

ECONOMIC PERSPECTIVE 1

INWARD INVESTMENT AND SCOTTISH DEVOLUTION: TOWARDS A BALANCED VIEW

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Introduction

Over the recent past there has been much debate about the likely impact of the Labour party's proposals to legislate for the establishment of a Scottish parliament to handle the internal affairs of the country (Labour Party, 1995). These plans have been subject to scrutiny from many quarters, not least from the business and financial community, with particular interest being shown in the potential fiscal implications. The inclination of much of the more vocal Scottish business comment has understandably been cautious about regional devolution as a concept within an integrating European market, implicitly rejecting the supposed benefits of a 'Europe of the Regions'. Within such comment, frequent reference has been made to the potentially negative effects on inward investment into Scotland, without too much evaluation as to the reasoning behind such conclusions.

This paper analyses the various issues relating to inward investment in Scotland upon which devolution, as currently proposed, might exert some influence. It does not speculate on whether independence for Scotland would follow or what impact that might have. Within all the potential business effects, the coverage here is confined to inward investment in view of its scale, mobility, international orientation, the role it plays within the Scottish economy and the choices which such companies can exercise on locations. Within that group of companies, the focus is mainly on manufacturing investment. It is written from a neutral political perspective and concentrates on bringing a balanced judgement to the whole question based on many years of both academic research and practical experience in this field. Its conclusions cannot be regarded as definitive; at best

they could, however, be regarded as reasonably well-informed. It is recognised that there are many aspects of the potential impact of devolution on corporate competitive positions and on their decision processes which are extremely difficult to forecast at this stage. All comments made on the issue should be made with a health warning, including those offered in this paper.

This being the case, attention is directed to four areas. The first section contains a brief review of the proposals, in as much as they raise uncertainties for inward investors. Secondly, attention is drawn to the relevant characteristics of foreign direct investment (fdi) in Scotland, related to which devolution might be of particular significance. It is evident that international companies of most types display certain behavioural patterns which are material to interpreting the possible effects of devolution on both existing fdi stocks in, and flows into, Scotland and some of these are covered in the third section. Fourthly, it is necessary to review the highlights of the likely EU environment for fdi attraction in the second half of the 1990s, in order to consider how the environment in a devolved Scotland might compare with it. Finally, and in the light of the interpretations contained in these three sections, the concluding part of the paper provides a speculative overview of the probable consequences of devolution on inward investment attraction and development in Scotland. Thereafter Appendix 1 gives an overview of the responses to this analysis when the earlier version was published.

Devolution and Uncertainty

Most business decisions are taken without perfect knowledge of their context or their consequences. Hence, it could be argued that the existence of

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some measure of uncertainty regarding the effects of devolution in Scotland is not in itself an issue. The more central questions may therefore be - how much uncertainty?; and concerning which areas of business activity? To answer these, several characteristics of the devolution proposals have to be borne in mind. The published intention is that the Scottish parliament's room for manoeuvre would be tightly constrained. It would be assigned all income tax and VAT receipts raised in Scotland, although these revenues together with local government taxes meet only some 86% of the present Scottish Office budget. Under the present proposals, there would be a top up arrangement with an equalisation grant from the UK Government, but the Scottish parliament would also have the power to vary the basic rate of income tax in Scotland by 3p in the pound - a power "to be used only with prudence and caution" (Labour Party, 1995, p3).

It is difficult to convincingly argue that these proposals constitute a level of uncertainty for international companies operating in Scotland which in any way matches the shifts of technological advantage, market demand and exchange rate volatility already handled by them on an on-going basis - assuming that the differential between Scotland and its competitors is not changed in their favour by other factors. Nor would such fiscal flexibilities as were possessed by the proposed parliament be likely to materially change the factor conditions which initially led these companies to be in Scotland. These views have been broadly shared by some others looking at this issue from an objective perspective in terms of the Scottish financial sector (Bain, 1994).

One of the particularly clear and welcome contributions regarding the financial sector (Patullo, 1994) has recently helped to move the debate to the stage where sector specialists have articulated the need for the maintenance of the same key environmental parameters in the Scottish and UK economies post-devolution. In this case the plea, particularly in the banking context, was for no different or additional taxation of corporate bodies in Scotland; the same supervisory disciplines and capital requirements as the principal London trading banks; and that the Financial Services Act and functional self-regulatory bodies should operate on both sides of the border. It is critical that well-argued and detailed contributions of this type emerge from business interests in Scotland to ensure that those drafting devolution proposals are made fully aware of the economic realities of

highly competitive markets and the implications which UK economic integration has for international competitiveness in many sectors. The addressing of these issues and appropriate political responses can only help to reduce some of the uncertainties associated with the present proposals.

The more critical uncertainty may, however, lie deeper than the proposals themselves, in that political tensions in the post-devolution UK environment might fuel the case for Scottish independence. There is a serious question of whether a parliament can be financed in a way which would not threaten the potential integrity of the UK (Bell and Dow, 1995). For example, one potential cause of such tensions is deemed to lie in the fact that identifiable public expenditure in Scotland is reported to be £16 per head higher than the rest of the UK. This type of scenario could subsequently generate differential levels of taxation across the full spectrum of fiscal activity and materially change the relative cost base within the UK. In effect this line of argument views devolution as opening up the prospect of a level of risk for business investment in Scotland which would not exist elsewhere in the UK unless similar powers were also vested in regional assemblies in England and Wales. This is, however, a rather malevolent scenario, which is arguably founded on substantial political discontinuity between Scotland and the rest of the UK (Stevens, 1995). A more benign interpretation would assume the continuing and long-standing commitment to the promotion of economic development in Scotland, and even the potential introduction of more positive measures to stimulate economic growth, thereby enhancing the Scottish case for investment attraction and development - provided this could be afforded without significant changes in the relative tax position.

In summary, while there are undeniable uncertainties associated with any constitutional change, their effects may well be neutral over the short to medium term. The final balance of judgement lies in the extent to which devolution in Scotland is replicated elsewhere in the UK and in the presence or absence of tensions which flow from that outcome. Since some 70% of Scotland's trade is with England and 70% of Scottish employees in industry are employed by companies based outside Scotland, it is not unreasonable to assume that there would be a high degree of responsibility applied to adopting any policy measures which would fail to recognise these economic realities. Indeed, it could be argued that

through the existence of bodies such as SDA/HIDB, and more recently the SE/HIE network, over the past 20 years Scotland has been a pioneer in many aspects of industrial and economic development and that such an environment would be highly creative in ways of exploiting the new opportunities open to it. In short, the jury is still out as to whether the uncertainty associated with Scottish devolution cannot be readily managed by all parties.

Relevant Characteristics of Inward Investment in Scotland

In this section attention is drawn to a number of features of both the existing stock of inward investment in Scotland and the potential flows in the immediate future, where the prospect of devolution, and some of the uncertainties associated with it, might have distinctive effects. The conditionality of that sentence is important, since some of these outcomes are far from clear.

- **US as a country of origin:** The US remains the single most important source of manufacturing inward investment into Scotland. But not all of these companies have international experience when they locate. Indeed, probably about one-third of the annual cases consist of companies making their first overseas manufacturing investment in Scotland. Stated another way, they are not experienced in arriving at a considered view of 'political risk' in environments which, though once stable, might now become rather less predictable. The risk aversion of such companies, and of many similar smaller investors from the Far East, has been one of the factors leading them to choose UK locations where many multinational enterprises (MNEs) have been established for several decades. Bearing in mind that the evidence (Netherlands Economic Institute and Ernst & Young, 1992) points to new inward investors choosing a country first and thereafter a region within it, it is just possible that negative perceptions being promulgated about Scottish devolution might lead them to choose other UK regions.
- **Reinvestment Decisions:** A counter-weighting variable lies perhaps in the proportion of inward investment projects which consist of expansions from within the existing stock of companies already in

Scotland. In recent years this has accounted for some 50% of reported projects at both Scottish and UK level. On the whole, companies reinvesting in Scotland have relatively few choices in the short term as to where to place that investment in order to supply European markets from within the EU borders. Thus, the conditions immediately post-devolution would have to be severely adverse to deter many projects in this category. However, this view has to be countered to some degree by the continued existence of multi-plant facilities in the same product area within many MNEs in Europe, even with the advent of the Single European Market (SEM). The rationalisation induced by these European changes has yet to occur in many corporations, and it is again possible that distinctive and new conditions in the Scottish environment could work against certain types of reinvestment. However, in these scenarios, and given continued world-class performance in Scottish plants within such networks, it is again difficult to argue that this would have an inherently negative effect on reinvestment patterns. Many other sector-specific and plant-specific factors would have to coincide to produce such a negative outcome.

- **Sectoral concentration in electronics:** In the case of this feature, there are perhaps three main variables which are particularly relevant. The first is related to the clustering of electronics activity in Scotland and the beginnings of an integrated base in this sector in terms of skills, products and services. While a compelling factor for many new MNE entrants in the present climate, the Scottish electronics environment is by no means unique in Europe (Peters, 1995). As a result it is difficult to argue that its existence would either increase or decrease the tolerance of MNEs to the changes which devolution would bring. The other two variables tend to confirm this. It is clear that electronics product cycles have been reducing dramatically in recent years and as a result the periods over which investment is recovered have reduced. The diversity of companies in this sector, in terms of both capital/labour intensity and original equipment/sub-contractor status,

makes it impossible to thereafter say that electronics companies are now more footloose than they once were. However, it is a sector which is characterised by global products and global sourcing, both of which factors make it subject to rapid adjustments to changing levels of profitability due to technological and market conditions. On balance therefore, if asked to judge whether electronics would be a sector within Scotland which would be sensitive to environmental uncertainty which would be deemed to exert an influence over its competitiveness, the answer would be in the affirmative.

- **European export bases:** It is well established that Scotland (and much of the UK) plays an important role as a manufacturing base for MNEs exporting throughout EU markets. For obvious reasons, it has little fdi leverage related to market size; although the 'clustering' effect of internal markets created between MNE subsidiaries in Scotland is significant for some parties. As a broad approximation, it can then be concluded that where the markets are largely external, the consistent case for Scotland as an fdi base must lie in its continued cost competitiveness and in associated skill and efficiency factors. The question then is would devolution, as proposed, materially alter these favourable conditions and thereby diminish the strongly positive effect arising from the Scottish economy being exposed to large scale business opportunities in growth markets through this route? Again there is nothing in the present proposals to suggest that this would be the case. Indeed, there is much to be said about the existence of inherent checks and balances in policy making which might have any potentially negative effect in this area, simply because many of the MNEs have (or can readily acquire) alternative ways of serving EU markets. A balanced approach is usually taken by politicians where the opportunity costs in terms of fiscal revenues and job losses are well understood. This is even more the case where other parts of the UK

and Europe would welcome investors were they to feel that they were uncomfortable in a devolved Scottish context. In effect therefore there should be a strong coincidence of interests between the public and private sectors in maintaining the 'export base' dimension of the Scottish economy.

- **MNE subsidiaries as a tax base:** The fiscal aspect of the devolution proposals would require a Scottish parliament to regard MNE subsidiaries as a critical part of their tax base, both in terms of their employment and trading. That this is the case is not merely related to their scale but also to their inherent characteristics as measured by productivity, investment levels, wage rates and so on (Young, et al, 1993). Viewed from a fiscal perspective, it is a relatively healthy and growth-oriented part of the tax base which should not be lightly tampered with. It is highly desirable that the interests of a devolved Scottish parliament within the UK are not allowed to stray towards corporate taxation and that this remains a UK issue. In effect, this proposition recognises that all MNE networks have tax offset capabilities and that they will so order their corporate affairs at a regional (European) or global level in order to minimise costs and maximise competitiveness. It also draws a clear distinction between a post-devolution Scotland as proposed and the independent country of Ireland as one of its proximate and vigorous inward investment competitors. The latter, from a particular history of late industrial development, has used corporation tax as a fiscal incentive in a manner which is outwith anything contained in the present proposals for Scotland. To try to move in the Irish direction from the present UK base, and given the stock of fdi in Scotland, would not only be highly detrimental in terms of the other implications for personal and sales taxation, but also probably impossible in view of the EU perspective on relative economic need. Such radical thinking would be best discarded by anyone with the medium to long-term interests of the Scottish economy at the forefront of their minds.

Relevant Characteristics of FDI in Europe

Attention is now directed towards the wider context within which both inward investment from outwith the EU, and intra-EU investment, occurs. Viewed from this perspective, the proposed changes associated with Scottish devolution are a rather minor matter when set against the wide range of market opportunities and environments within which fdi is demonstrably able to prosper. To illustrate this point, three related areas are reviewed within this section.

- **Integration and responsiveness:** It is clear that most MNEs show high degrees of adaptability when it comes to their accommodating of different types of policy environment, provided the fundamentals of these environments and their market are correct and it is in their business interests so to do. Among the many relevant dimensions which MNEs already adapt to in Europe are high social overhead costs; high barriers to plant closures and to labour shedding; nationalism in purchasing policies; two-tier boards; unstable political regimes; inadequate infrastructure; frequent changes of government, and so on. Meanwhile, many mature MNEs have recalibrated their tolerance for risk within Europe in their early investments in former Comecon countries, in this case driven by low costs and market opportunities. While being responsive to such features in their environment, many of the same MNEs are effectively integrating their operations across the region in order to maximise their competitiveness. Set against this diversity and frequent unpredictability, it is difficult to see how the Scottish devolution proposals as they stand can be regarded as a major threat to the corporations concerned. Of course, it is possible to contend that some of the country environments described above are recognised by MNEs as being less favourable to inward investors than the UK and that the volume which they attract reflects this. There is some truth in this argument in that no other EU country has pursued such consistent policies of inward investment attraction and development over the past 30-40 years. Scotland has had a central place in that strategy and it is highly desirable that this remains the case. Equally, there is no reason to believe that

the devolution proposals alone would lead Scotland to lose that position.

- **Investment decision-making processes:** As would readily be attested by inward investment agencies throughout Europe, the majority of projects handled by them which lead to greenfield investment decisions are under consideration for between two and four years. There is ample evidence (Hood and Truijens, 1993) to show that this is a complex and multi-stage process which evaluates and re-evaluates a wide range of corporate, sectoral, technological and environmental variables before finally choosing a country, a region within it and a location. Although these processes are well-documented on the macro level, many of the nuances at the micro level, which lead to the inclusion and exclusion of locations, are difficult to identify. For this reason, the gap between the realities of devolution as proposed and perceptions regarding these proposals is a potentially serious issue for Scotland. The very heat and vigour of the political debate regarding the subject over the past two years will probably be factored into the decision-making processes of some companies who will make European investment decisions over the next two to three years. Whether these will be rationally and systematically evaluated, and perhaps discounted, as a substantive factor to their investment or reinvestment decisions; or regarded as reflecting an emerging environmental change which could be material in the medium to long term, only time will tell. The thrust of the argument in this paper, however, inclines to the former view in most cases. The latter perspective is more likely to prevail in companies with little or no international production experience for whom a European investment project is a major departure from their normal decision processes.
- **Locational advantages and uncertainty:** As has been observed, inward investment in the EU has tended to gravitate to preferred environments, of which the UK is one. There are a whole series of well-established reasons as to why this is so, almost all of which are not called into question by devolution in Scotland. For

example, while the unitary UK position on inward investment policy and promotion is of some advantage to potential investors, the detailed pursuit of companies and the handling of investment cases is mainly undertaken at the regional level. In effect, the UK has addressed these issues by having a measure of differentiation within an agreed framework, whereby the development, presentation and integration of locational advantages is handled at the regional level and close to the customer. It is difficult then to argue that the 'unity and diversity' approach would be seriously impaired by a body such as Locate in Scotland (LIS) reporting to a parliament which is still operating within an agreed UK and EU framework. In effect, and viewed from a corporate viewpoint, such a change does not seem to heighten the 'uncertainty index' for an inward investor. Of course, were devolution to result in both Scottish independence and greater degrees of regional fragmentation in fiscal affairs throughout the UK, this conclusion would have to be revisited.

Relevant Competitive Trends for FDI Attraction in Europe

It has been particularly evident in the past decade that many European countries have begun to take steps to gain a greater share of the market for 'attractable' inward investment flowing into the region. There are many factors motivating this, including the high market share enjoyed by the UK and a few other countries; the desire to gain the spillover benefits from fdi (including those flowing from intra-EU investment); and the intention to deploy inward investment attraction and development as regional and industrial policy instruments. As a result of the adoption of a different or, in some cases, merely a more consistent policy towards fdi, there are now many more active agencies operating in this business in Europe, most of whom compete directly with Scotland. Not all of these are as well resourced

and few have as comprehensive international networks as LIS/SE. Many are sub-regional or local, and some specialise in particular sectors which do not always pose a threat to Scotland. However, taken together, there are probably at least twice as many inward investment agencies in Europe which compete directly with LIS than there were a decade ago. Outwith Central and Eastern Europe, this period has witnessed most of the Scandinavian countries entering the market, as well as revitalised efforts in France and Germany, to say nothing of the more effective efforts of other UK regions. Many of these new entrants have, within the constraints of their resources, attempted to emulate the one-door approach to inward investment targeting developed in the 1970s and early 1980s in Ireland and Scotland.

It is against this background that devolution is planned to take place. It is therefore essential to consider which aspects of that late 1990s environment might be relevant to the maintenance of Scottish inward investment competitive position post-devolution.

- MNEs operating in Europe have, as a matter of routine, to be able to both locate and develop their affiliates in an ever-widening range of political environments. Provided the fundamental factors of markets and costs remain within acceptable ranges, there is no *prima facie* reason to believe that these affiliates will not be able to adjust to the proposed changes in Scotland which are at the relatively moderate end of the spectrum of environmental change.
- In view of the strength of the Scottish inward investment performance, with between 20-25% of the reported UK cases over recent years according to the Invest in Britain Bureau (IBB) statistics, it is highly probable that some competitors will endeavour to highlight the uncertainties associated with devolution. This is likely to occur both within the UK and in other parts of Europe, and could prove damaging. There are several ways in which this could be countered. All of them require close dialogue between policy makers and international companies, together with the clearest possible communication about the detailed nature of the proposals for Scotland. It is well-known that such changes are among those

where the knowledge base of overseas-based business is particularly imperfect, and the subtleties of the debate readily misunderstood or misrepresented. This is an area where early and clear 'supportive signals' are required from the policy makers.

contemporary issue, there are a number of others which may well be considerably more important in both the short and medium term. A number of these were previously examined in another context (Hood, 1991), but the critical areas are considered in this section. They can be readily divided between external and internal environmental changes and are now briefly reviewed.

- One of the critical factors in Scotland's success with inward investment lies in the 'endorsement effect' flowing from successive management teams choosing to both invest and reinvest in the country as a consequence of good comparative performance in their plants. While the majority of that effect is generated by corporate performance within subsidiaries, it does have a public sector dimension in the maintenance of a consistently supportive environment. In view of the heightened competition outlined, this would not be an appropriate time to introduce major uncertainty into this process. Once more, such a conclusion places a premium on minimum change and maximum transparency.
 - A final point worth stressing in this section is the observation that a considerable volume of the direct, project by project competition which takes place for inward investment in Europe occurs between rather different environments. The competition between Scotland and Ireland for many electronics projects provide a consistent illustration of this over the past two decades and more. While there are similarities, there are also substantial differences between the two environments. Yet it is clear that when viewed over the long term and when the various factors are weighed up by MNEs, both provide equally attractive locations. As proposed, the devolution measures in Scotland seem capable of being factored in to such calculations without serious detriment to the Scottish case.
- *External environment:* There are many factors in this category which could act to challenge the relative position of Scotland as an inward investment location. They include the following:-
 - (a) *Changing investment modalities:* Although data are sparse, the weight of evidence points to greenfield projects being a relatively small and diminishing proportion of total manufacturing related inward investment. Mergers, joint ventures, alliances and other forms of collaborative agreements account for a growing proportion of both investment flows and stocks. In effect, the pool in which LIS and others are fishing is relatively smaller. Meanwhile, the strength, scale and range of the indigenous industrial base is a greater determinant of whether business collaboration of other types will occur and in any event such relationships are more determined by business synergies than by geography.
 - (b) *European enlargement:* While the 1992 EU integration effect has been positive for inward investment into Scotland, European enlargement is unlikely to be an unqualified benefit. Given the range of manufacturing options which the majority of US companies located in Scotland have within the EU, there is the prospect of differential investment patterns skewed towards the emerging markets in Central and Eastern Europe. Moreover, Czechoslovakia, Poland and Hungary, are now serious competitors for certain types of

The Relative Importance of the Devolution Issue

Before drawing conclusions, some observations are necessary on the relative importance of devolution within the spectrum of policy areas relating to the future of inward investment in Scotland. While devolution might appear to be a major

greenfield projects in their own right.

- (c) *Differentiation of the Scottish product:* This is a many-sided issue, wherein it remains necessary to offset peripherality and the perception of Scotland as a location to serve European markets. LIS competes with both national and regional development organisations on a world market basis, but it has become more difficult to differentiate UK regions from a marketing point of view. One reason for this is that the standard methodology of investment attraction has become ever more professional, integrated, analytical and based on selective company targeting. In the Scottish case, over the recent past, much of the differentiation has come from the educational infrastructure, the supplier base, the performance record of existing overseas companies, the work of LIS in customer care, and so on. These are likely to remain critical factors, as are continued upgrading of logistics, communications infrastructure, and the maintenance of some level of regional financial assistance. There is some considerable risk attached to the latter at the EU level as more deserving national cases emerge; although more transparency regarding aid throughout the EU may help to counter this to some degree.

- (d) *Single European Currency:* In the period since 1992 the combination of productivity improvements and shorter term exchange rate effects have combined to further enhance the UK case for fdi, even in a period of recession in most major EU markets. This favourable macro economic environment serves to highlight the potential effects on fdi of a move towards a single

European currency, with the prospect of the UK being outwith such a structure. While not always speaking with one voice, the general weight of international business opinion would appear to regard this as undesirable, given the strategic role which many UK based plants play in European markets. The scale of uncertainty surrounding the UK's position on this issue far outweighs that associated with devolution.

- *Internal environment:* There are perhaps two main areas of internal change which are of more fundamental importance to Scotland's inward investment effort than is devolution at this stage. These two areas concern organisational structures and functions for inward investment; and the nature of regional policy.

- (a) *Structures and functions:* This aspect of the internal Scottish environment has been highly supportive of the work of LIS, effectively co-ordinating public and private sector roles and focusing these upon customer care at all levels. This approach has paid good dividends for Scotland. Moreover, it has come through the transition of the past five years reasonably intact over a period which witnessed the emergence of Scottish Enterprise and Local Enterprise Companies and the beginnings of the rundown of the New Town Development Corporations. Both of these events are still capable of introducing fragmentation to an integrated effort. In addition, there are other core competitive issues associated with the role of the public sector in the provision of industrial land and property and the relative unwillingness of the private sector to fill the speculative build gap which is being left by the dissolution of the New Towns. Irrespective of the dogma which abounds in this area, the reality is that LIS competes vigorously with similar

bodies throughout Europe who aim to provide property and land as part of their incentive package. By whatever means therefore a further measure of flexibility will have to be developed to address this area.

- (b) *Regional policy:* The future relationship between inward investment and regional policy is a crucial one for Scotland (Young, et al, 1994). While not all inward investment in the UK is subject to the effects of regional policy, there is ample evidence that measures such as Regional Selective Assistance (RSA) play an important role in the distribution of such investment to the Assisted Areas (AAs). For example, in 1993/94, 43% of the inward investment success recorded by IBB throughout the UK had RSA (or equivalent) support. All of the external environmental challenges mentioned above call for the continuation of active regional policy measures in the UK for both the attraction and development of inward investment, while recognising the fundamental role of supply side factors in determining the attractiveness of the UK and its regions as business locations. However, as has been pointed out in another context (Hood and Young, 1995), the case for attempting to maximise the economic benefit from inward investment is a strong one and, if espoused, would lead to a different approach being taken to some regional policy instruments. For example, were the whole issue of subsidiary development within international companies to become a serious focus for policy initiatives, it would become evident that the enhancement of

the innovative and technological base of Scotland was not always readily addressed by RSA, on grounds of modest capital expenditure and few jobs created in many R&D projects. Experience in discussing these matters with MNEs and development agencies shows that there is ample evidence of development (and some research) projects migrating to more incentivised and/or more tax effective locations. In this regard, these projects have shown themselves to be internationally mobile. As presently operated, there is every expectation that many major development projects which could 'naturally' emerge alongside strategic manufacturing facilities in Scotland have not done so, and probably will not do so, because of the way in which the regional policy regime is operated. On a medium term basis, this is likely to have a much more serious effect on inward investment potential than has devolution.

Conclusions

In arriving at this relatively benign view of the potential effects of devolution on inward investment, much depends on the consequent behaviour of politicians in a Scottish Parliament in terms of their attitudes to business and economic development. Appendix 1 makes it clear that there are rather negative expectations in this area from some business quarters. It is acknowledged that there are many imponderables in this equation which go beyond the impact of the proposed measures. However, in the light of the foregoing commentary and recognising that informed judgement has to be applied in many of the areas considered, the following conclusions can be drawn:-

- There is no *prima facie* case for claiming that devolution as currently proposed will have a negative effect on Scotland's position for either inward investment attraction or development.
- However, the consideration of devolution

itself affords ample opportunity for the perpetuation of uncertainty regarding the proposals, both on the part of competitors in the inward investment business and by politicians engaging in speculation as to whether the implementation of devolution will lead to the ultimate pursuit of separatism.

- Such uncertainties can best be addressed by the development of a working relationship between the prospective policy makers and the business community, whether indigenous or international in their origins. Although such dialogue has been a feature of the Scottish environment, its significance takes on a new meaning in the devolution context where a different range of policy issues might be determined within Scotland. If such a change of environment is the policy of the government of the day, it is in the interests of all parties that it is shaped by informed opinion.
- There are relatively few inherent characteristics of the foreign-owned sector in Scotland where devolution is likely to have distinctive effects. Among these are smaller less experienced MNEs, and some parts of the electronics sector. In general the cost, market and efficiency factors associated with high performance in Scottish locations is likely to offset any potentially negative effects.
- Viewed from the wider European perspective, and bearing in mind the diversity of environments from within which MNEs assess European markets, devolution in Scotland has to be regarded as a relatively minor change. Such companies display capabilities of effectively integrating their operations at the same time as being responsive to local conditions. However, the time span over which location and investment development decisions are taken, together with the imperfections of information which abound, creates the real possibility of a gap between the realities of these proposals and perceptions about them.
- The European competition for inward

investment has grown substantially over the past decade. This has only served to make the range of operating environments accommodated by these companies ever wider, provided the market and cost conditions remain favourable. Few of these environments have been as stable and as welcoming to inward investment as Scotland/UK has been in the past four decades. While devolution will act to change this environment, some of the others are changing in more radical directions. However, every effort has to be made to have minimum change and maximum transparency in the Scottish context, so that a minor issue is not allowed to become a major one by default.

- Finally, many of the issues considered in this paper will require to be tested within the business environment and the elicited responses carefully reviewed. Such an exercise is particularly difficult where several different scenarios could be developed, ranging from the benign to the malevolent. It is, for example, evident that opinion differs widely on whether devolution can be contained to the proposals as specified; equally the potential impact on individual MNEs will vary, as will the perspective of the senior managers concerned.

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APPENDIX 1

When this paper was published in its original form, it largely contained the analysis, perspectives and interpretation reflected in the previous pages. At that time it was circulated to some twenty senior individuals who are prominent in Scottish business and public life, in order to seek their reactions. This section reflects a number of the comments which emerged from that exercise, without attributing them to their source. Together they provide an insight into aspects of the uncertainty and lack of trust in some quarters when it comes to assessing the devolution proposals. Before commenting on them, it should be stressed that the paper is concerned with inward investment and devolution as specified. Most business commentators found it either impossible, or artificial, to stay within these conceptual constraints. Their comments were mainly concerned with the potential impact on major indigenous businesses and were founded on the expectation that it would be difficult, if not impossible, for any government to stay within the remit of devolutionary powers as

presently specified.

The comments included the following lines of argument:

- 1 From those concerned within the public sector with inward investment there was broad agreement that devolution as specified did not appear to feature in the on-going process of evaluating Scotland as an investment location and that the macro risk and opportunity factors associated with UK locations were more dominant issues.
- 2 One clear message to emerge from the business perspective was that, while the making of complex business decisions does not involve the assessment of many risks, these are part of a normal process. On the other hand, the imposition of political risk and uncertainty above the norm, such as in the context of devolution, takes business into territory with which they are naturally less comfortable. This in itself was seen to call for dialogue and persuasive argument to reduce these uncertainties.
- 3 Another important concern which was voiced related to the importance of UK cost competitiveness both for indigenous and international businesses. The view was expressed that even if devolution did not lead towards independence, it could, if further spending powers were to be vested in a Scottish parliament, progressively lead to higher spending, thus affecting business costs and returns. The underlying assumption in this set of comments was that more localised government for Scotland would find it difficult to preserve the environment within which UK competitiveness has improved over the past decade.
- 4 The paper elicited a number of rather different evaluations about the political complexion of a devolved parliament. These included the belief that, irrespective of the policy platform on which devolution was introduced, there would be a substantial number of radical members whose past rhetoric was critical of MNEs and that could ultimately change the inward investment climate in Scotland.

Others argued that, under certain political scenarios, and the existence of proportional representation, a hung parliament was more likely and therefore that the political climate would continue to be broadly supportive towards inward investment. Both of these perspectives tended to regard the view taken in the paper as too benign, while claiming that there was still a lack of clarity about what was really being proposed.

5 Another recurring theme was that of the inexperience of the policy makers in matters relating to the maintenance of a competitive environment in Scotland and the implicit commitment to spending programmes which would require more tax raising powers. In its more extreme form, comment on this general theme focused on the potential narrow-mindedness of some of the likely factions in a Scottish parliament which would not be supportive of business interests in general and which might over-react to restructuring within MNEs in particular.

6 Most of the business comment noted above came from indigenous business leaders. In contrast the general perspective of the senior managers of MNEs who offered their views has been broadly supportive of the arguments presented here. Provided responsible attitudes were maintained in the design and implementation of devolution, such a change was not regarded as exerting a major influence on their activities in Scotland. This type of assessment has of course to be seen against a setting in which both the public and private sectors have been strongly supportive of inward investment and the central presumption that it was in the interests of all political parties for this to be maintained. It has also to be recognised that these companies do not have Scottish headquarters and that factor in itself would appear to underlie some of the concerns from indigenous business leaders.