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SOME ISSUES FOR THE COUNCIL OF ECONOMIC ADVISORS MEETING ON 8TH FEBRUARY 2008

Key Messages

- ***The Council of Economic Advisors (CEA) have an important role in the implementation of the Governments' Economic Strategy***
- ***As part of this role, we hope the CEA will take the opportunity to discuss the targets that have been set, and the economics that underpin these targets. We raise the following issues:***
  - ***There is a need for greater clarity around the economic analysis and evidence that underpins the Government's policies***
  - ***There is a need for more explanation on how such ambitious targets might be achieved, both in general terms and in relation to the subsequent Budget allocations***
  - ***Are the tight Budget allocations, and in some instances real terms cuts (such as infrastructure, post school education and enterprise development), still consistent with the Government's commitment to growth?***
  - ***Is the CEA confident in the quality of the economic data on the Scottish economy?***

On November 13th the Scottish Government published its new Economic Strategy document for Scotland, stating that the development of the Economic Strategy has been informed by the work of the Council of Economic Advisors (CEA) who will continue to play a key role in its implementation. As this will be the first meeting of the Council since the publication of the Strategy, we presume that work will now begin on implementation.

At the outset, we think it is appropriate for the CEA to consider what the targets are, what are the economics that underpin them, and how the Budget (which was presented the day after the launch of the Strategy) matches up with the goals set for the economy.

The full set of targets are listed in the appendix. We concentrate here on the following:

⇒ by 2011 to raise the GDP growth rate to the UK level;
⇒ by 2017 to match the GDP growth rate of the small independent EU countries.

We think there are two main issues that the CEA might consider with respect to such targets:[1]

[1] Of course there is a more basic issue, as CPPR have highlighted in the past, concerning serious outstanding issues in relation to the reliability of quarterly Scottish GDP data and its comparability with UK figures. See http://www.cppr.ac.uk/centres/cppr/newsandevents/ for various comments we have made on these data.

1. Is Scotland to achieve a higher absolute growth than before, higher relative growth and/or higher growth in living standards. Much of the higher UK growth rate (vis-à-vis Scotland) is accounted for by a faster growing population which in turn results in a higher growth rate, but not necessarily a higher standard of living (when measured by GDP per capita). Over the last 30 years Scotland's relative GDP growth rate has been poor when measured against the average achieved by the UK as a whole (on average 1.8% versus 2.3% p.a.); but in terms of GDP per capita, Scotland's growth rate has been closer to the average (1.9% versus 2.0% p.a. over the period 1976-2006). Higher GDP growth is quite naturally seen as a sign of economic health but it is GDP per capita that is generally acknowledged to be a better measure of prosperity.[2]

2. How will these targets be achieved, given performance over the last 30 years? Presumably there needs to be a strong evidence-base that tells us what are the comparative advantages and disadvantages of the Scottish economy, and therefore what (new) policy instruments need to be levered to achieve the required step-change in growth.

With respect to the second issue, we think that some of the budget spending decisions that impact directly on growth lack a clear rationale; there is also a lack of economic analysis in the Strategy document based specifically on Scotland's experience and evidence-base with which to underpin policy and it would seem reasonable to assume the CEA would now seek to discuss what policies will achieve which growth outcomes.

From the analysis that is included in the economic strategy it appears that much of the necessary step-change in Scotland's growth path depends on autonomy/independence; revision of competition policy to provide greater consumer sovereignty in Scotland, so stimulating more dynamic competition, innovation and growth; and employment policy being better handled by a Scottish Government. We made some comments on each of these in our earlier response to the Economic Strategy[3] noting that there is no unambiguous evidence to support the above. The CEA's views on whether they think these really are the main policy options would be of interest, as too would be their views on any other options that are open to the devolved Scottish Government.

The Strategy provides no discussion of potential short- or medium- (and probably long-) run trade-offs between increased GDP growth and 'solidarity' and 'cohesion', where solidarity refers to ensuring that those on lower incomes also benefit while cohesion is concerned with narrowing economic differences across sub-regions in Scotland.[4] Similarly, the strategy states that addressing social, regional and inter-generational equity is a key driver of economic growth, and that differences in income, participation and growth across Scotland act as a drag on economic performance. But these differences may in fact be outcomes of poorer performance as well as likely causes (the causal links here are not clearly recognised or set out and this is important when devising policies that are intended to produce different outcomes). The Scottish Government recently published consultation[5] recognises the potential trade-offs and conflicts between its chosen targets and we would assume that the

[2] In addition, when evaluating targets the more relevant measure of GNP should be used as opposed to GDP, where appropriate (i.e. for Ireland and Luxembourg)

[3] See http://www.cppr.ac.uk/media/media_55715_en.pdf.

[4] Specifically, these are covered by the targets: (i) to increase overall income and the proportion of income earned by the three lowest income deciles as a group by 2017; (ii) to narrow the gap in participation between Scotland's best and worst performing regions by 2017.

[5] See "Taking Forward the Government Economic Strategy: A Discussion Paper on Tackling Poverty, Inequality and Deprivation in Scotland" (January 2008) especially par. 35-39.

CEA will offer views on where they see the balance lying if the Scottish Government is to achieve its key growth targets.

Lastly, given the aims, ambitions and targets set out in the Economic Strategy document, it will be useful to understand how the CEA views the post-CSR Scottish Budget announced on the 14th November. In particular do they believe the budget allocations will assist Scotland's economic growth aspirations? Some of the key issues[6] for us are:

- A relatively poor settlement for post school education is at odds with the opening statement of the Strategy's Executive Summary: "Scotland has real strength in the most vital factor for modern economies – the human capital offered by our greatest asset, Scotland's people."

- Scotland's two specialist enterprise bodies, Scottish Enterprise and Highland and Islands Enterprise, also face real reductions in their budgets. In addition, funding for Innovation and Investment (including Regional Selective Assistance which is primarily demand driven) also falls 2.6% pa in real terms.

- Small real growth in Scotland's transport infrastructure and public transport services, although if we exclude 'motorways and trunk roads' there is a 2.2% pa *decline* in real terms (e.g. rail, air and buses).

Whilst the Scottish Government and all public service providers should be far more concerned with outputs and outcomes than about inputs, some of the budget allocations do appear to be at odds with achieving the necessary step changes in Scotland's economic growth.

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[6] For a more detailed commentary see footnote 3.

Appendix

Full set of targets in Economic Strategy

By 2011:

- To raise the GDP growth rate to the UK level;
- To reduce emissions over the period to 2011.

In the longer term:

- To match the GDP growth rate of the small independent EU countries by 2017;
- To rank in the top quartile for productivity amongst our key trading partners in the OECD by 2017;
- To maintain our position on labour market participation as the top performing country in the UK and close the gap with the top 5 OECD economies by 2017;
- To match average European (EU15) population growth over the period from 2007 to 2017, supported by increased healthy life expectancy in Scotland over this period;
- To increase overall income and the proportion of income earned by the three lowest income deciles as a group by 2017;
- To narrow the gap in participation between Scotland's best and worst performing regions by 2017;
- To reduce emissions by 80 per cent by 2050.