

Minute of the Sixth Meeting of the Council of Economic Advisers

18th – 19th January 2018

St Andrews House, Edinburgh

Attendees

- The following Council members were present:
- First Minister, Nicola Sturgeon MSP (18th only)
- Crawford Beveridge (Chair)
- Professor Sir Harry Burns
- Professor Sara Carter
- Professor Mariana Mazzucato
- Jim McColl

Also present:

- Cabinet Secretary for Finance and the Constitution, Derek Mackay MSP
- Cabinet Secretary for Economy, Jobs and Fair Work, Keith Brown MSP
- Callum McCaig, Special Adviser
- Liz Ditchburn, DG Economy, Scottish Government
- Allyson Stafford, DG Exchequer, Scottish Government
- Dr Gary Gillespie, Chief Economist, Office of the Chief Economic Adviser, Scottish Government
- Mary McAllan, Director for Economic Development, Scottish Government (19th only)
- Sam Anson, Deputy Director, Economic Policy Unit, Scottish Government (19th only)
- Andy Park, Senior Economist, Office of the Chief Economic Adviser, Scottish Government (19th only)
- Steven Ing, Economic Adviser, Office of the Chief Economic Adviser, Scottish Government
- Annabel Arbuthnot, Assistant Economist, Office of the Chief Economic Adviser, Scottish Government

Apologies

- Professor Frances Ruane
- Amanda McMillan
- Professor Anton Muscatelli
- Joseph Stiglitz

Purpose

This note provides an overview of the key points that were discussed during the sixth meeting of the Council of Economic Advisers. The meeting took place over the afternoon and morning of 18th and 19th January 2018.

Session 1: 18 January 2018

Welcome

The First Minister and Chair of the Council of Economic Advisers welcomed attendees, and outlined the programme for the meeting.

Apologies had been received from Amanda McMillan, Anton Muscatelli, Professors Jim Mirlees, Frances Ruane and Joseph Stiglitz.

Update on Developments / Previous Actions

The Chair gave an update on developments since the previous meeting in January 2017.

The Council had four conference calls during 2017, in March, June, August, and November. Members were notified of the intention to publish the minutes of these calls. In all four calls, the Council discussed various aspects of the Council's workstreams, including the development of the Enterprise and Skills Review, developments around economic data and procurement data, and progress around the various strands of work on inclusive growth.

In particular, in April the Council provided a written response to the UK's Industrial Strategy Green Paper, recommending that the UK Government consider the role of National Investment or Promotional Banks in providing patient, long-term capital. In addition, throughout the year, the Council provided advice on the analysis undertaken by Scottish Government analysts on the revenue risks, and possible mitigation actions, of an increase in the Additional Rate of income tax in Scotland from 45p to 50p; and, contributed to the development of the Inclusive Growth conference in October.

Since January 2017, the Chief Economist has also had one-to-one engagements with several Council members.

Several Council Members have also been involved in wider engagements in recent months. In November, Sara Carter joined the Enterprise and Skills Strategic Board. Anton Muscatelli, Frances Ruane and Amanda McMillan continued to contribute to the deliberations of the First Minister's Standing Council on Europe, which Professor Muscatelli chairs. In addition, Mariana Mazzucato joined the Advisory Group for the Implementation Plan of the Scottish National Investment Bank established in October.

The Chair also informed the Council that Amanda McMillan and Frances Ruane would both be standing down from their position on the Council. Amanda McMillan joined the Council in January 2015 and has provided important advice from a business perspective. Frances Ruane has been a member of the Council since its creation in 2007 and has contributed extensively to the advice the Council has provided. The Chair, joined by Council members, noted the significant contribution that both have made to the Council. The First Minister also noted her personal

appreciation of both members' substantial and helpful contributions to the work of the Council in advising both herself and ministerial colleagues.

The Chief Economist then gave an overview of the Council's workstreams since January 2017 and thanked members for their contributions throughout the year.

Update on State of the Economy

The Chief Economist gave an update on key developments in the Scottish and UK economies in recent months, as well as an outlook for the Scottish economy. Points that were raised included:

- 2018 could be a pivotal year for growth in Scotland. There are positive signs from the return to growth of the Production sector and a pick-up in confidence in the Oil and Gas sector – however economic growth remains below trend, with construction continuing to adjust downwards, towards more normal levels of output.
- There is a strong aggregate labour market with unemployment falling and employment increasing over the past year and both remaining close to their record levels. The increase in full-time employment is further evidence of a tightening labour market.
- Nominal earnings for full time employees in Scotland rose 2.4% over the year to April 2017, however higher inflation has squeezed households' spending power, with real earnings falling by 0.3%.
- Business confidence has broadly recovered from its lows in 2016. However, investment intentions remain sensitive to heightened uncertainty, with consumer sentiment also remaining weak.
- Forecasts for growth in the Scottish economy are positive but below trend growth, with projections of growth in 2017 of between 0.7% and 1.2% rising slightly in 2018 to between 0.7% and 1.4%.
- Brexit remains the key source of uncertainty to Scotland's economy. As we move towards March 2019 the extent to which positive expectations outweigh uncertainty will be crucial to driving short term output growth.

The following points were noted during the discussion on this topic:

- Members noted the close link between Scotland's production sector output and conditions in the energy market. Members noted that comparisons between Scotland's economy and economies with a similar production sector could be useful; and highlighted the importance of increasing diversification to ensure economic resilience and drive innovation. This could be both diversification across the wider economy, and the energy sector looking for opportunities to contribute to supply chains across the economy.
- Members were interested in comparing Scottish GDP against the GDP of UK regions, thereby excluding London from the comparisons.

- Members noted the decrease in the contribution of the construction sector to growth, which were due to large-scale infrastructure projects winding down, noting that the level of construction output was still relatively high.
- Members highlighted the impact of demographics and population change on the Scottish economy and were interested in this being added into future economy analysis – especially in light of uncertainties regarding Brexit.

Update on Public Finances and Fiscal Matters

The Cabinet Secretary for Finance and the Constitution provided an overview of developments in Scotland's public finances, with particular reference to the Scottish Government's Draft Budget for 2018-19.

In particular, the Cabinet Secretary noted the changes to Income Tax bands and rates noting that this makes the Scottish tax system more progressive and raises more money for Scotland. The discussion paper on income tax, which was published in November 2017 by the Scottish Government, was highlighted. The Cabinet Secretary also thanked the Council for their advice on the possible revenue risks, and mitigation strategies, associated with an increase in the Additional Rate of income tax in Scotland from 45p to 50p. The Scottish Government analysis was published in December 2017 in advance of the Draft Budget.

In addition, the Cabinet Secretary highlighted the changes to business rates in response to the Barclay Review of business rates undertaken in 2017; the lift of the public sector Pay Cap, and; an additional £400 million planned to be allocated to the NHS. The Cabinet Secretary also noted the plan for a Building Scotland Fund, funded with £150 million, as a precursor to the Scottish National Investment Bank.

The Chief Economist updated members on the Fiscal Matters workstream. A watching brief will be placed on this, with an update note provided in summer 2018.

The following points arose during the discussion on this topic:

- Members highlighted the opportunities of designing the tax structure to impact behaviour in positive ways, for example to stimulate business investment.
- Members discussed a global trend whereby the proportion of GDP accounted for by business profits has increased over recent decades. Members highlighted the importance of creating an environment that encouraged reinvestment of profits in businesses, and the spending of profits in the goods market. While recognising that both taxes are currently reserved, Members discussed the merits of using capital gains tax and/or corporation tax to promote greater levels of investment and inquired about firm level evidence of profits being reinvested in order to better inform this debate
- Members highlighted the concept of Citizens Basic Income and the Scottish Government funding towards feasibility work to Citizens Basic Income pilots. It was noted that such a scheme could have significant impact on progressivity.

- Members highlighted the importance of enabling transformative change through Government policy, alongside increases in funding to public services. This would require looking at services as a whole, and not segmenting activity.

Key Economic Challenges

The First Minister provided an update on developments around Brexit, highlighting the publication of Scotland's Place in Europe 2, which presents recent Scottish Government analysis on the impact on Scotland of the UK's withdrawal from the EU.

In particular, the First Minister highlighted that each trade scenario examined – a free trade agreement (FTA), remaining in the European Economic Area (EEA), or a 'no deal' situation, thereby reverting to World Trade Organisation terms – results in a permanent decrease in GDP relative to continued full EU membership; the least damaging scenario being to remain in the EEA.

The First Minister also highlighted that maintaining Scotland's working age population is a key concern in the context of Brexit. Scotland's natural rate of change is negative – something that inward EU migration has addressed by boosting the working age population in Scotland. It was noted that this challenge would be present without Brexit, but that Brexit could make the challenge much more acute.

Thereafter, the Chief Economist updated members on a number of key strategic economic issues facing Scotland. For context, noting that the international economic environment has strengthened in 2017 and 2018, however UK growth has weakened. In particular, he highlighted the role of uncertainty and its short-term impact on investment alongside potentially longer-term impacts if it continues through Brexit.

The Chief Economist also noted the significance of migration, especially the restrictions on inward migration that have implications for attracting skills and innovation alongside offsetting demographic changes impacting the working age population. Finally, the Chief Economist highlighted that Scotland's growth challenges and opportunities vary across economic geographies, and discussed some of the challenges that would be faced by specific geographies.

The following points arose during the discussion on this topic:

- Members discussed how trade substitution impacted the analysis. The Chief Economist confirmed that this effect is present implicitly within the internal dynamics of the model used for this analysis, as trade dependant on cost in prices and other markets develop as well.
- Members raised the evidence showing the impact of Adverse Childhood Experiences (ACE's) as significantly detrimental to maintaining an active working life up to the age of 65. Tackling inequality is important for this issue, as evidence shows that inequality is related to poor health outcomes, and results in people being excluded from contributing to the economy.
- Members noted that a national investment bank could support the economy by supporting Scottish companies to be more competitive on the EU stage.

This could facilitate these companies to invest money and opportunities in local communities.

- Members highlighted that import substitution could be possible in some key sectors, including the food and drink sector. But, noted the challenge of changing the structure of the supply chain and the current benefits of lower-cost imports lowering household bills.

Overview of Issues for Consideration on 19th January

The Chair invited an overview of the main topics of consideration in Friday's session. The Chief Economist provided members with a short overview of the Inclusive Growth update. Cabinet Secretary for Economy, Jobs and Fair Work provided a short overview of the Enterprise and Skills Review. In addition, the Director General for Economy, Scottish Government, provided an overview of the on-going work into the development of the Scottish National Investment Bank.

Session 2: 19 January 2018

Update on Inclusive Growth Workstreams

The Chief Economist provided an update on progress made across inclusive growth workstreams, focussing on two opportunities to engage with stakeholders on the subject.

The international conference held by the Scottish Government in October received highly positive feedback from speakers and delegates alike. In particular, it was noted that the conference was a success in bringing together many influencers in the field of Inclusive Growth, thus providing a forum for knowledge sharing and building collaborations. Scottish Government officials have continued discussions started at the conference with international organisations and countries. The conference also facilitated a session to discuss the development of the Wellbeing Economies Alliance. Following on from this, the Slovenian Government agreed to host a follow-up summit of the Alliance in March 2018.

Additionally, it was noted that in November 2017 the Cabinet Secretary for Economy, Jobs and Fair Work announced the creation of a Centre for Regional Inclusive Growth. The Centre will be a partnership between Scottish Government and others who have expertise and interest in regional economic development. It will provide a platform for disseminating analysis on inclusive growth at a local and regional level; sharing best practice; and developing ways to support the use of local and regional data and evidence to inform inclusive growth policies.

Professor Sir Harry Burns then led the Council discussion of inclusive growth, noting the importance of equipping people to join the labour market. This could not be delivered by top down approaches alone, but would require government to join up activity – often at a very local level, reflecting local conditions and targeting interventions.

The following points arose during the discussion on this topic:

- Members were supportive of the action the government is already taking to support inclusive growth, such as investment in childcare, but it was agreed that there is more to be done. Members recommended ensuring a joined up approach, across policy activity, to ensure effectiveness.
- Members noted the benefit of drawing together both international organisations and local Scottish stakeholders at the conference, to allow for a shared perspective on inclusive growth.
- Members noted that the Government is at the critical and more difficult stage of moving toward implementing inclusive growth policies more systematically.
- Members noted the increased international interest in an alternative to GDP.
- Members highlighted the importance of equipping people with the skills to enter, and have resilience in, the jobs market. Members highlighted the importance of taking a bottom-up approach, noting that top-down interventions can be beneficial in creating valuable jobs but should be used alongside approaches that equip people to join the labour market.

- Members discussed that at an individual level, the key to alleviating poverty is often removing the acute stresses that might stop individuals from seeking support or taking advantage of the opportunities created through inclusive growth.
- Members highlighted the difficulty of exclusion in modern economies. Members reflected that it is particularly important for policy to acknowledge intergenerational differences. For example, in the education sector there is a generation of digital natives who will go on to enter the labour market shortly. The skills required for their careers will likely be very different than the skills that previous generations needed, and bringing their skills and perspective into the labour market might change the shape of the economy.
- Members highlighted the importance of implementing change from an early age, and the importance of teaching life skills - for example, confidence in self-worth, feeling loved and cared for - as these build a foundation for children to take on the learning of other skills.
- Members highlighted the importance of evaluation of government initiatives and ensuring these are an efficient use of public spending. It was pointed out that lessons should be learned and rolled out more widely where government initiatives were successful.
- Members highlighted the opportunity to link inclusive growth to innovation led growth. The view that wealth is just in big industries is damaging to moving towards inclusive growth, so the view that society as a whole can share in redistribution, should be encouraged.
- Members suggested that the Centre for Regional Inclusive Growth could provide a platform for including the social aspects of inclusive growth.
- Members noted that there will be businesses which are fulfilling a number of the Business Pledge criteria but not be signed up to the Pledge, but adding value to the business contribution to community based economic activity. Members highlighted the role model effect of businesses signing up to the Pledge and encouraged Government to recruit more high profile businesses to sign up to the Pledge.

Update on the Enterprise & Skills Review

The Cabinet Secretary for Economy, Jobs, and Fair Work gave an update on the progress made following the recommendations emerging from the Enterprise and Skills Review. The Review Phase 2 reported in June 2017, following which a Strategic Board was created, to align and co-ordinate the activities of the enterprise and skills agencies. The board is chaired by Nora Senior, and includes a wide range of representatives with a majority of members from the business community. An analytical unit will also be established to ensure decision making is grounded on robust analysis. The Review also led to the announcement of a new enterprise agency for the South of Scotland.

Professor Sara Carter, who sits on the Strategic Board, led the Council in the discussion. Emphasising that there is a focus on joint-working, and to develop and understand a common goal – but also to identify challenges. So where there is a tension between economic growth and inclusion it is important to acknowledge this. One of the roles of the strategic board will be to enable solutions to these challenges. Discussion so far has covered the general approach of the board;

including the use of data analysis, the focus on ethos and community, and the importance of collaboration. The Board believes that having a clear plan of action and evaluating actions against that plan will be essential to success. Discussion has also taken place on evaluating successes – and whether this should include the use of social criteria, in addition to economic criteria.

The following points arose during the discussion on this topic:

- Members were in agreement that the data analytics were important to guide policy solutions, and were interested in how the agencies would draw this data together.
- Members highlighted the importance of data sharing to inform interventions, including working with other governments to have access to the best data.
- Members also highlighted the value of utilising big data for decision making.

Developments on the Scottish National Investment Bank

Andy Park, from the Office of the Chief Economist, presented to Council members the progress in developing the Scottish National Investment Bank. This will be a new, mission-led institution that will actively create and shape markets through the provision of patient finance. The bank will intervene in a variety of areas, from supporting early stage and small firms get access to investment, through to financing infrastructure and larger scale innovative projects. It will address cross-sectoral challenges by ensuring that the firms who are instrumental in addressing these challenges have the investment they need. The Bank will also support activity aligned to Scotland's economic objectives - making strategic investments and nurturing new industrial landscapes.

In addition, it was noted that the bank will be a new institutional player and therefore it will take time to build to a comparative scale of resource of other established national investment banks. A disciplined and supportive approach to capitalisation will be required for the bank to be a success; the benefits that could be realised by the bank are substantial.

Professor Mariana Mazzucato, who sits on the Implementation Plan Advisory Group, led the Council in the discussion. This included providing an overview of research that investigated the international evidence on national investment banks. It was found that the finance provided should be both patient and strategic. An investment bank has the potential to be catalytic in stimulating cross-sectoral activity to address missions framed around challenges. In particular, solutions should be sought that respond to country-wide challenges, and can impact across industries. A key aspect would be linking the offer of finance with a commitment from companies to innovate, therefore ensuring the Bank supports transformative change. And allowing companies to compete through innovation.

The following points arose during the discussion on this topic:

- Members supported the plan to address cross-sectoral challenges, and advised having a set of missions that are framed around these challenges (or problems).

- Members highlighted that the potential alignment with current EU policies should be investigated.
- Members highlighted the importance of clarity on the source of capital, and therefore where the return on equity will go. For example, if this was going to the government then it could be used to fund public services.
- Members advised that the development of the SNIB needs to be considered in the context of the wider eco-system of financial institutions and advised compiling evidence to the potential impact of a national investment bank on that eco-system.

Summing Up / Any Other Business

The Chair informed the group that Council members would be asked for availability in summer 2018, with the intention to hold the next formal meeting.