Scotland's Economic Performance

North Ayrshire Council

NAC Response to Economy, Jobs and Fair Work Committee Inquiry on Scotland's economic performance: trends, challenges and future developments

North Ayrshire Council welcome this opportunity to respond to this inquiry on Scotland’s economic performance. We refreshed our Economic Development and Regeneration Strategy in 2016 to reflect a changing economic and policy context and to outline our vision for the North Ayrshire economy for the next 10 years. Our mission is for North Ayrshire to be the most improved local economy by 2025.

However, our key challenges remain the same; high unemployment, lack of jobs, deprivation, low skills, and population decline. Some progress has been made in recent years across a number of indicators – but the fundamental gap between North Ayrshire and the Scottish averages remain. Furthermore, both existing and new global and national challenges have the potential to impact our ability to achieve inclusive growth for North Ayrshire, for example, stubborn and persistent poverty and inequality, pressure on public sector finances, an aging population, uncertainty surrounding the future trading relationship with the EU and a replacement for EU funding, consumer confidence and pressure on household incomes and benefit payments.

Questions

**GDP growth and productivity**

1. What have been the main drivers of growth in the Scottish economy since 2007?

The UK and Scottish recovery from recession is still unbalanced relying on consumer spending, service sector and loose monetary policy (low interest rates and quantitative easing). Also, real wage growth has been weak due to low wage growth and spike in inflation due to devaluation of the pound. It is notable that the recessionary output gap is almost 20% - if pre-recession GDP trends had continued and the recession not happened our GDP would be almost 20% higher than it is currently. The Scottish economy (GDP) has grown by less than 1% per annum for the last ten years in real terms and this cannot be considered meaningful ‘growth’. The growth of the service sector in Scotland has provided a significant driver for growth. Adjusting from an industrial economy to a knowledge economy has brought challenges as well as opportunities. Recently the fall in the value of the pound has made UK exports cheaper and encouraged growth in tourism.
2. How have Scotland’s key sectors performed over the past decade?

Scottish growth sectors have taken ten years to recover the output lost since 2007 in real terms. Any gains beyond this are marginal – only energy and financial/business services and life sciences can be considered to have grown faster than the anaemic whole-economy average. The decline of the oil and gas industry has provided knock on impacts on the supply chain, however North Ayrshire has experience little relative impact due to the lack of any significant oil and gas supply chain and few workers involved in oil and gas. Nevertheless, Ayrshire has a strong engineering sector which has identified this as a challenge. In a reflection of the national economy, North Ayrshire relies on small and medium enterprises and indeed micro businesses, 8 out of 9 of our businesses employ less than 10 people. North Ayrshire has a smaller service sector than Scotland as a whole but has relative strength in manufacturing and construction. Two growth sectors form a strong basis of the North Ayrshire economy: tourism and food and drink.

3. How does Scotland growth rate compares with the UK as a whole, other regions/nations of the UK, and other countries in the EU?

Scotland’s growth rate is lower than the UK as a whole and lower than the EU. The UK is a country of unbalanced economy growth – centralisation of growth is higher than most Western European economies and this has been well documented. London has the highest levels of productivity, by far, of any region or country in the UK, Wales and Northern Ireland have the lowest, whilst Scotland is close to the UK average. The UK Government’s new Industrial Strategy recognises this unbalanced growth and investment should be targeted at those regions most needing to ‘play catch up’. Uneven growth is also evident within Scotland. The Scottish Government’s Economic Strategy (2015) recognised this – highlighting the gap in output per person between Edinburgh and East and North Ayrshire as a specific example.\(^1\)

It is also important to note that the recent devolution of powers to the Scottish Parliament through the Smith Commission process now means that, although the Barnett formula is maintained, the total Scottish budget will now depend also on the revenue performance of the Scottish economy relative to the rest of the UK. Given the structural challenges for the Scottish economy, including poor productivity growth which is feeding into weakened pay growth putting downward pressure on household incomes, it is important, at both UK and Scottish levels, that measures are designed to address longer term economic growth and not just short term priorities.\(^2\)

\(^1\) Scottish Government Economic Strategy, 2015
\(^2\) Fraser of Allander Institute, Economic Commentary, June 2017
4. Where will we see future growth in our economy – exports, sectors, regions and innovations?

Future trading relationships could have an impact on future growth although the nature of this is uncertain as noted below. The growth of service industry and digital economy is recognised for Scotland. Investment is required beyond Scotland’s cities and there is a need for continued investment in post-industrial areas and the rural economy to ensure balanced growth. The refresh of the Enterprise and Skills Review recognises the importance of regions which is welcome. North Ayrshire Council are working with East Ayrshire and South Ayrshire Council to explore how an Ayrshire Regional Partnership could boost the Ayrshire economy and drive inclusive growth throughout the region. An Ayrshire partnership would build on the progress being made to deliver the ambitious Ayrshire Growth Deal.

The public sector is a large employer in many local economies, including North Ayrshire, and the sustainability of this is uncertain in the current climate of pressurised public finances. Diversification is required for the resilience of the economy as a whole and it is well highlighted that more Scottish companies need to be thinking internationally.

Technology and advancements such as automation may impact different demographics and geographies in different ways and we need to ensure our businesses and communities are resilient to this and able to play a role in the future economy.

The National Institute of Economic and Social Research has said (1 November 2017) it expects the Bank of England to raise interest rates every six months until the Bank Rate reaches 2%. The think tank is forecasting that the UK economy will grow by about 1.5% this year and next on the assumption of a smooth withdrawal from the EU - although its forecasts have been revised down by 0.25% since August, primarily reflecting a more negative view about the prospects of the economy. The short term future is therefore one of limited growth while in the longer term one might hope that the business services and finance sector, computer programming, renewables, high tech engineering, automation industries, tourism, aviation may be high growth sectors, although this is speculative. The UK Government’s Industrial Strategy introduced an Industrial Strategy Challenge Fund targeted at cutting edge technology in six sectors that the UK could become a leader in: healthcare medicine; robotics and artificial intelligence; batteries for clean and flexible energy storage; self-driving vehicle; manufacturing and materials for the future; and satellites and space technology. Whilst these sectors offer vast opportunities for the UK economy and our ability to adapt to the Fourth Industrial Revolution, some have argued that this narrow focus and investment could widen regional divides. Attention

3 https://www.niesr.ac.uk/media
4 HM Government, Building our Industrial Strategy Green Paper, January 2017
5 Sheffield Hallam University – Centre for Regional Economic Social and Research, 'Industrial Strategy and the Regions: The shortcomings of a narrow sectoral focus', July 2017
should be paid to ensure this does not become reality and that the Industrial Strategy stays true to its focus on place. One example of where enhanced focus on a key growth sector could help regional economic growth is the i3 Life Science Enterprise Area in Irvine. This site is also short-listed for a potential UK Medicines Manufacturing Innovation Centre (MMIC).

5. What is Scotland’s industrial composition and what are the barriers to diversification and growth?

Scotland is a country of SMEs and micro-businesses. There are low start-up rates and ‘dynamism’ compared to other economies. It has also been highlighted that funding to ‘scale up’ has been a barrier to growth.

We live in a time of vast technological change and no sectors are exempt from digital disruption. If companies do not have the ability to embrace new technologies and implement possible gains from digital infrastructure they may face an ‘innovate or die’ scenario. Innovation is recognised as being a key driver of productivity. Working smarter will become increasingly important as new technologies continue to disrupt the global economy. Technologies, including robotics and automation, also present traditional industries, like engineering and manufacturing, with the opportunity to innovate in processes and materials and drive productivity. Despite its strong history of discovery and invention, it is recognised that the UK has struggled to commercialise research. BERD (Business Expenditure in Research and Development) is low for the UK as a whole however it is also particularly low in areas of poor productivity, allowing correlation to be drawn between these themes.

In terms of future trading relationships, Fraser of Allander research on the ‘Long Term Economic Implications of Brexit’ modelled a range of scenarios regarding the UK's future trading relationship with the EU and concluded that, under all modelled scenarios, Brexit was predicted to have a negative impact on Scotland’s economy. The range of impacts were driven by the nature of any post-Brexit relationship between the UK and the EU – the stronger the economic integration with the EU, the smaller the negative impact. The report also notes that, in addition to the direct impact of becoming less integrated with the EU, there are also important spill-over effects from a slower rest of UK economy feeding through to Scottish sectors and firms. The scale of long-term impact depends on the precise trading arrangements negotiated post-Brexit.⁶

It is too early to know the implications of the decision to leave the EU for trade and investment, and any implications will be dependent on the terms negotiated as highlighted above, however, there are fears over rising material costs for business, skills shortages and delay in inward investment decisions. The removal of access to European Structural Funds (ERDF and ESF) could leave a policy and funding vacuum impacting regional economies and the

⁶ Fraser of Allander Institute, Long-term Economic Implications of Brexit – A report for the Scottish Parliament, October 2016
ability to achieve inclusive growth, particularly in the Highlands and Islands and post-industrial regions, including Ayrshire.

6. What role has Government support for innovation played in growing Scotland’s economy and boosting productivity?

Historically, UK labour productivity has grown by around 2% per year but since the 2008/2009 recession it has stagnated. Scottish productivity has now effectively caught up with UK levels – increasing from 94.5% of the UK average output per hour in 2007 to 99.9% in 2015 but continuation of this trend is highly uncertain. Stagnant productivity levels in relation to other Western European countries and the reasons behind this ‘productivity puzzle’ are still unknown. As noted, innovation, including R&D, can have a positive impact on productivity. However, productivity does not necessarily need to come from innovation. Infrastructure investment, including in roads, rail and digital infrastructure, and skills development are significant productivity-boosting levers. In North Ayrshire, as in other parts of Scotland, private sector investment is low and support to de-risk that private sector investment would be welcome and act as an incentive to stimulate local or regional economies. There may be merit in considering ‘regional interest rates’ that would spread investment more evenly across UK/Scotland.

The refresh of the Enterprise and Skills Review recognises the need for a greater focus on tailoring support to regional needs which is welcome. One example of this type of approach by Scottish Enterprise and a local authority partners is the North Ayrshire Innovation Pilot where North Ayrshire Council has worked jointly with SE, through the Team North Ayrshire approach, to deliver an innovation pilot. This has supported work to widen the take up of SE’s innovation-related products by North Ayrshire growth businesses. This is an example of the role that local government economic development can have in reaching important local SMEs and micro business and through relationship based approaches can identify and support their untapped potential. These local relationships and access to advice and support are needed given increased centralisation of business banking services and further development of local expertise across Scotland could be beneficial.

Inequality and labour market issues

7. What are the main drivers of income and wealth inequality in Scotland?

North Ayrshire Council worked with the Scottish Government’s Office of the Chief Economic Advisor (OCEA) to undertake a geographical pilot of the Scottish Government Inclusive Growth Diagnostic. Based on a methodology conceived by three Harvard Economists, diagnostics are increasingly used in developing countries to identify the main constraints to growth and prioritise spending actions to unlock them. The diagnostic's main purpose is to identify constraints and opportunities for driving inclusive growth in North Ayrshire order to prioritise actions to address them. The prioritisation exercise ranks
the identified constraints based on the interaction of two dimensions: impact (evidence-based) and care about.

Some of the key constraints identified through the pilot are: Intermediate/Advanced skills, Jobs density, Health and well-being, Childcare, Migration and Population decline. People to jobs (transport) and Goods to market (transport) were also identified as barriers to economic growth, as did digital connectivity and digital skills, highlighting the importance of ensuring our communities and businesses have the capacity to participate in the opportunities arising from the digital technology. The significance of physical and mental health as a barrier to participation was also evident. In terms of skills levels, education and training can be great leveller in terms of earning power and incomes.

North Ayrshire’s female employment rate is 59.3% compared to 69.1% in Scotland\(^7\). North Ayrshire Council believes that increasing female participation will have a positive impact on the productivity of the local and national economy and contribute to realising the goal of inclusive growth. A focus on female participation is timely due to the expansion of early years and childcare provision in 2020. A successful uptake of the expansion of childcare places has the potential to unleash an untapped labour potential into the economy, widening the talent and skills available to businesses across the Scottish economy. Enhanced female participation can also have an influence on child poverty through maximising incomes.

**8. How does income and wealth inequality in Scotland compare to other countries/regions and what are the policy responses to income and wealth inequality in Scotland and abroad?**

Income and wealth inequality is significantly higher, and growing, in the UK in comparison to other Western economies\(^8\). RSA Inclusive Growth Commission (2017) argue that investment in both physical and social infrastructure to create inclusive growth\(^9\). There is a need to make major infrastructure investment to deliver necessary conditions for an efficient economy, however, investment in training and supporting fair work, including through the living wage can help improve income inequalities.

North Ayrshire Community Planning Partnership (CPP) has developed and is implementing a ‘Fairer North Ayrshire’ strategy to address the unacceptable levels of child poverty and inequality in our communities. This Fair for All (FFA) strategy brings together diverse work across the partnership organisations into a cohesive strategy with a coherent monitoring framework to achieve equity. An advisory panel of national experts including Joseph Rowntree Foundation, Young Scot, NHS Health Scotland, and the Carnegie is also providing guidance. Our FFA strategy marks the start of a journey, where

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\(^7\) Annual population survey, Oct 2015-Sep 2016, ONS from Nomis on 7 March 2017


\(^9\) RSA Inclusive Growth Commission, Final Report 2017
CPP partners will increasingly work more closely together, in order to design, improve and challenge, how they individually and collectively act to reduce inequalities and promote equity. The high level outcomes from the Single Outcome Agreement (SOA) have been integrated into five key themes that North Ayrshire CPP considers integral to tackling and reducing inequalities locally, these are – Children and Young People, Health, Economic Growth, Environment and Food.

9. What have the trends in debt, wages and household income been over the past decade?

Personal debt has increased steadily and is now of concern, particularly with the recently announced increase in interest rates. Weak wage growth and higher inflation reduces the spending power in the economy. North Ayrshire Council has access to Paycheck, a gross household income model, provided by CACI Ltd. The data is provided down to postcode unit/data zone level and by £5k bandings. Gross mean household income in North Ayrshire in 2017 was £31,226. This is 14% lower than Scotland (£36,139) and 20% lower than Great Britain (£38,858). This is an increase in both absolute terms (2016 = £29,530) as well as relative to both Scotland (2016 = 15% lower) and Great Britain (2015 = 21% lower). However, the gap between the lowest and highest Data Zones in North Ayrshire has widened.

10. What are the reasons for regional differences in labour market participation?

De-industrialised areas have not recovered from the loss of jobs and there are not enough jobs in some areas to support high labour market participation. For example, North Ayrshire’s job density is 0.54 compared to the Scotland-level job density of 0.79 (2015 figures). Long term unemployment and social disadvantage in these areas compound the problem, locking in unemployment across the generations.

11. How has the labour market in Scotland changed over the past decade?

North Ayrshire’s population has been static for the last ten years but a future decrease is projected. Depopulation is viewed as a key driver of decline and a marker of a weak economy. The reduction in the working age population is a clear challenge.

A feature of the economy since 2013 has been that unemployment has fallen faster than in previous recession. The labour market is now more flexible which can encourage rising inequality. It is easier to cut hours and keep people employed on shorter working hour contracts (which has increased under-employment). Recent labour market trends show a growth in self-employment, much of which may be through the ‘gig economy’. Inactivity has been a recent concern but latest statistics have been less worrying. Whilst
progress has been made on female participation and addressing the gender pay gap, this is still a concern, particularly due to the dominance of women in low pay sectors and part time work. Given worrying in work poverty levels, the concept of fair work is of importance.

12. What are the different models of business ownership in Scotland and what is their importance to Scotland’s economy?

Social enterprises contribute £2bn GVA to the Scottish economy showing the growth and importance of the sector.\textsuperscript{10} Data from the 2015 Social Enterprise Census showed that social enterprises had a net worth of £17.4m and that there were 824 FTE employees in the local social enterprise sector\textsuperscript{11}. These businesses often employ those with disadvantages, are prominent in SIMD areas and have international activity, highlighting their contribution to Scotland’s inclusive growth. We have recently developed the Social Enterprise Strategy and recruited staff to help develop with the sector and we aim to increase numbers of social enterprises in North Ayrshire over the next 2 years by 15%. Furthermore, North Ayrshire Council was the first local authority in Scotland to have a dedicated Family Business Advisor as part of its Business Growth team recognising the unique support these businesses require.

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\textsuperscript{10} Social Enterprise Census, 2017
http://www.socialenterprisescotland.org.uk/files/4de870c3a3.pdf
\textsuperscript{11} North Ayrshire Council Social Enterprise Strategy 2016-2019