



Evidence briefing paper

The Welsh economy, skills and infrastructure

This evidence briefing paper summarises some of the key economic challenges and opportunities for the Welsh economy; and reflects upon issues that we expect the incoming Welsh Government will face after the 2021 Senedd election. The paper focuses specifically on Wales' economic performance; and the challenges related to skills, education and training; infrastructure and transport; procurement; and business support.

Key messages

- 1 The combined effects of the Coronavirus pandemic and the UK's departure from the European Union** significantly worsen the prospects for the Welsh economy, and risk reversing the gains made in the past decade. These twin economic shocks have already increased economic and social vulnerabilities, and are certain to exacerbate existing inequalities. To mitigate their impacts, Wales will need a combination of short-term investment and long-term restructuring, based on the core principles of economic resilience, prosperity, and inclusivity.
- 2 Investment in skills and education**, coupled with stronger collaboration between industry, educational organisations, and local communities, will be important factors in strengthening Wales's Research and Development (R&D) capacity, and broader economic performance in the long term. Ensuring a pool of skilled workers, who are equipped for the future labour market, helps to attract inward investment, and boosts wages, and future income tax receipts.
- 3 There needs to be investment in new infrastructure.** The OECD has identified a 'pressing need' in Wales for investment in new infrastructure to improve productivity, socioeconomic opportunities, and economic resilience. Once commuting resumes as the pandemic eases, large public transport projects, such as the North Wales and South Wales Metro, could play a significant role in stimulating economic activity.
- 4 There is a need to coordinate policies on regional governance, skills, and infrastructure.** This is necessary to move towards an economy that supports innovation, increases productivity, grows existing businesses, strengthens the foundational economy, attracts high-value inward investment, and minimises income inequality through the creation of high-quality jobs, and fair work.
- 5 Wales needs policies to support businesses** to stay afloat in the short term, and to encourage innovation and expansion in the future.
- 6 Adopting more strategic and sustainable approaches to public procurement** could support the national economy and local communities, in particular by ensuring that inward investors invest in skills development, and in supply chains that add value in Wales.

Wales's economic performance



By international standards, the UK has very high levels of interregional inequality, and productivity gaps between the best-performing and worst-performing areas have been widening since the early 1980s. According to most measures, Wales is among the lowest in the productivity rankings of the UK countries and regions, and its wage rates are also below the UK average.

The Welsh economy has relatively few high-value, high-productivity services compared to the UK average, and depends to a greater degree on lower-productivity services, manufacturing, tourism, and agriculture. It also has a relatively high proportion of small firms and lower-level skills.

Wales's economic performance can be largely explained by a range of important structural characteristics:

- Its population is older, in poorer health, and has lower levels of educational attainment and skills than the UK average;
- It has a larger public sector;
- There are few major economic centres, and they are not well connected to the rest of Wales or the UK;
- The effects of large-scale deindustrialisation and the move away from traditional industries are still being felt; and
- There is limited fiscal devolution and a small tax base, with few obvious sources of new revenue.

Brexit and the Coronavirus pandemic present additional pressures and, in the short term at least, will exacerbate existing inequalities and the challenges facing the working-age population. Their combined impacts risk reversing the economic gains Wales has made over the last decade.

Emerging research has shown that building stronger local institutions is extremely important for achieving both productivity and inclusivity

The economic restructuring needed to address these twin economic shocks presents an opportunity to address the structural challenges by creating a more resilient, prosperous, and inclusive future Welsh economy which responds to the urgent need to decarbonise. The key characteristics of such an economy will be high productivity, innovation, a strong SME sector, much higher levels of entrepreneurship, low unemployment, and reduced income inequality.

However, stimulating productivity growth will be challenging. Traditional approaches such as a focus on increasing the number of jobs can result in insufficient attention being paid to the quality of jobs created, fair work, and the problem of in-work poverty. Alternative approaches need to be explored.

Emerging research has shown that **building stronger local institutions is extremely important for achieving both productivity and inclusivity**. This is a particular challenge in Wales, which, according to the OECD, needs 'a more coherent and coordinated approach to regional development policy design and delivery', with enhanced capacity for local government and regional bodies to implement policy. Without this, Wales cannot make the most of its devolved powers and policy levers.

There is also a need for **business support to mitigate the impacts of Brexit and the Coronavirus pandemic**. It will be important to support sectors in which Wales has a competitive advantage and/or the potential to create good jobs. Support for inward investment should target these sectors, and there should be support for homegrown businesses to innovate and change their product market strategies. For business growth, Wales **needs both skills strategies to meet future demand, and robust transport infrastructure policies** (as discussed below).

All these interventions are medium- and long-term measures that need to be considered as part of the Welsh Government's overall economic strategy, and by local authorities seeking to support jobs, and stimulate growth in their local economies.

Skills, education and training

An educated and skilled workforce is vital for economic performance and productivity. Improving skills supports a virtuous circle – attracting investors, and giving impetus to innovation and R&D.

Policies are needed that support the career progression of those in low-paid, low-skill work, new entrants to the labour market, and the newly unemployed

Analysts predict a 'Fourth Industrial Revolution' in which the increasingly widespread application of **artificial intelligence will lead to the loss of many existing jobs that can be easily automated**. The impact on economies is uncertain, but experts agree that governments need to foster the development of transferable skills that are difficult to automate, such as creativity and critical thinking competencies, and promote policies that prioritise the technical skills and strong STEM curricula that are needed in a digital economy. This points to the importance of increased investment in opportunities for lifelong learning, in-work training, retraining and career progression.

The need to boost human capital through skills development and training has been brought into sharp focus by the Coronavirus pandemic, which has amplified pre-existing regional disparities within Wales.

Less prosperous parts of the country have concentrations of jobs in sectors that have been the most adversely impacted, notably tourism, retail, and agriculture. Reskilling will be an important response to the economic fallout from the pandemic, and **policies are needed that support the career progression of those in low-paid, low-skill work, new entrants to the labour market, and the newly unemployed**.

In-work progression and lifelong learning are vital to securing a skilled workforce fit for the labour market of the future. The loss of EU funding for training programmes means that it will be important to target interventions that have the greatest impact. Tackling intergenerational worklessness and supporting those who are still a long way off from being employable will benefit only a small number of people. **Enabling those who are currently in low-paid, insecure jobs and at greatest risk of cycling in and out of employment to gain the skills to progress into higher quality jobs** is a more effective way of tackling household poverty, supporting local communities, and strengthening the Welsh economy as a whole.

It is well known that barriers to job progression include:

- The cost to low-paid individuals of participating in training;
- Lack of incentives provided by management;
- Lack of welfare support;
- Limited internal job ladders, and flat employment structures; and
- Weak correspondence between skill improvements and increased earnings.

Policies that address these issues can facilitate improved long-term economic performance, particularly in regions with lower growth rates. Improving the prospects of individuals with low skills is one of the most important ways to improve economic outcomes, and it is also more effective than merely increasing the share of people with very high skill levels. There is evidence that investment in skills and education can improve outcomes for individuals, regions, and nations over the longer term; and it is these policy tools that have the potential to 'shape the fundamental socioeconomic profile of Wales'. In particular, **investment in primary and secondary education is strongly associated with boosting the economic performance** of nations and regions with low productivity.

Educational institutions have a key role to play as providers of training, and as an integral part of Welsh social and cultural life. They are also major employers in many parts of Wales, and important anchor institutions with substantial buying power. **Further and higher education needs to focus on serving the future needs of the Welsh economy.** The post-16 education system (including schools, colleges, universities, and apprenticeships) is hugely important in training and upskilling. Our work has highlighted ways to foster high-quality vocational training in Wales, and in recent years, a number of reports and recommendations on the post-compulsory education system and Welsh society have been published. However, a strategic vision and plan for Wales's post-16 education system is still to be developed.

Wales needs a strategic plan to maximise universities' civic contribution which specifies the roles and responsibilities of the different kinds of institution, and aligns the structure and funding of higher education to ensure it meets the demands of the future labour market.

Evidence from other countries highlights the importance of collaboration between industry, local communities, universities and research institutes in supporting growth in deindustrialised areas and regions. This can help to ensure that investment in skills meets the needs of employers, boosts innovation, and increases the resilience of local economies.

Over the next ten years, the type of work performed in low-paid sectors will change, and there will be greater risks of job displacement and increases in insecure work. Offering people sustained learning throughout their lives is vital to allow them to keep up with change, and thrive in the workplaces of the future. We have identified **key sectors of the foundational economy where there is the potential to support training that could lead to better career progression.** This, in turn, would improve job quality, income and wellbeing; and boost overall economic performance. Improving training and career progression is also key to recruitment and retention in key sectors such as social care. It is important to communicate to employers the benefits to them of supporting in-work training, which include increased productivity, and workforce retention. There is evidence that trade unions help to foster training, particularly in organisations with workforce representatives, and that the resulting lower staff turnover benefits employers.

Infrastructure and transport



Transport infrastructure and digital connectivity are important for supporting business growth and labour productivity, as increased mobility supports knowledge sharing and diffusion. Infrastructure also connects places, and can therefore boost access to high-skilled employment opportunities. Infrastructure policies, particularly spatial and transport policies that allow people to access employment, are, by extension, an important way to address regional inequalities. Public transport efficiency is important for labour productivity in urban areas: more efficient public transport can increase the effective population of a place as more people can travel there as the congestion usually present at peak times is smoothed out.

Many of those working in key sectors of the Welsh economy, including hospitality, domestic tourism and the foundational economy sectors, **rely on good public transport networks**. There are regeneration initiatives already in place, such as the Welsh Government's Transforming Towns programme, which may help to support sectors, as well as the cities, towns and villages reliant on them.

While evidence shows that the performance and effectiveness of firms are contingent on the land and transport infrastructure around them, research is less conclusive on the exact causal relationship between the two.

In Wales, as elsewhere, well connected cities play an important role in fostering economic growth

It is, however, clear that the benefits of transport infrastructure investment include the greater catchment of available workers, lower costs of production, stimulation of inward investment, and the unlocking of previously inaccessible land. In Wales, as elsewhere, **well connected cities play an important role in fostering economic growth** through 'agglomeration economies', where economic activity is concentrated in a particular area. Projects such as the North Wales and South Wales Metro aim to generate these benefits.

The pandemic has heightened awareness of **the importance of digital technology**. It can boost economic prosperity, improve access to public services and reduce the risk of loneliness and social isolation. It is vital that the interests of those who are digitally excluded through lack of access to fast broadband, devices and/or digital skills are safeguarded.

But it is also necessary to harness the opportunities that digital technology offers to improve productivity in both the public and private sectors. In addition, the reduction in the level of commuting due to remote working contributes to decarbonising the Welsh economy.

Decisions about new developments, such as housing, hospitals and offices, are often made without considering environmental or holistic economic objectives. However, **more integrated decision-making is critical to successful economic strategies**. An example of effective integrated planning decision-making is the 2019 Wales Infrastructure Investment Plan Project Pipeline, which outlined spending on housing, transport infrastructure, digital infrastructure, business support, schools and colleges, national parks, and community facilities. Similar efforts to invest in transport in an integrated way that reflect other aims, such as cutting car use, would more effectively achieve policy objectives.

Business support

Research shows that **business performance is strongly influenced by the extent to which firms have strong networks with other companies.** Business networks in Wales are limited and do not sufficiently support networking activities, recruitment of high-skilled employees, and growth: Furthermore, networks of collaboration between industry, universities, research institutes and local communities are underdeveloped.

Economic shocks leave businesses that have less adaptability and innovative capacity in a vulnerable position.

The evidence points to a lack of dynamism and innovation acting as a more important constraint, as opposed to business type or size. Few firms in Wales have a comprehensive strategic plan for growth in place, and many have limited systems for monitoring performance. Economic shocks leave businesses that have less adaptability and innovative capacity in a vulnerable position.

It is important, therefore, to think about the objectives of any support provided to business. Some interventions are designed to help businesses survive short-term economic shocks; some aim to help a business innovate or adapt to new circumstances; and some may facilitate more effective networking and collaborative activities, to address productivity and performance issues.

While businesses in Wales need a combination of both short and long-term support, it is important to get the balance right. This often involves difficult choices about the **trade-offs between supporting existing jobs and investing in areas with strong potential for future growth.**

Investment in key infrastructure, including **implementing the recommendations of the digital innovation review**, could drive pro-business infrastructure. The Welsh Government's recently announced Digital Strategy for Wales provides a platform to make some of these recommendations happen. Other ways to support business include creating and financing innovation clusters across Wales; developing an Artificial Intelligence (AI) institute; formulating a new skills framework; and increasing funding to support areas of the foundational economy, to improve digital infrastructure and skills.

During the Coronavirus pandemic, the **Development Bank of Wales** has taken on a larger and more interventionist role in the support it has provided to businesses. This could be further extended to prioritise restructuring, and regenerating the Welsh economy, during the recovery. Increased investment in business surveys – similar to those carried out by the Federal Reserve in the United States – could provide an ongoing, and more nuanced understanding of businesses' issues and opportunities.

A new, government-backed venture fund of scale, embedded in Wales, run by experts, and encompassing a network of smart enterprise and business support, could help Welsh firms get to the next level; and encourage start-ups to be established. As entrepreneurship and innovation are key priorities for businesses in Wales, especially for small and micro firms, targeted support to understand, and apply new organisational processes, would be beneficial.

The **foundational economy** – including sectors like utilities, food, banking, transport, telecommunications, parts of retail, and public services (such as education, health and social care) – can be more resilient to economic shocks than other sectors.

But businesses in these areas often lack the networks, job quality, and innovation that underpin resilient economies, and frequently rely on part-time, casual and temporary jobs which are disproportionately held by women. The Welsh Government's funding and strategic focus, in relation to the foundational economy, has been on improving innovation and fair work; and the Institute for Welsh Affairs is carrying out a research project on how the foundational economy can be strengthened over the long term. The OECD, however, highlights the challenges that an ageing population, and a shrinking tax base, present to achieving a more prosperous foundational economy.



Procurement

Since 2018, the WCPP has been **advocating for a more strategic approach to public procurement**. The Welsh public sector spends approximately **£6 billion annually** on goods, services and works. This represents nearly one-third of total devolved expenditure, and the procurement processes underlying this spending have the potential to leverage substantial economic, social, and environmental benefits.

Evidence suggests that **Welsh businesses can be supported through procurement strategies**, and by encouraging SMEs (small and medium-sized enterprises) to compete for bids. Improved information, and extending the reach of communication about bids, can help to foster local economies.

A strategic and **sustainable approach** to public procurement, which includes delivering social, economic and environmental benefits for communities, also helps to achieve the aims of the Well-being of Future Generations (Wales) Act 2015; and could boost both SMEs, and the foundational economy.

The Welsh Government's 2018 procurement review sets out the challenges and constraints faced by the Welsh procurement profession; and the Heads of the Local Government Procurement Network have published principles to underpin a **collaborative approach to procurement**.

The forthcoming Social Partnership (Wales) Bill will require public bodies to have a procurement strategy to encourage more transparent, joined up and sustainable approaches.

Our research has shown that there is a collective will in Wales to use procurement to promote improved economic and social outcomes

The **2020 progress review** notes the challenges that need to be addressed and that these challenges will be compounded by any necessary adjustments post-Brexit.

Our research has shown that there is a collective will in Wales to use procurement to promote improved economic and social outcomes, but that public bodies need to overcome a series of practical challenges. To this end, Wales needs to develop and empower **a cadre of senior procurement professionals; raise awareness among local political leaders and finance directors of the strategic benefits of better procurement; and promote innovation and existing good practice.**

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All the WCPP research on the Welsh economy can be accessed [here](#).



About us

The Wales Centre for Public Policy helps to improve policymaking and public services by supporting Welsh Government ministers and public service leaders to access and apply rigorous independent evidence about what works. The Centre works with leading researchers and policy experts to synthesise and mobilise existing evidence and identify gaps where there is a need to generate new knowledge.

The Centre is independent of government but works closely with policymakers and practitioners at national and local level to develop fresh thinking about how to address some of the key economic, social and environmental challenges facing Wales.

The Centre's work covers a wide range of policies but is currently focused in particular on:

- Promoting equality
- Tackling loneliness and social isolation
- Children looked after
- Economy and skills
- Health and adult social care
- Effective governance and implementation

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