Council of Economic Advisers meeting: 5 and 6 March 2020

Attendees and apologies:

The following Council Members were present:

The First Minister, Nicola Sturgeon MSP (Thursday)
Crawford Beveridge (Chair)
Professor Sir Harry Burns
Professor Sara Carter
Craig Clark
Professor Anton Muscatelli
Julia Unwin
Martine Durand
Professor Brynhildur Davíðsdóttir

Also Present:
Cabinet Secretary for the Economy, Fair Work, and Culture, Fiona Hyslop MSP
Minister of Trade, Investment, and Innovation, Ivan McKee MSP (Thursday)
Willie Watt, Chairman, Scottish National Investment Bank (Thursday)
Liz Ditchburn, DG Economy, Scottish Government
Dr Gary Gillespie, Chief Economist, Directorate for Chief Economist, Scottish Government
Kersti Berge, Director Energy and Climate Change, Scottish Government
Cornilius Chikwama, Deputy Director, Office of the Chief Economic Adviser Economic Strategy, Scottish Government
Kathy Johnston, Deputy Director, Office of the Chief Economic Adviser Economic Analysis, Scottish Government (Friday)
Sasha Maguire, Senior Economic Adviser, OCEAEA, Scottish Government (Thursday)
Joanne Briggs, Senior Economic Adviser, OCEAES, Scottish Government
Stefan Hoyte, Economic Adviser, OCEAES, Scottish Government (Thursday)
Alison Lang, Assistant Economist, OCEAES, Scottish Government
Juan Pedro Castro, Assistant Economist, OCEAES, Scottish Government

Apologies:
Professor Joseph Stiglitz
Professor Mariana Mazzucato
Jim McColl

Welcome and Introduction

The Chair of the CEA welcomed attendees and thanked them for travelling to Edinburgh.

The Chair noted the appointment of two new Council members – Martine Durand and Brynhildur Davíðsdóttir and welcomed them to the meeting. Martine Durand has had a distinguished career in the OECD, most recently as Chief Statistician and Director of their Statistics and Data Directorate. Brynhildur is the Vice Chair of the Icelandic

Climate Commission and Director of the University of Iceland Arctic Initiative where she also holds a professorship.

The Chair also welcomed the First Minister and announced that the Council would soon also be joined by the Cabinet Secretary for Economy, Fair Work, and Culture and the Minister of Trade, Investment, and Innovation.

Update from the First Minister

The First Minister provided an update on the Scottish Budget 2020-2021 reflecting on its key elements and their relation to the Scottish Government's approach to the economy.

She reiterated the Chair's welcome message and thanked members for being their support and commitment to the Council. The First Minister had to leave for parliament after her update and resulting discussion.

The first element highlighted by the First Minister was Inclusive Growth. The budget includes a number of measures to tackle poverty and barriers to labour markets, like the new Child Payment. It also includes more resources allocated to infrastructure investment, and innovation support measures. This would also be the first budget contributing to the capitalisation of the Scottish National Investment Bank. All these measures reflect and help realise the Scottish Government's vision for the economy.

The second element was Climate Change. The First Minister reflected on the world-leading emissions targets the Scottish Government had set, and the challenges of meeting them. The budget reflects the increasing efforts in this direction, through support to energy efficiency and decarbonising public transport. The First Minister pointed towards the great challenges in decarbonising heat and agriculture, but also the great opportunities arising from transitioning to net-zero Scotland would have to grasp.

The third element was Brexit. It was emphasized that the Scottish Government was continuously working to protect the economy from inevitable damage of Brexit. Given the UK has now left the EU, the focus has now shifted to the details of the future relationship with the EU, and the First Minister shared her disappointment at the approach taken by the UK Government in this regard.

It was noted that the Scottish Budget was prepared and discussed before the spread of coronavirus, which threatens growing into a pandemic. Coronavirus, and the measures introduced to mitigate its spread, would have a significant impact on the economy. The potential effect could be of the scale of the 2008 depression. Moreover, the impact could affect disproportionately most vulnerable groups – elderly, precarious workers, low-income families, etc. This raises critical ethical questions. A wellbeing approach would help navigate these issues and different economic, health, and social impacts.

The First Minister concluded that against this backdrop, the advice of the Council would be crucial over the coming months.

The following points arose during the discussion on this topic:

- Members noted the importance of understanding the potential economic impact of the virus. The Chief Economist shared details of ongoing work to models scenarios, as well as understanding the channels and nature of the economic impacts.

- Members noted the importance of protecting vulnerable groups, like self-employed, in precarious employment, such as zero hours contracts, those with caring responsibilities, and benefits claimants, and ensuring measures would work for them.

- Members highlighted the importance of the timing of measures. This would be critical to spread the impact on the NHS, with limited ICU beds, and, on the economic side, to achieve a strong V-shaped recovery.

- Members praised the efforts to coordinate actions with the UK Government, and to influence the UK policy and fiscal response.

- Members noted the importance of transparent and clear communication. The government should provide key information, while avoiding the spread of panic, and it has a responsibility to provide advice and guidance to business.

Theme and Agenda Overview

The Chief Economist presented the theme of the meeting: Dealing with the multiple transitions impacting our economy and the need to enhance and protect our economic, social, and environmental wellbeing. This new approach aims to make the meeting more strategic and focused. With all papers and discussions for the two days linking to the wellbeing approach to deal with diverse challenges and transitions.

The Chair of the CEA provided an overview of the agenda for the day.

Update on State of the Economy and Brexit Analysis

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:

Part 1: Brexit – Recent effects on the economy

The UK is now an external country to the EU and has entered the transition period. Despite this, there have yet not been any material changes to market access, freedom of movement, etc. The effects of Brexit have so far manifested through increased uncertainty, affecting business confidence and investment, and tightening labour markets.

Business investment has slowed down through the transition period, affecting capital accumulation. Moreover, uncertainty has made investment more volatile and led to period of stockpiling. Brexit has also had a negative effect on business and consumer confidence.

And yet, this has not translated into a decrease in retail sales. Consumers have continued to spend, probably supported by higher levels of employment. Unemployment is at historically low levels. This may be because businesses have invested more in labour relative to capital, given its lower risk. Tighter labour markets also reflect industry-specific skills shortage, which has been affected by changing flow of skills coming to Scotland as a result from Brexit.

The following points arose during the discussion on this topic:

- Members noted the importance of looking beyond aggregates to understand if the jobs created were high or low quality. The Chief Economist noted that increases were divided over full- and part-time, but that percentage of zero-hour contracts was lower than in the rest of the UK. The share of employees earning above the living wage is also high.

- The Cabinet Secretary for Economy, Fair Work, and Culture noted that the impact of Brexit in EU migration is already being noted. This lack of access to immigration will have a strong effect on the economy and labour markets.

Part 2: Future challenges

The Chief Economist noted that the trend of GDP growth has been weak through the post-crisis period. Productivity tells a more positive story, with Scotland growth consistently outpacing the UK and approaching the OECD average. This situation is threatened by a number of challenges.

The future trade relationship with the EU will likely be more protective than originally though, with a particularly negative effect on some sectors. This comes as geopolitical tensions and anti-globalisation feelings increase across the globe, reflected through the US-China trade war.

Another external factor affecting the economy is climate change, and the changes arising from Scotland’s efforts to reach net-zero emissions by 2045.

More recently, coronavirus presents a big threat to the economy. Analysis carried out by the Office of the Chief Economic Adviser investigates the different channels through which the Covid-19 pandemic will impact the economy. These can be categorised under potential domestic impacts, from the outbreak in Scotland; global impacts, economic effects from the outbreak elsewhere; and impacts arising from the contingency measures introduced, e.g. quarantines, travel restrictions, and closure of events.

The following points arose during the discussion on this topic:

- Members noted the importance of measures to limit loss of capacity through the coronavirus crisis. Since this will influence the speed of recovery. Lessons were drawn from the experience through the Eurozone crisis.

- Members raised the need to differentiate between external trends that the Scottish Government needs to react to – technological change, demographics, EU exit – and transitions that the Scottish Government is actively trying carry through – net zero and reducing inequality.

Inward Investment Plan

The Minister for Trade, Investment, and Innovation presented to the Council work on a new Inward Investment Plan.

The Plan aims to attract investment into Scotland that results in wide socio-economic benefits. This is done through a targeted approach and a focus on Scotland's values and strengths. Analysis shows that although Inward Investment makes a significant contribution to the economy, its contribution to Research and Development, wages, and productivity in the wider economy is lower than in other UK regions. The Plan sets out measures to close this gap.

The following points arose during the discussion on this topic:

- Members noted the importance of recruitment possibilities and the skills challenge to attract businesses. Members raised the importance to coordinate the Inward Investment Strategy with education plans. This is relevant not only for higher education, but from school.

- Members noted the importance of EU students for this. The Cabinet Secretary for Economy, Fair Work, and Culture mentioned the ongoing actions under the 'Stay in Scotland' campaign to ensure more students stay in Scotland and contribute to the economy.

- Members agreed on the strength of Scotland, as a country with high quality of life, to attract businesses and investment.

Update on the Scottish National Investment Bank

Willie Watt, recently appointed Chair of the Scottish National Investment Bank, provided an update on the Bank's preparatory activities and strategic approach.

Willie argued that the Scottish context provided significant potential for a national investment bank. First, Scotland is a coherent social, economic, and political unit so it makes sense for financial institutions to follow that coherence. Second, Scotland counts with a high level of connectedness - between business, academia, and government- which maximises the potential of such an institution.

Willie informed the Council that The Scottish National Investment Bank Bill received royal assent on 25 February, having passed through the Scottish Parliament with cross-party support. The Bank was currently processing the state-aid application. The staff is developing the work the work on the banks' mission, following the initial advice from Mariana Mazzucato. The Net-Zero carbon target for 2045 has been agreed as the prime mission. The Bank was currently going through the process of recruiting key staff members like the Chief Executive Officer.

In this process, the Bank is drawing from the experience of similar institutions. Namely, the Dutch development Bank, which is one year ahead in the process; and the experience of the UK Green Bank.

Willie highlighted a number of challenges that they are currently facing. It is being discussed how much the Bank should focus on the missions, whether it should do any investment outside of them, and how to spread resources between them. Another question is how to translate the into an investment strategy, covering areas of investment and tools. He also highlighted the need to manage expectations, pointing at the small size of the bank relative to the scale of the problem. This links to the challenge of communicating with stakeholders, government and wider finance community, to maximise mobilisation.

The following points arose during the discussion on this topic:

- Members noted the potential for the bank to support local initiatives and social enterprises, particularly in left-behind areas.

- Members supported the bank's plan to utilise a wide variety of financial instruments at its disposal. Ranging from long-term equity to short-term guarantees, a varied toolkit to best support the bank's missions.

- Members noted the obstacles to creating a multidimensional impact measuring framework to guide the bank's decisions in alignment to the multiple missions. The bank is currently working on a tool that will allow this in alignment to the National Performance Framework.

- Members noted the importance from the bank to collaborate with other financial actors to maximise its leverage and impact, as well as the need to be careful not to obstruct areas that are currently performing optimally.

Net-Zero Challenges for Scotland

Sasha Maguire, Head of Climate Change and Energy Modelling at the Office of the Chief Economic Adviser, provided members with an overview of Scotland's climate change challenge and plans, and of the analytical work supporting policy.

Scotland's greenhouse gas emission have halved since 1990 and currently accrue to 40 megatons of CO2 equivalent. This downward trend has been driven by the decarbonisation of electricity sector.

Sector based analysis shows that currently the biggest contributors to emissions are transport, buildings, and agriculture. Electricity was also a significant contributor, but a strong shift to renewable energy has significantly reduced the emissions contribution from the sector.

Scotland has legislated to reach net-zero by 2045, following advice from the Committee on Climate Change. The government has committed to update a climate change plan every five years, including one to be published later in the year to reflect the new targets.

TIMES, a Whole System Energy Model, is being used to guide the division of efforts in emissions reduction across different sectors and the policy direction. The model provides pathways, for technological or other changes, to meet pre-established envelopes, sectoral carbon budgets.

Analysis suggest targets are at the limit of what is technically feasible. They will require significant changes to land-use and result in a transformation of Scotland's landscape. As well as a rapid transformation in transport and industry, including the development of hydrogen fuels, low-carbon heat, and carbon capture and storage technology. At the same time, these changes come with implications and challenges for costs and competitiveness.

Brynhildur Davíðsdóttir was asked to provide some thoughts and to bring in an Icelandic perspective. The following points were raised:

- Brynhildur noted the ambition of the Scottish targets and the numerous policy challenges they raise. She also raised concerns around the scientific uncertainty as to how much carbon peatland restoration captures.

- Iceland has set a target to be net-zero by 2040. There is a strong focus on land and the industrial sector, where 40% of emissions come from. They are developing an innovative form of Carbon Capture and Storage that will reduce emission from aluminium production. They are also taking actions to increase the pace of change towards electrified transport

The following points arose during the discussion on this topic:

- Members noted the importance to align emission target to a performance framework to ensure alignment between climate change action and broader societal challenges. This was linked to the Just Transition approach the Scottish Government is committed to.

- Members raised and discussed the challenge of carbon leakage. This was linked to the importance of expanding carbon accounting, looking beyond just direct territorial emissions, and also at carbon-footprint and extraction.

- Members praised Scotland's progress in decarbonising electricity and noted the challenges of decarbonising transport, heating, and industry, which more directly affect people' everyday activities.

- Members noted the importance of consulting the general public throughout the transition, to ensure buy-in, and to adapt policies to different needs: across regions, across the rural-urban spectrum, etc. Members agreed that integrating environmental and social consideration was crucial to this.

DAY 2

Update on the Wellbeing Economy Governments (WEGo)

The Chief Economist provided the Council with an update on the Wellbeing Economy Governments group and the wellbeing agenda within the Scottish Government.

The Wellbeing Economy agenda has developed from the Inclusive Growth work, which is embedded in Scotland's Economic Strategy, and the National Performance Framework (NPF). The 2018 NPF update explicitly defines Scotland's purpose to increase wellbeing through sustainable and inclusive economic growth.

Inclusive Growth and Wellbeing Economy are place-based policy approaches. They aim to understand whole-system interactions, looking at constraints faced by different groups and places. They are also whole-of-society efforts that encourage business-led initiatives and a thriving civil society.

The Wellbeing Economy Governments (WEGo) is an international platform that fosters collaboration and mutual learning around Wellbeing Economy policies. The OECD has been supportive of the group and hosted its launch in their 2018 World Forum. Membership, which currently consists of New Zealand, Scotland, and Iceland, is expected to increase over the present year.

The group held their first Policy Labs in May 2019, just before the last Council of Economic Advisers meeting. Lessons from the Wellbeing Budgeting session, helped shape the 2020-21 spending priorities, which draws its prioritisation methodology from New Zealand's Wellbeing Budget.

Future plans include hosting another series of Policy Labs, organising a side event around COP26, and the inclusion of new members.

Martine Durand was asked to provide some reflections and to bring in her perspective from her position in the OECD. The following points were raised:

- Martine Durand celebrated the significant efforts in developing 'beyond-GDP' metrics across the globe but noted that the next crucial step was how to translate this into policy. She also noted the need for dashboards to be concise and targeted, policy-oriented, prioritising a few areas for improvement. Dashboards with too many indicators, like the UN-SDGs, make policy development difficult.

- Martine noted the need to develop methodological tools, beyond regular CBA and impact assessments, that will guide policy assessment and evaluation. This currently being researched, and developed, but more work needs to be done.

- In this context, the work of WEGo is really important and pushing in the right direction.

The following points arose during the discussion on this topic:

- Members noted the importance of cross-departmental support and collaboration to a wellbeing approach. Martine pointed at New Zealand's approach as a way of promoting this.

- Members noted that there is increasing evidence to support the idea that sustained growth requires societal wellbeing.

- Members noted Scottish Government work around promoting fair work through procurement rules and community wealth building, and supported the use of all tools available to public bodies to support Inclusive Growth and Wellbeing.

Higher Education Institutions and Scotland's Economy

Anton Muscatelli provided the Council with a summary of his recently published report on the economic role of the higher education sector in Scotland.

The report limited its scope to the link between university research and private business. It offered 22 recommendations covering three areas.

First, competitiveness needs to be a national mission. It should not be understood as isolated issues, or isolated agencies or universities, but a genuine national effort. This would require more collaboration across universities, and coordination of activities between Scottish Government, universities, innovation agencies, and the Scottish Funding Council.

Second, the report emphasizes the need to identify clear priorities. A hierarchy of priorities is required to ensure key strategic programmes receive enough funding. This links to the scattered innovation environment and the high number of agencies that are discussed in the next session.

Third, the report offers a set of recommendations to improve the research and development environment. The Scottish Government needs to utilise all tools at its disposal, encouraging R&D spending, and linking up through different policies. For example, the Inward Investment strategy discussed earlier offers an opportunity to integrate innovation promoting policies.

The report also calls for a better understanding of the socio-economic benefits of investment in higher education, through its time horizon.

The following points arose during the discussion on this topic:

- Members noted the importance of coordination at the Scottish level, and the need to ensure place-based initiatives do not obstruct each other.

- Members noted the significant socioeconomic benefits that derive from universities and the potential for these to be better framed, emphasizing the long-term contribution to productivity.

Evaluation of Effectiveness of Measures to Support Innovation

The Chief Economist provided the Council with an update on their analysis of the effectiveness of measures to support innovation.

The Enterprise and Skills Strategic Board aims to drive alignment between public agencies in the area. Analysis shows there are 90 different programmes for innovation support, resulting in a clustered environment. Thus, the Strategic Board is encouraging agencies to look at how they work together.

Analysts are currently looking at new data sets to understand the impact of these programmes.

Sara Carter, who is also a member of the Enterprise and Skills Strategic Board, noted that there had been progress in collaboration on strategic investment and coordination of plans, particularly at the chief executive level, but that there is still work to be done.

Balancing the transitions – Economic, Social, and Environmental

The Chief Economist provided members with an overview of the theme of the session before opening the discussion.

Scotland is facing a number of trends and transitions that could potentially affect its citizens' economic, social, and environmental wellbeing. These are very varied and range from automation and rising inequalities, to the climate crisis. To ensure the sustainability of wellbeing these different transitions need to be balanced and dealt with conjointly.

Thorough analysis is required to understand the need for change and to expose the potential tensions between different objectives. In resolving these tensions, the Scottish Government is guided by the idea of a Just Transition which ensures shared prosperity across people and place. A Wellbeing Economy lens is useful in understanding how all the different pieces fit together.

Systemic change to achieve a Wellbeing Economy will require getting broader society involved, and using all policy tools available.

The following points arose during the discussion on this topic:

- Members emphasized the importance of engaging the public and communities in the process, through public consultations and citizen assemblies. They noted the work underway in Scotland through the Citizen's Assembly, which has discussed Wellbeing Economy issues, and the Climate Change-specific assembly that is being set up. Care needs to be given to ensure the consultations are representative of the population at large.

- Members noted the need to integrate mitigation and adaptation plans and policies. The effect climate change is already having on communities, across the world, and also in Scotland was discussed, including the socio-economic distribution of these impacts.

- Members raised the need to apply a place-lens to climate change plans. While the problem is global, both emissions and effects have a strong place-based character. Changes to industry, housing, or jobs will mean different things across Scotland.

- At the same time, members noted the need to for strategic coordination of local/regional plans at the national level. This is necessary to ensure the sum of local actions meets the national targets.

- Members noted the potential to learn from local initiatives across Scotland, drawing lessons on what works, and replicating useful tools

- Members noted the importance of developing fair instruments that would look at distribution of effects across dimensions of wellbeing. A first step is the development of a multidimensional performance framework, like the National Performance Framework.

- Members noted the need to invest in the necessary skills to carry through the transition, as well as core skills, like problem solving, that will help address uncertain future challenges. This has not only a positive economic effect, but also a human dimension, as education helps individual wellbeing and resilience.

Income Tax Analysis

The Chief Economist informed Council members that income tax research, which had been presented to the Council previously, had moved on from understanding behavioural analysis of top-earners to understanding the drivers of income tax receipts more generally.

The Deputy Director of Economic Analysis at the Office of the Chief Economist provided Council members with the new findings. The paper attempts to disentangle the structural and cyclical components from differences in earnings growth. Evidence suggests that over the long-term, earnings growth in Scotland and the rest of the UK appears to follow a similar path, although it does divergence at some points caused by asymmetric shocks like oil price changes or the financial crisis. However, some structural factors, like different income distribution and the effects of sustained relative earning changes to income levels, will require further exploration.

The following points arose during the discussion on this topic:

- Members praised the quality and usefulness of the analysis.

- Members noted the importance of having a deep understanding of Income Tax drivers to inform future Fiscal Framework reviews.

Close of Meeting

The Chair of the CEA reminded members that the next meeting was scheduled for the 29th and 30th October 2020, and that Council members would be asked for availability for the following meeting in 2021.

The Chief Economist suggested holding a conference call in May to agree on themes for the October meeting.

The Director General Economy thanked Council members for the valuable support and advice to the Scottish Government. Their advice has been crucial over the last years, driving key policies like the Scottish National Investment Bank.

Attendees and apologies:

The following Council Members were present:

The First Minister, Nicola Sturgeon MSP (Thursday)
Crawford Beveridge (Chair)
Professor Sir Harry Burns
Professor Sara Carter
Craig Clark
Professor Anton Muscatelli
Julia Unwin
Martine Durand
Professor Brynhildur Davíðsdóttir

Also Present:
Cabinet Secretary for the Economy, Fair Work, and Culture, Fiona Hyslop MSP
Minister of Trade, Investment, and Innovation, Ivan McKee MSP (Thursday)
Willie Watt, Chairman, Scottish National Investment Bank (Thursday)
Liz Ditchburn, DG Economy, Scottish Government
Dr Gary Gillespie, Chief Economist, Directorate for Chief Economist, Scottish Government
Kersti Berge, Director Energy and Climate Change, Scottish Government
Cornilius Chikwama, Deputy Director, Office of the Chief Economic Adviser Economic Strategy, Scottish Government
Kathy Johnston, Deputy Director, Office of the Chief Economic Adviser Economic Analysis, Scottish Government (Friday)
Sasha Maguire, Senior Economic Adviser, OCEAEA, Scottish Government (Thursday)
Joanne Briggs, Senior Economic Adviser, OCEAES, Scottish Government
Stefan Hoyte, Economic Adviser, OCEAES, Scottish Government (Thursday)
Alison Lang, Assistant Economist, OCEAES, Scottish Government
Juan Pedro Castro, Assistant Economist, OCEAES, Scottish Government

Apologies:
Professor Joseph Stiglitz
Professor Mariana Mazzucato
Jim McColl