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**COUNCIL OF ECONOMIC ADVISERS
FIRST MEETING – 21 SEPTEMBER 2007,
BOARD ROOMS, MUSEUMS OF SCOTLAND,
EDINBURGH**

These are the minutes of the first meeting of the Council of Economic Advisers, held on 21 September 2007. They are also available on the Scottish Government's website at <http://www.scotland.gov.uk/Topics/Economy/Council-Economic-Advisers/>

The Council of Economic Advisers has been created to advise the First Minister on the best way to improve Scotland's sustainable economic growth rate. The Council will meet on a quarterly basis and minutes of its meetings released within two weeks of a meeting taking place. Accordingly, the minutes of the Council meeting to be held on 8 February 2008, will be published by 22 February 2008.

MINUTES OF THE COUNCIL OF ECONOMIC ADVISERS' (CEA) FIRST MEETING – 21 SEPTEMBER 2007

Introduction and discussion of remit and working of the CEA

1. The Chair welcomed all members of the Council to the inaugural meeting and invited the First Minister to introduce the meeting and Council members.

2. The First Minister noted that the starting point for any conversation on the Scottish Economy is to recognise that Scotland is a country of vast resources, growing key industries and enormous potential. Further, that of Scotland's many assets, our people are the most important. He stated the importance of, firstly, being honest about Scotland's recent performance, which - relative to resources and a highly educated, skilled workforce – has been disappointing; and, second, signalling the ambition to match the economic success and prosperity of other small neighbouring economies such as Norway, Finland, Iceland, Ireland and Denmark.

3. The First Minister introduced the Council members and expressed his thanks and sincere appreciation to members for agreeing to serve on the Scottish Council of Economic Advisers.

4. The Council considered the Draft Remit of the CEA. It was agreed that the Council's remit is to:

- ◆ Advise the First Minister directly about the best way to improve Scotland's sustainable economic growth; and
- ◆ Have quarterly meetings and publish an annual report on progress.

5. The Council also agreed that in fulfilling this remit:

- ◆ Members may undertake specific pieces of work in-between meetings to inform the Council and advise the First Minister; and
- ◆ The Council may commission research/preparatory work to inform future discussions.

Setting the Scene - The State of the Scottish Economy

6. The Chair invited Dr Andrew Goudie, the Director General Economy and Chief Economic Adviser to the Scottish Government to give an overview of the Scottish economy.

7. The Chief Economic Adviser noted that in order to advise the First Minister effectively, the Council would need to have a good understanding of the performance of the Scottish economy. His presentation at this first meeting, therefore, would set out the long term and more recent trends in the Scottish economy and draw out the key challenges around growth, including productivity, participation and migration.

Trends in the Scottish Economy

8. The structure of Scotland's economy has changed significantly over the past thirty years. In common with many industrialised countries, manufacturing has declined and the services sector has grown.

9. Within this broad trend of a declining manufacturing sector and a growing services sector, there have been two substantial structural changes. Until the 1980s, heavy industry was relatively important to the Scottish economy. In the 1980s and 1990s, however, a different picture emerged with the growth of foreign direct investment (FDI) and electronics. During this period, Scotland's FDI could be characterised as large-scale assembly, with few higher value activities and limited research and development. In 2000, the electronics sector went into sharp decline and a new period emerged which was less dependent on FDI and more dependent on services and on indigenous business growth. Continued efforts to attract FDI are focussed at the higher value end, where Scotland is better able to compete.

10. The dramatic decline of manufacturing alongside the continued growth of services has resulted in a substantial change in the sectoral balance, with services moving from being twice the size of manufacturing to eight times its size. This restructuring has brought with it a number of significant changes around type of employment, skill requirements and earning patterns.

11. Within services, a number of major sectors dominate Scotland's economy. The public sector, education and health is the largest sub-sector, accounting for 21.8% of total economic output. Scotland also has a strong real estate and business services and financial services sectors; accounting for 18.7% and 7.0% respectively of the economy's output; with the retail and wholesale sector accounting for 11.5% of the economy. Within manufacturing, now only 15% of GDP, the largest sub-sector is electronics and electrical engineering (E&IE) which makes up 3.3% of the economy. This is followed by food & drink (2.9%), chemicals (1.4%) and metals and metal products (1.3%).

12. Economic restructuring has had a direct impact on the level and nature of Scotland's international trade. The growth and decline in manufactured exports over the period 1995-2004 is largely explained by the rise and fall of the electronic sector. The electronics industry remains Scotland's largest exporting sector and accounted for 34% of Scotland's total manufactured exports in 2006. However since 2004, Scotland's exports have grown as other manufacturing industries and areas of the services sector, such as business services, increase their contribution to Scotland's international trade.

Challenges for the Scottish Economy

13. Scotland's **economic growth** has underperformed both relative to the UK average and to small European countries and delivering faster and more sustainable economic growth is the over-riding challenge. Meeting this challenge will depend on Scotland's performance in boosting productivity, population and participation. Moreover, Scotland's economic performance has been characterised by significant challenges in terms of the distribution of economic growth. This sets a further set of challenges around 3 dimensions of equity: cohesion (regional equity), solidarity (social equity) and sustainability (inter-generational equity).

14. **Productivity:** While Scotland's labour productivity, measured by GVA per hour worked, is around mid-range among OECD economies, it is significantly lower than other small European countries. Labour productivity in Norway and Ireland is 60% and 29% higher than in Scotland, respectively. Scotland's labour productivity is 2.5% lower than in the UK. Scotland also faces challenges around key drivers of productivity such as business start-up and innovation. Enhancing productivity is perhaps the most important and challenging component in increasing economic growth.

15. **Population:** From the 1950s to the mid 1990s, Scotland's demographics have reflected economic performance, resulting in substantial net out-migration. More recently, Scotland has enjoyed net in-migration, largely due to the arrival of workers from the new EU member states. However, between 1997 and 2006, Scotland's population has increased by less than 1%. Over the same period Ireland's population has risen by more than 15% and the UK's population by more than 3%.

16. The most recent population projections (2004 based) suggest that Scotland's population will rise to 5.13 million in 2019 (a 1% increase on 2004 figures), before falling below 5 million in 2036 (a 2% fall). These projections are based on past trends, established at a time of low growth. They can be countered by higher levels of in-migration driven by higher economic growth.

17. **Participation:** Scotland's level of participation is historically high. The working age employment rate is currently 77.2% which is higher than the employment rate of the UK as a whole (74.4%). Scotland's employment rate is mid range among smaller European countries. The unemployment rate in Scotland is currently 4.5% which is lower than the unemployment rate of the UK as a whole (5.4%). Although Scotland's unemployment rate has improved in recent times, it has remained above the rate in Denmark, Iceland, Ireland and Norway. The relative tightness of the labour market suggests challenges in achieving higher growth and raises questions about the quality of employment.

18. Furthermore, Scotland's overall performance masks the fact that some areas of Scotland have low levels of participation and high rates of unemployment. Persistent pockets of multiple deprivation remain where key socio-economic indicators fall significantly short of the national averages.

Views of the Council of Economic Advisers

19. The Council then explored a number of issues covered in the presentation, and, in particular, focussed on four key elements:

- ◆ **How to measure Scotland's economic progress** – Given that the Council is tasked with advising the First Minister on how to boost Scotland's sustainable economic growth, they were keen to explore how best to measure progress towards this target. The option of measuring progress through more directly identifiable figures such as earnings from employment was considered, but the importance of tracking Scotland's progress against other economies, using an accepted measure of economic progress, meant a continued focus on GDP. There is a need to explore further how effectively GDP captures the full value of economic activity in Scotland, particularly in sectors such as energy and financial services;

- ◆ **Challenges faced in a service dominated economy** – The Council reflected on the different approaches required to understand and enhance performance in areas such as productivity and international trade in an economy where output is dominated by the service sector. The changing quality of employment as a result of restructuring was also considered. Approaches across the service sector need to vary, for example, between public sector dominated components and internationally traded services. The example of how Scotland’s oil and gas industry has continued to prosper, with growth in services, was explored. The cluster of supply-chain companies developed at peak periods of production have developed a critical mass of high-value, internationally orientated activities that continue to prosper;
- ◆ **Interaction of population, migration and participation issues** – The Council discussed the likelihood of current patterns of in-migration being sustained and the impact of other trends such as the migration of high-income older people from Scotland. The importance of migration and population growth in supporting growth will depend on the participation levels among the working age population, which in turn, will reflect levels of health and capacity to participate. Levels of demand in the labour market will also be crucial to ensure highly skilled individuals can be retained by high level employment opportunities;
- ◆ **Geographic spread of the participation challenge** – The Council reflected on the high numbers of people on Incapacity Benefit and the concentrations of economic inactivity, particularly in Glasgow and around west central Scotland. The Council recognised that considerable efforts have already gone into addressing this issue and the importance of education was highlighted. Members suggested that this would be a fruitful area to explore more fully within the Council.

20. The Council agreed that the presentation on the Scottish economy identified several areas for the Council to address:

- ◆ Promoting *Short-term Economic Growth* over the life of this Parliament: strategy and policy to achieve the immediate target of matching the UK economic growth rate by 2011;
- ◆ Developing Scotland's *Comparative Advantage*: the longer term contributions of key elements including the high level skills, the planning environment, key sectors etc;
- ◆ Addressing the *Inhibitors of Scotland's Economic Growth*: tackling the problem of economic inactivity; and
- ◆ Enhancing *Scotland's Economic Statistics*: strengthening the basis for the formulation of economic strategy and policy.

The Government Economic Strategy

21. The Chair invited the Cabinet Secretary for Finance and Sustainable Growth to outline the Government Economic Strategy.

22. The Cabinet Secretary noted that the Government Economic Strategy would be presented to Parliament and published in full in late October and that insight from the Council would be welcomed.

23. The Cabinet Secretary explained that the Government Economic Strategy will represent the overarching strategy for all of the public sector in Scotland. The fact that the Government Economic Strategy is at the very top of the pyramid, recognises the fact that sustainable economic growth is at the heart of this Government's agenda.

24. The Government Economic Strategy will set out the route to achieving the Government's Purpose: to focus the Government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing and sustainable economic growth. The principal target for this Parliament in pursuit of this Purpose is to raise Scotland's economic growth rate to the UK level by 2011.

25. The Government's five **Strategic Objectives** play a key role in focussing all of the activity of the Government and wider public sector on achieving the purpose:

- ◆ **WEALTHIER & FAIRER** – Enable businesses and people to increase their wealth and more people to share fairly in that wealth;
- ◆ **HEALTHIER** – Help people to sustain and improve their health, especially in disadvantaged communities, ensuring better, local and faster access to health care;
- ◆ **SAFER & STRONGER** – Help local communities to flourish, becoming stronger, safer places to live, offering improved opportunities and a better quality of life;
- ◆ **SMARTER** – Expand opportunities for Scots to succeed from nurture through to life-long learning ensuring higher and more widely shared achievements;
- ◆ **GREENER** – Improve Scotland's natural and built environment and the sustainable use and enjoyment of it.

26. All policy and spend needs to be aligned to address the 5 Strategic Objectives in pursuit of faster and more sustainable economic growth.

27. The Cabinet Secretary highlighted some of the key aspects of the Government Economic Strategy, in particular the **strategic priorities**. These priorities will be developed further – prior to publication of the Strategy – and will be embedded in the delivery of the five Strategic Objectives through which the Purpose will be pursued.

28. The Council supported the approach set out by the Cabinet Secretary in the Strategy. Members emphasised in particular the following elements:

- ◆ The key drivers of economic growth;
- ◆ How to retain and attract highly skilled human capital;
- ◆ The role of the private sector, particularly the role of internationally successful firms;
- ◆ The lessons that can be learnt from the oil and gas cluster and financial services - and replicated with advantage elsewhere in the Scottish economy e.g. medicine, renewable energy;
- ◆ The rate of investment and R&D ratios;
- ◆ The need to declutter the delivery landscape for public services; and
- ◆ The importance of explaining why faster economic growth means a better quality of life for everyone.
- ◆ Council Members agreed to make further input to the strategy prior to publication.

29. The Chair thanked the Cabinet Secretary and introduced the next speaker, Jim Mackinnon, Chief Planner to the Scottish Government, inviting him to present on Scottish Planning and economic development.

The Scottish Planning System and Economic Development

30. The Chief Planner began by acknowledging that, during the last twenty years, the Scottish Planning system has not been performing well and, as a result, far too many development plans are seriously out of date and planning authorities are struggling to process applications within the timescales required. Consequently, many see the planning system as an inhibitor to growth rather than a major driver of economic development. It is for that reason that the planning system in Scotland is currently undergoing the most comprehensive and fundamental overhaul since its creation in 1947. After extensive consultation and debate, the Parliament passed the Planning etc Scotland Act in December 2006, and a two-year implementation phase is now underway. That implementation holds the key to improvement.

31. Two main drivers for the programme of modernisation were identified: first, the business and development communities felt that economic growth was being hampered by excessive delay, inconsistency and uncertainty; secondly, and equally strongly, there was an increasing sense that local community and environmental interests were not being taken into account, and were not able to influence the decisions that directly affected their living and working conditions.

32. The core components of the modernised Scottish Planning system were identified:

- ◆ **A statutory National Planning Framework (NPF)** – to allow the Government to set out its priorities for Scotland’s spatial development; to ensure a joined-up approach to the planning of infrastructure to support that development; and to designate projects of national significance;
- ◆ **A revitalised Development Planning system** – with fewer development plans, required to be updated every five years, prepared in a way that maximises participation and deals with potential controversies “up-front”, allowing for clearer and quicker decisions;
- ◆ **A fit-for-purpose Development Management System** – with a hierarchy of applications to ensure a proportionate approach. Major projects will be dealt with through “processing agreements” to increase efficiency and certainty. The hierarchy includes stripping out small-scale applications from planning altogether, to release resources to deal with more complex applications. This also includes an overhaul to the system of appeals, to enable them to be dealt with more efficiently. The Parliament rejected moves to introduce a Third Party Right of Appeal, but instead legislated to maximise community engagement in the early stages of applications; and
- ◆ **Provisions to assess planning authority performance and support performance improvement.**

33. The Chief Planner identified the benefits this modernisation programme should bring in terms of process. He also identified the ways in which the Government can use the NPF to create a planning environment and culture that supports economic development:

- ◆ By setting out a vision based on sustainable economic growth. In particular, business needs to engage with the NPF to identify how national infrastructure should develop to support growth;
- ◆ By setting out and emphasising the importance of economic considerations in policy and decision making, encouraging planning authorities to take on a development and growth agenda;
- ◆ By encouraging planning authorities to ensure there is a generous allocation of land for development that supports sustainable economic growth (although this needs to be matched by appropriate infrastructure provisions and market willingness to invest);
- ◆ By continuing to promote the modernisation of systems, particularly through the e-Planning project, which aims to secure more than £40m of savings for users of the planning system, from an investment of around £10m;
- ◆ By easing the process for business and industry, particularly for small and medium sized enterprises, through better support in processing applications and also encouraging the development industry to offer high standards to reduce community and council opposition.

34. The Council considered:

- ◆ How the Government's overall purpose of supporting sustainable economic growth be could be reflected in implementing the reforms;
- ◆ How local authorities and central government bodies could be equipped and encouraged to weigh economic considerations in making planning policy and taking planning decisions;
- ◆ How Scotland might learn lessons from other countries' approach to planning; and
- ◆ How the National Planning Framework could provide the right environment for sustainable economic growth.

35. The Council requested that more work be done on this issue over the coming months ahead of a more substantive discussion at the Council.

Discussion of the Future work of the Council and Research

36. The Council agreed that the future work of the Council, picking up on the issues identified in the discussion on economic performance, would focus on:

- ◆ Promoting *Economic Growth* over the life of this Parliament: strategy and policy to achieve the immediate target of matching the UK economic growth rate by 2011;
- ◆ Developing *Scotland's Comparative Advantage*: the longer term contributions of key elements including the high level skills, the planning environment, key sectors etc;
- ◆ Addressing the *Inhibitors of Scotland's Economic Growth*: tackling the problem of economic inactivity; and
- ◆ Enhancing *Scotland's Economic Statistics*: strengthening the basis for the formulation of economic strategic and policy.

The following members of the Council were present:

First Minister
Sir George Mathewson (**Chair**)
Mr Crawford Beveridge
Professor Andrew Hughes Hallett
Professor John Kay
Professor Alexander G Kemp
Mr Jim McColl
Professor Sir James Mirrlees
Professor Frances Ruane
Sir Robert Smith

Apologies: Ms Frances Cairncross
Professor Finn Kydland

Also present: John Swinney, Cabinet Secretary for Finance and Sustainable Growth
Dr Andrew Goudie, DG Economy and Chief Economic Adviser, Scottish Government
Jim Mackinnon, Chief Planner, Scottish Government (part of meeting only)
Jennifer Erickson, Special Adviser, Scottish Government
Dr Jennifer Steedman, Economic Strategy Directorate, Scottish Government
Claire Smith, Economic Strategy Directorate, Scottish Government