

Minutes of the Sixth Meeting of the Council of Economic Advisers

Bute House, Edinburgh, 12th November 2014

The following Members of the Council were present:

First Minister Alex Salmond MSP
Crawford Beveridge (Chair)
Dr Kirsty Duncan
Professor Andrew Hughes Hallett
Jim McColl
Professor Sir James Mirrlees
Lady Susan Rice
Professor Louise Richardson
Professor Frances Ruane

Also present:

Dr Gary Gillespie, Chief Economist, Scottish Government
Dr Graeme Roy, Deputy Director, Office of the Chief Economic Adviser, Scottish Government
Mia Ayres, Deputy Private Secretary to the First Minister, Scottish Government
Kevin Brady, Economic Adviser, Office of the Chief Economic Adviser, Scottish Government

Present during the Economic Opportunities for Women item:

Dave Signorini, Head of Communities Analytical Services, Scottish Government
Rona Sweeney, Deputy Director for Employability and Skills, Scottish Government

Purpose

This note provides an overview of the key points arising during the sixth meeting of the Council of Economic Advisers. The Meeting was focussed on Recovery and Jobs, and Economic Levers, with the latter session including items on Enhancing Economic Opportunities for Women in the Scottish Economy, and the Smith Commission.

Welcome

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

Before the business of the meeting began, the First Minister thanked all current and previous Members for the contributions they had made over a number of years as Council Members.

Apologies had been received from Professor Stiglitz, who was unable to attend the meeting.

The Chair of the Council and the Chief Economist highlighted the main developments since the meeting of 7th March:

- The second Annual Chair's Report had been published in May 2014. This provided a summary of the Council's work over the previous year, and the Chair thanked Members for their input into the Report prior to its publication.
- The Chair and Jim McColl attended the Commonwealth Games Business Conference in July 2014.
- The Chief Economist had met with Professor Stiglitz in New York in May 2014, and subsequently in Edinburgh in August 2014.

Although it was entirely separate to their membership of the Council, it was noted that Lady Susan Rice and Professor Hughes Hallett had been appointed to the Scottish Fiscal Commission, with Lady Rice being appointed as Chair. The SFC came into operation on a non-statutory basis during summer 2014 to scrutinise tax revenue forecasts underpinning the 2015-16 Draft Budget, and published its first report on 9 October 2014.

Session 1: Recovery and Jobs

Update on Developments in the Scottish Economy

The Chief Economist provided an update on recent economic developments. Points discussed during this update included:

- The global economic recovery remained strong, but growth and recovery were unevenly spread, with the UK and USA growing more strongly than the Eurozone.
- The Scottish economy had grown continuously for two years, with employment levels and GDP having passed their pre-recession peaks. However, employment rates and the full time share of employment were yet to recover to pre-recession peaks, while real wages remain significantly below pre-recession levels.
- A number of areas of opportunity were noted. Domestic demand remained solid, while the Scottish labour market continued to strengthen, particularly with regard to female employment and youth employment. Both household and business confidence was continuing to improve, and business surveys and independent forecasts indicated a positive outlook for the remainder of 2014 and into 2015.
- Several areas of uncertainty were highlighted. It was noted that there were mixed conditions in Scotland's main export markets, with the strong growth in the US economy sitting alongside difficult conditions in Eurozone economies. Productivity growth continued to disappoint, while there continued to be slow growth in real wages. Further potential headwinds from the impact of quantitative easing being unwound and diverging monetary policy in the US, UK, Europe, and Japan were noted, as was the on-going growth impact of fiscal consolidation in the UK.

Session 2: Economic Levers

Enhancing Economic Opportunities for Women in the Scottish Economy

The Council were joined by Dave Signorini, Head of Communities Analytical Services, and Rona Sweeney, Deputy Director for Employability and Skills, who provided an overview of issues related to economic opportunities for women in Scotland.

It was recognised that Scotland's female employment rate is above the UK overall and many other European countries. However, Scotland's female employment rate lags behind that of several countries (including Scandinavian countries), and is markedly below Scotland's male employment rate. It was also noted that, despite performing better than men academically, women are more likely to be in lower skilled, lower paid work than men, and are more likely to be in part-time employment. It was also highlighted that female entrepreneurship rates are lower than male rates.

Several barriers to economic opportunities were identified. These include: childcare (with childcare in the UK being the most expensive in the OECD); parental leave (which is focused on mothers, poorly remunerated, and poorly linked to public childcare provision); and limited use of 'employee-focused' flexible working. These reduce the gains to work for women and mitigate against labour market attachment. The persistent gender pay gap was identified as both a consequence and a driver of this situation.

The Council noted that the Scottish Government are undertaking a wide range of policy interventions in this area. These include: expanding childcare provision; implementing the recommendations of the Commission for Developing Scotland's Young Workforce; implementing the Women in Enterprise Action Framework; and supporting CareerWise, to encourage girls and young women to consider careers in Science, Technology, Engineering and Maths (STEM).

The Council also noted that powers to address several of the structural barriers to economic opportunity are currently the responsibility of the UK Government, including around employment law, equalities legislation, welfare and taxation. These were recognised as significant levers, which can influence areas like incentives and financial returns for second earners, and requirements for female representation on boards. This suggested that, although the Scottish Government would not have the levers to directly influence private sector behaviour in these areas, it could play an important leadership role through its practice in flexible working, equal pay, and public appointments.

The Council highlighted the importance of continued efforts to expand childcare provision, particularly given the cost differentials between the UK and other countries. STEM was recognised as a particular area of importance, particularly with regard to retention rates of women within these areas, and a continued focus on this area was strongly encouraged.

Trends in the gender pay gap were considered. It was noted that the pay gap has narrowed since the economic crisis, despite recent increases in female labour supply. However, it was unclear as to the extent to which this was a temporary phenomenon, attributable to restrained wage growth in the private sector, or a

permanent change. Expansion of the Living Wage among low paid occupations was identified as an area that may mitigate against increases in the gender pay gap, and identified as an area where the Scottish Government could provide leadership to employers.

The Smith Commission

The Council discussed a range of issues related to further devolution of powers to the Scottish Parliament, in light of the work of the Smith Commission. In their discussion, the Council considered and reflected on the principles that should inform further devolution of powers. The Council also commented on several issues that had been raised in the context of the debate on the Smith Commission.

As Chair of the Scottish Fiscal Commission, Lady Susan Rice participated in the discussion on the devolution proposals in an observer capacity only. Both Lady Rice and Professor Andrew Hughes Hallett did not participate in the discussion on the potential role an independent Fiscal Commission may have under further powers.

Council Members were content for their thoughts to be shared with the Smith Commission Secretariat in order to help inform their work. This has been published separately.

Minutes of the First Meeting of the Council of Economic Advisers

Bute House, Edinburgh, 3rd March 2015

The following Members of the Council were present:

First Minister Nicola Sturgeon MSP
Crawford Beveridge (Chair)
Sir Harry Burns
Professor Sara Carter
Jim McColl
Professor Sir James Mirrlees
Professor Frances Ruane

Also present:

Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy
Graeme Dickson, Director General Enterprise, Environment and Innovation, Scottish Government
Dr Gary Gillespie, Chief Economist, Scottish Government
Lucy Proud, Senior Economist, Office of the Chief Economic Adviser, Scottish Government
Liz Lloyd, Chief of Staff to the First Minister, Scottish Government
Mia Ayres, Deputy Private Secretary to the First Minister, Scottish Government
Jack Causley, Assistant Economist, Office of the Chief Economic Adviser, Scottish Government

Purpose

This note provides an overview of the key points arising during the first meeting of the refreshed Council of Economic Advisers. The Meeting was focussed on the future remit of the Council and the publication of Scotland's Economic Strategy.

Welcome

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

Members had earlier attended the launch of Scotland's Economic Strategy.

Before the business of the meeting began, the First Minister thanked all Members for their commitment to the Council and noted that the former First Minister valued the advice and contributions made by the previous Council.

Apologies had been received from Amanda McMillan and Professors Mazzucato, Muscatelli and Stiglitz, who were unable to attend the meeting.

Role and Operation of the Council

The Members discussed the role and future operation of the Council. The Chair noted that the Council will meet twice a year with the next meeting in the Autumn. He reflected on the operation of the previous Council and the importance of Council members working collectively and developing work and meeting outwith the full Council meetings. This approach worked well in the previous Council and he was open to Council members continuing on that basis. There were also opportunities for Council members to speak in public forums about Council work or in relation to their particular areas of expertise. The flexibility around how the Council operated was important and the extent of Members' involvement would depend on how much time they could commit.

During their discussion, Council Members were open to this type of approach.

Members recognised the twin objectives of improving competitiveness and tackling inequality set by the First Minister. The First Minister looked forward to receiving the Council's detailed advice on how to best progress both of these objectives and to build a greater understanding of the link between them both.

The First Minister, as part of, Scotland's Economic Strategy asked the Council for advice on how to measure progress as part of Scotland's National Performance framework. She acknowledged the expertise within the Council within this area and was seeking advice from the Council regarding the development of a set of measures of Scotland's performance across a wide range of dimensions of economic prosperity.

The Council welcomed this opportunity and agreed that this would be taken forward for consideration at the next meeting.

Update on Developments in the Scottish Economy

The Chief Economist provided an update on recent economic developments. Points discussed during this update included:

- The Scottish economy has been recovering and strengthening, with output expanding continuously for more than two years and moving beyond its pre-recession peak at the start of 2014.
- Aggregate trends within the Scottish labour market are also positive, with record levels of employment. However, structural challenges remain, in particular, high levels of underemployment, weak real wage growth, high levels of part-time working and high levels of youth unemployment.
- A number of areas of opportunity were noted. Domestic demand remained solid, while the Scottish labour market continued to strengthen. Both household and business confidence has largely been restored, and business surveys and independent forecasts indicated that the outlook remained positive for 2015.
- Several areas of uncertainty were highlighted. It was noted that productivity growth continues to disappoint, while growth in real wages remains slow. It

was also noted that conditions in Scotland's main export markets were mixed, with difficult conditions in the Eurozone economies sitting alongside the strong growth in the US economy. Further potential headwinds include the on-going growth impact of fiscal consolidation in the UK.

- The positive and negative implications for Scotland from the substantial fall in oil prices since the end of 2014 were also discussed.
- Members requested more detail on the underlying trends in the labour market in Scotland, how these linked to productivity and the extent to which these could be viewed as structural changes following the recession and recovery.
- The Chief Economist agreed to provide further detail relating to these areas and in subsequent meetings.

Scotland's Economic Strategy

The Deputy First Minister (DFM) provided an overview of Scotland's Economic Strategy (SES), which was published earlier in the morning. The Council had attended the launch of the Strategy and had seen earlier iterations of the document as it was being developed.

The DFM set out the Government's vision for what they aimed to achieve by approaching the economy in a more holistic approach, recognising the twin pillars of improving competitiveness and reducing inequality as integral features of their approach. He set out the key policy areas identified in the document and how this framework would drive their approach and prioritisation of the economy. In particular, the focus on inclusive growth, innovation, investment and internationalisation as being strategic priorities for the Government in brigading policy and the inter-dependence of these priorities.

During the subsequent discussion, Members discussed the different components of inequality and how it impacted on different aspects of life in Scotland. The Council highlighted the need to identify what issues the SES was trying to address, such as the inequality of opportunity or inequality in outcomes. The need to focus on the key barriers faced by different sections of society was also emphasised.

Regarding the policy announcements, the Council recognised continuing difficulties for business to access finance, alongside weak demand for finance from many SMEs. The Council highlighted the Scottish Business Development Bank (SBDB) as a positive policy being taken forward by the Scottish Government and discussed the space in which the Development Bank would operate. It was noted that the Scottish Investment Bank (SIB) already lends to small businesses and that the SBDB would be looking to build on the work of the SIB. It was suggested that the recent rise in debt funds may provide a useful example of an innovative approach to funding the SBDB.

The Council also discussed the potential impacts of using procurement to tackle inequality in Scotland, in particular regional aspects. However, it was recognised that there are restrictions due to European Union laws. It was noted that Community Benefit Clauses provided a good example of what could be done through procurement policy.

The current adoption of the Living Wage was also considered. It was noted that demand for the scheme run by the Poverty Alliance was very high but that caution should be taken as some companies that have signed up may already have been paying the Living Wage. During this discussion, the Council noted the potential productivity and efficiency improvements that could arise from paying workers more.

Following the discussion, the Council agreed to develop work on inclusive growth and innovation.

In addition, the Council considered and welcomed the opportunity to establish working groups to examine specific areas in greater detail. It was agreed that two sub-groups would be established with particular focus on innovation and inclusive growth.

**Office of the Chief Economic Adviser
May 2015**

Minutes of the Meeting of the Council of Economic Advisers

Bute House, Edinburgh, 8th October

The following Council Members were present:

First Minister Nicola Sturgeon MSP (8th only)
Crawford Beveridge (Chair)
Sir Harry Burns
Professor Sara Carter
Jim McColl
Professor Mariana Mazzucato
Amanda McMillan
Professor Sir James Mirrlees
Professor Anton Muscatelli
Professor Frances Ruane

Also present:

Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy
Graeme Dickson, Director General Enterprise, Environment and Innovation, Scottish Government
Dr Gary Gillespie, Chief Economist, Scottish Government
David Patel, Deputy Director, Office of the Chief Economic Adviser, Scottish Government (8th Only)
Uzma Khan, Senior Economist, Office of the Chief Economic Adviser, Scottish Government
Kevin Brady, Economic Adviser, Office of the Chief Economic Adviser, Scottish Government
Malcolm Fleming, Special Adviser, Scottish Government
Mia Ayres, Deputy Private Secretary to the First Minister, Scottish Government (8th Only)

Welcome

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

Apologies had been received from Professor Joseph Stiglitz, who was unable to attend the meeting due to another commitment.

Update on Developments

The Chair gave an update on developments since the last Council meeting in March.

Council Members had held two conference calls with officials in May and August. The call in May had considered remits for the Council's work streams on inclusive growth,

innovation and measurement, and early priorities for analysis in each of these areas. The call in August had focused on inclusive growth in greater depth, including initial considerations for the development of a Scottish policy framework for inclusive growth and key inter-linkages.

On the morning of 8th October, the Chair, Professor Carter, Mr McColl and Professor Muscatelli gave evidence to the Scottish Parliament's Economy, Energy and Tourism Committee on the work of the Council.

In his capacity as Chair of the Council, Mr Beverage attended the meeting of the Innovation Forum on 7th October as an observer. The Chair also highlighted his recently announced role leading a review of Scotland's planning system. (This position was unconnected to his role as Chair of the Council.)

The Chief Economist gave an overview of wider developments since the March meeting that touched on the Council's areas of work:

- In June, the First Minister led a discussion on inclusive growth at the World Bank, involving officials from the World Bank and IMF;
- The Deputy First Minister led a discussion on inclusive growth with European and international policymakers at Bruegel – a Brussels-based think tank – in September, with an OECD official responding to the Deputy First Minister;
- There is continuing dialogue between the Chief Economist and OECD officials relating to inclusive growth and measurement of wellbeing. The Chief Economist has agreed to present the emerging framework at the OECD.

Priorities of Government, State of the Economy, Public Finances

The First Minister gave Council members an overview of the Scottish Government's policy priorities, as set out in the Programme for Government.

The Chief Economist gave an update on recent economic developments in the global, UK and Scottish economies. Points discussed during this update included:

The evolving economic context for policymakers in Scotland:

GDP and employment levels had risen above pre-crisis levels and in many areas the economy was returning to pre-recession norms. However real wages, though now growing, were still below pre-crisis levels in real terms with recent rises being attributable in part to near zero inflation. Low commodity prices were having varying impacts on the economy in Scotland (particularly oil prices) and the weaker external environment (particularly China) was maintaining wider deflationary pressures;

Significant external headwinds remained for the Scottish economy, including continued uncertainty and divergence in economic performance within the Eurozone, and the slowdown in China's economy;

The Scottish economy had grown for 12 consecutive quarters, but the latest data (for Q2 2015) were the weakest for several quarters. This reflected the negative impact of the contraction in onshore activities associated with oil and gas, including supply chain

impacts. GDP growth in Scotland had been supported by the performance of the construction sector, where public sector investment in new infrastructure had driven output growth.

Business expectations in Scotland remain broadly positive, although there are variations across business sectors. There are positive expectations around future growth for 2015.

The Deputy First Minister provided a brief update on developments around the UK Government's Comprehensive Spending Review, the outcome of which would not be known until 25th November.

Inclusive Growth

The Chief Economist gave an overview of emerging thinking in SG around inclusive growth, which had built on the discussions during the Council's conference calls. Inclusive growth has important interdependencies for the other key elements of Scotland's Economic Strategy (Investment, Innovation and Internationalisation), and has policy implications beyond traditional labour market policies.

Following the Council's conference call discussions, recent work had focused on development of a policy framework for inclusive growth, which is intended to help identify contributions, synergies and trade-offs between individual policies and objectives. This framework was being piloted with the Scottish Government's Directorate for Housing, Regeneration and Welfare, and was also the subject of on-going engagement with the OECD.

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

The framework recognised the inter-linkage of inclusive growth with the Investment, Innovation and Internationalisation, the potential importance of the labour market and the need to recognise the impact of policy across the different spheres of the framework and over different time periods.

There was discussion around how the framework could be developed into a practical model to support policy delivery, and to test assumptions underpinning policies. The importance of those involved in delivery understanding the impacts of policy was highlighted. There was also discussion about the use of improvement science, with a method and data to drive change in these key policy areas.

The importance of corporate governance and behavioural change was noted as something that was potentially missing from the framework. The need to encourage business to look beyond the short term, and to have innovation and investment activity based on a longer term horizon, was emphasised. There was discussion of the Business Pledge in this context and the extent to which this policy, although voluntary, could be developed further to capture the importance of corporate responsibility. Early indications around the Business Pledge policy suggested there were examples of culture and behavioural change, which the Scottish Government will continue to monitor.

It was recognised that inclusive growth was an emerging area of interest internationally and the work being developed in Scotland was potentially more applied given the range of new policy initiatives. There was an opportunity for Scotland to be a 'brand leader' in this area and lead the international agenda. It was recognised that continued engagement with organisations like the OECD and World Bank was beneficial.

The Council were encouraged by the work on inclusive growth that had been undertaken to date. It was agreed that further work would be taken forward to identify drivers around uptake of the Business Pledge, and analysis of the priority policy areas, including childcare and procurement, using the inclusive growth framework.

Innovation

The Deputy First Minister and Chair updated Council members on the previous day's meeting of the Scotland CAN DO Innovation Forum.

The Innovation Forum includes members from several notable innovative companies in Scotland, along with representatives of Scotland's universities and funding bodies. Its work is focused around the themes of Ambition, Connections and Culture, with the previous day's meeting's conversations revolving around how to motivate a wider group of individuals and companies to participate in innovation, how to make it easier to access new ideas, and how to improve connections through modern technology. The overarching aim was of making involvement in innovation a more mainstream, rather than niche, activity in Scotland.

The Deputy First Minister highlighted that a key priority for innovation policy in Scotland related to focusing the diffuse range of current innovation activities in Scotland. In order to ensure that its work dovetailed with that of the Innovation Forum, the Council was asked to focus its advice on the activities that could make a difference to Scotland's innovation performance, and on how Scotland was performing.

9 October 2015 (St Andrews House)

The meeting resumed on Friday 9th October. The Chief Economist recapped on the previous day's discussions, while members offered their reflections, particularly around inclusive growth. It was agreed that the important issue in this area lay around embedding 'inclusiveness' in policies aimed at supporting growth, and in the overall economic agenda.

Inequalities

Professor Sir James Mirrlees gave a presentation on some emerging research on income and wealth inequalities. Key points included:
Gini coefficients for income are lower than those for wealth in the US and UK. Although income Gini coefficients in both countries are relatively high. Income inequality is arguably of greater concern than wealth inequality, from a life cycle perspective.

Income inequalities stem from inequalities in earnings, capital, and investment returns. Wealth inequalities arise from unequal incomes in the past, variations in savings

(partly from differences in profits, losses, and random windfalls), and variations in giving and receiving.

Randomness of returns to capital may be a major cause of inequalities. Investment is inherently risky, and it is empirically difficult to distinguish success and returns due to effort from those due to chance. Wealth exhibits 'random walk' characteristics – these might explain a considerable part of observed inequality.

These insights can also apply to labour income, as well as capital income. Education, career and job-search decisions are similar to investment decisions, subject to risk, and with uncertain outcomes.

The cause of inequality matters for policy decisions. Redistribution should apply to the source of inequality – earnings, and excess income from capital.

Professor Anton Muscatelli offered the initial response to the presentation, which was followed by a wider discussion among Council members. The following points were noted:

Understanding the drivers of inequality (such as the role of technology, education and bargaining power) is essential to developing an inclusive growth agenda.

Important to recognise the dynamics of wealth in UK – housing and property, rising value of inheritance. Gains from these are often not the result of productive investments by the beneficiaries themselves.

Redistribution through the tax and benefit system is important for reducing inequalities, but there needs to be greater focus on drivers that affect inequalities in market incomes. Priorities would include early years.

Change in corporate environment in 1980s onwards: perception of shareholders being only risk-takers leading to shareholders having main claim on 'residual'.

Changes in corporate governance and culture to promote 'long termism' are needed, as is a recognition that 'risk takers' are a wider category than private shareholders. The importance of greater corporate responsibility (e.g. through the Business Pledge) was emphasised.

The need for improvements in employability initiatives such as the Work Programme were noted, given their importance in addressing economic inactivity and improving resilience.

There was also a wider area discussion of the drivers of inequality, growth in financial services activity, focus on short term returns and the ability of certain sectors of the economy to extract economic rents above market norms. The marked reduction in the top rate income tax threshold in the US and elsewhere.

Innovation

Professor Mariana Mazzucato gave a presentation on Innovation Policy, concentrating on government's role in innovation. Key points included:

The public sector's role in the innovation economy is about more than creating 'level playing fields' or addressing market failures: it sets and supports 'missions' that guide innovation activity, and help development and use of general purpose technologies. US experience shows that Government plays an important role each stage of the 'innovation chain', not just at the basic research stage.

The public sector's role as an investor raises issues around sharing risks and rewards associated with innovation. Ensuring taxpayers receive clear benefits from innovation investments help offset costs of 'failed innovation'. Approaches to this include providing income-contingent loans, retaining equity, allocating shares of 'payback' from successful innovation into innovation funds, and state investment banks.

Challenges for economic policy include: learning how to actively set directions for change (missions); evaluating public sector investments; building explorative public sector organisations – ones that welcome trial and error; and, how to socialise risks and rewards from innovation.

Professor Frances Ruane offered the initial response to the presentation, before a wider discussion took place. The following points were noted:

Government has an important role as a long run investor, with different investment timescales to private actors. Important to understand how government interacts with each part of the innovation ecosystem.

How far is the US innovation 'narrative' replicated in Europe, and what actors play the equivalent roles of US institutions.

Need to explore what drives differences in R&D behaviour between Scotland and other countries: industrial structure; policy landscape. Need to avoid establishing a system that tries to incentivise R&D in sectors with low innovation potential and capacity.

Question of what Scottish 'failure' in business R&D activity is: are companies focusing on research, development, doing both or neither. Does Scotland's higher education sector substitute for companies' basic research.

The importance of a country's vision for innovation was emphasised: this helps attract talent and investment (e.g. Denmark and wind technology).

Contracts matter for how innovation takes place, as they determine relationships, and distributions of risks and rewards.

Scottish examples of approaches to sharing risk and reward include initiatives like Scottish Enterprise's Co-Investment Fund.

The Council requested that further analysis be undertaken around the factors underlying differences in R&D and innovation performance between Scotland and other small countries, and that analysis be undertaken to identify the Scottish Government and its partners' innovation activities and spend against the stages of the innovation value chain.

Measurement

The Chief Economist gave a brief update on developments since the last Council meeting regarding measurement of the priorities in the SES and economic progress, along with wider developments around performance measurement in the Scottish Government. These included the Scottish Government signing up to the United Nations Sustainable Development Goals, progress with the refresh of the National Performance Framework, and OCEA's on-going engagement with the OECD on measurement of wellbeing.

The Chief Economist undertook that OCEA would continue to take forward work around measurement of Scotland's Economic Strategy and its ambitions, and provide options to the Council for consideration and approval before the New Year.