

Submission to the Scottish Parliament Enterprise and Culture Committee Business Growth Enquiry

March 2005

Introduction

The Committee recognises that Scotland faces a serious problem with regard to business growth. In particular, business formation rates are near the bottom of the table, compared to both other UK regions and foreign countries. The Global Entrepreneurship Monitor measure of entrepreneurial activity is half that of the Republic of Ireland. More than twice as many Irish than Scots know an entrepreneur. At the same time, recent figures show that the business failure rate is much higher here than in England and Wales.

The Scottish Parliament's powers to affect the business environment are considerable. The Policy Institute is committed to generating new ideas on how these might be used to encourage business growth and economic prosperity generally. We have no 'corporate view' on these matters – instead, we commission and publish work by a broad range of commentators and experts on this subject. All is available on www.policyinstitute.info.

What follows is therefore a brief guide to the kind of ideas which the Parliament might consider to encourage business growth, with indication on where these can be explored in greater detail. We begin with the obvious ones – taxation, regulation and the role of economic development agencies.

But discussed less often are ideas for channelling investment in the economy where it is most needed. Market forces are essential here to making the right decisions, on transport infrastructure, land development, education and more. But the Parliament has a big role to play in establishing the right legal structures for the market to operate efficiently. Finally, we end with a note on public sector reform.

Taxation

Whether we should use the Parliament's tax powers to help the economy is frequently debated in Scotland. There is no need to

rehearse the arguments in detail here. Suffice it to say that there can be no doubt that lowering taxes helps business growth and the economy in general. Allowing businesses and individuals to keep more of the money they earn increases investment and wealth creation.

It is perhaps worth reiterating here that, while the Parliament's tax raising powers are famously limited to 3p on income tax and influence over local taxes, its tax cutting powers are effectively unlimited. The Parliament could use its budget to rebate corporate or individual tax liabilities. So, for example, it could imitate the successful model in the Republic of Ireland by rebating Scottish companies two thirds of their corporation tax. For a full exploration of tax cutting possibilities, see *Scotland's Hidden Tax Cutting Powers* on the Institute's web site.

Regulation

Red tape is the bugbear of all business, and a serious brake on business growth and economic prosperity. The essential problem is that government imposed regulation is a blunt instrument – its costs and benefits are rarely calculated, and it does not adjust to changing technologies. Usually, superior voluntary mechanisms can be found, for example through insurance products.

Although the Scottish Parliament issues twice the number of statutory instruments than the old Scottish Office, much regulation in Scotland is of course generated in Westminster or Brussels. But the Parliament could do much to lobby in these places more effectively by co-ordinating with their Scottish representation. In addition, we could install home grown mechanisms which would automatically cost, review and repeal (or lobby against) red tape which damages Scottish business. For more ideas on this subject, see *Financing Our Future* on the Institute's web site.

Economic Development Agencies

Debate is on-going about the efficacy of economic development agencies. Many argue that business itself would know better how to spend the £500 million budget of Scottish Enterprise and Highlands and Islands Enterprise. Effectively, under the current arrangements, some businesses are taxed to pay for the services provided to others by these agencies. Is this just? There is also some absolute cost in the process of administering them.

However, others argue that, properly targeted, development agencies are essential to fix elements of the market economy which are not functioning properly. *The Voyages of the Starship Enterprise* advocates that Scottish Enterprise establishes an investment fund, matched by private contributors, to finance the success stories of the future.

Using Market Mechanisms to Target Economic Investment Correctly

The central problem of government spending or regulation on economically related projects is that politicians and civil servants have no way of knowing whether such spending will yield adequate returns to prove worthwhile.

For example, should we spend £100 million on a new bridge? Would the extra economic activity generated by such a project justify the taxes on businesses and individuals necessary to pay for it? Would it be more sensible to spend that money instead on an airport or a hospital? Or on sending more students to university?

In practice, the process of democracy, through elections, lobbying, and the legal framework, produces some kind of answer which approximates to correct investment decisions. But within that there must be considerable waste and misallocation of resources.

In many cases, of course, elected politicians want to retain control of spending for philosophical or social reasons. But there are some areas where politicians could create the legal framework for the market to make spending decisions based on a proper assessment of likely economic return. This would help business growth enormously by reducing waste (and therefore public spending / taxation) and ensuring that investment took place where it was needed. Here are three examples:

Transport Infrastructure

Where transport infrastructure is economically useful, the gain far surpasses the cost. This has been demonstrated by the measurement of property price rises around new infrastructure. But the political process of finding money to prioritise for such projects can be very slow. Also, politicians have no accurate way of telling which projects are worth it. Governments often find themselves committed to costly investment which has little prospect of adequate economic return.

Instead, the Scottish Executive could consider creating legal entities which allowed private companies to capture some of the economic gain of the project (this might also involve reform of the planning framework - see below). This would allow the Executive to stand back from the whole process and allow transport investment to go ahead when and where it was needed.

Many of Scotland's rail and road infrastructure was originally created in this way. Meanwhile, around the world there are practical examples of how this can be done. The Policy Institute is currently

commissioning a study of how to channel private sector investment into transport in Scotland.

Such policies would not, of course, preclude the Executive from subsidising uneconomic transport projects if it thought there were other reasons for them to go ahead.

Development Planning

One of the major barriers to new transport infrastructure, and also to business and residential development is the planning system. This is one of the most important brakes on economic growth in Scotland, which businesses large and small, new and old, complain about.

Essentially the problem is the same as described above. Government has taken upon itself to balance economic interests against environmental concerns and tries, through the planning process, to decide which should have priority. But politicians and civil servants have no accurate way of judging economic versus environmental value. A costly and slow process is inevitable, which leads to both economic stasis and environmental blight.

Instead, the Executive could consider creating a legal framework where such matters were decided by residents and developers according to a market value of both environmental amenity and economic development. Again, this would allow politicians to step back from this controversial process and allow investment to flow (or not – either way, the decision would be quick). The Policy Institute has published *The Planning Famine* which proposes some modest reforms to rebalance the system. A more radical approach can be found in *Liberating the Land*, published by the Institute of Economic Affairs in London.

Higher Education

What is the value of a degree? Increasingly, research is showing that mass higher education has limited benefits for economies such as Scotland's (see for example *Skill Policies for Scotland*, published by the Fraser of Allander Institute). Should the Executive really subsidise half our young people to spend four years at college when the population is in decline and business is crying out for skilled labour?

Perhaps the market should decide instead. There is certainly a case for removing all subsidies from higher education. Instead, students would have to make an economic case to their source of funding to show that what they were proposing to study was worthwhile – i.e. that their earnings would be higher as a result of their degree than the cost of it. Philanthropic foundations could fund purely academic study.

Such an approach would have a triple effect – we could arrive at the right level of students in higher education (more or less, according to the real needs of the economy and business). Public spending and therefore taxes would be lower. And education providers would come under much more pressure to provide relevant, time efficient courses.

Enlightened Universities, published by the Policy Institute, takes a look at the issue of funding higher education, with an alternative view in the introduction.

Public Sector Reform

How public services are run might not seem directly relevant to business growth. But there are two massive benefits to be had in this respect from improving productivity in the public sector. First, it would allow public spending to fall to more normal levels in the medium term. And second, as the Deputy First Minister is fond of pointing out, business would benefit from having a better educated and healthy workforce.

This is not the place to discuss such reform in detail however. Suffice it to say that most developed countries have developed competitive markets in both health and education. Competition is the key ingredient in driving up standards and efficiency. This need not preclude various types of ownership (including some public ownership, though variety here can be beneficial), nor does it stop governments from redistributing wealth so that such services remain affordable to all. The Policy Institute has published widely on this theme. See, for example *A Healthy Future for Scotland*, *Beyond the New Consensus*, and *Setting Schools Free*.

Conclusion

These are only a few short introductions to some ideas that might help business growth in Scotland. We would be very happy to provide more detail on any, or help the committee in other ways.

Tom Miers,
Executive Director