial revolution, it has become economically peripheral too. Wales' GDP per head is only slightly more than 70 per cent of the UK average, and West Wales and the Valleys, together with Cornwall, are the last remaining areas of the UK classified as less developed regions by the EU. That means their GDP per head is less than 75 per cent of the average of the 27 EU countries.

The papers in this volume range from those taking an extensive view of development issues for peripheral countries in the globalized economy today to those concentrating on particular policy areas. The papers by John Kay, Ricardo Hausmann, Ron Boschma and Robert Huggins look at fundamental issues of how we should understand the problems of economic development and the role of government in promoting it. The papers by Colin Mason, Ken Mayhew and Bridget Rosewell address specific areas of policy action. The paper by Jonathan Price provides an overview of the Welsh economy and its challenges.

Government and contemporary economic development

John Kay's paper addresses the role of government in the modern state. He notes a change in the primary role of government, at least in Europe, from providing defence and security through a monopoly of coercive power, to providing a range of welfare services to citizens and promoting social cohesion through some measure of income support or redistribution. The defence function, which used to dominate budgets, evinces scale economies because large states are militarily stronger than small ones. During the 19th century states tended to increase in size reflecting the importance of scale in discharging their then primary function. In the period following the Second World War, however, the average size of states has fallen as empires have dissolved and new states have proliferated, reflecting the changing functions of the state. Kay observes that many of the more diverse services that states now provide for their citizens are best delivered locally while others require international co-operation. It is appropriate, and not surprising, therefore, that instead of a single government, citizens may now deal with several governments with overlapping functions in the same geographical space. Wales, with its own Parliament and government, part of the UK and also the EU, is a case in point.

Kay's conclusion is that this outcome should not necessarily be resisted. Calls for complete independence of ancient nations within larger states or calls for those larger states to leave international associations in pursuit of complete sovereignty may be misguided from an economic standpoint, reflecting a failure to understand the changing role of government in a world of highly interdependent and nested economies.

In commenting on Kay's thesis, James Wilson argues that it receives substantial empirical support from the experience in the Basque country of Spain. Business and economic policy there have been successful in promoting the regeneration of the economy and, while motivated by a regional "project" with a strong emotional and cultural drive, they have been characterised by complex interactions and co-operation between local, regional and Spanish national administrations. They have also involved extensive partnerships between the public and private sectors.

Ricardo Hausmann identifies know-how or implicit knowledge as a key, perhaps the key, factor in economic development. As both objective and implicit knowledge grow they exceed the capacity of individuals to master them; increasing specialisation by those individuals is necessary if society is to deploy all the knowledge available. The stage of development of an economy can be measured by the range of skills its inhabitants possess and the extent of their specialisation. These factors are reflected in the range of goods and services in which the economy in question has a comparative advantage. The more diverse an economy is, the more complex it may be said to be, and the higher its GDP is likely to be. Hausmann reviews the techniques developed at Harvard for measuring diversity and complexity, and shows that these are indeed correlated with GDP and its growth.

Theory and observation both indicate that the more diverse an economy the easier it is to absorb new skills and know-how and put them to profitable use. Diversification is easier for the already-diverse. That implies a possible development externality whereby acquisition of know-how has a greater social than private benefit. The techniques developed by the Harvard school raise interesting possibilities for policy in indicating how complex the economy is, how far it may be left to develop without intervention, or how far it may need State initiative to promote acquisition of essential know-how that entrepreneurs or individuals may not think it worthwhile to acquire given the existing state of affairs.

Ron Boschma's exposition of the notion of "smart specialisation", the prevailing new orthodoxy in EU regional policy, touches on the same territory. The idea behind smart specialisation is to identify those very areas where the existing capabilities in the economy mean diversification and development are most likely to be successful. Entrepreneurs are the likeliest people to identify such areas but may well require an appropriate policy setting, whether active or merely permissive, to exploit the opportunities.

Yet the paper by **Robert Huggins**, drawing on the work of AnnaLee Saxenian, illustrates how difficult it is for government to insert itself constructively into the development process – at least once it has supported fundamental research. Silicon Valley and Taiwan flourished through clusters of initially small firms that co-operated

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and outsourced extensively in developing new products. There was a pattern of changing relationships within a dense network, which enabled many new ventures to be launched and techniques to be tested in parallel. That model, which Huggins terms recombinant innovation, contrasts with, and ultimately dominated, a more vertically-integrated model of innovation within a large firm, such as seen in Massachusetts or Finland. There, lock-in to an established line of product development often meant initial success was followed by a falling away.

Recombinant innovation, however, is arguably more unpredictable and harder to plan. Silicon Valley owes its origins to public procurement and the needs of the US defence establishment, but once it started to grow it outstripped any central authority's ability to predict or match its course. The lesson of Taiwan, however, is that a peripheral region can enjoy great prosperity if it can develop the skills and know-how that enable it to insert itself into a global supply chain and become part of a network of co-operation and mutual stimulation. Movement of people was important in Taiwan's development with a "brain drain" becoming a "brain circulation", as the Taiwanese diaspora either returned or co-operated in business ventures in Taiwan.

Policy areas: education

Given the emphasis on know-how and the ability to absorb and employ new skills, the importance of education and training is evident. Ken Mayhew tackled the question of how public policy in these areas should seek to foster economic development – acknowledging at the outset that education had a broader role than simply fitting people for the labour force. He notes that there is a tension between planning for the future and equipping people for the current labour market. Currently in Wales many jobs are low-skilled. There is a lack of technical skills and many graduates report that they are over-qualified for their jobs, which do not use their education and do not challenge them. Those results suggest more technical or vocational education would be good with less emphasis on expanding entry to academic courses beyond the current level. Yet the aim in the future should be to generate more employment requiring higher skills and education.

On the vexed question of growing economic inequality, Mayhew notes that educational inequality starts very young, and all research shows the most important interventions are made in the early years with good nursery and primary school provision. Directing resources there, if necessary at the expense of higher education, would be the most promising way to tackle economic inequality.

Infrastructure

Bridget Rosewell notes the role of infrastructure in ensuring the kind of connectivity that is important for economic development. She observes, however, that techniques of cost-benefit analysis used to assess large infrastructure projects in the UK seldom take their economic development potential into account. Transport projects, for example, usually just estimate time saved in making journeys assuming that patterns of travel and economic activity are unaffected. Of course, predicting how reduced travel times will alter patterns of economic activity and how that will affect development is difficult. Because outcomes may be conjectural, there is a tendency for hard-nosed Treasury officials, perhaps mistrusting prestige projects, to retreat to narrower predictions and harder numbers. That, however, risks missing the main point of many infrastructure developments. Relative growth impacts may be hard to assess but the effort to do so is necessary.

Rosewell points out that intensive infrastructure is necessary for the development of large urban areas, where she says efficiency gains associated with agglomeration are to be found. Public policy has become influenced by the finding that productivity levels are higher in larger cities and this lies behind the interest in developing city regions around some smaller cities, such as Cardiff or Swansea in the Welsh case.

In his comment, however, Graham Gudgin points out there is an older and perhaps more plausible explanation for the higher productivity of larger cities than dynamic supply-side agglomeration effects. The central place model explains productivity differences in terms of demand; specialised services are supplied in only a few centres since population size does not justify their provision everywhere. These services tend to be high value-added activities so the central places do show higher productivity. However, this value-added would be the same if the service happened to be located elsewhere and does not depend on agglomeration somehow improving efficiency. The implication is that a balance needs to be maintained in infrastructure provision and excessive concentration is possible. That is perhaps particularly true of digital networks which can abolish distance in some activities and bring smaller communities into broader supply-chains.

Finance

Access to finance is an important element in investment and the development of businesses. Colin Mason's paper acknowledges that there may be gaps in the provision of finance for growing businesses but he also shows how difficult it has been for public sector organisations to plug the gaps effectively. One of the difficulties in the UK is the segmented nature of the market for finance with some institutions concentrating on start-ups while others consider only finance deals above a certain size. That can mean that a growing business, needing successive rounds of finance, cannot rely on the same, familiar supplier. Each round requires a new pitch to a new class of financier. Public venture capital institutions have often positioned themselves in one segment of the market and had the same preoccupation with "exit" as a private venture capitalist – no doubt under political pressure to demonstrate financial results. Yet the need is for informed, "smart" but patient capital or some means of linking vertically the different finance specialists so that a growing company can pass smoothly up the chain, raising larger and larger amounts of capital as it grows.

The Welsh context

The Symposium has many lessons for policy in Wales, though these need to be considered and assimilated with appropriate adaptations to local conditions. Jonathan Price recapped the current situation of the Welsh economy, which he described as challenging but not particularly surprising. Welsh GVA per head was substantially lower than the UK average but had not worsened since devolution, in contrast to the previous decade. Given the country's peripheral position, lack of a really large conurbation, and relatively low skill levels in the general population, economic performance is much as would be predicted. While sceptical of many quick-fix prescriptions, Price saw the avenue to long-run improvement through raising the educational and training levels of the people, especially ensuring adequate literacy and numeracy were universal. That was a conclusion enjoying considerable support from the other papers. There were differences among Symposium participants about how ambitious public policy could reasonably be in attempting to promote economic development in Wales relative to the UK as a whole. And it would probably be agreed that the right educational policy might well not be sufficient to change Wales' relative position substantially but that it is a necessary element few, if any, would dispute.

Note

1. The Learned Society of Wales is Wales' first national Academy. (See http://learnedsociety.wales/)