

THE INDEPENDENT REVIEW OF ECONOMIC POLICY – A CONSULTATION RESPONSE

Overall, I very much welcome the rigorous analysis and I agree with the vast majority of the recommendations contained within the Barnett /IREP Report. Clearly, this represents an important report at a critical time for the NI economy. That said, I am struck by the sense of déjà vu of many of the proposals, the essence of which was contained in previous strategies. For example, the need to move towards funding capability (e.g. R&D & innovation) and not capacity (e.g. funding machinery) was central to previous strategies such as *Competing in the 1990s* (1991). Once again, this highlights the key challenge is to recognise and understand a strategy and then follow it.

I have included comments on a range of the indicators where I had a view on them. These are highlighted below.

I Policy Development

Recommendation: As part of the review of structures within DETI, the department should ensure that more resources are dedicated to policy development and monitoring.

I would agree with the need to shift more of DETI's existing resources towards policy development. This would not necessarily require new resources but a shifting of existing staff out of low-value added administrative tasks into policy development. Monitoring is important but I am not convinced that this requires more resource over and above what is needed already. There is a danger that monitoring of targets can develop into an industry of its own. This occurred following the setting up of the Economic Development Forum whereby the focus on targets became more important than the focus on policy. DETI needs to make policy development a new industry not the design and monitoring of targets. Targets and their monitoring are a by-product of policy.

There is considerable knowledge and expertise in economic development not currently in DETI / Invest NI and within the wider public sector. Surely, moves should be made to identify this expertise and attract it back into the economic development sphere, particularly within DETI. DETI is largely staffed by career civil servants the majority of whom have had no experience of economic / policy development until they arrived at DETI. DETI / DEL / Invest NI need a strategy to identify, attract, train, develop and retain economic development expertise.

The place DETI needs to get to is to become a Department fluent in all aspects of the NI economy and economic development. This requires experts in innovation, enterprise, economic infrastructure and skills who know all of NI's economic development initiatives and the key policies and strategies of the UK / RoI inside out. This is the position DETI needs to get to.

Recommendation: DETI should appoint an independent economic adviser (with extensive experience as an economist) to strengthen capacity in economic policy making.

This recommendation has merits. It would appear obvious that, the Department for the Economy should have its own in-house Chief Economist / economists embedded within the department, free from the administrative burden of the NICS.

However, it also draws into question why this role is not already being performed in-house by existing staff? There is talent already within DETI and the wider NICS which already has over 100 economists at its disposal. Indeed, it is noted that DETI currently has the largest number of economists in the NICS and more economists than any public or private sector organisation operating in NI. From this perspective, DETI is already better placed than any organisation or individual to provide advice on its own economic development policy.

The Report does not elaborate on the rationale for such a post which states the individual “*should be able to provide strategic advice on the direction of the economy, priority areas for investment and independently validate economic research and evaluations commissioned by DETI / Invest NI*”. These tasks are the bread and butter roles and responsibilities of economists. Why is an additional outside economist required? Has the provision of quality economic advice been a problem to date or are economists being deployed in other non-economist activities? If so, should this current arrangement not be addressed to reflect priorities? The internal review of DETI structures, which is described elsewhere in the report, must look at the existing roles and responsibilities of the existing economist resources and policy development personnel and whether they are being utilised to the greatest effect.

Based on my own experience, there was a marked shift in the roles and responsibilities of economists away from activities normally associated with economists and a move towards administrative responsibilities over the five years to 2007. For example, economic research, forecasts and analysis are increasingly outsourced as opposed to be undertaken in-house. This is not an efficient and effective use of resources and is detrimental from both a department’s and an economist’s long-term career development perspective. There is a danger that if economists do not stay within these core competencies they will dumb down their economic and analytical skills. I am not aware of how this situation has changed since my departure in 2007.

DETI could also look at how policy development functions / economist roles are performed in Scotland, the RoI and in the UK (e.g. BERR) and establish best practice for structuring an economic policy development function.

In my view, the economists need to re-focus on the core skills and functions of economists namely: in-house research, analysis and advice. These are where their

key skills lie not as administrators. There also needs to be a formal tailored long-term economic development training programme within DETI / Invest NI and DEL.

IREP includes two important recommendations for staff development / promoting expertise:

1. *“World class training in sales and marketing should be provided for relevant Invest NI staff (particularly those working in international offices). In addition, staff should be recruited with relevant experience to meet the demands of investment decisions that are increasingly based on Innovation and R&D”*
2. *“High level experience in international business and expertise in economic development should be sought when the Invest NI board is reconstituted”.*

Such training needs to be widened to include economic development policy making within DETI. DETI should also be recruiting high level experience in business and economic development within its senior managerial ranks. The report highlights skills development issues for Invest NI but nothing jumps out for DETI. More resources for policy development are highlighted but there appears to be no reference to skills development. The tailored economic development programme should include secondments to economic development agencies in the UK, ROI and elsewhere.

Should Invest NI have a Chief Economic Adviser on its Board?

II Policy Delivery (Invest NI)

Recommendation: Grants for business expansions should be phased out towards 2013, after which such grants are unlikely to be available under EU state aid rules

The fact that 40% of the SFA budget was allocated to business expansion projects already operating in NI looks excessive. Equally, the fact that only 15% of the budget was directed towards the support of new jobs is disappointing. I would support a significant reduction in the level of support going to business expansions. However, a complete blanket ban on supporting expansions is not necessarily desirable either. Some Government-funded expansions have represented poor VfM. However, for some FDI coming into NI, particularly in the services sector, investments can be modular in nature. That is the initial investment is exploratory and depending on how successful this is will determine whether subsequent investment is undertaken. Therefore it would be useful to have follow-on incentives for additional assistance should subsequent investments materialise. This is simply utilising an incentive compatible contract at the outset which could be live for a set period e.g. 10-15 years.

Recommendation: Business expansion not involving Innovation and R&D should, where necessary, be supported in the form of co-investment in companies that have already been successful in securing funding from the private sector. Invest NI assistance should be in the form of sub-ordinate debt or equity

I agree with. However, the fact that a company engages in R&D / innovation should not be a guarantee that it receives financial assistance. There is an important distinction that there are 'good' projects that do not necessarily justify intervention. There are also 'bad' projects that may carry the innovation and R&D banner but should not be supported either. These important distinctions should always be borne in mind. Any company that is only viable if it receives repeated financial assistance, even if it is R&D and innovation specific, is not sustainable and therefore should not be supported.

Invest NI should further reduce its support for company training, and concentrate support mainly to small firms and to projects with a high Innovative content, where retraining is necessary to realise a substantial rise in productivity

I agree with.

III Policy Performance

Recommendation: DETI, as the funding department, should report on the strategic performance of Invest NI, with the co-operation of Invest NI statistical staff.

I agree with.

Recommendation: Relevant policies and accompanying resources should be updated annually to quantifiably demonstrate how individual policies/organisations contribute to the PfG productivity goal

It is likely to be more difficult in directly quantifying and stating direct impact on productivity goal than outlined here. There is also a danger of becoming too mechanistic and technical than is practically possible.

Recommendation: Wherever data availability / quality allows, 'impact' targets for economic development should be expressed in relative terms (to the UK average or appropriate subsection of UK regions) rather than in absolute terms

I agree with.

Recommendation: When reporting on performance, DETI / Invest NI should include targets specifically for investments new to NI (expressed as a share of equivalent jobs coming into the UK)

I agree with.

Recommendation: The Invest NI data collection system needs to be developed as a single database, to be maintained by DETI. The IREP database, constructed specifically for the Review, will be transferred to DETI to help facilitate this process

I agree with.

IV Finance

Recommendation: Aside from those funds designed to support seed stage projects, Invest NI should disengage its direct involvement with venture capital (VC) funds. Rather than direct participation in the market, Invest NI should act as a facilitator between companies and VCs. In the case of seed stage VC funds, Invest NI should avoid placing restrictions on the market as outlined in Chapter 3.

I am not entirely convinced by this recommendation and have some sympathy that there is a market failure in VC in NI. That is, the market failure of missing markets. The analysis of VC activity could have been supplemented with RoI VC activity within NI and not just that recorded by the BCVB. I am not aware of the scale of current RoI VC involvement in NI. Perhaps this identifies the lack of an all encompassing statistic of VC activity in NI and could be addressed?

V Skills

There appear to be different approaches being suggested for the skills development of Invest NI and DETI. There is considerable reference to enhancing skills within Invest NI but nothing that I could see within DETI.

There is no mention of **developing** skills in economic development within the economic development organisations. DETI could take the lead in designing on a programme of training and development on “economic development” drawing on the experience of best practice in other economies within and outside the UK.

VI Portfolio of Innovation Policies

Recommendation: Invest NI’s export assistance should become more dedicated and professional, adopting a similar model to the fee-charging export agencies identified in Chapter 6, with two tiers of charges depending on whether the company is an SME or large firm

In relation to the above, Invest NI could explore the potential for introducing more fees for its services. After all, a firm’s willingness to pay for a service often reflects its value.

VII Further Research

DETI should commission a study on the NI economy's exposure to the construction / property sector. This may appear to be locking the stable door after the horse has bolted. That said, it has been the key factor that led people to underestimate the impact of NI's downturn and propel the local economy into its first recession since the early 1980s. This would link in with the Executive's capital investment plans. Capital investment is likely to be slashed in the forthcoming public expenditure crunch. Furthermore, NI's construction sector is bearing the brunt of the ROI recession. The implications of delaying / cutting capital investment need to be urgently assessed in terms of job losses, knock-on effects to sectors beyond construction and the spatial impacts within the NI economy. In my view, the potential economic damage from reducing capital investment and its impact on employment is vastly underestimated. A key research topic, which may sit more logically with DFP, is to model the economic impact of cutting capital expenditure versus current expenditure (wages and headcount) within the public sector.

“DETI and other relevant departments should undertake a study to establish how the social economy might be further helped to reduce deprivation and increase labour force participation in disadvantaged areas within NI.”

If productivity continues to become the overarching economic development policy objective, and low valued added investments such as Call Centres are increasingly frowned upon, the social economy angle is going to become a more important strand of economic development policy within deprived areas. Furthermore, within the context of cuts in capital investment and the DFP Minister's recent announcement not to relocate public sector jobs outside Greater Belfast, urban regeneration and the social economy will be of even greater significance in addressing East-West economic disparities. From this perspective, a “Department of the Economy” needs to be heavily involved in this area if it is seen to be a Department striving for all areas of the economy. By extension, urban regeneration and rural development, which currently fall under other Department's responsibilities, would also logically fit under the same departmental umbrella.

VIII Co-ordination of Economic Policy

If NI is to achieve a step change in economic performance, the economy needs to remain the top priority of the Executive for the next 20-25 years. It is also recommended that the core economic functions (*covering DEL & DETI areas of responsibility*) should be brought together under a single 'Department of the Economy'. I would endorse this but would encourage even more responsibilities are housed within a 'Department of the Economy'. For example, these should include the urban regeneration responsibilities currently falling under the Department of Social Development's remit and the Department for Agriculture and Rural Development (DARD). Notwithstanding the importance of NI's Agriculture sector, NI is too small to have a separate department devoted to this sector. We do not have

separate departments for manufacturing, construction or services and these sectors account for a larger share of the economy than agriculture.

We would also endorse the following recommendations: *The FM / dFM and the Executive should establish a permanent sub-committee to prioritise action on the economy, to be chaired by the Minister for the Economy (in the interim, the Enterprise, Trade and Investment (ETI) Minister); and The Executive sub-committee should agree an economic strategy, building on the findings of the IREP, as a matter of urgency.*

In terms of the latter, such a strategy needs to adopt a “whatever it takes” approach to radically address NI’s longstanding economic weaknesses. In particular, it is vital that the Executive reaches a consensus on raising revenues within NI and drastically reducing and reallocating public expenditure. If the economy is to remain the Executive’s priority it must embrace difficult and unpopular decisions with the same vigour as its populist measures. Rapid public sector reform must move from being desirable to essential.

IX Governance Arrangements

I am pleased to note the emphasis on enhancing DETI / Invest NI governance arrangements given the weaknesses that have been identified. In relation to the recommendation highlighted below:

DETI should undertake an internal review of its structures to ensure that the allocation of staff is more fully aligned with its policy objectives

The internal review of DETI’s structures should include Invest NI participation. Going back to the original formation of Invest NI and DETI, this process appeared to be missing. It is important that Invest NI’s and DETI’s structures complement each other so both organisations have input into each others optimal structures. If DETI is the policy formulator and Invest NI is the service delivery function there should be greater similarity between the two organisation’s structures. Does every aspect of Invest NI’s interventions have corresponding policy expertise in the Department? This is an area that Invest NI and DETI could tie down in reviewing the Management Statement and Financial Memorandum (MSFM). For example, Invest NI should be more prescriptive over the amount and quality of policy / economic advice that it receives. In turn, this would help better inform DETI on its optimal structures. My own experience, having worked in both organisations, was that there was a misunderstanding over policy in terms of ‘who’ did what and ‘what’ would be delivered. I also refer to the comments I made under “Policy Development” on pages 1 & 2.

I would fully endorse the *recommendation to have a senior member of the DETI Departmental Board on the Invest NI Board*. It would be most beneficial if this member was on the policy side of DETI.

Recommendation: The core functions of strategic policy development and performance monitoring should be brought together within any revised DETI structures. The department should also provide the necessary support, professional and otherwise, to the Executive sub-committee on the economy

Again I would broadly agree with this recommendation. However, there is some concern that a key theme appears to be an over-emphasis on monitoring. Indeed, my take on the report, gives greater focus on monitoring and target setting than policy development. In my view, the greater emphasis must be on analysis and policy development and monitoring / targets are secondary to this role. The report recommends providing Invest NI with greater autonomy, yet a tighter monitoring role will be undertaken. The correct balance needs to be struck here. In particular, in terms of policy development, Invest NI and DETI need to become joined at the hip. *Recommendation: Invest NI should be allowed more freedom to operate, with DETI having less involvement in operational matters, to enable the organisation to be more entrepreneurial and responsive to business needs*

I agree with.

Recommendation: To help achieve greater autonomy for Invest NI, their delegated authority limits should be both simplified and increased significantly. The current DFP delegated limits for mobile SFA (currently £10m) should also apply to Innovation and R&D projects

I agree with.

Recommendation: An NI version of the Central Project Review Group (CPRG) should be established, incorporating Invest NI, DETI and DFP, in order to speed up the decision making process for major industrial assistance cases–

I agree with. Major industrial cases could also be speeded up if there were clearer policy guidelines in key areas such as repeat assistance. Cases that have not represented Value for Money in the past are unlikely to represent VfM in the future. Casework processing time, and staffing levels / costs, could be reduced dramatically if there was a clear policy steer regarding what can and cannot be supported from day 1 of a potentially controversial case.

Equally, DETI should monitor the performance of Invest NI casework with a view to continuous improvement. For example, if an Invest NI case is deemed VfM but is subsequently ruled not to represent VfM by DETI or DFP this should be reflected in the performance appraisals of the individuals initially presenting the case. Clearly, if in policy terms, DETI and Invest NI are joined at the hip, this situation should not arise.

Recommendation: For projects involving financial assistance to industry, ex-post assessments of value for money should be taken on a portfolio basis.

I agree with.

X Advisory Bodies

Recommendation: The ETI Minister should stand down the Economic Development Forum and establish a small advisory body, comprising expertise on regional economic development (drawn from business and economics) to provide independent advice on the economy.

I agree with. The EDF became too unwieldy and placed too many demands on DETI without yielding a significant return.

Recommendation: Stakeholders involved in economic development should continue to engage with the ETI Minister on a bilateral basis.

I agree with.

OTHER ISSUES

XI Third Party Funding

One area of intervention in economic development has been, and continues to be, the support of Third Party Organisations. The Report does not appear to cover how these organisations should or should not be supported. For example, should trade bodies be provided with public funds and should there be a greater emphasis on self-funding as in the UK? A clear policy statement on this is required.

XII Support to a small number of firms

It is noted that 30% of all grants offered to companies in the period 2002/3 – 2007/08 went to only 10 companies. While acknowledging the significance of these firms to the economy there is a concern that too few companies are receiving too much assistance. Assisting the large companies should be proportionate to the economic importance of that company to NI. Invariably this will be measured by the size of the supply chain and how embedded that company is within the NI economy. The larger the supply chain, the more justified large scale financial support would be in theory. By extension, it is questionable whether large firms which are not embedded in the local economy should be supported at all. If repeated assistance has failed to embed firms in the past it is unlikely that future assistance will do so.

It is noted in an excellent piece of Managerial skills research, commissioned by DETI, that improving areas of weakness is more important than excelling in others. Perhaps economic development policy should apply this same logic by focussing more on those companies in the second and third tiers where weaknesses are more

prevalent? After all, the reason why NI's top firms are the top firms in terms of R&D & export performance etc is because they are good at what they do. Therefore, more focus, should be targeted at those firms that have the potential to be more export & R&D intensive. The law of diminishing returns kicks in when supporting firms that are already successful. Clearly this is not saying NI's top firms should not be supported where the conditions warrant it. However, there is a danger that large dominant firms may view Invest NI support as simply a permanent revenue stream to their business that can be tapped into at every stage of their business development whether they require it or not.

DETI / Invest NI should look into the potential for introducing more competition within funds, where possible, particularly for large grants to large firms. Such competition would secure greater VfM.

XIII Productivity v Employment trade-off

If DETI and DEL merge the new department would be the lead on the productivity and employment targets. On the latter, NI has made practically no progress on reducing economic inactivity over the last decade when jobs were plentiful. Indeed, over the last year, NI's inactivity has shot up again while the UK's has remained unchanged. The Barnett Review's emphasis is on productivity. Will the new department have to drop the DEL employment target – which is extremely unrealistic? If not, the new department will be torn between trying to encourage low paid jobs (e.g. within tourism) to hit the employment target, thereby compromising the productivity target? If the Barnett Review is adopted, one aspect of moving the inactive onto the employment ladder may disappear. This is in the context of NI's unemployment remaining stubbornly high, relative to recent experience.

Against this background, are our MLAs lobbying for employment creation in their constituencies going to accept this? Will DETI / Invest NI refuse to back a project which is not deemed to be Value for Money yet safeguards a significant number of jobs in a deprived area?

If even call centres are turned down, how is NI (DEL, DETI, Invest NI) going to create employment particularly West of the Bann? With Barnett's emphasis on productivity (*and I would agree with this*), the West of the Bann will be even more reliant on public expenditure. But the DFP Minister has already said no to public sector jobs relocating to the West (as a policy to spread wealth). At the same time, the west of the Bann / Mid-Ulster has borne the brunt of the construction downturn. Public expenditure cuts of £370m cuts mean capital investment will be slashed plus forecast cuts of a further £730m post 2011 will reduce capital investment even more. Under these conditions it is likely that the current economic disparities between East & West, within NI, will widen. What will the economic policy response be to such a scenario? Will DETI / the Executive be prepared to say no to safeguard a large number of jobs even for just a few years?

XIV Enhancing the visibility of the Department of the Economy

If the economy is the number one priority a key action that could be undertaken to raise the profile of the Department of the Economy would be its physical location. Notwithstanding the delays with Workplace 2010 and pre-empting any departmental mergers (e.g. DETI & DEL), the Department of the Economy would benefit greatly from a city centre location, or alternatively in Titanic Quarter. This would enable the new Department to be more connected with business and more visible. Invest NI has successfully adopted a modern, visible, working environment in line with best practice. This is more relevant to DETI than other Departments as it is meant to be leading by example and encouraging best in practice within business. DETI's current location, infrastructure and building design is far from ideal and does not project the right image. A new Department for the Economy would benefit from a new building and a new start.

I hope these comments are useful and constructive to the debate that IREP has stimulated.

Richard Ramsey

Chief Economist, Northern Ireland

Ulster Bank Capital Markets

17 November 2009