

Towards a robust, resilient wellbeing economy for Scotland

Report of the Advisory Group on Economic Recovery

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Foreword

"Those who wish to sing, always find a song."

Old Scandinavian proverb

If the monumental scale and nature of this economic shock is not a catalyst to accelerate change and to find new bold, radical interventions that will transform Scotland's economy, then nothing ever will be. We must be willing to revisit old demarcation lines without bias, and to discover new methods and levels of collaboration as we navigate our path of rehabilitation, recovery, and re-imagination. The importance of national leadership in a crisis is paramount. It must demonstrate an adherence to our sense of purpose, maintain our ambitions, and - more than ever - be based on the values which we wish to be the hallmarks of our country.

In the world before Covid-19, Scotland had the ambition to become a robust, wellbeing economy. That is one that generates strong economic growth with the concomitant creation of quality jobs, and that does so with an unequivocal focus on climate change, fair work, diversity, and equality. Diversity – in all its aspects - is not simply a moral issue; there is conclusive evidence that diversity of thinking leads to better outcomes.

The advent of this societal disruption makes it necessary to reconsider this ambition. The focus on establishing a robust, wellbeing economy matters more than ever, but we must now recognise more explicitly the essential nature of resilience. We need to build readiness to deal with the next cataclysmic disruption which will inevitably arrive either for current generations or for future ones. Next time it may be another pathogen, or it may be related to cyber-attacks or to climate change or some as yet unknown source. The fragility of our society and our economy, like that of others, has been laid bare these past few months. The public

health crisis which has tragically taken so many lives prematurely cannot be allowed to lead to an economic one that is socially destructive. And the pursuit of building greater resilience must not be considered negotiable.

Prior to the onset of the health crisis, we faced a number of significant economic challenges. Extended steady but low economic growth combined with relatively full employment indicates structurally low productivity. Our export base is narrow. Our population is an ageing one. There is the jeopardy, as well as the opportunity, of the transitions associated with climate change and the so-called fourth industrial revolution, which will be characterised by digitisation, the use of data, machine learning and artificial intelligence. And, of course, the long-term ramifications of Brexit – the outlook for which has worsened markedly. These challenges have not gone away.

But we have a new starting point. Three themes have emerged as even more dominant than before; inequality, education, and unemployment. The last few months have exposed and illuminated the scale of inequality across the world and here in Scotland. And the events of the last few weeks have brought an acute, overdue point of inflection in how we reflect on racism. The health crisis has spawned further inequalities, and the relaxation of restrictions will create yet more. It is illustrative to consider that 90% of the top 50% of earners in the country can work from home, whilst 90% of the bottom 50% cannot do so. Many of the lowest paid essential workers have put their health and that of their families at risk during this crisis. There are countless studies that demonstrate the impact of 'learning loss' when young people are denied access to conventional schooling. Once again, it is most pronounced in disadvantaged communities, where the alternative to formal delivery is very constrained.

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The central importance of the role of education in the reconstruction of the economy is unarguable, and the breadth of what this means needs to be reconsidered. We need to accelerate existing concepts being developed in schools to prepare some children in their later years for vocational roles and apprenticeships. We must strive to ensure that learning is designed to match the skills we need in Scotland in future. Reskilling and lifelong learning will be vital too. Our universities are the envy of many around the world. We must protect them but also leverage them to greater effect; we must transform acknowledged world-class research into comparable levels of development, and, in turn, large-scale commercialisation. We need an education-led recovery.

The prospect of an inevitable sharp rise in unemployment demands direct and urgent intervention. We need to create jobs at an unprecedented rate, and also to ensure that they are quality jobs, holding firm to the principles of fair work. There are two imperatives here. Firstly, we must take specific care to shelter those currently in their mid-teens through to those in their mid-twenties. Over the next few years they will be the young adults due to leave different stages of education, or be those at risk of losing their jobs now having only just embarked on careers. We know well from previous recessions that there is a material risk of long-term scarring for this cohort of young people. They do not deserve it. We must act now to mitigate this risk. The second is that 79% of jobs in Scotland exist in the private sector. So the solution to unemployment will depend heavily on how we mobilise the private sector to create employment.

The Advisory Group on Economic Recovery (the Group) was asked to address the challenges beyond the need to provide emergency life support to the economy. The steps taken by the Scottish and UK Governments to provide such immediate protection for individuals and

businesses have been essential and critical. But we must chart a future path for the economy. The Group was purposefully designed to be small enough, with only eight members, to act with pace and agility. Central to our approach, however, has been an intensive dynamic dialogue with a broad church across all sectors – public, private, third – and around the country. In particular, Lord Smith has led a structured conversation with business leaders in Scotland on our behalf. The level of engagement over just a few weeks – through meetings, formal submissions and less formal contributions – has been both substantial and welcome. Given the sheer speed with which we have had to proceed, there will be some who may feel they didn't get a sufficient opportunity to engage fully, but hopefully not many. The kernel of the role of the Group has been to discuss, challenge, and curate the ideas and suggestions emerging from the external engagement.

Our approach has been to view Scotland's economy through the lens of four economic pillars of capital: financial and physical capital, natural capital, human capital, and social capital. This is not a novel approach insofar as it has been used elsewhere, including by the OECD, but it is a new approach for Scotland. It is helpful in a range of ways. For one, it enables us to take a holistic view of our national balance sheet in a progressive manner that is entirely consistent with the barometer that is the National Performance Framework. In doing so, we have sought to treat each pillar as equally important; to understand their interaction; and to pursue interventions that will first protect and then progress each of them. A concept such as 'Place', for example, weaves like a thread through the four pillars: others do too. The approach has served us very well for the purpose of our analysis, but, given the interaction between the pillars, we opted not to apply it slavishly to classify our recommended interventions.

The backdrop to those interventions will be one of constrained public sector finances. There are

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inevitable consequences that flow from this premise. The calculus of prioritisation, which always matters, becomes even more pivotal. And the difficult bedfellow of de-prioritising to create headroom needs to be tackled. The Fiscal Framework is due to be reviewed next year, and we encourage a gear change that may allow it to be concluded more quickly. Quite separately, however, there needs to be a plan to unlock financial borrowing at the exceptionally low prevailing long term interest rates. We are agnostic on how the Scottish and UK Governments choose to achieve this outcome. A case of what matters most not being at the mercy of what matters less.

The identification of areas where change might be executed through both willingness and determination, but at limited financial cost, should be given due attention. An example of such an area is regulation and planning. We should adopt a pragmatic approach that seeks to maintain adequate standards but breathes more life into sectors such as tourism and hospitality, renewables, and affordable housing. Progressive change will play an important role in redefining Scotland's prospectus for inward investment – a subject that we discuss more broadly in this report.

The financial constraints also manifest themselves as a pressing need for the financial might of the private sector to be deployed alongside Government to stimulate economic activity and create jobs. Strong relationships between all parts of our society will be a fundamental element of recovery plans. At this time it is particularly important that we make fresh start on the relationship between business and Scottish Government. For some sectors - notably financial services, agriculture, and renewables – the relationships are both mature and reasonably effective, but there remains authentic concern expressed more broadly that engagement with Scottish Government needs to be transformed. It is uncontroversial to say that when one party in a

relationship says that it's not working, then it isn't. But it is also a truism that, commonly, both parties have to adapt to make it work.

So this report calls for both the private sector and Scottish Government to embrace an opportunity to reset their engagement. Some suggestions are included in our recommendations: but this a sphere where progress will be judged over time by action, not words. This is the time to start.

To extend that point further, this report was commissioned by the Government but its call to action is aimed beyond Government to all parts of our society. Mention has already been made in relation to the private sector, but the cultural sector and the third sector have urgent roles to play too. Culture will play a definitive role in the recovery of our wellbeing, and it must be an intrinsic element of how Scotland is represented at home and abroad. The sector must be cultivated and nourished for the greater good.

The framework and apparatus of economic support in Scotland is not without its critics. The temptation at this juncture is, therefore, to tear some of it apart and to recast a new model. Now is not, however, the right time to be absorbed in abstract arguments around the creation of new institutions. There is a powerful argument that the landscape is already too confusing and cluttered. So, for example, the likely emerging Scottish Government stakes in larger businesses should be managed within Government, albeit there needs to be confidence in the capability and capacity to do so. This may provide an opportunity for Government to draw on businesses to second senior executives.

On the subject of broader restructuring of economic development, the parliamentary consequences - in a year ahead of Holyrood elections, no less - would be to run the risk of a bureaucratic vortex when we can least afford it. The right answer is to redefine and repurpose the

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existing model to meet the new challenges and opportunities that we confront today. We can do so by considering our national, regional, local and international needs and by adapting the thrust of existing activity to empower regions, cities, and local communities.

Furthermore, this requires the careful but immediate development of an economic and investment prospectus at each level, recognising the merit of judicious choices over where one city or region, say, is best placed to take the lead to allow others to follow. In developing prospectuses for Scotland at a national and other levels, we must focus on where we possess natural strengths or where we have a genuine belief that we can develop relative competitive advantage. An obvious example is the desire for Scotland to have a strong green spine to our recovery.

Had we not concluded more than two years ago that we needed the Scottish National Investment Bank, we would need to do so now. The Bank, which opens its doors this year, will play a transformative role by focusing on long-term, missions led patient capital.

We have an entirely legitimate ambition to be near the top of the table of performers with respect to natural capital. We must focus on green trade, the opportunities for carbon capture and storage in the North Sea, and take a leading role in progressive calibration including carbon consumption. Moreover, to make our carbon targets realistic we must address and tackle the emissions related to transport and agriculture. We must also recognise that natural capital goes beyond carbon related dimensions to encompass the natural beauty of our country that we must protect and develop. By doing so we can underpin the recovery of tourism and hospitality which is a fundamental characteristic of Scotland's brand. Other brand considerations include the aforementioned university sector, a focus on the right skilled talent pool, our attractiveness as a

technology hub, and our identity and excellence in the culture spectrum.

Trust must lie at the heart of a robust, resilient wellbeing economy. Since the global financial crisis, trust in many components of society has been diminished. During this crisis some have restored trust while others have eroded it further. It is the glue which binds the pillars of capital together and reinforces our sense of belonging. Our approach to economic recovery must reflect the importance of economic growth, but in a manner that builds trust. Together, we can pursue our aims with a level of confidence that is pivotal to sustainable prosperity in Scotland.



Benny Higgins

1. Remit, Membership and Approach

Gaining independent and expert advice when responding to the long-term impacts of coronavirus is essential. That is why the Scottish Government established the Advisory Group on Economic Recovery in April 2020. The Group was asked to focus on Scotland's economic recovery, with the emphasis on the period after the immediate emergency created by coronavirus has been addressed.

This report provides advice to the Scottish Government on actions that will make a difference to businesses across sectors and regions throughout Scotland. Solutions are being brought forward to enable a swift economic recovery and one that also ensures the Scottish economy will emerge stronger and more resilient. This has been done through proactive engagement with those affected by this crisis, and listening to those who are crucial for the rebuilding of a resilient economy.

This Group is just one of a number of mechanisms initiated by the Scottish Government to identify and inform its approach to shaping Scotland's economic recovery. The Group has considered how to ensure an economic recovery that will increase wellbeing, fairness and inclusivity, and makes the most of opportunities towards a greener, net-zero society.

Specifically this report responds to the remit set by the Cabinet Secretary for Economy, Fair Work and Culture, and *"advises on the economic recovery from the coronavirus pandemic, including:*

- *measures to support different sectoral and regional challenges the economy will face in recovery*
- *how business practice will change as a result of coronavirus, including opportunities to operate differently and how Government policy can help the transition towards a greener, net-zero and wellbeing economy"*

1.1 Membership of the group

The work of the Group was led by Benny Higgins (Special Adviser to the First Minister on the Scottish National Investment Bank and Member of the Infrastructure Commission for Scotland). The members were;

- Dame Sue Bruce (Electoral Commissioner with responsibility for Scotland and a Non-Executive Director with Scottish and Southern Energy)
- Professor Dieter Helm (Professor of Economic Policy at the University of Oxford)
- Professor John Kay (economist whose career has spanned the academic world, business and public affairs)
- Professor Sir Anton Muscatelli (Principal of the University of Glasgow)
- Grahame Smith (General Secretary of the Scottish Trades Union Congress)
- Dame Julia Unwin (senior strategic leader with extensive professional experience in the voluntary and public sectors, and corporate social responsibility)
- Professor Anna Vignoles (Professor of Education at the University of Cambridge)

1.2 Call for views from Scottish society

In recent months, governments around the world have recognised the need to act swiftly to mitigate the short and long-term impacts of the pandemic. Alongside the very human tragedies and loss of life, the pandemic, brings a strategic challenge for our future economy and for our future livelihoods. Over recent years it has been increasingly apparent that if we want to build a greener, fairer and more inclusive society in Scotland, we need to reimagine our economy. So the Scottish Government has asked the Group not to signpost a return to the status quo, but to set out possible paths towards a better recovery - towards a more robust, more resilient Scottish economy.

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The Group was asked to provide recommendations by the end of June, in time to inform the Scottish Government's strategy for the recovery. The Group has met on a twice weekly basis to discuss the key issues. A key part of the Group's work has been a process to gather external evidence and advice, at pace, on the insights of a broad cross-section of organisations, businesses, unions and individuals across Scotland.

The areas for consideration were recognised to be broad, and the consultation with key groups, and an open call on the Scottish Government website, was based on a series of questions and issues. The Group commissioned specific expert input, survey and research activity.

In parallel with this exercise, the Group developed a targeted programme of engagement activity, supported by Scottish Enterprise. Lord Smith of Kelvin commissioned specific input from business organisations, and the Group benefited from relevant work across the Scottish Government, its agencies and key sectoral fora.

The immediate crisis has brought forward radical and necessary responses to the health emergency. The consultation encouraged engagement which could be radical about the economic recovery as well. The Group sought brave new ideas, and ideas that have not been seriously considered before. The consultation also confirmed existing proposals whose "time has come" and need implementation.

The response to our engagement has been of high quality and considerable breadth and depth. In the time available, there will not be scope to provide definitive answers to every question or to set out a comprehensive and detailed blueprint for the period ahead. This report provides a direction for our economic recovery, but requires a very considerable mobilisation of activities across Scotland to enable a response. The dialogue and engagement which has been accelerated by the pandemic and harnessed by the Group needs to be

built on further, and this is acknowledged in the recommendations.

In terms of the call for views:

- A further report, providing a detailed summary of the responses received will be published in July;
- All responses will be posted on the Scottish Government's website, unless consultees have specifically asked for their responses to be confidential;
- Responses from partner organisations, who have supported the process, and commissioned advice referred to in the report are published alongside this report; and
- The engagement initiated by the Group will be built on further, including by the Scottish Government and its enterprise and skills agencies, and responses of specific relevance to ongoing policy development, for example on the green recovery, will be passed on to the relevant lead organisation.

1.3 Guiding Principles

In developing the report, the Group has been guided by a set of principles, which have helped provide a frame of reference for the whole report. These Guiding Principles have also acted to perform a set of criteria on which to judge the recommendations which the Group have chosen to make.

The Scottish Government has recognised the four categories of harms that have resulted from this crisis. The virus causes direct and tragic harm to people's health; it has a wider impact on our health and social care services; the restrictions which Scotland, together with the other UK nations, has necessarily put in place to slow the spread of the virus can in turn cause wider social harms; and the wider negative impacts of the global pandemic and

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the lockdown has had an enormous impact on our economy.

The unprecedented economic harms of this crisis are already substantial. It has affected long standing businesses, and undermined aspiring growth companies. It has undermined livelihoods and jobs. The productive capacity of the economy has been hit hard, and this will ripple forward during the recovery phase. Yet, there is no question that it was right to prioritise the response to the health emergency to protect lives and the NHS, and it is clear that the economic harm would have been worse unless the health emergency was addressed.

In response to the crisis, significant action is required to mitigate the economic recession. Governments have provided an extraordinary safety net to business and individuals during the crisis.

The economic and social harms, and how we manage them, will become the substantive policy challenge facing Scotland for the foreseeable future. This challenge will be further and substantially increased by the prospect of a changed relationship with the European Union at the end of this year.

Over recent weeks, Governments have rightly stepped in to counteract the precipitous drop in economic activity during the crisis, and this will inevitably impact on the fiscal options open to government in future. It is essential that we acknowledge the resulting fiscal constraints, without recourse to a policy preference for austerity and without undermining the capacity of public services to support the country into recovery. As the economy does begin to recover, we must not repeat the mistakes of the past, whether the early years of the 1980s recession or the post 2008 austerity.

Over coming months, as the economy recovers, the level of government support to business and employees will wind down. This transition out of lockdown represents just as big a challenge as

going into lockdown, and indeed a greater one. Managing this transition will be crucial in enabling economic recovery and in preventing wider social harm.

The lived experience of the crisis has brought some positives, including the collective willingness to respect the need to save lives and protect the NHS. It has helped us rediscover what we value, and helped us realise the importance of community, of key workers, and of the wider foundations of society, environment and the economy. The opportunity now is to maintain and nurture the true wealth of our nation which has too often been overlooked

The collective endeavour against the virus can evolve into a common purpose to think differently about our economy, including the respective roles of public and private sector. This will require action by government – Scottish and UK – but also by businesses, households and individuals. There is a historic chance to ‘build back better’, and fairer, in a way which will leave the Scottish economy more robust and resilient than before.

We must seize the opportunity for a process of national renewal. Business in Scotland should be at the centre of this renewal. And since Scotland cannot thrive if it is not back to work, and since over 70 per cent of Scots work in the private sector, Scottish businesses must lie at the heart of our recovery plan.

While Scotland’s National Performance Framework remains the objective, we now have a new starting point. This report is only a first step in assessing the balance sheet of Scotland as it enters economic recovery. We have adopted a broad and robust framework for looking at the Scottish economy that would capture all of its assets and provide the basis for a holistic view of paths to a more robust and resilient economy in the future.

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At the heart of this report is an assessment of Scotland's economic recovery which consider all facets of Scotland's capital assets, rather than prioritising one dimension over another. This assessment is structured broadly under the four capitals, acknowledging that most issues straddle more than one.

The impact of the crisis, and the necessary restrictions on economic activity to eradicate the virus, have had clear impacts on all four capitals. It is too early, and too big a task, to make precise estimates, but the impacts are mostly negative. The productive capacity of the economy has been put at risk, wage packets have been reduced and investments in learning for the future have been compromised. Yet we should not discount the positives, in social cohesion and in environmental quality.

These impacts have been experienced disproportionately by different groups across society, whether directly in terms of mortality and illness or in consequence through impacts on employment patterns, earnings and the lived experience.

In building forward the best possible economic recovery, the key role of government is to set the direction and to promote the positive freedoms, capabilities and choices in society. We came into this period seeking to lay the foundations of a robust, wellbeing economy. We must come out of it with an additional focus on resilience. A robust and resilient economy is a foundation for human wellbeing, and a worthy objective for the future. Over the recovery phase, and in future, the economic development strategy should give greater strategic attention to the resilience of business and the economy, to address future risks, whether pandemics, changes in international trade and climate change.

The crisis has exposed both the inequalities in our society and vulnerabilities in our economy. It has

put at risk the livelihoods of workers, the self-employed, small business owners, entrepreneurs and Scotland's economic potential. It has revealed the vulnerability of businesses and supply chains to deal with shocks. And it has impacted disproportionately on those already experiencing hardship, thereby compounding the inequalities already evident in our society.

Unless the economy is nurtured into recovery, we could see a compound crisis of joblessness and of loss of learning and of skills. We could see a sharp rise in unemployment and underemployment, with prolonged economic hardship and loss of potential. And as we have experienced so harshly in Scotland after previous recessions, the social harm of economic recessions can have permanent damaging effects on wellbeing and public health.

Going forward, this points to the need to prioritise resilience in our economy rather, than just over-prioritising efficiency and low cost. This resilience will require acknowledging the importance of economic security, whether against risks like a future pandemic, cyber-attacks, trade dislocation or climate change. It will need a greater recognition of the mutual interdependencies in our society, whether the importance of key workers, the reliance on digital technology, and the contribution of our social and care services. And it will recognise our collective need for entertainment, sport and culture - all of which have been so badly missed in recent months.

This report begins to identify those areas of focus for the recovery stage, based on the need to protect businesses, workers and the self-employed, prevent long term consequences of learning and employment gaps, and promote positive changes for the future.

In the short to medium term, we must protect economic activity. This has taken the form of unprecedented steps to protect the productive capacity of businesses and the incomes of workers.

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This approach builds on a sound macroeconomic case to seek to mitigate the damage to the economy now to protect against even greater losses later. While Scotland is currently, and permanently, poorer as a result of the pandemic, we are in a better position than we would have been without the extensive measures taken to protect businesses and individuals during the crisis.

In the months ahead, we must seek to prevent sustained, long term damage to our economy and society. The steps taken to mitigate reduced consumer spending, failure of businesses, bankruptcies and closure have all provided some protection against the immediate economic recession. But they also seek to prevent future harm to the economic and social fabric of the country. The impact on the economy of the permanent closure of otherwise viable companies and the loss of otherwise productive jobs will have future economic consequences.

Moreover, the loss of a period of schooling or compromised education could lead to a so-called “learning loss” which could have long term effects. A sustained period of unemployment harms wellbeing and can compromise long term earning potential. Likewise, a compromised transition for our young people moving from education into the labour market runs the risk of permanent economic and social harm.

So the prevention of lasting long-term effects on the prospects of companies and of people’s livelihoods in the future must be a key objective for government intervention. It is nearly 10 years since the Christie Commission recommended that priority should be given to preventative action. These principles remain relevant, and ensuring prevention of lasting negative consequences of this economic recession, especially for the young, the unemployed and those in precarious employment must be a priority.

And for the future, we must promote the acceleration of positive actions and trends, which can now be embedded and encouraged. The greater utilisation of digital and “virtual infrastructure” can lock-in beneficial changes. This can enable greater choices for urban transport and deliver better for rural areas.

The drivers of recovery will reflect many of the same issues as before, but will need to be addressed in different ways. There will be a need for a proactive, muscular intervention from all layers of government and from economic and skills agencies, which will need to adapt to the new circumstances. This can build on the improvements already underway, including the development of new organisations like the Scottish National Investment Bank and South of Scotland Enterprise and the pivoting of activities to support recovery.

A number of common themes have emerged through the assessment of the Group and from the consultations with businesses and stakeholders. These point to employment and education being at the heart of our plan for recovery, while accelerating action to tackle inequality.

The ambition to respond proactively and positively to the recovery must acknowledge the fiscal context facing governments. The crisis has led to exceptionally high levels of government and private sector debt, albeit alongside a likely sustained period of low interest rates. So while public spending and borrowing and other government interventions will have a critical part to play in stimulating the recovery, we need to be realistic that financial resources are extremely tight and likely to become tighter. A balance needs to be found between the need for restraint and the opportunity to invest at low cost to promote recovery.

Therefore, this report seeks to make recommendations which will have impact without simply recommending more spending. The Group has sought to make recommendations which are an

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action list, and not just a shopping list for more government expenditure. A commitment to fiscal sustainability should in turn be a basis for

accelerating and adjusting the Fiscal Framework in Scotland to ensure it is fit for a new purpose.

The ten overarching principles guiding the work of the Group are:

Our Guiding Principles

1. The economic harms of this crisis are substantial, and significant action is required to mitigate the economic recession caused by the pandemic
2. In responding to the economic situation, we must not repeat the mistakes of the past (whether the 1980s recession or the post-2008 austerity)
3. We must seize the opportunity for a process of national renewal, with economic recovery underpinned by a new deal with business
4. The crisis has made us rediscover what we value - we must nurture the true wealth of our nation which has too often been overlooked
5. A key role of government is to set the direction for economic recovery and to promote the positive freedoms in society
6. We need a focus on a robust and resilient, wellbeing economy.
7. We must accelerate action to promote wellbeing and Fair Work and tackle inequality by mitigating the risks of unemployment, especially among groups hit hard by the crisis
8. We must restore employment, by prioritising a green investment and education-led recovery, with a prominent role for digital technologies.
9. A renewed sectoral and regional approach can release the innovation and collective spirit required to adapt to the new world
10. Our recommendations are an action list, not a shopping list

2. Scotland's economic context

Prior to the coronavirus pandemic, the Scottish economy was influenced by a range of global and domestic economic and political developments over the past decade such as the global financial crisis of 2008-09, the significant fall in oil price in 2014 and the UK vote to leave the EU in 2016. These have had significant impacts on the performance of the Scottish economy and on expectations of how the Scottish economy, and sectors within it, will continue to evolve going forward.

In the year leading up to the pandemic outbreak, growth in the Scottish economy had weakened in the face of slower UK and global growth and significant uncertainty regarding Brexit, impacting on investment, trade, sentiment and output. The Scottish economy grew 0.7% in 2019, significantly below trend, while business investment had fallen 13%.

Scotland's labour market continued to perform strongly over 2019 with unemployment remaining around 4% and close to record low levels and high employment. This fed into stronger wage growth over the year with full time gross median weekly earnings rising 2.4% over the year to £576.70: however, growth remained subdued in real terms rising 0.4%.

Annual productivity slowed to 0.5% growth in 2019, after increasing by 3.2% in 2018. Annual productivity growth can vary widely from year to year, but looking over the longer term it has grown by an average of 0.8% per year since the 2008-09 recession. Prior to the recession, from 1998 to 2007, output per hour worked increased by 1.5% per year on average. In 2018, Scotland was ranked in 16th place (out of 37 countries) for productivity levels amongst OECD countries, in the lower half of the

second quartile. Scotland's international ranking within the OECD has been largely unchanged since 2007.

However, over the period since the financial crisis, growth in GDP per head was similar to that of the rest of the UK but in Scotland was driven by both increases in productivity and population whereas for the UK as a whole it was primarily driven by an increase in population from inward migration. However, inward migration is important to Scotland due to the (older) age structure of the population. This is picked up in greater detail in section 2.5.

Despite the uncertainty caused by Brexit in 2019, Scotland retained its position as second to London in attracting new Foreign Direct Investment projects in 2019 with 101 new inward investment projects being secured, up from 94 the previous year.

2.1 Scotland's economic strategy

Scotland's Economic Strategy¹ was published in 2015 and sets out the ambition to reach the top quartile of OECD countries on productivity, wellbeing, sustainability and equality. It placed an emphasis on boosting competitiveness while simultaneously tackling inequalities and set out four priority areas: investment, innovation, internationalisation and inclusive growth.

There is growing evidence that delivering sustainable growth and addressing long-standing inequalities are reinforcing – and not competing – objectives. The OECD estimated that rising income inequality had reduced UK GDP per capita growth by 9 percentage points between 1990-2010² and

¹ <https://www.gov.scot/publications/scotlands-economic-strategy/>

² <http://www.oecd.org/unitedkingdom/making-inclusive-growth-happen-in-the-uk.htm>

the IMF notes that tackling inequality is not only a social imperative; it is critical for sustaining growth³.

2.2 Current economic situation

There is broad consensus that the pace and scale of collapse in economic activity is unprecedented but acknowledgement that this has occurred to protect public health.

The Scottish Government's most recent assessment of the impact on the Scottish economy by the Chief Economist in June 2020 suggests a fall in GDP in Scotland of a third over the current period of distancing and 14% over the year. The Scottish Government's scenario analysis suggests unemployment could reach 10% later in 2020.

These impacts are similar to what we might expect to see in other countries and the global economy is forecast to contract this year for the first time since the financial crisis.

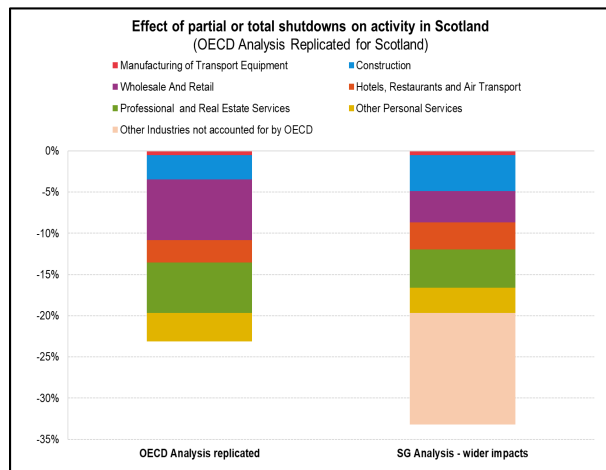


Figure 1 - Effect of partial or total shutdown on economic activity in Scotland (Source: SG Analysis)

The priority has been to protect public health with physical distancing measures quickly introduced to contain the spread of COVID-19. Some of these measures have necessitated the shutdown of many parts of the Scottish economy. Our economic

analysis shows that 22% of the economy has been strictly closed which has impacted over 900 thousand jobs and over one third of the business base (including the self-employed).

Scotland's GDP fell by 2.5% in real terms during the first quarter of 2020 (Jan to March)⁴. Over the same period, GDP in the UK as a whole fell by 2.0%. Compared to the same quarter last year, Scotland's GDP fell by 2.3%. Over the same period, the UK as a whole fell by 1.6%. The largest single contribution to change over the quarter came from contraction in Manufacturing (within Production), but there were falls across almost all industries.

In experimental statistics released on 17 June⁵, developed to track the impact of the crisis as quickly as possible, Scotland's GDP is provisionally estimated to have fallen by 18.9% in real terms during April, after a fall of 5.0% in March. These results are very similar to the pattern seen across the UK as a whole, in which GDP fell 20.4% in April, and reflect the direct economic impacts of the COVID-19 pandemic in Scotland during the first weeks and full month of the lockdown phase.

The industries with the largest falls in output over the latest two months are those which have been required to close or where working at home is not possible. This includes Accommodation & Food Services (down 85% over two months) and Arts, Culture & Recreation Services (down 51% over two months). These results are provisional and likely to be revised in the coming months as data sources and methods are further improved but go some way to confirm the analysis above.

We are just beginning to see the impacts of COVID-19 on the labour market with the most recent labour market figures for the period until April 2020 and for youth unemployment to March 2020.

³ <https://blogs.imf.org/2018/01/23/5-things-you-need-to-know-about-inequality/>

⁴ <https://www.gov.scot/publications/first-estimate-of-gdp-2020-q1/>

⁵ <https://www.gov.scot/publications/monthly-gdp-april-2020/> Note: Any apparent differences between Scotland and the UK as a whole are within the likely margin of error and should not be interpreted as significant.

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Over the quarter February – April 2020 rates for unemployment increased to 4.6%, employment decreased to 74.3% and inactivity decreased to 22.1%. There were 127,000 people unemployed in Scotland up 30,000 since the last quarter. It should be noted that furloughed workers are recorded in the employment category as they are only temporarily away from work.

The youth labour market (16-24 year olds) is already beginning to show Covid-19 impact. For the year April 2019 - March 2020 compared to the previous year, the employment rate was significantly lower, a drop of 3.6% to 54.8%, and the unemployment rate was slightly lower at 8.8%. Over a third of those working in accommodation and food services are aged 16-24, a sector particularly hit by lockdown measures, and those in this age group more likely to have non-secure contracts.

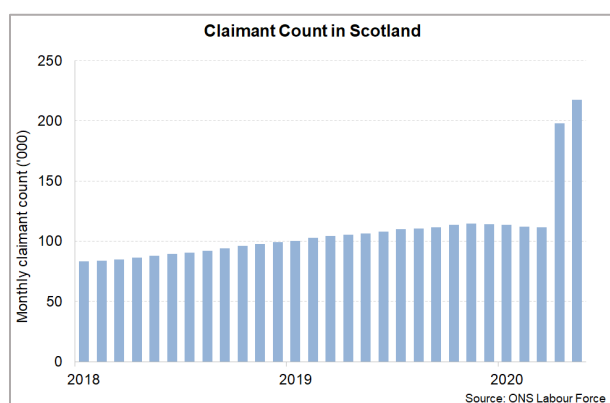


Figure 2 - Claimant Count in Scotland

Experimental claimant count data for Scotland⁶ between April and May 2020, shows a 10% increase, taking the level to 218,000 and the rate to 7.8%. The experimental claimant count data covers claims for Jobseeker's Allowance and those claimants in the Universal Credit "searching for work" conditionality. These suggest that unemployment in Scotland in May was closer to 187,000 (from 127,000 in April) with a rate at around 6.7%. We can expect to see unemployment rise each month,

depending what happens with workers currently furloughed (628,000 workers in Scotland up to 31 May)⁷.

2.3 Economic prospects

We estimate a 33% fall in Scottish GDP over the months that the current distancing measures are in place (see Figure 1). These estimates are similar to those produced by the OECD as well as other organisations such as the OBR.

The outlook for the UK economy is increasingly pessimistic. The latest UK GDP data for March 2020 was down 5.8% compared to February (and down 2% over the first quarter of 2020). The average of independent forecasts for the UK suggests a fall of 8.6% in GDP in the UK.

The Bank of England scenario analysis (7 May) suggests that UK GDP could fall by 14% in 2020 with a bounce back to growth of 15% in 2021. Unemployment could rise to 8% in 2020 and remain elevated at 7% in 2021.

The Bank of England and the OBR have in recent analysis assumed a V-shaped recovery, that is, a short, sharp decline in economic activity followed swiftly by a rebound in growth within 12 months. As more economic data emerge, there is a growing recognition that a quick rebound in economic activity following the phasing out of lockdown may be unlikely.

The Scottish economy will recover from the current impacts of COVID-19, but the shape and speed of adjustment are uncertain. Although physical distancing measures are expected to be temporary in nature, there is potential for even short term measures to have long lasting impacts and become more structural.

⁷ <https://www.gov.uk/government/statistics/coronavirus-job-retention-scheme-statistics-june-2020>

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Scottish Government has undertaken modelling of illustrative scenarios. Figure 2 shows a V-shaped recovery scenario, with a sharp fall in GDP and then a strong recovery, unemployment rises to 10% in late 2020, before returning to pre-pandemic levels after around a year.

The modelling presents two illustrative scenarios for the economy, not forecasts or predictions, but scenarios that reflect key policy variables and potential recovery paths for the economy. Scottish Government has undertaken modelling of illustrative scenarios. Figure 3 shows a V-shaped recovery scenario, with a sharp fall in GDP and then a strong recovery, unemployment rises to 10% in late 2020, before returning to pre-pandemic levels after around a year.

We estimate a 33% fall in Scottish GDP over the months the current distancing measures are in place (see Figure 1). These estimates are similar to those produced by the OECD as well as other organisations such as the OBR.

There is still a significant amount of uncertainty over how the labour market may recover. For example, during the financial crisis, there was evidence of employees willing to accept pay cuts in order to maintain employment. Alternatively, firms may prefer to maintain wages to retain experienced staff in the short-term, whilst keeping fewer staff to cut costs.

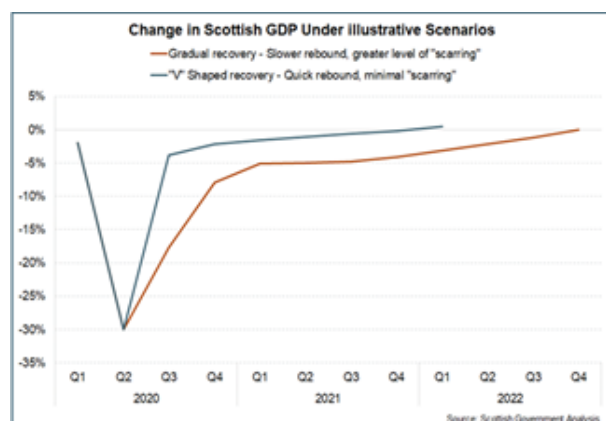


Figure 3 - Illustrative modelling on medium term impacts on GDP

Figure 3 shows that, in the first scenario, “V-shaped Recovery”, there is a swift recovery across all sectors, with minimal loss of productive capacity or scarring on the economy. In the second scenario, “Gradual Recovery”, a greater degree of scarring is assumed and sectors recover at different speeds as restrictions are gradually lifted.

Despite both scenarios having the same profile up to 2020 Q2, the medium term pathway looks very different. In the ‘Gradual Recovery’ scenario, the slower rebound in demand causes the short-term downturn to be more protracted, and more importantly the greater degree of scarring means economic output does not recovery to pre-crisis levels until the start of 2023.

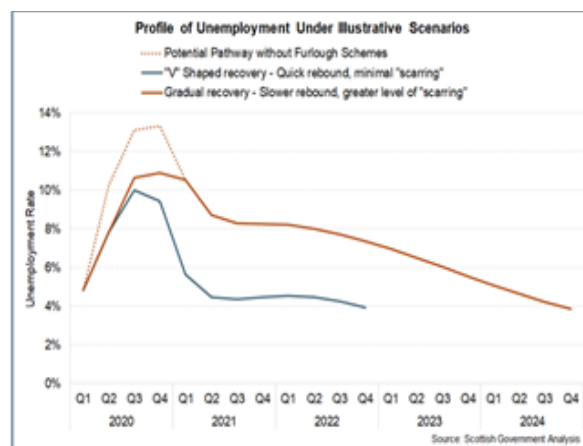


Figure 4 - Illustrative modelling on medium term impacts on Unemployment

Figure 4 also shows the impact the Job Retention Scheme could have on headline unemployment rates in Scotland. Even with the current levels of government fiscal support, in the absence of the scheme, it is estimated that unemployment could have reached around 14%. This is similar to what has already been seen in the US, where there is no equivalent scheme. Ultimately, the level of unemployment will depend on how many people currently furloughed become unemployed as the scheme is unwound. This highlights the importance of withdrawing the scheme gradually.

2.4 Assessment of factors affecting the economic recovery

There are a number of factors that are uncertain around the recovery and the medium term outlook.

As the economy restarts, we will see a reversal of the output contraction for many parts of the domestic economy. Not all sectors will come back immediately, however, as external demand, consumer tastes, and business models will have changed significantly in order to operate in a safe manner.

There may be a loss of productive capacity as the restrictions in economic activity continue and this will lengthen the recovery period. This may manifest itself in high unemployment and high rates of business failures and the scarring effects that this has on individuals and communities.

The crisis may also accelerate some structural changes that were already happening, such as a switch from high street retail to online.

The policy response to the economic shock, most notably the fiscal stimulus to support jobs and businesses, is already of a greater scale than that witnessed in the financial crisis. The unwinding of these support schemes will be critical to the recovery.

The costs of the support schemes means that the UK will run an unprecedented fiscal deficit in 2020. Despite the fiscal stimulus and support measures in place, businesses, households, organisations of all kinds and government will all emerge from the crisis with debt and how this debt overhang is dealt with will have a substantial bearing on the speed of recovery.

The global nature of the crisis means that the recovery will depend on how other countries and trading partners also recover from the crisis.

Whilst the factors affecting the recovery are uncertain, there is clarity that the rapid pace and scale of collapse in economic activity that has been witnessed is the starting point for the recovery and the point of departure.

Commissioned Report by Dr David Skilling

We commissioned Dr David Skilling, an acknowledged expert in small, open advanced economies, to look at other countries' policy responses to the pandemic and identify possible lessons for Scotland. We are publishing his report alongside ours.

In summary, Dr Skilling's analysis is that the crisis will accelerate structural dynamics and lead to more enduring change than the global financial crisis of 2008, with increasing frictions on globalisation; pressures to localise supply chains; support for national champions; and restrictions in cross-border flows of capital and people. The role of government in the economy will grow, and new growth sectors will emerge while others decline sharply.

In response, he recommends that Scotland should:

- Increase investment in research and innovation
- Give new impetus to the upgrading of skills
- Reprioritise support towards strategic growth sectors - digital, life sciences, green

2.5 Potential impact of Brexit

Although the UK has left the EU, it is still able to benefit from most aspects of EU membership because it is in an implementation period during which pre-Brexit rights and obligations apply in almost all areas. Ending that period at the end of 2020, even with the type of basic deal the UK Government is pursuing, or worse still without a deal with the EU at all, will represent a significant additional downside risk to the trajectory of the economic recovery.

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A full assessment was published by the SG in 2019⁸, which noted that tariffs and non-tariff barriers will clearly make it harder for Scottish businesses to trade with the EU, and will likely reduce the volume of trade. The sectors that appear most vulnerable include food and drink, chemicals, life sciences and other manufacturing sectors. Impacts are likely to be felt quickly, although longer-term there may be opportunities to explore alternative international markets and rebuild domestic supply chains. The level of regulatory alignment (e.g. via agreement on equivalence or mutual recognition) with EU standards is important in facilitating trade, not only with the EU, but also with non-EU countries where EU standards are widely accepted such as financial services, chemicals, life sciences, creative industries and food and drink sectors.

Immediate and short-run effects will include:

- Introduction of non-tariff barriers to trade with the EU (and tariff barriers in a no deal outcome);
- Increased disruption to supply chains already experiencing challenges due to COVID-19; and
- Heightened uncertainty in some markets.

The combined impact of these effects on businesses that are already severely affected by COVID-19 could result in widespread business closures and job losses over and above those resulting from COVID-19 alone.

Scottish Government modelling⁹ indicates that ending transition this year would result in Scottish GDP being between £1.1 billion and £1.8 billion lower by 2022 (0.7 to 1.1% of GDP), compared with ending transition at the end of 2022. That would be equivalent to a cumulative loss of economic activity of between nearly £2 billion and £3 billion over

those two years. This will clearly hamper the economic recovery.

Looking to the longer term, in 2018, the Scottish government published a discussion paper¹⁰ on the impact of Brexit on migration and the specific Scottish impacts in terms of the population challenges we face as a nation.

Powers over immigration are reserved to the UK Government under the Scotland Act 1998 but inward migration brings benefits to Scotland's demography, economy and society. The demographic benefits of migration are made clear in projections from NRS and ONS of Scotland's future population growth.

There are projected to be more deaths than births in every year going forward. Each year for the next 25 years all of Scotland's population growth is projected to come from migration. UK Government policy and the impact of Brexit means that international migration to Scotland is projected to decline, further inhibiting Scotland's population growth.

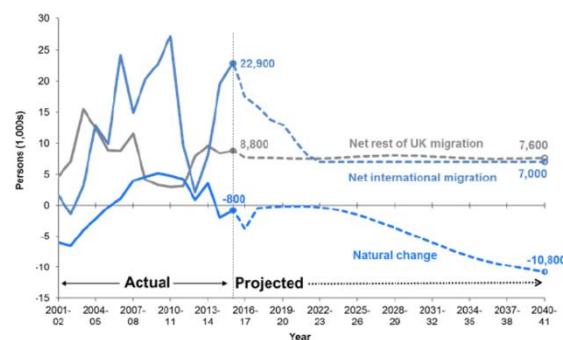


Figure 5 - Actual and projected natural change and net international and rest of UK migration in Scotland

The age profile of the population will also change. The proportion of the population of state pension age will increase by 25% in the coming years as the Baby Boomer generation reaches retirement. People aged 75 and over are projected to be the

⁸ <https://www.gov.scot/publications/sectoral-impact-analysis-brexiteadiness-assessment/>

⁹ <https://www.gov.scot/publications/Covid-19-case-extending-brexiteadiness-period/pages/1/>

¹⁰ <https://www.gov.scot/publications/scotlands-population-needs-migration-policy/>

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fastest growing age group in Scotland, increasing by 79% over the next 25 years.

The prospect of people in Scotland living longer, healthier lives is welcome, and increasingly many people of state pension age continue to work and contribute to the economy in that way. It is also the case that people in the oldest age categories become more likely to need access to health and social care services to support them in old age. Those essential public services will require a buoyant working age population with appropriate skills that over the last decade has been supported by inward migration from the EU that may be restricted following Scotland's exit

3. The National Performance Framework and the Four Capitals

The Scottish Government’s National Performance Framework (NPF)¹¹ provides an overarching view of how Scotland is faring; and is a critical and broadly accepted barometer of success. It is a sound framework which is still just as relevant after the crisis; and the group have taken this as the key policy backdrop for our discussions.



Figure 6 - The National Performance Framework

But we wanted to adopt a broad and robust framework for looking at the Scottish economy that would capture all of its assets and provide the basis for a holistic view of paths to a more robust and resilient economy in the future. In that context, we have found the Four Capitals approach a helpful tool for analysis.



Figure 7 - The 4 Capitals¹²

3.1 The Four Capitals

For business, economic capital (as we use the term) includes physical, intellectual and financial assets. The traditional notion of (physical) capital is the outcome of applying human capital to natural capital to generate physical assets that provide a flow of goods or services, with the classic example being the machinery in a factory but also including wider aspects of public (or private) infrastructure (roads, bridges, power stations). Whilst some notions of intellectual capital are closely related to human capital, a reasonable view is to consider the “intangible assets” of organisations (goodwill, brand recognition and intellectual property) that are wider than a single person whilst accepting that this also has links to social capital in some respects. Finally,

¹¹ <https://nationalperformance.gov.scot/>

¹² Natural capital: World Forum on Natural Capital <https://naturalcapitalforum.com/about/>

Social Capital OECD <https://stats.oecd.org/glossary/detail.asp?ID=3560>

People: World Bank Human Capital Project <https://www.worldbank.org/en/publication/human-capital/brief/about-hcp>

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financial capital consists of the financial resources of organisations and is crucial in making decisions around the use of the other capitals.

Natural capital, is broadly defined as the world's stock of natural assets which include geology, soil, air, water and all living things. There is an important distinction between the aspects of natural capital that (within reasonable timeframes) is a fixed amount i.e. non-renewable and that which, provided it is treated with respect, is renewable. For the former, the issues are around how a finite resource is used over time, raising issues of inter-generational equity and in the case of fossil fuels how much should be used given the externality of climate impacts. For renewables, the questions are around the technology to make best use of the asset (e.g. wave power) and how to avoid overuse or extraction - the "problem of the commons" (e.g. fishing).

Social capital, can be thought of as the networks, together with shared norms, values and understandings that facilitate co-operation within or among groups. The concept has recently gained traction but the term has been in use for over a century and the concepts go back further still. Whilst there are many definitions and debates over the various forms it can be divided into 3 main categories – bonds, bridges and linkages. Bonds are links to people based on a sense of common identity, bridges are somewhat wider (distant friends and associates) and linkages are wider still (across wider society). There is an argument that there is a strong link between social and human capital – simplistically, that social capital is a key mechanism in how individuals are able to "exploit" their own human capital.

Human capital comprises the skills, knowledge and (crucially also) the health and wellbeing that people accumulate throughout their lives. As such it is a key component of labour (and hence, wider) economic productivity but also has personal and intrinsic value to individuals. Whilst there is a wealth of

evidence that a healthy and well-educated population will increase economic growth there is also an obvious link to reductions in poverty and inequality within economies and more recent thinking on how improvements in human skills and knowledge can make climate change action and adaptation easier. The term human capital is usually used within economics texts, but is often associated with a narrow view of the economic impact of people rather than a rounded view that includes wellbeing so the group has chosen to use the wider concept of People to capture this aspect.

Drawing these two frameworks together is subjective in places but is illustrated in the following diagram.

3.2 OECD Wellbeing Framework

There are strong links between the National Performance Framework (NPF) and the OECD Framework for Measuring Well-Being and Progress. This Framework is built around three distinct domains: material conditions, quality of life and sustainability, each with their relevant dimensions. It represents a different way of viewing the same issues - concerns that macro-economic statistics, such as GDP, don't provide a sufficiently detailed picture of the living conditions that ordinary people experience - that are picked up by the NPF and the four capitals.

The Well-Being Economy Governments (WEGO) initiative, of which the Scottish Government is a founder member, grew from a discussion of these issues at Scotland's Inclusive Growth conference which was held at the University of Glasgow on 20th of October 2017.

3.3 Summary Assessment

Using the four pillars framework as a broad structure, we reviewed the situation of the Scottish economy immediately before the COVID-19 crisis

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and now, looking at the strengths and challenges under each pillar.

We also reviewed the written contributions we received - whether commissioned inputs, responses to formal invitations to contribute, or the open call for views - through this lens.

The transition of priorities from short-term survival to longer-term prosperity for Business in the context of a constrained fiscal environment, and a situation that will impact differently for different sectors and areas, are the crucial issues for Economic capital. A key part of the solution will be found within the role and relationship between the Scottish Government and its agencies and business and how policy, appropriate finance and regulation can be brought together supportively.

For people, the fundamental issues are how to mitigate the disproportionate impacts on certain groups (the young, the disabled and those of black and minority ethnic backgrounds), how to avoid poor transitions causing labour market scarring and how to ensure that the negative impact of the crisis on skills, participation and health and wellbeing is reduced.

For the community, the crisis has revealed the depth and breadth of the reach of the third sector and the value of social care, and the importance of maintaining and enhancing these valuable assets, as well as the importance of place- and community-based interventions.

In terms of natural capital, the crisis has created some positives that may be temporary but has greatly reinforced the importance of the ongoing value of Scotland's natural assets and their ability to form the basis, with the correct prioritisation, of a green recovery.

This analysis across the four pillars, described in more detail in the annex to this report, allowed us to take a holistic approach to the Scottish economy, rather than a narrowly sectoral one. It helped identify the key strategic issues which needed to be tackled as a matter of priority to accelerate recovery and move towards a robust, resilient wellbeing economy in the future; shaped and guided our discussions; and underpinned the recommendations, which are set out in Chapter 5.

Assessment of the 4 Pillars of Capital

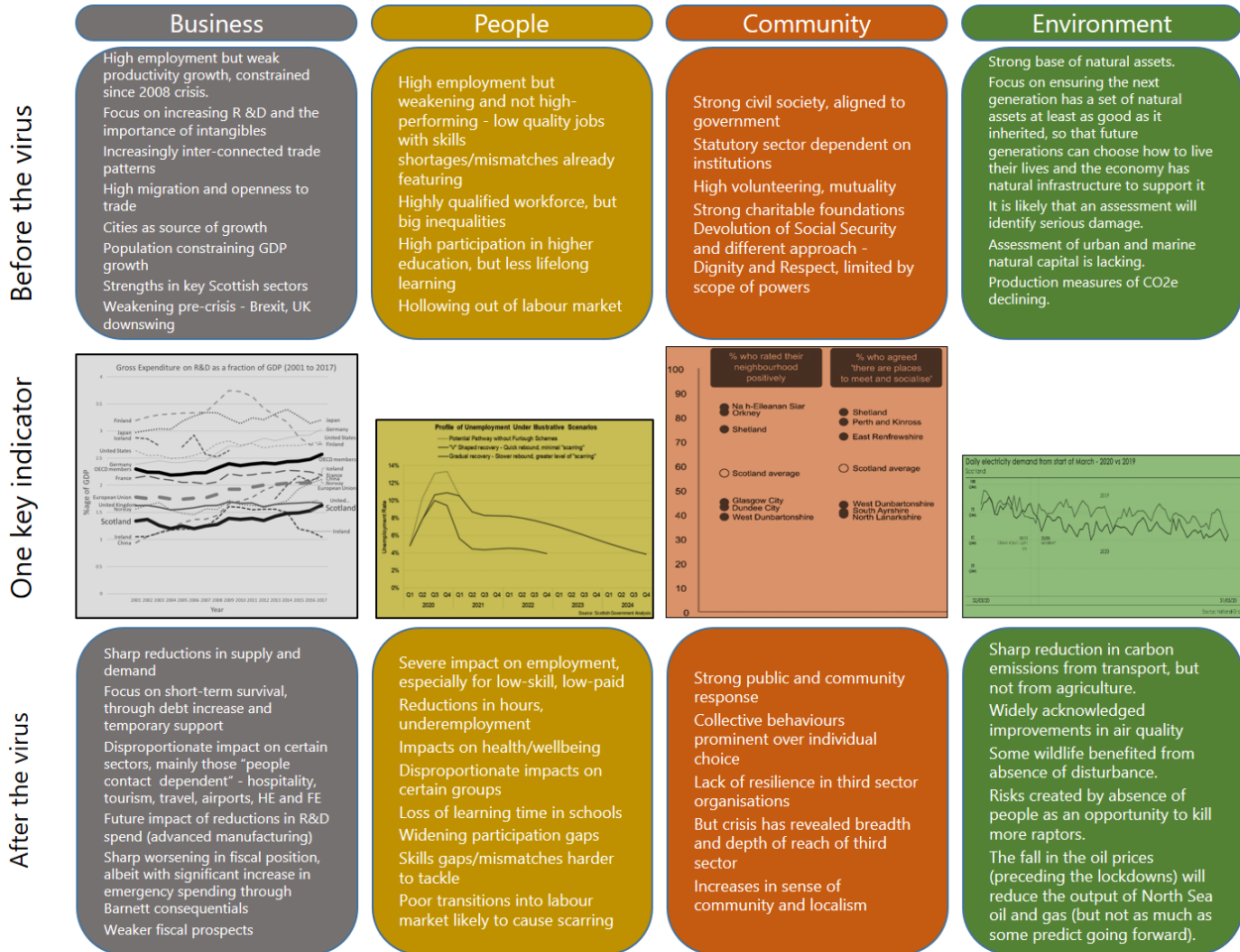


Figure 8 - Summary of 4 pillars analysis

4. The challenges

Clearly different parts of Scotland and different sectors of our economy were facing challenges even before the onset of the COVID-19 pandemic. The Scottish Government's commitment to inclusive growth has a strong regional dimension, recognising the significant differences in economic opportunities, activities, levels of output and income per person that exist in different parts of Scotland. These derive in part from our particular economic geography, with large remote and rural areas, coupled with recent trends towards city-based economic growth and our post-industrial legacy.

Different sectors also face different challenges with some, such as retail, hospitality and tourism, operating with relatively low productivity and wages but employing large numbers of people, sometimes with low skills. The rise of the "gig" economy comes with challenges in some sectors. Regional and sectoral differences intersect to contribute to the significant social inequality that we observe in Scotland. In addition, big epoch-characterising issues such as climate change, artificial intelligence, demography and adaptation to EU exit may present different challenges across sectors and regions.

To these we can now add recovery from the COVID-19 health and economic crisis, which is affecting different sectors of the economy in different ways, and through which there is also likely to be localisation of some of these impacts where affected sectors and firms are concentrated.

4.1 Sectors and industries

It is all too self-evident that the virus and resulting public health measures are having a disproportionate effect on some sectors/ sub-sectors, with some operating largely as normal, some adapting to new circumstances as best they can and others almost wholly shut down. The Scottish

Government has mapped sector vulnerability based on each sector's risk exposure in terms of viability (domestic and international demand) against international supply and labour market disruption. This is shown in Figure 9 and Figure 10 below, with the sizes of the "bubbles" representing relative employment in each sector. Of course, it is important to bear in mind that there are large differences within sectors. For example, within retail, essential and online retail will not face the same challenges as non-essential high street retail. This sector also provides an example of where the effect of the pandemic is to accelerate existing trends already in train.

These channels are described in more detail below from a more forward looking perspective as the global economy charts its way through recovery. Summary sectoral assessments of debt and digital skills are also included.

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Exposure of Sectors to Labour Market Disruption and International Supply Chains

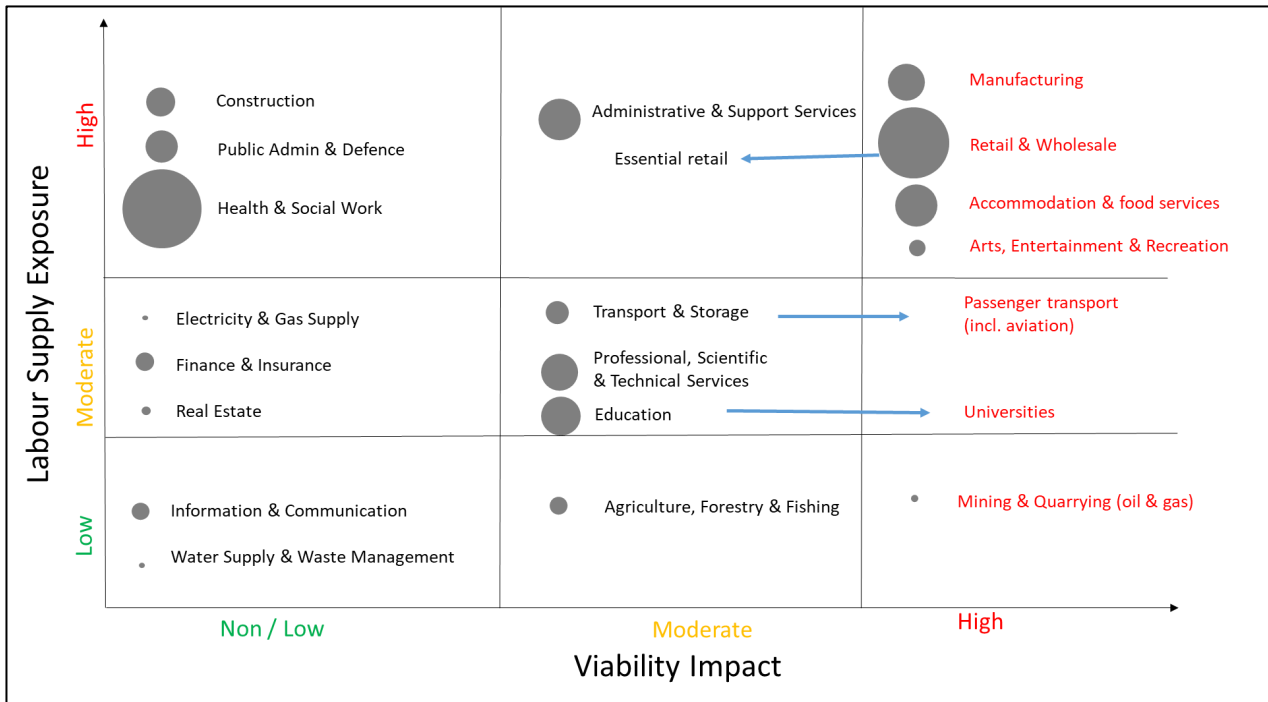


Figure 9 - Interaction of viability and exposure to labour market disruption

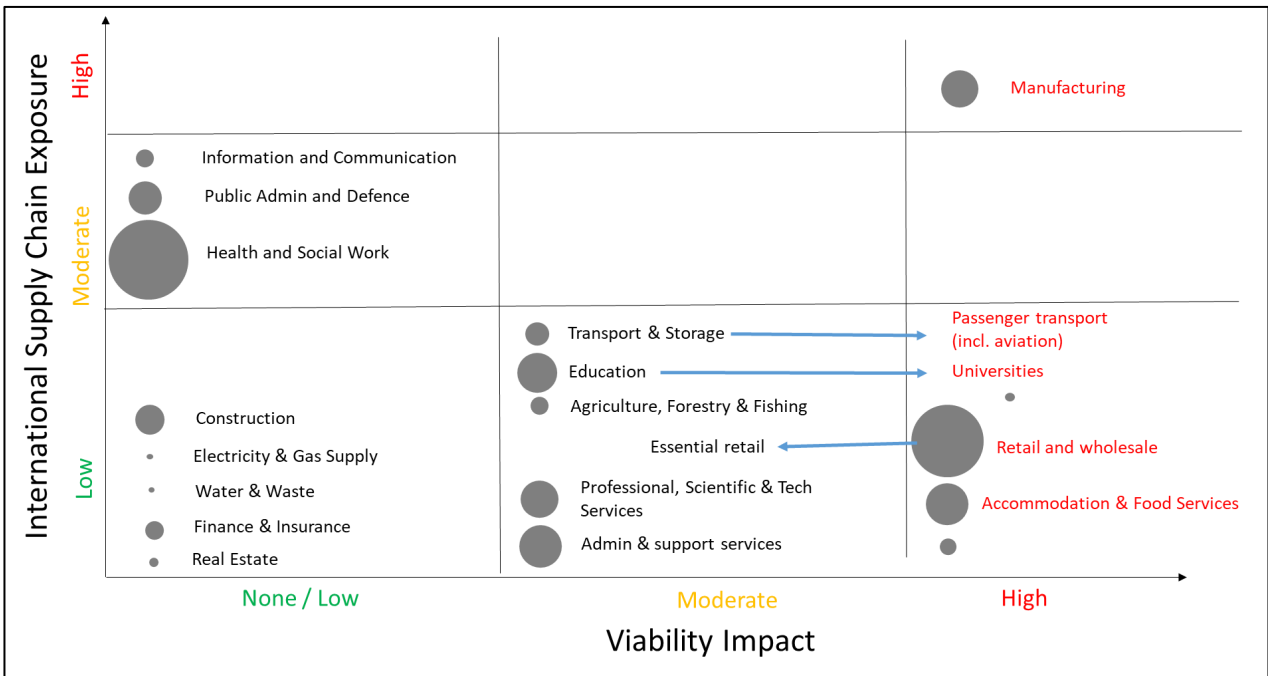


Figure 10 - Interaction of viability and exposure to international supply chains

Towards a Robust, Resilient Wellbeing Economy for Scotland

Overall Assessment of Impacts on Sectors

Domestic demand	
<p>Incomes reduced and higher savings rates affect overall demand across the economy; particularly sectors most reliant on discretionary spending, e.g. Accommodation and Food Services (including Tourism), Arts, Entertainment & Recreation.</p>	<p>Caution over COVID-19 risks, affecting sectors reliant on face-to-face contact, e.g. Accommodation and Food Services (including Tourism), Retail (non-essential), Arts, Entertainment & Recreation If there is subdued government expenditure in the recovery phase, this will affect sectors such as Construction, Accommodation and Food, Health and Social Work</p>
Labour supply	
<p>Rising unemployment: economy-wide, but Accommodation and Food Services and Arts, Entertainment and Recreation unlikely to recover quickly</p> <p>Workplace health & safety restricting working practices, e.g. manufacturing. Will ease over time.</p> <p>Caring responsibilities – particularly parents (school closures) but any workers with dependents affected by COVID-19. These fall disproportionately to female workers, affecting sectors such as Public Admin & Defence, Education, Health and Social Work. Will also ease over time</p> <p>COVID-19 has affected movement of people – especially across the EU. Greatest impact will be on seasonal workers. Affects sectors such as Accommodation & Food, Manufacturing and Agriculture</p>	<p>Shielding measures – especially in the short- to medium-term – may create labour shortages in some sectors. Sectors with higher than average proportions of workers with health conditions and hard to fill vacancies include Water Supply/Sewage, Health and Social Work, Education, Transport and Storage</p> <p>Scarring effects of sustained unemployment (e.g. young people). Additionally, during summer a whole new cohort of those leaving education will be looking for work but with few opportunities, particularly in those sectors that previously provided entry-level opportunities, such as Accommodation & Food and Wholesale & Retail. Importance of inclusive recovery for women and minority ethnic communities, aligned with green recovery</p> <p>Mental health impact of lockdown on employability skills of workforce: all sectors</p> <p>Skills Shortages & Gaps: sectors particularly affected pre-COVID-19 were Manufacturing, Hotels & Restaurants, Wholesale & Retail, Business Services and STEM employers</p>
International demand	
<p>Perceptions about UK public health security may affect recovery in some sectors, such as Tourism and Hospitality</p> <p>Economic impacts abroad (fall in demand, mass business closures or further lockdowns) could see markets collapse for some sectors of the Scottish economy, e.g. sectors relying on international demand such as Scotch whisky and chemicals. Also, some reliant on a small number of international markets (such as refined petroleum, pharmaceuticals and aquaculture) can less easily spread risk.</p> <p>Travel restrictions could hinder services exporters who deliver their services in person, especially engineering services, education, accommodation and food services</p>	<p>A slow recovery in the aviation industry would see continuing increased air freight costs which have risen as the number of flights has plummeted. This would affect higher value manufacturing and specialist sub-sectors such as oil and gas equipment and scientific instruments.</p> <p>COVID-19 response risks accelerating economic nationalism/ protectionism raising costs and reducing Scottish businesses' competitiveness. Would particularly affect those sectors reliant on exports for a high proportion of turnover</p> <p>Brexit: increased barriers with the EU could compound difficulty of COVID-19 recovery. Sectors particularly reliant on EU trade include oil and gas and food (particularly seafood)</p>
International supply	
<p>Business failure/disruption internationally will have affected supply chains for Scottish business, especially sectors relying on international markets for intermediate inputs such as manufacturing sectors, but also wholesale and retail.</p> <p>Increased search costs for businesses, but also opportunities through supply chain reorganisation</p>	<p>Second waves/rolling public health measures could see businesses finding it more difficult to source international intermediate inputs or the cost of inputs increase. Sectors that rely heavily on a small number of markets could be most at risk</p> <p>Building resilient and sustainable supply chains for "green recovery"; seizing opportunity from supply chain re-organisation</p> <p>Brexit: increased barriers with the EU could compound difficulty of COVID-19 recovery, affecting sectors particularly reliant on EU in their supply chains, such as manufacturing.</p>
Debt/ finance	
<p>Highly geared firms or those with poor liquidity may be less resilient to the crisis. Need to support businesses rebuild working capital. Key impacts are likely to be on investment growth, including on innovation. In the long term this will act as a drag to productivity growth – already a challenge. Capital financing will be required to help facilitate a green recovery.</p> <p>Sectors with highest levels of indebtedness are often the same as those identified as being hardest hit by the pandemic</p>	<p>Sectors considered to have to poorest liquidity are: Accommodation and Food Services, Water Supply & Waste Management, Construction, Retail & wholesale, Transport & Storage, Administrative and Support Services</p> <p>Electricity and Gas Supply is considered to have the highest level of gearing. Other sectors with high levels of gearing are: Transport and Storage, Accommodation and Food Services, Real Estate Activities</p>
Digitalisation	
<p>Digital technology, skills and connectivity are key as firms adapt to new ways of working. Firms without the necessary skills, technology, or connectivity could struggle to adapt. Across Scotland, there are a number of sectors with considerable digital skills gaps. Skills gaps relating to digital technology are most prevalent in: Agriculture, Hotels/Restaurants (taken to be roughly equivalent to Accommodation and Food Services) and Retail. There is also a regional dimension whereby digital connectivity is poorer in rural areas.</p>	

Edinburgh Business School Pulse Survey

The Edinburgh Business School Pulse survey was launched with the support of the Scottish Council for Development and Industry contributing to the call for views from the Group. The survey consisted of 10 questions related to opportunities for change in working practices, access to finance and working environments. The survey attracted 206 responses from businesses across various sectors of the economy.

The overall response from the Pulse survey provides insight into the way in which business practices across size and sector may change in the medium term and more immediately post COVID-19 crisis. From the responses it is evident that there is agreement about the lasting impact of the pandemic on working practices, digital equality and skill requirements going forward.

There is uniform agreement of the requirement and likelihood of increased remote working, even when it is deemed safe to return to office environments. Survey responses also clearly indicated businesses' plans to revisit space requirements. This was truer for bigger businesses and notably truer for public and charitable organisations than it was for private business.

Other important insights were the need for reskilling within businesses to enable new working practices and a simplification of funding mechanisms to better suit companies of all sizes and resources but with limited concern related to access to finance, at least in the medium term. This was true across company sizes and sectors.

From a government policy perspective the outputs of this survey provide insight into developments within future business practices and the possible support needed to accommodate such shifts. Such actions could include:

- A simplification of funding mechanisms to aid in the provision of support as well as ongoing access to finance for businesses. This is likely to be particularly important to micro and small firms who may not have the resources held by larger enterprises to apply for such funding.
- Increased connectivity between enterprise agencies, organisations such as Skills Development Scotland and higher education institutions' business education and research to foster rapid increased knowledge transfer.
- An inclusive approach to IT infrastructure to ensure social mobility as both study and work feature higher use of digital platforms and creative solutions to unused office space in the medium term, and a proactive approach to the consequent drop in business rates which will impact local authority budgets as remote working patterns normalise.
- Developing solutions geared towards vocational skills and apprenticeship outcomes, mimicking aspects of the German higher education model.
- A requirement where government holds a stake in businesses (e.g. to maintain sector presence, support employment or to retain key skills) that structured help is provided with relevant academic expertise supervising student-led internships to address business improvement. This would (a) help businesses professionalise and (b) give valuable skills/experience to a student/graduate population who will face greater challenge securing work.

We sought to get a snapshot of the impact on different sectors and industries in different parts of the country through four channels: a programme of engagement orchestrated on our behalf by Scottish Enterprise, Highlands and Islands Enterprise and South of Scotland Enterprise; direct discussions with a number of business and sectoral organisations; an open call for views; and a survey of businesses conducted on our behalf by the Edinburgh Business School at Heriot-Watt University, in partnership with

the Scottish Council for Development and Industry (see associated publication for full detail).

We are publishing the written inputs from our partners alongside this report; and we will publish a separate, more detailed, analysis of the full range of contributions we have received (which are listed in the annex to this report) in the coming weeks.

On the basis of this exercise, the picture is:

- That sectors most dependent on physical presence, travel and discretionary spending by consumers – hospitality, tourism, culture and leisure – have been hit the hardest;
- That plans for recovery need to recognise that some sectors will recover at a slower pace than others, depending on how restrictions are eased and how far and how quickly travel resumes;
- That there has been a sharp increase in remote working in some sectors, but that this has been limited in some areas by both infrastructural and skills challenges;
- That business resilience, particularly cashflow, is the key issue for all sectors, but that the situation varies widely;
- That the issue of rebuilding confidence in supply chains is prominent;
- That reskilling will be a key issue across all sectors;
- That improving digital infrastructure will be a critical factor in improving the prospects for recovery; and
- That businesses think there is a need for tailored sectoral approaches.

The Scottish Government is leading a wider programme of work to achieve a creative and ambitious approach to Scotland's renewal and which we anticipate will draw on the recommendations of this Group. As part of this work, the Scottish Government and Scottish Enterprise are using a scenario thinking process to identify the potential implications of the pandemic for Scotland across a range of dimensions. In parallel with the work of the Advisory Group, the scenario thinking process is testing the resilience of key policy and delivery themes over the medium-term to 2025.

4.2 Places and regions

Ensuring that all regions and communities can prosper is important for both overall economic performance and ensuring that all areas have the opportunity to fulfil their potential. There were significant variations in regional social and economic outcomes prior to the current crisis. For example, output per head in Edinburgh was £47,632 in 2018 and £13,320 in East Ayrshire (Figure 11, top left)

This reflects, in part, the nature of growth in cities, which benefit from a concentration of economic activity, also drawing in workers from surrounding areas. In addition, some areas of Scotland still suffer the legacy of past industrial decline.

A similar pattern is seen in the variation of labour market, health and social outcomes. For example, the proportion of the population with degree qualifications also varies from 11.6% in Shetland to 50.7% in Edinburgh¹³. The gap in outcomes has been fairly consistent over time – Figure 11 (bottom, left) shows the percentage point gap in the employment rate between the best and worst-performing local authority over time.

Whilst output per head varies by region in Scotland, these differences are smaller than those in the UK and many other EU countries. However, countries such as Finland and Sweden have smaller regional differences in GDP per person than Scotland. As well as differences between regions, there is also a high level of variation in income and economic activity within regions¹⁴.

¹³ Annual Population Survey.

¹⁴ <https://simd.scot/> The Scottish Index of Multiple Deprivation incorporates a variety of different aspects of deprivation including income, employment, access to services, health, education, housing and crime. Some characteristics of disadvantage in rural communities are not all picked up on this measure and communities in rural areas can face other types of challenges, such as accessibility and connectivity.

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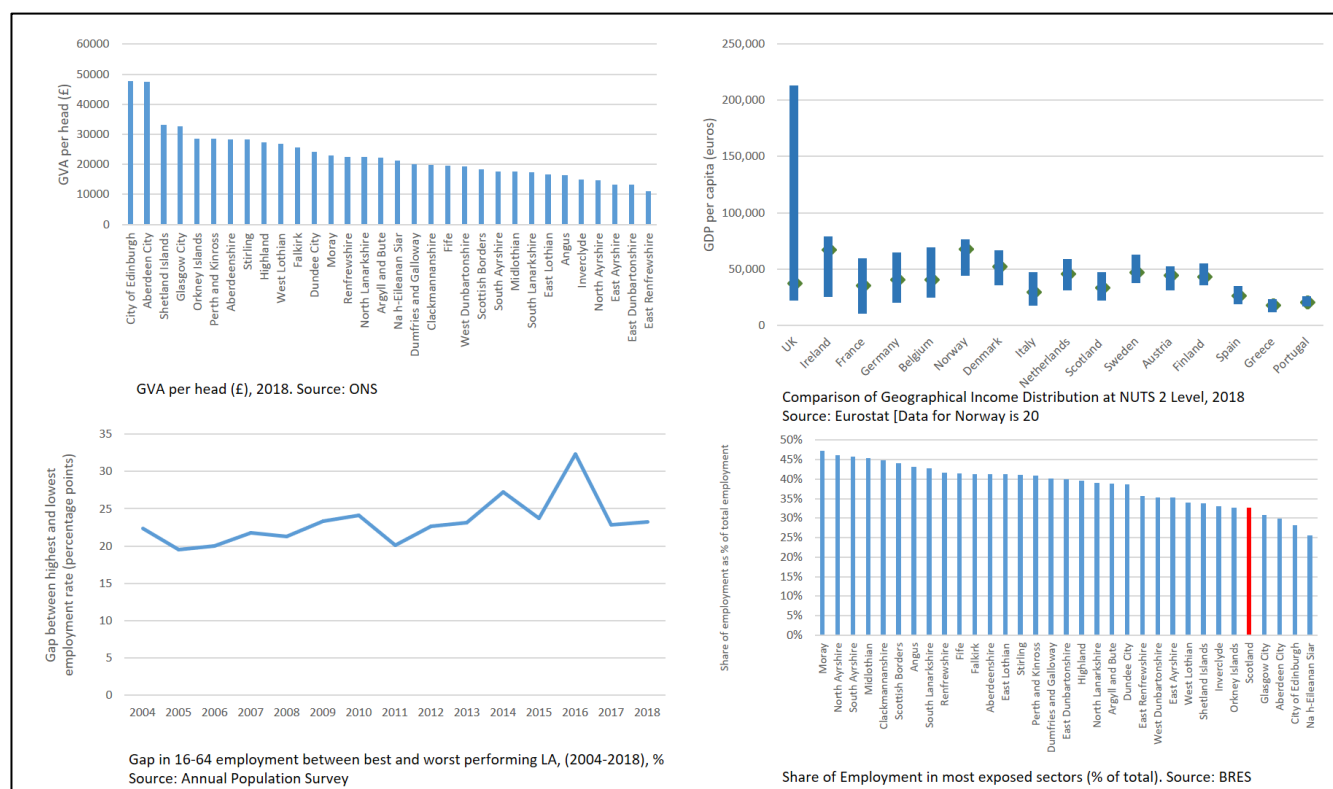


Figure 11 - Regional Indicators

Regional exposure to the impacts from COVID-19 will vary due to the varied composition of industrial, workforce and wider population structures. As stated in the section above, Scottish Government analysis developed a sectoral risk rating based on exposure to international supply, international and domestic demand and labour market disruptions¹⁵ which shows cumulative impact across the economic channels appears greatest for manufacturing, construction, retail and wholesale, accommodation and food services, and entertainment and recreation.

Figure 11 shows the share of employment in these sectors where overall risk exposure to the economic effects of COVID-19 may be greatest across Scotland's 32 local authorities. Island local authorities and some urban areas have lower shares of employment in the most exposed sectors.

Overall, local authorities that are rural or mainly rural have slightly higher shares of jobs in the most-exposed sectors. However, the number of jobs in the most exposed sectors is highest in Glasgow, Edinburgh and Fife.

Other factors, such as the level of international exports and the structure of the business base, will also impact on regional exposure to the impacts of COVID-19.

The Scottish Government has developed an index to assess relative resilience of local authorities across Scotland which considers the business base, existing deprivation and income levels, digital connectivity and productivity – factors which are likely to make areas more resilient to shocks (Figure 12).¹⁶ This suggests that a number of areas that experienced industrial decline may be less resilient.

¹⁵ <https://www.gov.scot/publications/state-economy-april-2020/>

¹⁶ Index is composed as follows: 1. Population skills (degree qualifications of 16 – 64 population) – 25%, 2. Business Stock (Businesses per 10,000 adults) – 10%, 3. Deprivation (Fuel poverty – 10%/ Children in absolute low-income households – 15%), 4. Income (Median hourly

Figure 12 reflects the potential resilience of areas based on pre-crisis characteristics. It does not account for the relative severity of the impacts that regions will face, for example due to sectoral exposure.

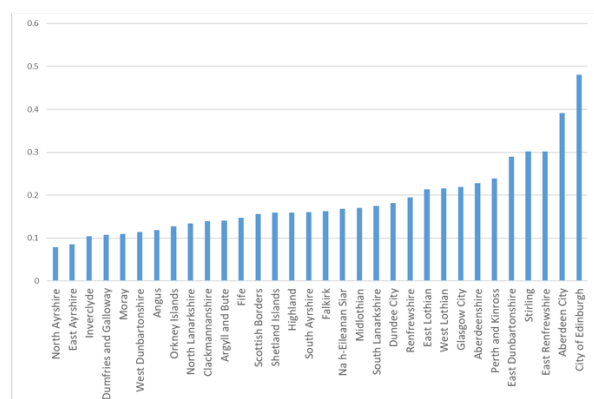


Figure 12 - Index of Regional Resilience

There is considerable uncertainty regarding the economic outlook and understanding the regional impacts and recovery paths will be important to ensuring that the specific needs of Scotland's regions are supported.

Nevertheless, the analysis above showing the wide divergence in exposure and resilience across different regions and local authority areas in Scotland has been underscored by what we have heard through our engagement in the course of our work.

From the many contributions that we have received - from the enterprise agencies, from individual local authorities, from COSLA, SOLACE and SLAED - it is clear that the challenges posed by the crisis have differing characteristics in different places around Scotland. There can be no "one-size-fits-all" approach to securing the recovery that Scotland needs.

Different solutions will be needed in different parts of the country - which is why Scotland's recovery

plan(s) need(s) to be place-based, building on local assets and on the role and powers of local authorities and their partners. This is all the more important given the distinctive challenges faced by rural and remote communities. So we propose an approach to recovery and economic development that is grounded in local and regional approaches and partnerships, and the development and delivery of interventions at regional and local level that best reflect the characteristics of Scotland's diverse places.

4.3 People and skills

As detailed in the People Annex, pre-crisis employment was close to record levels but with the position worsening. Whilst Scotland has a highly qualified labour force with a growing proportion of people having high skills, there were already concerns about whether the nature of the labour market in Scotland meant that these skills were being fully utilised. This is demonstrated by the persistence of low pay, insecure work, underemployment and in-work poverty. And these issues will be exacerbated by the impact of the virus.

Young Scot Engagement Report

We commissioned YoungScot to convene a group of young people to discuss the particular impacts of the crisis on them and their concerns and priorities for the recovery. We are publishing their report alongside ours.

Key concerns expressed were the disruption of education and its effect on young people's future skills and employability; the likely sharp reduction in opportunities for both full- and part-time work and for apprenticeships; and the impact on financial security and mental health, particularly among the most vulnerable groups. But the group saw opportunities from a switch to remote working, if young people could access them; and from the chance to promote active travel and reduce carbon emissions.

earnings for all workers) - 10%, 5. Infrastructure and connectivity (Households unable to receive high-speed broadband of 10 Mb/s) - 10%, 6. Productivity (GVA per head) - 20%.

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The Institute of Fiscal Studies has summarised the impact on inequalities¹⁷, noting the vulnerability of low income households to this crisis, in terms of low levels of savings, higher likelihood of losing a job, disproportionate impact of school closures on childcare and a differential impact on mortality and morbidity. While there may be some less negative - indeed positive - impacts which may bring behavioural change, such as time spent by fathers with children, the disproportionate impact of the crisis is real. And it must be tackled.

The IFS has made it clear that *“Policymakers have rightly been consumed by the immediate response to the crisis, but attention should already be turning to the longer-term effects. If, for example, we can limit the severity of career disruptions now, or the extent to which small firms that had a productive future are squeezed out by larger established competitors, and if we can prevent a persistent widening of inequalities in health or educational progress, then the government’s job in future years will be much less difficult than if it instead has to try to limit or undo the damage”*.

The sectors most affected by the COVID-19 crisis so far have been those most impacted by physical distancing guidance that has meant that businesses have had to close, employees have been unable to work, and demand for goods and services has been hugely reduced.

Labour Force Survey (LFS) data, covering the period up to end of April 2020, show weakening employment rates, with the self-employed and men seeing some reduction in employment. The largest changes are seen in the number of people temporarily away from work, including furloughed workers, which rose by 6 million at the end of March into April, leading to a large fall in hours worked.

The latest ONS Business Impact of Coronavirus Survey¹⁸ results (covering 4-17 May) show that the proportion of the UK workforce on furlough, in businesses that have not permanently stopped trading, was highest in the Accommodation and Food Services (83.0% furloughed) and Arts, Entertainment and Recreation (72.6%) sectors. For Construction (40.5%), Transport and Storage (36.9%), and Admin and Support Services (31.0%) rates of furloughing were also higher than the average rate for all industries (28.1%). Furloughed rates were lowest in the Health and Social Work (6.1%) and Education (10.0%) sectors. Across almost all UK industries who responded, the proportion of the workforce made redundant was less than 1%.

But there are signs that this may not be maintained over time as the Job Retention Scheme moves towards its end. The UK Labour Market Review¹⁹ published on 16 June, with more recent data, presents a less positive picture. Early indicators for May 2020 suggest that the number of employees in the UK on payrolls is down over 600,000 compared with March 2020. The Claimant Count increased in May 2020 to 2.8 million. This represents a monthly increase of 23.3% and an increase of 125.9%, or 1.6 million, since March 2020, although some of the change is due to greater eligibility due to changes to Universal Credit.

And the number of vacancies in May has fallen to a record low. There were an estimated 476,000 vacancies in the UK in March to May 2020; this is 342,000 fewer than the previous quarter, and 365,000 fewer than a year earlier; experimental single-month estimates indicate a decrease of approximately 60% of vacancies for May 2020 compared with March 2020.

Employee average pay growth slowed notably in April 2020, and the three months to April saw total

¹⁷ <https://www.ifs.org.uk/inequality/Covid-19-and-inequalities/>

¹⁸ <https://www.ons.gov.uk/businessindustryandtrade/business/businessservices/bulletins/coronavirusandtheeconomicimpactsontheuk/4june2020>

¹⁹ <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/june2020>

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pay fall in real terms for the first time since January 2018. Pay declined in industries where furloughing was most prominent, many of these being the lowest-paying industries, in particular accommodation and food service activities.

Scottish data, where available, confirms the UK position. For example, Burning Glass Technologies data shows online job postings in Scotland in April were 54% lower than this time last year, reflecting the significant drop in demand for staff from employers. The largest regional declines over the year were seen in Aberdeen City and Shire (-64%), West Lothian (-63%), and Glasgow (-60%), but every area in Scotland has seen at least a 33% fall in job postings on last year.

4.4 Impact on inequalities

A key feature of the crisis is how it is impacting differently on different groups. The higher rate of health impact on Black and Minority Ethnic populations have been widely documented²⁰; these differences are also stark across different socio-economic groups. The focus of the Group has been on the economic rather than health impacts of the crisis - these are also starkly different for different groups.

For example, COVID-19 job disruption is likely to have a disproportionate impact on women's employment, as a result of low-paid women being particularly affected by job disruption; and women are potentially faced with an increase in childcare responsibilities as a result of school and nursery closures in the shorter term.

The Institute for Public Policy Research²¹ notes that young people are also likely to be hit hard in Scotland, as they are disproportionately concentrated in the sectors most affected by the economic shutdown, and so face heightened

exposure to job loss or furlough. The IPPR estimates that 41% of young people in work in Scotland were furloughed in April, compared to 22% of all workers in Scotland.

This is similar to research from the IFS²² that has found that workers under the age of 25 are two and half times more likely than those aged 25 and older to work in sectors that have been shut down and is reinforced by work from the Resolution Foundation for the Nuffield Foundation²³ that estimates that youth unemployment could rise by 600,000 across the UK, affecting the least qualified the most.

Whilst at the moment we have less in the way of hard data, the likely differential impact on those with a disability or from other groups, including black and minority ethnic communities, was a key insight from the responses to the call for views that the group received.

As articulated in the National Performance Framework, the Scottish Government has set itself the considerable challenge of eradicating inequality and has implemented various measures over recent years in order to deliver on this ambition. Despite these efforts, however, discrimination based on race, gender, religion, sexuality or disability persists in Scotland. In 2018, the Equalities and Human Rights Commission observed that: *'the stark reality of inequality in Scotland today is that too often people are unable to realise their full potential, are excluded from positions of influence, and experience prejudice and discrimination in daily life.'*

It will be crucial for the Scottish Government to monitor the unequal impacts of the crisis. For example, the Scottish Commission for People with Learning Disabilities have suggested a redesign of the Scottish Core Survey questions to allow for learning/intellectual disability to be identified.

²⁰ <https://www.ifs.org.uk/inequality/Covid-19-and-inequalities/>

²¹ <https://www.ippr.org/blog/what-does-Covid-19-mean-for-the-labour-market-prospects-of-young-people-in-scotland>

²² <https://www.ifs.org.uk/publications/14791>

²³ <https://www.nuffieldfoundation.org/news/Covid-19-pandemic-could-increase-youth-unemployment-by-600000-this-year>

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The impact of the crisis and the measures necessary to control it have not been felt equally across society. Instead, they have exacerbated existing inequalities. A large proportion of key workers – including frontline care staff, essential retail workers and public transport employees are people who already experience inequality, leading to the disproportionate burden that women and people from black and minority ethnic communities have shouldered in confronting the virus.

In addition, measures to control the virus have presented distinct challenges for older people and disabled people (including those who are physically disabled and those with mental health conditions) associated with increased need for physical distancing, shielding, loss of normal health and care arrangements and the impacts of isolation. Additionally, as primary informal and unpaid carers, women have also experienced additional pressures from juggling childcare and home schooling alongside paid work.

In setting the direction of Scotland's economic recovery, we must seek not only to mitigate inequality but to reduce it. Not only do we owe it to those groups and communities who have been at the forefront of responding to the crisis, and to those who have experienced the impacts of the lockdown most acutely, but we owe it to society at large to address pre-existing inequalities. As analysis by Close the Gap has highlighted, improving gender equality alone could add £17bn to the Scottish economy. The downturn gives added impetus to ensuring that inequality is reduced and prevented across the board.

Early indications are that groups with protected characteristics (including intersectional characteristics) are more likely to suffer disproportionately in the recovery phase. To address this, the Scottish Government and its economic development partners must ensure that

reducing and seeking to eradicate inequalities and advancing equality, rights and non-discrimination, are at the heart of the policy response.

In doing so, the Scottish Government must build on the approach that it adopted for the Framework for Decision-Making²⁴ which places upholding the principles of human dignity, autonomy, respect and equality at the heart of lifting lockdown restrictions. Similarly, these principles must be front and centre of economic recovery plans at all levels of government. Scotland can build on its commitment to equality and human rights budgeting and the progress that the Scottish Government has made towards embedding equality analysis and improving transparency in the budgeting process.

The first step towards achieving this will be ensuring that all groups across society are fully visible to policymakers and their lived experiences understood across the economic development landscape.

This requires adopting new approaches going beyond current methods to assess the outcomes and experiences of groups with protected characteristics, in order to provide greater insight into how recovery plans can actively reduce and prevent inequality. In its submission, the WISE Centre for Economic Justice suggested an intersectional approach to collecting and assessing data, in recognition of the fact that people's identities are shaped by many factors. Submissions by Engender and Close the Gap, among others, have further stressed the need for recovery plans to be informed by gender-sensitive and sex-disaggregated intersectional data, presented in the Scottish Government's Equalities Evidence-Finder, to ensure that the distinct experiences of men and women inform policy-making.

People experiencing discrimination and the resulting inequalities must also be given the

²⁴ <https://www.gov.scot/publications/coronavirus-Covid-19-framework-decision-making/pages/5/>

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opportunity to participate actively in decision-making to ensure their voices are heard. The expansion and activation of the measures in the Community Empowerment Act (2015) would provide a mechanism for this.

Finally, to ensure that outcomes for groups with protected characteristics focus and shape recovery plans at all stages, all levels of government should consider, integrate and report on action to reduce

inequalities, advance equality and progress economic and social rights and wellbeing. This work should recognise that many of those most disadvantaged by COVID-19 are those who were already furthest from the labour market.

Public Attitudes Survey

We commissioned Mark Diffley Consultancy and Research to survey *a representative sample of the economically active population* in Scotland to explore their expectations of returning to work after lockdown. There were 1150 completed responses.

Headline findings from the survey are as follows:

- A fifth of the sample (21%) reported that they had been furloughed; while a small proportion (3%) had become unemployed since lockdown. Women were more likely than men to be working part-time, and the converse is true for full-time employment;
- As anticipated, there are higher levels of furloughed and unemployed staff in the Hospitality and Tourism sector as well as the Wholesale and Retail sector. Furthermore, there is a higher proportion of workers in these sectors residing in accessible rural and remote small-town locations, which has implications for the rural economy in Scotland;
- Three-quarters (76%) of those unemployed at the time of the research reported that it would be difficult to find a job as good as the one they previously had, after lockdown. There was particular concern expressed among young people on this issue;
- There were a range of concerns in relation to returning to work among those currently working or furloughed. In particular, there were high levels of concern expressed regarding social distancing and health and wellbeing at work – 62% and 55% respectively;
- Respondents reported that they are more likely to work from home (58% more likely) after lockdown, reducing their reliance on transport to and from work;
- Around six-in-ten respondents (63%) reported that they are more likely to need flexible and home-working arrangements to meet their childcare responsibilities, reflecting the phased return to school, blending school and home learning that is anticipated from August 11th. A further 46% reported that they are more likely to need help to support the learning of their child at home when they return to work after lockdown; and
- In terms of anticipated changes to working practices in the next 3 years, 77% “strongly” or “fairly” agree that there will be more guidance on health and safety at work. Moreover, there is broad agreement (62%) that there will be more acceptance of flexible working arrangements in the next 3 years as a result of the lockdown in 2020.

5. Recommendations

This section builds on the assessment of sectors and regions and of the four pillars of capital set out in previous chapters. These recommendations also draw on the large amount of material submitted through the consultation, and in engagement directly with business and the wider community.

We have chosen to be selective in our recommendations, and to prioritise and highlight the interventions that we think will make the most immediate impact on the course of Scotland's recovery: supporting jobs, protecting and progressing education and skills, and thereby helping to tackle inequality. But we are very clear that action will be needed across a very wide front, involving all sectors and all parts of the country in a collective effort: our recommendations do not seek to make detailed prescriptions for each sector.

We have not sought to lay out in detail exactly how each of our recommendations should be implemented. That will be for others to determine. And while many of our recommendations are directed at the Scottish Government and its agencies, businesses, the third sector and other organisations all have an essential role to play in securing the recovery Scotland needs.

5.1 The Fiscal Framework

The UK and Scottish Governments should accelerate the review of the Fiscal Framework. It is vital that the overall funding approach is robust to address economic recovery and is resilient to future economic shocks.

The immediate crisis has required governments across the world to increase fiscal deficits to support vital public services and livelihoods. The OBR estimates that the fiscal aid provided by the UK Government to date will cost £132.5 billion, or 7% of GDP, in 2020-21²⁵. The UK Government announced it would make available an initial £330 billion of guarantees to support firms – equivalent to 15% of UK GDP²⁶. In addition, at the end of May 775,000 people in Scotland were either furloughed or unemployed.

This fiscal response is significant in international terms, and reflects the scale of the global crisis. Internationally, the focus of the fiscal response is now beginning to shift from emergency assistance to fiscal stimulus to kick start the economy. The European Commission has announced a €750 billion package to support the recovery over the next three years, around 1.8% of GDP. Germany has announced a €130 billion support package for 2020-21, which is around 4% of GDP. The stimulus in Germany²⁷ includes a VAT cut, direct funding to families, and a €50 billion climate change and innovation fund.

The UK Government's fiscal stance has led to recent increases in the Scottish Budget, leading to support of £2.3bn in additional funding to the Scottish Government for support to businesses in Scotland. A £230m Return to Work package to stimulate Scotland's economy in light of the coronavirus pandemic was announced on 17 June.

The availability of these various forms of support has been essential to mitigating the immediate crisis. In the weeks and months ahead, the focus

²⁵ <https://obr.uk/coronavirus-analysis/>

²⁶ <https://www.gov.uk/government/news/chancellor-announces-additional-support-to-protect-businesses>

²⁷ <https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/Public-Finances/Articles/2020-06-04-fiscal-package.html>

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of the fiscal response will shift from emergency assistance to appropriate fiscal support as the economy begins to recover.

In continuing to support business and workers over the coming transition, it is inevitable that governments will emerge from this crisis with significantly higher levels of debt and a smaller tax base. This debt will need to be managed over a long period and in a way that aids rather than hinders economic recovery. The UK's economic performance after the 2008 financial crisis shows that another round of austerity is not the right answer. At the same time however, the UK and Scottish governments will require to achieve fiscal sustainability in the medium- to long-term. That will depend on a resumption of growth.

While there is wide recognition that governments should "do what it takes" during the immediate crisis to prevent further damage in the future²⁸, the focus will shift to ensuring an agreed set of fiscal arrangements to guide government policy in the years ahead. The costs of the present crisis will need to be funded eventually, and this raises important choices for the government²⁹.

The fiscal arrangement between the UK government and the devolved administration needs to take into account policy autonomy and tax competition, fiscal solidarity across the UK and devolved fiscal responsibility, devolved debt and the UK's debt burden and its ability to finance itself on international capital markets.

The current Fiscal Framework binds Scotland closely to the UK Government's fiscal stance, which remains a key factor in determining the Scottish Budget. The baseline for the Scottish Budget remains the Block Grant, based on the Barnett Formula, which has historically maintained relatively higher per-capita funding

for Scotland but is entirely dependent on UK spending decisions. Even though Scotland now raises a large portion of its budget through Scottish income taxes there are limited opportunities for policy autonomy, given that UK tax policy decisions fall back onto Scotland through the block grant adjustments.

Moreover, the Scotland Reserve and borrowing limits are extremely low in relation to the overall budget, limiting further any deviation from the UK's budget stance. In a time when governments are providing unprecedented levels of support to their citizens, Scotland's capital borrowing is to less than 0.3% of GDP.

The current UK fiscal policy framework was not designed for times of emergency. The carry-over and borrowing capacity for the devolved administrations was designed and calibrated for normal economic cycles. It was not designed to enable decisions, based on a long-term 'capital-based' approach as described in this report.

It would benefit both the UK and devolved governments to design a model for investment in the economic recovery period, which enabled an appropriate flexibility to allow different priorities to be pursued. There is also a strong case for the Scottish Government to have greater autonomy to use targeted fiscal measures to stimulate demand or incentivise behavioural change in the recovery period.

We have identified a number of policy areas in which the Scottish Government could make significant progress in the recovery and renewal phase. The Fiscal Framework is intended to protect the Scottish Budget from UK-wide economic shocks, the crisis has demonstrated that such shocks do not necessarily impact evenly across the UK.

²⁸ [Centre for Macroeconomics survey](#)

²⁹ <https://www.resolutionfoundation.org/publications/doing-more-of-what-it-takes/>

The upcoming review of the Fiscal Framework should look fundamentally at the scope of devolved fiscal powers. It should consider whether they enable the policy responses that Scotland will need to tackle the many challenges of economic recovery and of achieving fiscal sustainability. And it should take steps to enhance fiscal transparency, and enhance public participation in decision making on fiscal matters, as suggested by the Scottish Human Rights Commission³⁰.

The UK and Scottish Governments should therefore accelerate the review of the Fiscal Framework, and ensure that the remit is sufficiently broad to ensure that the review covers the present circumstances. The review must identify what we have learnt during this crisis about the effectiveness of the existing framework during a serious economic shock.

5.2 An investment-led recovery

The UK and Scottish Governments should commit to securing significant increase in access to capital investment to support the recovery. This should maintain the Scottish Government's commitment to a Mission to raise infrastructure investment and it is imperative that the Scottish National Investment Bank opens this year.

The role of sustained increase in investment is well recognised in the Scottish Government's Mission to raise investment in infrastructure. In 2018, the Scottish Government announced a National Infrastructure Mission to increase annual investment in infrastructure by 1% of 2017 Scottish GDP by 2025-26. This must be maintained as a key factor in recovery, with the Scottish and UK Governments collaborating on securing significant increase in access to capital investment to support the recovery.

The challenge to deliver increased investment in response to the crisis will be an essential element of the economic recovery. The global response to the crisis recognises the importance of investment. For example, the EU Recovery Plan³¹ identifies the twin green and digital transitions, and the need to strengthen strategic autonomy while preserving the benefits of an open economy. In order to achieve these objectives, the importance of strategic public investment and more effective leverage of private investment into projects to provide public good could not be clearer.

Our departure from the EU means that Scotland will no longer have access to the EU Structural Funds supporting regional development and social investment. These measures played a vital role in the recovery after the 2008 global financial crisis. The UK Government has indicated its intentions to create a shared "prosperity fund" to replace these funding streams, but has not yet set out its detailed plans. Its decisions will have significant impact on the resources that the Scottish Government will be able to deploy.

We need an investment-led recovery in Scotland. The submission from the Scottish Futures Trust stressed the vital importance of infrastructure investment.

The Group has not taken a view on a single best mechanism to ensure capital investment is prioritised to support economic recovery. But it is clear that the Scottish Government should be able to access low cost capital funding, and deploy it to maximum effect. This could be within the existing UK devolved framework, through an agreed extension of the fiscal framework or a combination of both.

Many commentators have already noted that with the cost of government borrowing at very

³⁰ https://www.scottishhumanrights.com/media/2034/20_05_fincom_covid_publicfinances_humanrights_vfinal.pdf

³¹ https://ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response/recovery-plan-europe_en#documents

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low levels, it makes sense to look to long-term recovery investments which are funded through long term borrowing. There may be scope to allocate some borrowing undertaken by the UK Government for the benefit of all four nations across the UK as the current Fiscal Framework is reviewed.

In addition, there will need to be an acceleration of private sector investment, often in partnership with the public sector. In Scotland, considerable work has been undertaken already on the formation of the Scottish National Investment Bank. The crisis accelerates the need for an investment institution at the heart of the Scottish economic landscape.

The initial priority for the Scottish National Investment Bank is of course to open this year, and its initial focus will be on investment towards its primary mission which is to support the transition to a net zero society by 2040. Once established, the Bank will also become a major contributor to economic recovery through investment in place-based projects and innovation. The consultation has revealed the significant interest and appetite for co-investment with the Bank, including with universities, digital infrastructure providers and the third sector.

The Bank is being established as Scotland's primary public sector debt and equity investment institution. It will provide patient capital to projects and businesses that are both long-term and commercial and are aligned with the Bank's missions. The Bank's mission-oriented approach provides an innovative and strategic way in which the public sector can more effectively address Scotland's grand challenges, including the impacts from the pandemic. By crowding-in investment, the Bank will be in a

unique position to help deliver a robust and resilient wellbeing economy.

One of the main objectives outlined in the Implementation Plan³² which laid the basis for the Bank was to develop the ability to leverage initial public capital by issuing bonds – thereby increasing the amount of funds available for investment. The ability to leverage relatively small amounts of public capital, including its initial capital base, into a significant source of strategic and long-term finance is a key source of strength for development banks internationally. Under the original plan, this ability would not be activated for some time: the crisis has made it a more pressing priority, and it should be brought forward.

The impact of the crisis will refocus businesses' investment decisions, creating a new set of choices on the deployment of their capital. The Bank will be well placed to use its investment criteria to continue to support businesses and the third sector to pivot towards mission-oriented outcomes.

The Bank's mission-oriented approach will also respond to the disproportionate impact on particular places and income groups. The Bank will continue to show commitment and leadership, focusing investment in strategic opportunities across all of Scotland. This can, for example, help ensure that viable housing and infrastructure projects do not decline as a result of a lack of available capital. It can also include investment in the provision of education.

The Bank can also help play a critical and creative role in supporting community-led projects which impact on all of the Bank's missions. The Bank will invest in innovation and industries of the future. The pandemic has emphasised the opportunities which require patient capital support to unlock technology in response to

³² <https://www.gov.scot/publications/scottish-national-investment-bank-implementation-plan/>

public health challenges. There is early evidence that knowledge-based, technology-driven businesses continue to perform strongly, while there is the risk that productivity challenges which have persisted for generations will intensify.

Within this context, the Bank will look to accelerate its activity to ensure Scotland creates and internationalises innovation, and harnesses technology which helps address long term demographic trends. By continuing to provide encouragement through the investment of patient capital, the Bank will play a prominent role in underpinning confidence in companies and entrepreneurs who seek to innovate.

5.3 Enterprise and regional economic development

The economic development landscape in Scotland should pivot to a more regionally focused model in order to address the specific new challenges of economic recovery. This model should be tasked to drive delivery of place-based and regional solutions, especially the City-Region Growth Deals.

Our national economic development system has grown organically over time with enterprise and skills bodies, local authorities, other agencies and the Scottish Government working across geographic and sectoral boundaries. Recent reforms, including the 2016 review of the enterprise and skills system, have improved alignment and enhanced coordination. The South of Scotland Economic Partnership was added to the enterprise system and a Strategic Board was formed, involving private sector representatives and the chairs and chief executives of the enterprise and skills bodies.

The crisis has served to accelerate the need for collaboration and the need for responses which are tailored to regional and sectoral needs. Scotland is not a big economy, but it is an economy of many parts; and geographical and sectorial differences need to be recognised, respected and championed. The new South of Scotland Enterprise and Highlands and Islands Enterprise already work at a regional basis, and a series of Regional Economic Partnerships are being implemented.

We see significant common ground in the responses received, which have argued for enhanced collaborative working at regional level. The key role played by local authorities was self-identified as undervalued and constrained by a lack of resources. The Scottish Futures Trust suggested that, alongside funding to support projects, there was an urgent need to support the capacity to deliver large and complex projects at pace. They suggested a national delivery capability, and there is much to learn from the Infrastructure and Projects Authority³³.

There is an opportunity now to acknowledge the severity of the recession and to accelerate reform and crack the longstanding, difficult problems of collaboration at pace. It is essential that there is a golden thread to link international, national, regional and local responses.

In that context, we believe that Scottish Enterprise should align resources more closely at regional level, while playing a leading role at international and national level in support of economic recovery.

This would have the benefit of strengthening and bolstering the capacity across the cities, local authorities and regional economic partnerships, where significant resources are

³³ <https://www.gov.uk/government/organisations/infrastructure-and-projects-authority>

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already directed at economic development. In addition, this will provide assurance that those regional projects and programmes that seek Scottish Government funding have a strategic fit with our national economic strategy. Recent investment in digital platforms for business support should be invested in and scaled-up to be meaningful and accessible to all.

The regions of Scotland already have partnerships in place: but they now need to reset their focus on recovery and use them to maximum effect. These Regional Economic Partnerships should be strengthened and bolstered to ensure the recommendations we make here take root.

In normal times, the reform of existing institutions has proven politically sensitive and difficult to implement. This crisis makes it urgent. Given the current environment, any changes should be made without passing any new legislation or making change to staff terms and conditions.

The Scottish Government should drive forward further changes to the Scottish economic development landscape, especially the more regionally focused model. This would be designed to enhance the implementation of place-based and regional solutions, especially the City-Region Growth Deals.

5.4 Ownership stakes in companies

The Scottish Government should build its professional capability to manage ownership stakes in private businesses, which are likely to arise out of the crisis. This should not require new legislation, nor a new public sector organisation.

The experience of the development of the Scottish National Investment Bank, and the Scottish Government's recent experience with

taking on ownership of Prestwick Airport and Ferguson Marine has led to consideration of whether a Scottish equivalent of United Kingdom Government Investments (UKGI) should be considered.

UKGI is the UK Government's centre for expertise, acting as shareholder for, and leading the establishment of, UK Government's arm's length bodies. UKGI has evolved to perform an increasingly important role overseeing publicly held companies, advising the UK Government on corporate finance and restructuring and managing corporate activity such as share sales. There is no equivalent function within the Scottish Government.

In terms of international experience, Temasek in Singapore has now invested widely and at a very large scale. It is run independently of government to ensure it operates commercially and that its investments compete on a level playing field. Temasek issues its own debt instruments in support of its investment programme.

There is a strong case for having a dedicated, specialist expertise to manage any expanding ownership role on behalf of the Scottish Government. This need not require a new organisation at this stage. There is significant benefit to be gained by recruiting specialist financial expertise, covering corporate finance, asset management and governance, together with specific sector specialism. Alternatively, the necessary expertise could be acquired through secondments from the private sector.

However it is resourced, the remit for the shareholder role of government should be clear, and it should operate to achieve its remit independently while reporting to Ministers who are then accountable to Parliament.

5.5 Strategic support for businesses

Banks should develop new instruments to enable the strategic incubation of otherwise viable and strategically important companies to ensure they are protected during the recovery phase. The Scottish Government should use its convening power to co-ordinate approaches to different sectors of the economy, in close liaison with financial services institutions, sectoral organisations and the enterprise bodies.

While there is likely to be a need for the Scottish Government to take on some ownership stakes, it should not seek to play roles more suited to the private sector. The various government schemes have provided loans to businesses to maintain productive capacity and avoid redundancies. However, these measures leave businesses with higher indebtedness. A continual supply of credit from the banks will be key to supporting businesses through the recovery phase.

Over time this current phase of universal forbearance will come to a close, but this may be for an extended period for some industries. Banks should focus on supporting businesses with good longer-term prospects of survival in sectors which will be important for Scotland's future economy. The transition of government support for businesses over the coming months will raise complex and difficult issues. Complex judgements will be required on the timing of the winding down of the current schemes, and focussed and specific support will be required for sectors most severely affected over a longer timeframe.

Banks, including the British Business Bank, and other financial services institutions should work closely with the Scottish Government on the development of instruments and frameworks to enable the thoughtful strategic forbearance and

incubation of otherwise viable and strategically important companies to ensure they are protected during the recovery phase.

The Scottish Government should use its convening power to co-ordinate approaches to different sectors of the economy which are important for Scotland, in close liaison with financial services institutions, sectoral institutions and the enterprise bodies.

Alongside the scaling-up of the Scottish National Investment Bank, Scottish Enterprise will maintain key parts of its current investment functions over the immediate recovery period. It will continue to provide debt-based support and equity co-investment for sub-£2m investments in businesses in Scotland, including the current activities of the Scottish Investment Bank.

This is a critical and crucial role, which should pivot to reflect the needs of Scotland's viable and strategically important companies. This of course includes early stage and growth companies, which have the prospect of making a vital contribution in future. This will require a clear and targeted investment strategy in support of Scotland's small and medium-sized enterprises (SMEs) in the medium term.

It will be important to provide support to entrepreneurs and businesses in Scotland to innovate and seek new markets. There is substantial support already available, as well as new schemes which are being introduced in response to the crisis. But new sector-specific banking products and differentiated solutions such as re-start loans, new deals, repayment plans will be required. This should be brought together as a focused SME recovery capability, as part of any transition of activities to the Scottish National Investment Bank.

This combination of active collaboration between the UK Government, Scottish

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Government, the Bank and the enterprise bodies is essential to ensure the extensive support for business in Scotland that has been put in place is tapered in a way that will enable businesses to restart and recover.

5.6 Foreign Direct Investment

The Scottish Government, Scottish Enterprise and VisitScotland must ensure a strong and bold prospectus on Scotland and on available investment opportunities, recognising the substantial, twin shocks of the pandemic and leaving the European Union. This will require a focus on opportunity areas and deployment of its international presence to maximum effect.

A robust and resilient wellbeing economy needs to be outward looking and competitive. Attracting businesses to invest in Scotland, and in turn stimulating trade in international markets, retains a critical role in shaping Scotland's economy of the future. Attracting talent and ideas from overseas, that can mix with our indigenous businesses, can deliver mutual benefit. And bringing additional financial capital to Scotland will be increasingly important as a contribution to deliver investment-led growth.

The context for our international engagement is, however, changing. The analysis commissioned for the Group from David Skilling and summarised in Section 2.5 sets this out in detail. We face the prospect of new barriers to trade. These may result from a reassessment of the trends in globalisation we have seen for some years. Striking the right balance between resilience in the supply of goods and services (what the EU have called "strategic autonomy") and openness to trade will be a key challenge. And steps which many countries are likely to take to achieve greater resilience in supply may add to the uncertainty that exists around international markets.

In addition we face the prospect of dislocation of trade and our international relationships with the UK Government decision to leave the EU, and apparently to decide against any proposal to extend the implementation period beyond the end of this year. This increases significantly the shock facing the Scottish economy.

We do not see a conflict between openness to trade and a robust and resilient wellbeing economy. A retreat into protectionism is not the way to secure our economic future. But greater care and attention to the balance between reliance on trade to provide essential products and what can be secured domestically is required.

Yet the changing context for international trade, will impact on our potential to export and our scope to bring in inward investment. A bold Prospectus for Scotland should be based on a revised assessment of the sectors where Scotland has a competitive advantage. This assessment, should take account of the differential impact on sectors of the end of the Transition Period, especially with a WTO-style trade outcome.

Notwithstanding the prospect of considerable trade uncertainty, there is scope to gear-up our internationalisation agenda as a powerful mechanism for recovery. This agenda can help realise the undoubted and substantial opportunities that exist in global markets, which are changing with a centre of gravity that continues to shift East. There are sectors where we have very real advantage, such as in natural capital that can be leveraged through our emerging tech, advanced manufacturing and low-carbon innovation talent and assets.

Scotland should not be shy about taking its place in the world – its economy is globally integrated with a large base of international investors and strong exports. It should speak openly of itself as

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a progressive economy that strongly values working with other nations.

In order to differentiate itself in a crowded and competitive marketplace, Scotland needs to demonstrate those values in action:

- By galvanising its international efforts around key areas where it has real strengths, and can make a difference to solving complex global issues;
- By proactively seeking out inward investors who share our vision of the future. Scottish Enterprise have identified nine opportunity areas with strong inward investment flows and the opportunity for further growth, which map to Scotland's strengths and
- By delivering a market focus, with effective deployment of resources in world markets.

The Scottish Government and Scottish Enterprise must ensure priority on its internationalisation agenda, to leverage private/foreign investment to recapitalise and develop green and investment-ready sectors.

5.7 Relationship with the Business Community

The Scottish Government and the business community should take urgent action to develop a new collaborative partnership on the strategy for Scotland's economic recovery.

The economy can only thrive if there are successful and supportive relationships between business and government. This is all the more vital in difficult and challenging times. Now is the time to embark on the deep and sustained partnership that will attract the right kind of partners and investors to Scotland in recovery. A dynamic 'Team Scotland' effort is required, involving a broad collaboration between policy

officials, regulators, funders, higher and further education, innovation centres and the private and third sectors.

There are a number of fora in which business leaders currently come together with the Scottish Government to discuss strategic issues, in particular the Industry Leadership Groups. We welcome the fact that Nora Senior, Chair of the Enterprise and Skills Strategic Board, is currently conducting a review of the functioning of these groups. But we think that more is required.

Although the picture is variable, the feedback, for some sectors and some parts of the business community is that relationships and dialogue need to be improved. And it is striking that there is no single strategic forum that brings together the leadership of the Scottish Government and the leadership of Scottish business.

At a time when government will of necessity hold much greater stakes in Scottish businesses big and small, and when the future path is so uncertain, we think that there is a pressing need for a reset.

This could involve action at different levels:

- There is a strong case for seconding business expertise to the Scottish Government, to work on specific projects where private sector knowledge can supplement policy skills. One specific example could be in managing the Scottish Government's function as a shareholder, as we propose above. Over time, such a process, which could also involve secondments the other way, would build stronger understanding and relationships along the board;
- The Singaporean government, which has established an "Emerging Stronger Task Force" of senior business leaders, co-chaired by a Minister, to advise on the recovery, reporting in to its Future

Economy Council, chaired by the Singaporean Deputy Prime Minister;

- Others have suggested setting up a small, time-bound group to inject energy into a sales-led recovery and kick-start the conversation between business and government around the prospectus for Scotland that we have described earlier in this report;
- The Scottish Government should consider establishing a top-level Council of Business Advisers to work alongside its Council of Economic Advisers in helping Ministers to map out Scotland's future strategy in partnership.

But the precise form and structures of a new partnership are not an end in themselves. The key thing is that business and government have a shared imperative and opportunity to work together – involving other parties too – to deliver the kind of recovery that Scotland needs.

5.8 Planning and regulation

The Scottish Government, regulatory bodies and local authorities should review their key policy, planning and consenting frameworks, especially for key infrastructure investments such as marine renewables, to accelerate projects.

Scotland has high-quality regulatory standards that are essential to underpin inclusive, lasting and green economic recovery. The Scottish Government, its agencies and planning authorities should ensure that they are administered through processes that are efficient, flexible and outcome-focussed. A focus on improving regulation is a call for accelerating good processes, not for lowering standards. This should lead to improvements which can accelerate due processes in order to

deliver on economic recovery. Scotland is making some progress on this: but it can go further, through the provision of clear strategic direction and an enabling approach.

Public agencies of all kinds showed great pace, flexibility and innovation in decision-making during the crisis. Now, as Scotland resets and restarts, we see opportunities to learn from that experience to promote more agile approaches across the public sector. There is significant scope to develop enhanced capacity in the Scottish Government to ensure that necessary and desirable regulatory processes are implemented at pace and with due process. A key lesson from the crisis is that government capacity is a key factor in supporting business success.³⁴

The approach taken to regulation in the forestry sector, where a 2016 review of the regulation associated with approving forest creation projects led to a streamlined process, with faster decision-making saving money, time and increasing confidence for investors as well as more trees being planted.

The ability of the aquaculture sector to operate, innovate and grow is dependent on how the public sector engages with industry. Regulation itself has clear benefits for Scottish aquaculture – helping protect quality, standards and reputation: but the industry has regularly asked for more timely and transparent approaches to regulation and enforcement.

The public sector's rapid adoption of new ways of working and regulating during lockdown has shown that change, pivoting direction, and fleetness of foot are very possible. Scotland, as a small nation with short lines of communication, is also well positioned to switch to more agile approaches to innovation, policymaking and regulation.

³⁴ <https://www.project-syndicate.org/commentary/small-governments-big-failure-covid19-by-mariana-mazzucato-and-giulio-quaggiotto-2020-05>

A number of regulatory agencies and planning authorities are testing new ways of becoming active drivers of business and community innovation, investment and jobs. For example, the Scottish Environmental Protection Agency (SEPA) has created a formal, active partnership model of Sustainable Growth Agreements, and a new Regulatory Practitioners' Network is being established jointly by SEPA and Food Standards Scotland to support discussion of new models and approaches across different sectoral interests. These efforts need to be accelerated.

One of the most critical areas for strategic focus in the context of a green recovery and climate change, however, is the marine renewables sector. Scotland has some of the most ambitious climate change targets in the world. Central to the Scottish Government's response, and a key component in the transition to a low carbon economy in Scotland, is the development of offshore wind energy. With huge wind resources and a marine area six times the size of Scotland's land mass, offshore wind offers considerable potential for sustainable economic growth. Scotland can and should be a leader in marine renewables.

To date, the realisation of offshore wind projects in the journey from their initial concept at a strategic planning level, through the consenting and licensing systems and ultimately on to construction, has taken around a decade. The pace of development in recent years has not matched earlier ambitions. And the regulatory process has itself been the subject of challenge, reflecting in part the complex and sensitive nature of the potentially conflicting interests, whether environmental or economic, which are engaged whenever large scale developments of this kind are proposed.

There is a need now to considerably increase the pace and scale of deployment to meet low carbon generating targets over the next 25 years, and to enable Scotland to grasp the tremendous opportunities for a green recovery which such a transition offers. This imperative presents increased and urgent challenges for the existing policy, planning and licensing framework to identify and consent suitable projects with a sufficient level of impact in the light of the climate change emergency at a scale and to a timetable to deliver on Scotland's net zero targets.

Against that background, the Scottish and UK Governments should review the existing framework to ensure they are fit for the purpose. And ensure that we can protect the rich natural resource of Scotland's biodiversity, and enabling the deployment of offshore wind to meet the challenges of the climate emergency.

5.9 Conditionality

The Scottish Government should deploy its expanding tax powers and business support interventions to enable economic recovery. This should include targeted use of rates relief to incentivise economic recovery and greater use of conditionality in business support, building on the experience of the Business Pledge and Fair Work First.

The Review³⁵ into Tax Rates for Non-Domestic Properties in Scotland undertaken by Ken Barclay in 2017 has been implemented with significant use of rates relief to promote business growth. And the non-domestic rates system has supported businesses through the crisis, with rates relief of 1.6% for all non-domestic properties in 2020-21, and 100% rates

³⁵ <https://www.gov.scot/publications/report-barclay-review-non-domestic-rates/pages/6/>

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relief for all non-domestic properties in the retail, hospitality, leisure and aviation sectors.

This has been an effective mechanism to provide immediate, broadly-based support to business. But it is a blunt instrument. Over the coming months, it will be necessary to deploy more targeted, continuing support in specific areas, and to specific sectors, as part of recovery plans. That is one reason why, as we have said above, we think there is a case for Scotland to have greater autonomy over fiscal measures.

The Scottish Government has been developing forms of conditionality in its business support. The Fair Work Action Plan³⁶, published February 2019, sets out that by the end of this Parliament, wherever it is appropriate to do so, the Scottish Government will extend Fair Work criteria to every type of grant, funding stream, and business support budget open to us, and extend the range of Scottish Government and public sector contracts to which the Fair Work criteria will apply.

The approach is a positive encouragement to apply good practice. For example, it includes “genuine workforce engagement, such as trade union recognition” as one of 5 key criteria. The Scottish Government’s Fair Work First approach asks employers to commit to working towards it. This approach encourages and rewards employers rather than penalise. Fair Work First asks employers to commit to: investment in skills and training; no inappropriate use of zero hours contracts (for example using zero hours contracts when people are working regular hours; exclusive contracts that stop flexible workers working for other people); action to tackle the gender pay gap; genuine workforce engagement such as trade union recognition; and payment of the real Living Wage.

The application of the Fair Work First approach to the award of business support grants has been phased in by the enterprise bodies and the Scottish Government, and the Scottish National Investment Bank will align its activities with this approach.

There is also the potential to use conditionality more broadly. Many countries are developing wider approaches. In New Zealand, the Provincial Growth Fund³⁷ is channelling loans into regional projects, such as water storage, horticulture development on under-utilised land and riverfront revitalisation. It includes conditions on ongoing payments of the loans subject to reaching key milestones - public benefits such as contribution to regional growth, job creation, skills development and improving environmental, cultural and social indicators.

The European Commission recognised the option of applying conditionality alongside projects approved under State aid. This could include applying green conditions to companies to promote the transition to net zero emissions. There is active consideration of this approach in many EU countries.³⁸

While the use of conditions in the allocation of grants and loans should be pursued actively, this approach requires careful application of enforceable criteria. And the conditions applied need to avoid any unintended consequences in terms of shifting emissions or activity abroad. Yet, as an approach, it merits active development.

5.10 Digital Infrastructure

The UK and Scottish Governments should mobilise investment in Scotland’s digital

³⁶ <https://economicactionplan.mygov.scot/people/fair-work/>

³⁷ <https://www.beehive.govt.nz/release/pgf-backing-regions-through-loans>

³⁸ <https://www.bruegel.org/2020/04/a-green-recovery/#.XoyYzl8qYjM.twitter>

infrastructure, covering broadband and mobile networks, to build resilience and enhance exports.

Digital connectivity is an essential enabler of growth, productivity and inclusion. The crisis has confirmed the foundational importance of digital technologies in all aspects of our lives, and enhanced investment will likewise be a foundation of economic recovery and a robust and resilient wellbeing economy.

The behavioural changes brought about by the crisis – and specifically the move to flexible and remote working - are crucially dependent on the provision of digital services.

The crisis has required many people to work from home, which has accelerated a significant structural change in our economy, although we are conscious that for many people, home-working is not possible. The change is likely to stick, as behavioural attitudes have made home-working more effective and more widely accepted. This has also placed an increased reliance on online public service delivery and brought in to even sharper focus the need for greater digital inclusion. Retaining this change and accelerating the trend toward home-working and online delivery of public services can make a significant contribution to the country's economic competitiveness.

Experience during the crisis has shown our dependence on digital connectivity – for work, for the provision of services, for social and community connection, and for wellbeing. In recovery, we should treat digital connectivity as critical national infrastructure, and give higher priority to improving it.

For example, there are currently no landing cables in Scotland, other than older cable systems running between Scotland and Northern Ireland. This is a major deficit for

Scotland's infrastructure: we only need look at Ireland, for a case study of how to do it properly. Their investment in subsea cabling has allowed them to become part of the gateway to the United States, as well as continental Europe. The resulting capacity, diversity and resilience for connectivity has attracted substantial inward investment from US corporations wanting a European footprint.

Virtually all of Scotland's internet traffic transits via London. Scotland is today the only European country which does not have multiple independent routes to the main nodes of the internet in Europe. It is heavily dependent on the London – Amsterdam corridor.

Scotland is significantly behind in terms of data centre market size and the amount of digital infrastructure to support it. Scotland has 2.2 MW of data centre capacity per million people. Wales has 32 MW per million.

The net benefit of developing this infrastructure will enable the establishment of data centres, which is a requirement for the full rollout of 5G, autonomous cars or surgical robotics within hospitals outside of major cities.

The delivery of new fibre infrastructure will be central to improving digital connectivity across Scotland. The Scottish Government's R100 project will see new fibre deployed across rural Scotland in the coming years, enabling access to superfast broadband, and increasingly full fibre, services and providing a backbone that other digital services can utilise. The project has the potential both to enhance economic output and reduce Scotland's carbon footprint, as it enables greater diversity and inclusion in geographical economic contribution. It needs to be accelerated.

The Scottish Government can also use its wider policy responsibilities to enable and stimulate

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improved connectivity. This could include utilisation of non-domestic rates powers to stimulate investment, with a fibre rates reduction. There is currently a 10 year rates holiday in place for new digital infrastructure. Scotland should lean in to this and offer the same rates holiday for all digital infrastructure in rural areas. This would lead to greater deployment of infrastructure spending in Scotland, with firms using UK funding to capitalise on the benefit of investing in Scotland. We should aim to make Scotland more attractive than the rest of the UK.

For mobile connectivity, Scotland is lagging behind the rest of the UK. The Scottish Government is funding a number of new masts through its Scottish 4G Infill Programme and DCMS is investing £500m into rural infrastructure to significantly improve “not-spots” and “partial not-spots”. Accelerating this activity, and exploiting the links between the two programmes, would be a real strategic opportunity for Scotland, especially as there are three major obstacles to mobile infrastructure - cost of access, cost of connection and business rates, which are extremely high for rural digital infrastructure.

There is also a real opportunity to enhance local distribution power networks and civil works. At the moment, there are regulatory obstacles set by Ofgem which limit Scottish Power’s and SSE’s ability to invest in improving the energy grid. Scotland should press for changes to planning rules to enable faster development. This would also have the benefit of allowing faster rollout of electric vehicles across Scotland.

Ensuring widespread access to connectivity will also enable further innovation in public service delivery – with services designed around people not structures, and able to operate securely and

flexibly across organisational boundaries. This will require common operating platforms, greater interoperability and a systematic approach to addressing barriers to digital inclusion, including affordability, skills and access to devices.

The UK and Scottish Governments should collaborate to scale up and accelerate planned investment in Scotland’s digital infrastructure.

This should include action to further promote investment in broadband networks, where there is potential to join up elements of the UK Government’s planned £5 billion investment in full fibre with the Scottish Government’s £600 million R100 broadband programme; and in mobile networks, where the recently announced UK-wide Shared Rural Network could dovetail effectively with the Scottish 4G Infill Programme. Opportunities to enhance Scotland’s international fibre connections and datacentre capacity should also be explored; and the extended use of connection vouchers as a means of getting investment into the system without lengthy new procurements should be considered.

But investing in our digital infrastructure, while essential for our recovery and resilience, is not enough on its own. It must be accompanied by action to tackle digital poverty, by helping those who don’t have access to the internet, don’t have digital devices or don’t have the skills to use them. The Scottish Council for Voluntary Organisations³⁹ estimates that nearly one in five adults in Scotland do not have the skills to make full use of digital technology at home or at work; while one in ten, particularly older people, have no digital skills at all.

The Scottish Government has recently announced targeted measures to help the most

³⁹ <https://scvo.org.uk/p/36175/2020/03/19/no-one-left-behind-digital-scotland-Covid-19>

vulnerable elderly people acquire such skills over coming months: these efforts need to be maintained and accelerated in the recovery phase, as part of building resilience.

5.11 Prioritisation and delivery of green investments

The green economic recovery is central to recovery overall. The Scottish Government now needs to establish a priority on delivering transformational change with clear sector plans, where the coincidence of emissions reductions, the development of natural capital and job creation are the strongest.

The task of mitigating our contribution to climate change is a generational challenge. Transformational change is required and the policy response to COVID-19 has shown us what rapid, radical change feels like and the sort of energy and focus that it requires. Responding to climate change needs to be a thread through every policy action.

This should be the key task of the Scottish Government's forthcoming Infrastructure Investment Plan and the update to Climate Change Plan. These Plans should set out the role for our primary industries and investments to deliver net zero emissions and the interrelated and necessary improvements in our natural capital.

Building on the work of the Infrastructure Commission for Scotland and the Just Transition Commission, they should cover detailed plans for green transport infrastructure, Carbon Capture and Storage, energy generation and storage, hydrogen, heat decarbonisation, land use and the promotion and embedding of the Circular Economy and positive behavioural change. As businesses rethink their business models following the crisis, there is a real

opportunity to use Circular Economy principles to promote new ways of reducing our use of scarce natural resources.

The Group strongly endorses the six principles for a resilient recovery set out by the Committee on Climate Change. These principles are entirely consistent with the approach taken here. The principles are:

1. Use climate investments to support the economic recovery and jobs;
2. Lead a shift towards positive long-term behaviours;
3. Tackle the wider 'resilience deficit' on climate change;
4. Embed fairness as a core principle;
5. Ensure the recovery does not 'lock-in' greenhouse gas emissions or increased climate risk;
6. Strengthen incentives to reduce emissions when considering fiscal changes.

Our consultation brought forward a detailed, rich and wide-ranging set of proposals for green investment. This level of engagement and commitment needs to be mobilised into the successful delivery of a wide range of projects, large and small, and behaviour change.

One of the particular challenges during the economic recovery will be the medium- and long-term behaviours toward transport choices. The submission from Professor Iain Docherty noted that the single most important intervention for a green recovery is to manage the rebound effect in the demand for car travel. During the crisis, car use has fallen, and use of other transport options, especially cycling and walking, has increased sharply. There is considerable scope for the trend toward remote working to be normalised and maintained. Yet there is a potential for a significant rebound effect with increased car use and reduced confidence in public transport for some time.

Taking carbon out of our economy and out of our lifestyles will require sustained investment and the creation of new jobs, industries and supply chains. And we must do this in a way which ensures that global emissions are reduced, not simply relocated. This is a potential unintended consequence of Scotland's net zero target which is based on territorial emissions and there is a case for having a more explicit focus on consumption-based emissions (e.g. Carbon Footprint). This could be in the form of new or additional targets, or a greater role for those consumption-based measures in government decision-making and could provide an opportunity to embed the principles of a Circular Economy within government.

Non-traded sectors and activities which are less affected by international competitiveness concerns such as domestic heating, energy efficiency and ground transport are all ripe for a programme of investment and innovation which will deliver emissions reductions, jobs and potential opportunities in supply chain development.

There is also now an opportunity for Scotland to lever some of its natural advantages: the almost limitless quantities of renewable energy potential from wind, wave and tidal power can be used to generate electricity surpluses to export to the rest of the UK and elsewhere and to generate 'green' hydrogen to use in the heat and transport sectors; the geology of the North Sea in combination with the pre-existing pipeline infrastructure leaves Scotland almost uniquely placed to become a centre for the transport and storage of carbon captured from combustion processes; and the prioritisation of nature-based solutions can build on the natural environment as a key part of Scotland's brand and comparative advantage to the benefit of tourism and other sectors.

5.12 Investment in natural capital

The financial services sector and the Scottish Government should develop and promote nature-based investments to protect and enhance Scotland's natural capital. This should include the development of financial solutions to fund forestry and other nature-based solutions, including agriculture, and should be accompanied by the development of a Scottish Natural Capital Census.

Our approach to natural capital should be founded on the goal that each generation should leave its successor a set of natural assets at least as good as those that they inherited, so that future generations can choose how to live their lives and the economy has natural infrastructure to support it. The degradation of our environment and the overuse and misuse of the natural world has contributed to climate change and a loss of biodiversity. This has caused multiple harms which diminish our wellbeing, reduce the opportunities of future generations and constrain our economic capacity and productivity over the long run.

Scotland has outstanding natural assets, which are at the heart of who we are. They represent an area of significant 'comparative advantage' for the country. The industries underpinned by Scotland's natural capital will therefore have an essential role to play in supporting economic recovery.

A number of submissions argued that a greater integration of natural capital approach into policy making can help establish policies to improve resilience to external shocks, as well as generating opportunities for economic recovery and inclusive, sustainable growth. Measures to support natural capital are essential to the future of land based industries including agriculture as well as the tourism and hospitality sector. They can form a key part of the Scottish 'brand'. Much

of Scotland's natural capital is in the land and the key to unlocking the necessary improvements to a whole range of natural assets lies in how that land is managed. There is a need now to prioritise nature-based solutions such as peatland restoration and afforestation which support multiple objectives including climate mitigation, flood protection and biodiversity enhancement while at the same time boosting the rural, tourism and nature-based economies. Now is the time for fresh approaches which can be tested and piloted, building for a future beyond the 'Stability and Simplicity' framework enabling Scottish agriculture to a world after the Common Agricultural Policy.

An intensification of activities to restore and rebuild Scotland's natural assets should be informed by a full and comprehensive Scottish Natural Capital Census. We need to ensure that any demand for so-called shovel-ready projects to support jobs and recovery are tempered by proper consideration of the long run implications, good and bad, for the natural infrastructure which sustains the whole economy.

But it is challenging to monitor and measure the safeguarding of these assets without a strong measurement framework. We should build on the experimental natural accounts prepared by the Office of National Statistics for the Scottish Government⁴⁰ as a measure of the initial balance sheet, and it should be extended with a broader definition of the natural economy. This framework for natural accounts can guide the underlying health of this natural 'balance sheet', as well as the annual flow of economic gains derived from it. Such economic gains would include the restoration of peatland and the promotion of forestry, the promotion of biodiversity and methods of funding nature

based solutions that enable us to enhance our natural capital and reduce net emissions.

5.13 Tourism and hospitality

The tourism and hospitality industries should work in partnership with the Scottish Government to develop a sustainable future strategy; the Scottish Government should consider a targeted reduction in business rates to support the sectors' recovery; and it should press the UK Government to consider a reduction in VAT.

Scotland's tourism sector makes a major contribution to Scotland's finances. Visitor spending in 2019 supported some £7bn, or 5% of Scottish GDP – and the sector employs around 218,000 people, making up 8% of Scotland's workforce. Over half of them are women; 40 per cent of them are young people; and half of the workforce is employed in small and medium-sized companies, particularly in rural and island communities.

Tourism and hospitality are vitally important to our economy. And they are a key dimension of 'brand Scotland' – we welcomed 3.5 million visitors in 2018. So they are systemically important sectors, which have to be at the heart of the future national prospectus for Scotland.

The sectors have been hit particularly hard by the crisis, and will struggle to recover quickly. It is vital that it does. Many of the interventions we recommend elsewhere in our report – on bank finance, on a regional approach to business support, on digital infrastructure, on support for skills, on inward investment – will be of particular benefit for tourism and hospitality too.

⁴⁰ <https://www.gov.scot/binaries/content/documents/govscot/publications/statistics/2020/03/scottish-natural-capital-accounts-2020/documents/scottish-natural-capital-accounts-2020/scottish-natural-capital-accounts-2020/govscot%3Adocument/scottish-natural-capital-accounts-2020.pdf>

But we think that further, specific action is also needed. We were pleased to see that the Scottish Government has set up an industry taskforce to look at options for the future of tourism. We hope that, working in partnership, it will be able to set out a more robust and sustainable vision for the sector going forwards; and that it will look specifically at new, longer-term investment models and ways to grow and support local talent.

As a result of the serious financial impact on the interrelated tourism, events and hospitality sectors, there may be a need to develop specific solutions for these sectors, in line with our recommendations elsewhere in this report on ownership stakes.

There are a wide range of ownership models for tourism and culture facilities at present, covering private and public ownership, and national and local government. Glasgow Life, the Glasgow City Council arm's-length company responsible for managing the city's main cultural and sporting assets has expressed interest in a new more mixed partnership approach to the cost of managing national assets. And international experience may be valuable, for example the state owned 'Parador' hotel model in Spain.

But given the strategic significance of the sectors to Scotland, the impact of the crisis, and the importance of the tourism sector in particular for employment around the country, especially in rural communities, we think that there is a strong case to go further, and to look at fiscal measures to protect and progress it. We think that the Scottish Government should consider a targeted reduction in business rates for tourism establishments; and should press the UK Government to consider targeted and temporary reduction in VAT to support the sector's recovery.

5.14 Creative Sector

Given the significant contribution of the arts, culture and creative industries to Scotland's economy and to our social capital, the Scottish Government should take steps to protect the sector; seek to increase public and private investment; and work to create a National Arts Force.

The arts, culture and creative industries make an important and growing contribution to Scotland's economic and social capital. They create high quality, fulfilling jobs, which can be amplified through specialist apprenticeships, skills development and training. And they play an important role in Scotland's international offering as part of 'brand Scotland'.

With this in mind, we invited specific input from a group of key leaders from across the sector. We are publishing their paper for the Group alongside our report.

The sector has been hit disproportionately hard by the crisis as a consequence of physical distancing requirements. Many parts of the sector are hampered by physical infrastructure - often of significant heritage value - which will be particularly difficult to adapt to new requirements. This will call existing business models into question.

A significant proportion of the workforce are either freelance or gig economy workers, who will struggle to find or maintain jobs in the post-crisis period. Yet the sector can play a big part in our recovery, attracting visitors and investment alike once the present restrictions are lifted, and helping to build both confidence and resilience for the future.

The sector is inherently innovative and entrepreneurial, and can be integrated into recovery and development work right across the

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economy, with particular emphasis on health, education, including blended learning, tourism, leisure and overall wellbeing.

Against that background, the sector should be given high priority in Scotland's recovery plan. Scotland must emerge from the crisis with purpose, humanity and resilience. We must look after our cultural heritage and create an enabled, inclusive society to build the heritage of the future.

There are a number of dimensions to a strategy for supporting the recovery and future flourishing of the sector. But as a priority, the Scottish Government should:

- Support the sector to protect and adapt strategically important physical cultural infrastructure, with a strong link to apprenticeships in the construction and specialist industries to help develop new skills;
- Seek ways to increase public and private investment across the sector to allow it to recover and compete; and
- Work with the sector to create a National Arts Force, composed of freelance and gig economy workers across the sector, to work in schools, care homes and communities.

5.15 Care Sector

The Scottish Government should accelerate its work on reforming adult social care; and should urgently review the structure, funding and regulation of the sector to ensure its sustainability and quality going forward. The review should address workforce issues, including the Fair Work Convention's 2019 report on the sector; and should recognise and support the contribution of unpaid carers.

Care homes are not just a key part of our social and health care system: they are a key part of Scotland's economy. Scotland's social care sector employs 200,000 people, 80 per cent in the private and third sector, and has a financial value to the Scottish economy of over £3 billion. But care is not only a vital contributor and support to the economy: much more than that, good quality, safe, supportive and effective care is essential to our society.

Before the crisis, the sector was confronted by major challenges in relation to procurement of services from public authorities; to the recruitment, retention and pay of its workforce; and to the longer-term sustainability of its funding, and indeed its entire business model.

The crisis has only sharpened the nature of these challenges: but it has brought home to us how precious a function the care sector provides for us all. Care homes in particular have truly been at the front line in the crisis; we must make sure that, as we come out of the immediate emergency, Scotland takes action to strengthen the capacity and sustainability of the care sector as a whole.

5.16 The Third Sector

The Scottish Government should take action to protect the capacity and financial sustainability of the third sector, in recognition of its important role in building and strengthening social capital. It should examine the scope for longer-term funding arrangements for services; more flexible and collaborative approaches to procurement; and new ways to incentivise private investment in the sector.

The third sector provides a central component of Scotland's social capital. The activities and services it provides and supports have been of critical importance in maintaining a level of

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community resilience during the crisis. They will be just as important in the period of economic recovery, supporting young people, employability, health and wellbeing.

During the period of lockdown the sector has not been able to raise income from trading, fund-raising and investment, so its already thin financial reserves are perilously tight. Looking ahead, the coming recession will certainly increase the demand for the services that the sector provides, while the likely squeeze on public spending following the current large-scale emergency Government expenditure will reduce the state's ability to meet needs, and also reduce the funds flowing to the sector.

Given the risks, it seems clear that if a different approach to the sector is not built into Scotland's recovery plans, it will not be able to carry on as it has in the past. Without support and investment, it might not survive. So we think that it is essential to put the third sector at the heart of planning for recovery and renewal, recognising its critical contribution to the goal of a wellbeing economy in Scotland.

As an immediate first step, we were pleased to see the Scottish Government's announcement of a £25 million Third Sector Resilience Fund to address the short-term emergency. But action on a larger scale and a wider front is needed to secure the future.

5.17 People, place and community

The Scottish Government should support a renewed focus on place-based initiatives, building on lessons learned from initiatives on Community Wealth-Building. It should also accelerate investment in housing, in particular through the Scottish National Investment Bank

The analysis that we have undertaken and the evidence that we have heard underline the

importance of 'place' as a key factor in Scotland's economic performance, and also in the strengthening of our social capital; and, as a consequence, of the importance of place-based interventions. This is already embedded in the Scottish Government's wider policy framework through the Local Economic Partnerships and the City Deals, and is supported by Scotland's Centre for Regional Inclusive growth: but we think that it should play a more important part in economic recovery and in future policy.

The Scottish Government should support a renewed focus on place-based initiatives, working with Regional Economic Partnerships, City Deal teams and local authorities. This work should explore how local business can be incentivised and encouraged to provide finance and support for Community Wealth-Building.

Housing is central to the Scottish economy and to our wellbeing. The construction sector is a major source of employment, and makes an important contribution to Scotland's GDP. In normal times, investment in social housing alone by the public and private sector runs at over £3bn a year. But more important than its direct impact on jobs and finances, everyone in Scotland should have a home that is warm, affordable and accessible. And support for housing is vital to help our most disadvantaged communities and create sustainable, attractive places.

Scotland faces a number of structural challenges, including caring for our ageing population and tackling homelessness, which have only been exacerbated by the crisis. Investment in housing has an important part to play in supporting Scotland's recovery, in supporting jobs, creating confidence and contributing to both social policy and climate change goals.

The Scottish Government should develop mechanisms to accelerate investment in

housing, and in particular affordable housing, in rural as well as urban areas, using its policy and funding interventions to leverage private finance wherever possible. The Scottish National Investment Bank should play an important role in this effort, under its mission-oriented approach.

We received a number of responses to our call for views that relate to the idea of a Universal or Citizens Basic Income (CBI) or related concepts. We have also seen the recent report of the independent CBI Feasibility Study Steering Group who have been exploring the scope for piloting CBI in Scotland, and in particular, the ethical, legislative, financial and practical implications.

The key conclusion of the report is that while a pilot is desirable and worth exploring further, it must be done with the agreement, co-operation, and collaboration of all relevant parties, particularly the UK Government.

In the recovery phase, our priority must be to recover the jobs that are likely to be lost as a result of the pandemic. So while we understand the arguments in favour, we do not think that now is the time to prioritise a universal basic income.

5.18 Learning Loss

The Scottish Government and local authorities should assess the impact of any learning loss and ensure that pupils are fully supported as schools return, in order to mitigate the risk of reduced educational attainment, particularly among disadvantaged groups.

The early years of a child's life are pivotal for their development. Investment in children during this time is particularly valuable, in terms of

improving both their cognitive and their non-cognitive skills.

Conversely, the negative impact from a lack of face-to-face school provision is likely to be particularly large for children in the early years and primary school.

Skills beget skills, as shown by the Nobel Prize winning work of James Heckman. So children who fall behind at school will struggle to catch up without intervention⁴¹.

And such "learning loss" will be compounded for socio-economically disadvantaged students. Household income and family environment are major determinants of children's academic achievement in normal circumstances. Parents who are more educated and have more resources (money, time) invest more in their children in normal times. This is proving to be true during this pandemic. This will mean the socio-economic gap in educational achievement widens without intervention.

This long-term skill loss has major economic implications. If this generation of students leaves the education system with lower levels of skill and less human capital, this will negatively impact on their productivity and increase the skills shortages that firms report.

Research evidence suggest that a loss of a period of schooling can lead to substantial loss of educational development, which in turn can lead to poorer employment and life outcomes. There is clear evidence, too, of the disproportionate impact of learning loss on disadvantaged children and young people. Research⁴² shows that while young people appear to be less affected by the virus, they are more vulnerable educationally and in terms of their long-term employment prospects,

⁴¹ <http://cep.lse.ac.uk/pubs/download/cepCovid-19-001.pdf>

⁴² <https://blogs.ucl.ac.uk/cepeo/2020/05/22/the-Covid-19-crisis-and-educational-inequality/>

exacerbating the already considerable inter- and intra-generational inequalities in educational attainment in Scotland and the UK.

Overall, the learning loss that has been caused by the crisis will, if not addressed urgently, lead inevitably to long-term damage to our economy and more importantly to the prospects of a generation of children. So it is vital that action to tackle it starts now.

Over the coming months, we expect schools to identify the group of pupils who have fallen furthest behind in lockdown. It is likely that this group will map closely to children from disadvantaged families. Then schools will need to take targeted and urgent action to help these children to catch up, over and above the efforts for all children.

This will inevitably require extra resource in qualified teachers (or teaching time). So it will be essential for schools, local authorities and the Scottish Government to assess and address the financial implications of the additional efforts that will be required.

The challenge of learning loss arising from the crisis is one that is common to many, if not all, countries as they emerge from the immediate emergency. So it is important that the action taken should learn from, and be shared with, approaches being taken across the UK and internationally.

5.19 Workplace innovation

The business community should work with the Scottish Government and the enterprise bodies to accelerate the embedding of Fair Work principles, in the context of changes to the workplace and to working patterns. This could cover the shift in experience and attitude to flexible and home-working which has been accelerated by the pandemic, and

the concerns about precarious and “gig economy” work.

Underpinning all activity is the importance of work that is fair and rewarding both for economic success and for the wellbeing of the Scottish people. The Scottish Government has made significant progress in this area: but we think that, in response to the crisis, it should build further on that.

Changes in what constitutes the ‘workplace’ and how work is undertaken - remote and home-working, flexible working, workplace ergonomics, safe working - will be accelerated by the crisis.

Many of these changes could be positive. As businesses rethink the way they operate in the wake of the crisis, there may be opportunities to introduce a range of new and more flexible forms of employment which would suit the needs of the employer and the circumstances of the employees better than more traditional models. For example, we heard from Unilever about its Agile Working approach, which offers employees a suite of differing options for employment and work patterns.

However, the crisis has also exposed the lack of resilience and the instability of the UK’s ‘flexible labour’ market; and has had a significant impact on those with atypical employment contracts that make their employment status precarious. Addressing the work/workplace implications of the crisis demands an understanding of the evidence and a framework to consider and implement change.

In the absence of legislative power over employment and trade union law and labour market regulation, Scottish policy has adopted a ‘voluntarist approach’ to addressing a range of economic disrupters. The Fair Work Convention’s Fair Work Framework offers a

means of addressing the workplace and employment implications of the recovery. Its emphasis on the importance of 'effective voice', is critical in giving workers a full say in how the workplace and the nature and quality of work should evolve.

Many – indeed most – businesses have had to re-engineer their businesses during the crisis; this will continue over the recovery period. From modest changes through to wholesale transformation of production processes, change has been imperative, and has been carried out at speed. As we approach the recovery, we have both an unprecedented opportunity and a requirement to develop ways to support workplace innovation, embedded in Fair Work practice. So we think that there is scope to accelerate and strengthen the support available to businesses to ensure workplaces and work practices can change safely, fairly and productively.

In this context, we think that Skills Development Scotland (SDS), in partnership with the enterprise agencies, further and higher education, business, and the trade unions, should, by the end of 2020, establish a new Centre for Workplace Transformation, with a fully costed plan. This would be aimed at improving business performance, productivity, innovation, Fair Work, workforce resilience and worker wellbeing.

Many of those identified as 'key workers' in tackling this 'life and death' crisis have hitherto been neither respected nor rewarded as such. Large sections of the workforce in our health and social care sectors; in food production, processing, distribution, and sales; in education and childcare; key public services; in local and

national government; in utilities; and in transport, are amongst the lowest paid and face economic disadvantage on multiple levels.

The Scottish Government is considering how relevant employers and unions can support the development of collectively bargained Fair Work Agreements, including in sectors where the pandemic has highlighted the need to build workforce resilience and address precarious work and poor working conditions and practices. This can learn from the experience of the New Zealand Government⁴³. As a starting point, we think that arrangements should be put in place in the social care and hospitality sectors, with a view to concluding Agreements within a year.

5.20 Skills and the labour market

The Scottish Government should refocus its skills strategies to address the risks of unemployment, recognising the importance of high participation sectors, and of improving the provision of lifelong learning to enable people to reskill.

The June Monthly Economic Brief⁴⁴ from the Scottish Government's Chief Economist outlined the challenge facing the labour market in Scotland. Latest business surveys have shown record falls in business activity in April, reflecting the fact that an estimated 19% of businesses have been temporarily closed in Scotland. It is provisionally estimated⁴⁵ that Scotland's GDP fell by 18.9% in real terms during April, after a fall of 5.0% in March. The Scottish Government estimate that these closures (and wider knock-on effects) have impacted over 750,000 jobs in Scotland between those furloughed and the self-employed who are unable to work.

⁴³ <https://www.mbie.govt.nz/business-and-employment/employment-and-skills/employment-legislation-reviews/fair-pay-agreements/>

⁴⁴ <https://www.gov.scot/publications/monthly-economic-brief-2/>

⁴⁵ <https://www.gov.scot/binaries/content/documents/govscot/publications/statistics/2020/06/monthly-gdp-april-2020/documents/april-gdp-publication/april-gdp-publication/govscot%3Adocument/mGDP%2B-%2BApril%2B2020%2B-%2BPublication.pdf>

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The latest official labour market data for Scotland⁴⁶ shows that the unemployment rate in Scotland was 4.6 per cent, which is 1.1 percentage points up on the quarter and 1.3 points up on the year. The UK unemployment rate was 3.9 per cent. Given the trends since then, the unemployment rate will now be closer now to 7 per cent, and probably higher.

To date, the Coronavirus Job Retention Scheme (CJRS) appears to have been highly successful in mitigating job losses. With the current levels of government fiscal support, in the absence of the scheme, the Office of the Chief Economic Adviser has estimated that the unemployment rate could have reached around 14% by the end of the year.

There is significant amount of uncertainty over how the labour market may recover: but it is clear that the repercussions of the health crisis will be with us for some time. The Scottish Government's Chief Economist has produced illustrative scenarios on how the labour market may recover. Depending on how the recovery progresses, unemployment could reach between 8% and 13% in the latter part of 2020 – which is between 220,000 and around 360,000 people. And although it is expected to fall back after then, it could take between three and six years to return to pre-crisis levels.

The initial priority must be to ensure that existing measures to keep staff in employment are wound down in an orderly and sector-specific manner, recognising the specific circumstances of different sectors. Different sectors are being affected in different way; some will recover more slowly than others.

In parallel, the various business support schemes should enable viable businesses to maintain staff, even once employers are required to contribute towards the costs of furloughed staff.

As we have already noted, the crisis has exposed the lack of resilience and the instability of the UK's 'flexible labour' market; and it has impacted significantly on those with atypical employment contracts that make their employment status precarious. This calls for a reconsideration of the approach to labour market regulation and enforcement, not least in relation to workplace health and safety; the definition of a 'worker'; working hours; minimum wages; flexible working; and collective rights. These are complex issues that push at the boundaries of currently devolved powers.

Nevertheless, even with substantial action to maintain people in jobs, the scale of the likely increase in employment will require a very significant response from the skills and education system in support.

In that context, we supports the work being undertaken by the Unemployment Sub-Group of the Enterprise and Skills Strategic Board to look at specific measures that can be put in place immediately. That is clearly essential.

These challenges that the skills and education system will need to address are multiple. They will involve developing detailed approaches across the range of organisations to:

- Maintain existing employees in employment as a transition measure to build back businesses after reopening;
- Maintain the level of in-work training;
- Support people who are made redundant and become unemployed; and
- Increase the availability and suitability of education and learning options, provided by universities, colleges and

⁴⁶ <https://www.gov.scot/publications/labour-market-trends-june-2020/>

other providers, to enable retraining and reskilling

Throughout our work we heard a consistent message that there will be more business failures and redundancies in the economy as a consequence of the crisis. This process is already under way; and it will undoubtedly lead to an increase in the need for Partnership Action for Continuing Employment (PACE) type services, offering transition into new jobs or retraining opportunities. So these services will need rapidly to be expanded to provide more proactive support. This will need intense collaboration between the enterprise bodies, local government, SDS and the education sector; and they need urgently to prepare now for an increase in demand in the coming months.

The increase in unemployment is likely to affect 19-25-year-olds disproportionately. Young people will need to learn more employability skills at college to give them a greater chance of moving into a tough post-crisis job market. Many will be catching up on learning after lockdown. And there are risks that existing apprentices will not be able to complete their training.

As a consequence, there is a pressing need to expand the scale and reach of the Flexible Workforce Development Fund (FWDF) to encourage employers to invest in work-based learning to increase productivity and to include small businesses. Colleges have been instrumental in delivering workforce upskilling, reskilling and soft skill; and we heard that the college sector has already helped to support organisations across Scotland to rebuild their businesses and rebuild their confidence. But this will need to go further.

We also heard that there is a pressing need for greater alignment of the skills system in

Scotland. SDS characterised the pre-existing challenge facing the labour market in Scotland as follows. In recent years we have seen record levels of employment, but 2m of Scotland's 2.5m workers earned £45k or less and of those, and around 1m workers earned between £24k and £14k.

Moreover, notwithstanding the significant investment in skills and education in recent years, there are persistent skills shortages sitting alongside graduate under-employment. This clearly suggests a need for rebalancing of skills provision. Such a rebalancing should include work-based apprenticeships; and should exploit the fact that the crisis has given greater impetus to online learning.

5.21 Universities and colleges

The Scottish Funding Council and the Scottish Government should protect universities and colleges from the financial impact of the crisis, so that they can maintain and enhance their role as “anchor institutions” and take decisive steps to align their teaching and learning provision, including postgraduate skills training, to meet business and employer needs; and to focus their support for research investment and growth.

Colleges and universities have responded to the crisis by changing approaches to learning and research, supporting the alternative qualification models and responding to the global research effort.

We recognise the enormous contribution made by universities to the economy, including as significant economic “anchor institutions”. The particular role of universities in Scotland is summarised in the Muscatelli Report⁴⁷ from 2019.

⁴⁷ <http://www.sfc.ac.uk/news/2019/news-77799.aspx>

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This report highlights the need to encourage greater collaboration within the university sector to boost the sector's performance in research and development and innovation.

The Scottish Funding Council (SFC) outlined in stark terms to us the possible implications of the unique and significant external shock to universities and colleges, and told us that their immediate priority is to provide assurances of stability and continuity. The higher education sector is experiencing a huge fall in international students, and many Scottish universities are highly exposed to this international market. Current funding arrangements in Scotland have benefited from the growth of international students and students from the rest of the UK, which have cross-subsidised tuition for home students and research activities. So the temporary loss of international students directly impacts on provision of education for home students.

The SFC analysis shows that, even allowing for some new and returning international students, and mitigating action by institutions, we might still expect a significant deficit this year of at least £450-500 million. All 18 Scottish universities are likely to go into deficit; for several, cash levels could become critical towards the end of this financial year. Bridging support will be required to protect some institutions for the future.

We welcome the recent announcement⁴⁸ that the Scottish Government has commissioned work on the future provision and sustainability of colleges and universities. Over the summer, the SFC will consider its funding model for teaching and learning.

Given the systemically important role of universities, there will be a continuing need to stabilise and protect the sector in the short term.

Looking forward, the sector and institutions will need to adapt and adjust to this major change in income and activities. The consequences of the crisis will reverberate for years, and adapting to this changed operating context will be a major leadership challenge. But it is essential that universities face it.

The demand for learning will remain strong. With the planned wind-down of the current income support schemes, there will be a greater need for upskilling and re-skilling provision to support people to get back into the labour market. We expect a disproportionate impact on lower skilled jobs and widespread job losses in hospitality, retail and tourism businesses. Any financial support from government provides the opportunity to respond to global change, and pivot the role of universities and tertiary education within Scotland to meet the needs of economic recovery.

University teaching and research provision needs to respond to these challenges with considerable flexibility. The early signs are strong, with a rapid response to shift teaching online and adaptation of research programmes. The response from the sector body Universities Scotland highlights the scope for further collaboration between institutions, and with other parts of the education sector, to ensure all learners have access to opportunities that meet their ambitions and needs.

This is a significant moment of inflection for universities and colleges. Many institutions are facing serious financial shortfalls. It is vital that a more aligned tertiary education, skills and research system can be built. The SFC and SDS already collaborate on skills provision, but will need closer working and joint planning on a regional approach to develop further regional collaboration. This, in turn, could incentivise

⁴⁸ <https://www.gov.scot/news/review-of-further-and-higher-education-support/>

colleges and universities to deliver an increasing number of integrated degrees and graduate apprenticeships where two years of delivery are undertaken at college.

In terms of research, given the financial challenges faced by the sector, the SFC will need to consider how a more collaborative and aligned approach could be incentivised between Scotland's most research-intensive universities.

5.22 Apprenticeship Training

Skills Development Scotland and the Scottish Funding Council should collaborate with colleges, universities and businesses to prioritise apprenticeship training; and should respond to youth unemployment with a flexible learning response. This should include further development of Graduate Apprenticeships and online learning.

Colleges are an agile, collaborative, and inclusive national asset to which the Scottish Government allocates significant resource. As in the aftermath of 2008, colleges will need to be at the heart of the recovery effort.

When considering the role of the college sector, we drew heavily on the recent report⁴⁹ and analysis by Audrey Cumberland and Paul Little. We asked the authors to provide an assessment of the new circumstances following the crisis.

This assessment highlighted that:

- The gains made through the Developing our Young Workforce approach, which was at the heart of the response to the global financial crisis in 2008, are now at risk;
- There is now a need for a targeted and concerted set of interventions, based on a 'triage' approach rather than 'first-aid for all';

- There is an urgency to support some of the most vulnerable groups in society, all of whom are natural clients of the college network. This is not solely about the challenges facing young people: lone parents, low income families, minority ethnic groups, disabled learners and those with learning difficulties and experience of care or who are estranged are all at risk;
- There is a need to ensure system-wide leadership, and enhanced collaboration across business and learning providers; and
- There is a clear need for flexibility and adaptation of the tertiary education sector to respond to economic recovery.

The Flexible Workforce Fund will need to drive a significant increase in activity. In the immediate term, economic recovery will call for the swift introduction by colleges of short course provision targeted at furloughed staff and those seeking to retrain. Colleges can underpin the acceleration of Developing our Young People and ensure the continued availability of a work based curriculum that helps to offset increases in youth unemployment.

Many apprenticeships have high value in the labour market: but this depends on their quality. Given the financial hit to firms, and the fact that many have had to suspend their apprenticeships, this is a route that will be badly affected by the crisis. It is imperative that we support firms to restart their training. Unfortunately training in the UK is pro-cyclical: firms train less in bad times. So policy intervention will be essential.

Expanding the number of apprenticeships in this period of depressed economic activity will be challenging. Generating new apprenticeships that are not of high quality will undermine the reputation and value of apprenticeships.

⁴⁹ <https://www.cityofglasgowcollege.ac.uk/news-events/news/report-published-economic-impact-scotlands-colleges>

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Nonetheless, there will be scope to develop the provision of Graduate Apprenticeships, enabling greater coherence of learner progression alongside more jointly delivered degrees.

One of the most striking changes that may come out of the crisis is the normalisation of digital learning. Universities have deployed their experience of online learning to adapt to significant provision of undergraduate teaching. Against this background, Audrey Cumberford and Paul Little recommended targeted investment for online learning to underpin a shared capacity and capability for a realigned tertiary sector.

Universities should also be able to provide Postgraduate Skills Training to Scottish students as part of the recovery. Key sectors such as manufacturing, nanotechnology and life sciences rely on a flow of high-level skills at advanced undergraduate and postgraduate level. As discussed earlier, Brexit may create bottlenecks in these skills: the SFC should consider how supply can be maintained.

5.23 A Scottish Guarantee

The business community, with the support of the Scottish Government and in partnership with local authorities, should mobilise urgently to develop a business-led Scottish Jobs Guarantee scheme. This would respond to the likely increase in unemployment among young people and the serious, generational challenge that this represents for our country,

The damage done to the generation currently aged 16-25 and their job prospects will be a scar across their working lives if there is no urgent, ambitious and focused intervention to address it

We were struck by the success of the Edinburgh Guarantee, where businesses worked in

partnership with the local authority and other agencies to offer placements of at least 6 months to young people. The current circumstances, and the generational challenge facing our country, demand a more ambitious, nationwide approach.

We therefore propose a Scottish Jobs Guarantee, to be led by businesses working in partnership with local authorities and other agencies, and with the active support of the Scottish Government, to ensure that no young person is left behind.

The scheme should offer secure employment, for a period of at least 2 years, to 16-25 year olds, paid at the Living Wage, with access to training, apprenticeships and the possibility of progression. It should be delivered locally, with brokerage of opportunities between employers and jobseekers: but it should be set within a coherent national framework.

There should be targeted funding support from the Scottish Government to set up the scheme, and to assist small and medium-sized businesses, as well as larger firms, to participate.

We also think the Scottish Government should discuss with the UK Government the scope for offering participating employers some flexibility in relation to the Apprenticeship Levy.

5.24 The Four Capitals

To promote an approach to economic policy that values all of Scotland's assets, the Scottish Government should consider adopting a Four Capitals framework in forming its future economic strategy, and reporting against it.

As we have noted, we found the Four Capitals framework valuable in seeking to form a view of Scotland's economy that takes account of the full range of our national assets – natural, social, human – as well as the purely financial and physical – and

that encourages a more rounded and holistic policy approach. It is entirely consistent with the National Performance Framework.

More importantly, the recovery Scotland needs will require all parts of society to work together in a different way. The Four Capitals approach gives us a lens through which to look at the different aspects of that collective endeavour, and to value the contribution that all parts of our society and country bring to it.

We therefore recommend that the Scottish Government considers using the Four Capitals approach in forming its economic strategy, both in the recovery phase and for the longer term.

This will require considerable technical work in order to measure and monitor our assets, notably in natural capital, as we have already noted: but we think that the potential long-term benefits in terms of policy provide sufficient justification.

5.25 Implementation

To create momentum and build confidence, the Scottish Government should set out its response to the proposals in our report by the end of July, and should publish regular updates on its recovery plan.

The economic recovery will be a long haul. But the action needs to start now. The Scottish Government needs to define and execute its recovery plan with purpose and urgency, in partnership with business and other key stakeholders. The Scottish Government should publish its response to our proposals, and set out its strategy and initial action plan for economic recovery by the end of July. In order to maintain momentum, it should publish regular updates on that strategy and its execution over at least the next year.

Our recommendations are diverse and wide-ranging. Implementing them will create many

workstreams and involve multiple partners and stakeholders. It is not for us to prescribe in detail of how each one should be taken forward. But, pace, alignment and coherence in the execution of the recovery plan will be required. We hope that the Scottish Government will adopt a streamlined and strategic approach, and will take the opportunity to revisit any structures and processes which may stand in the way of the focused, thoughtful but urgent action that the recovery demands.

6. Charts and figures

Figure 1 - Effect of partial or total shutdown on economic activity in Scotland (Source: SG Analysis)

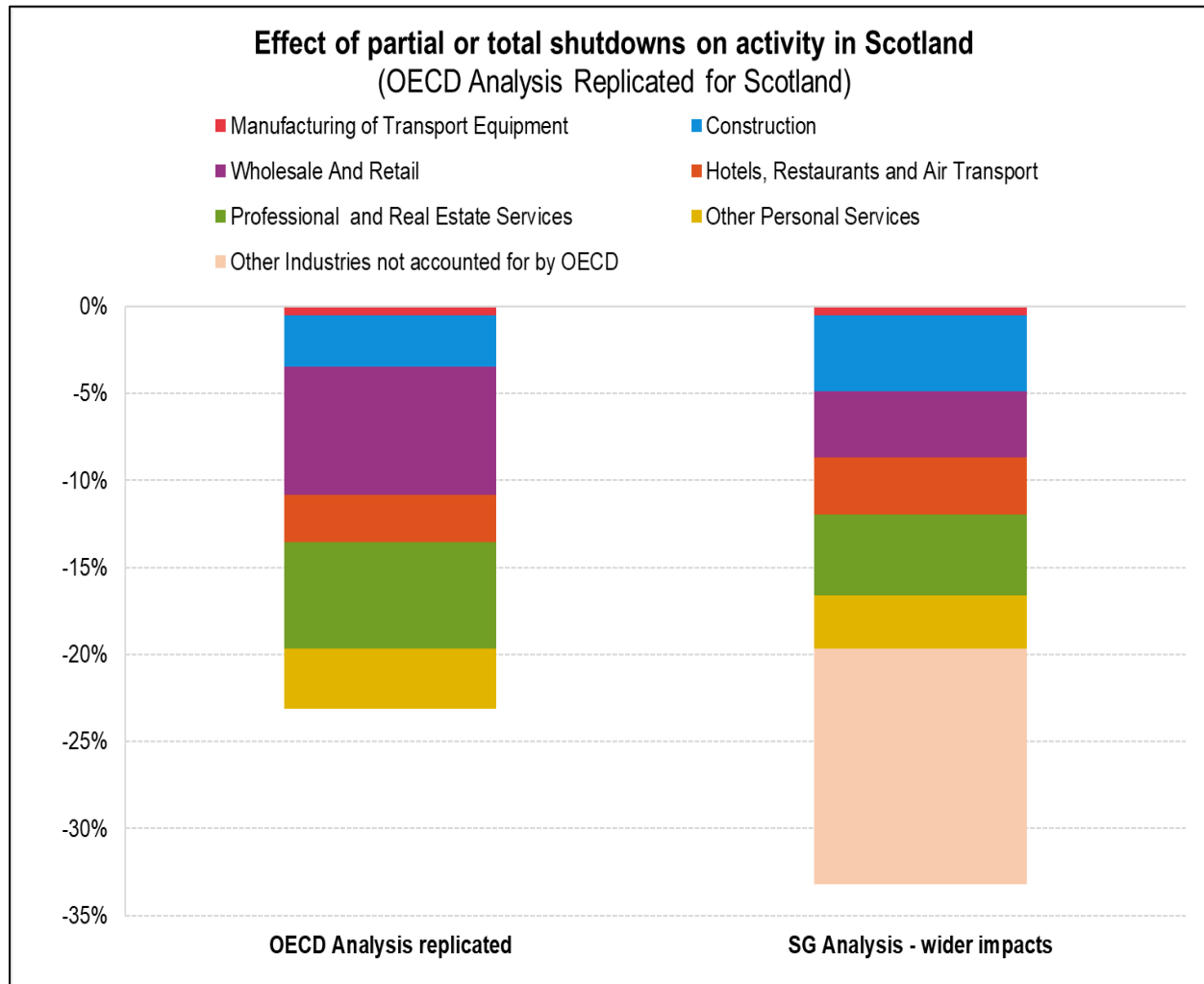


Figure 2 - Claimant Count in Scotland

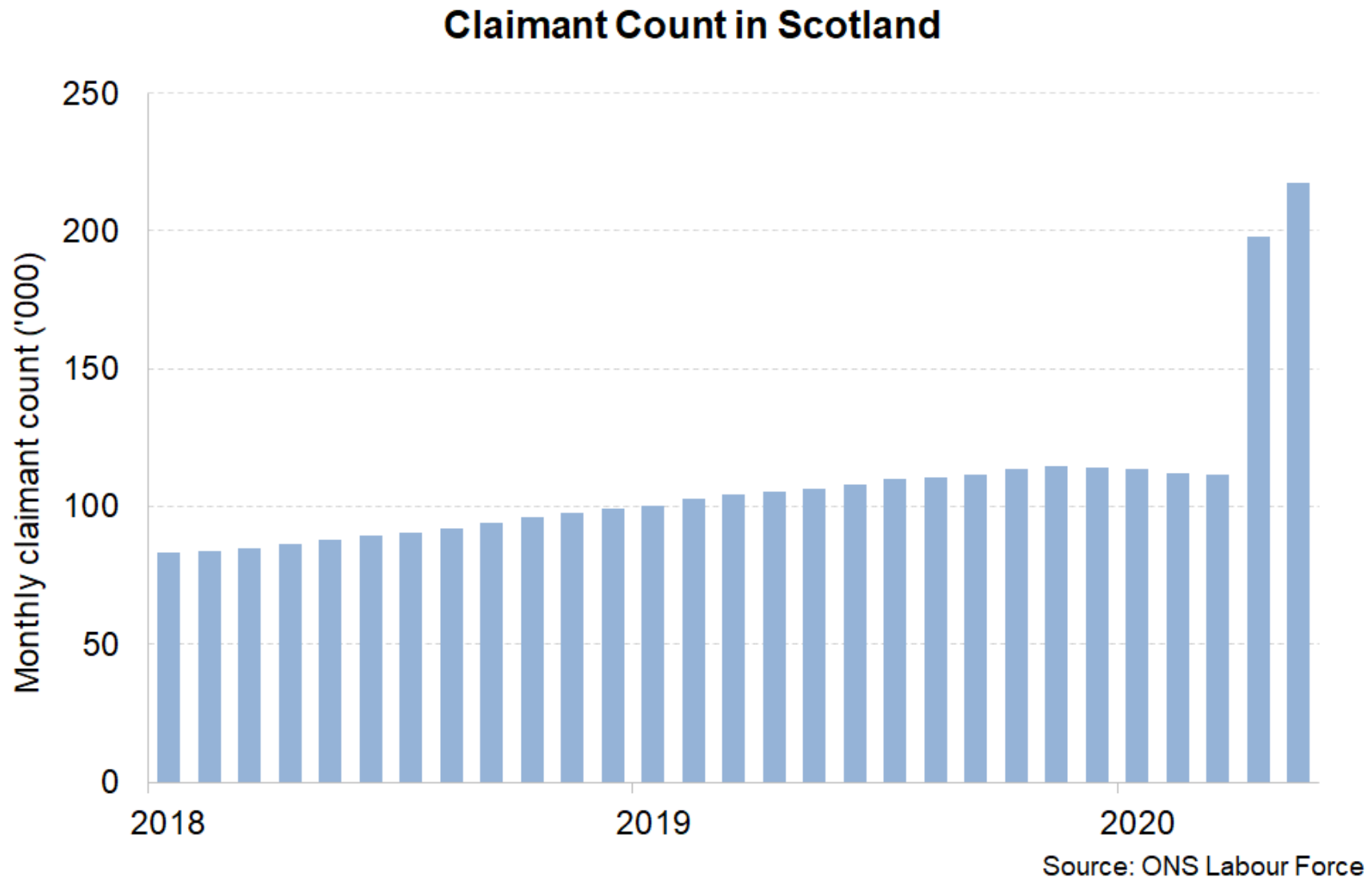


Figure 3 - Illustrative modelling on medium term impacts on GDP

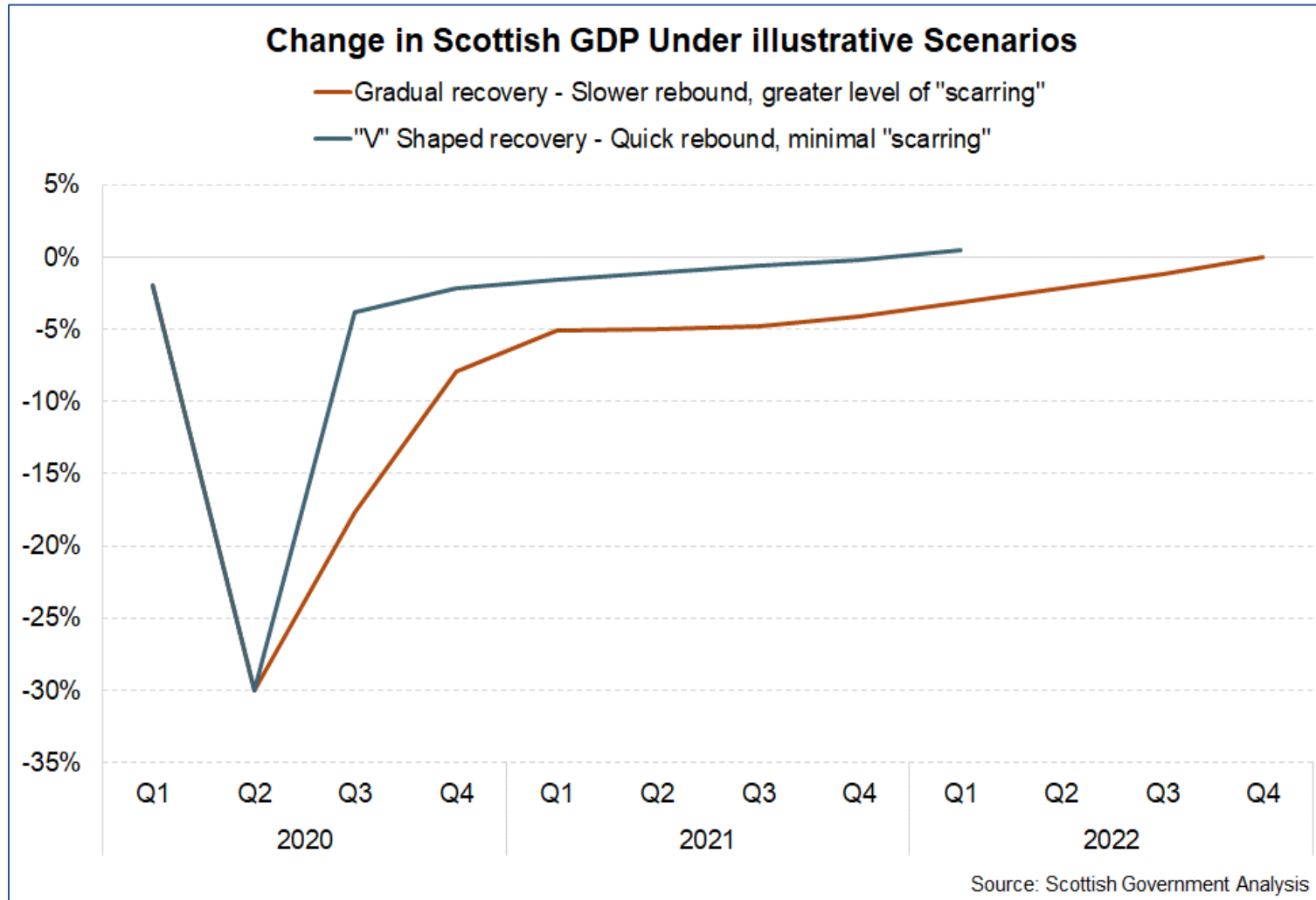


Figure 4 - Illustrative modelling on medium term impacts on Unemployment

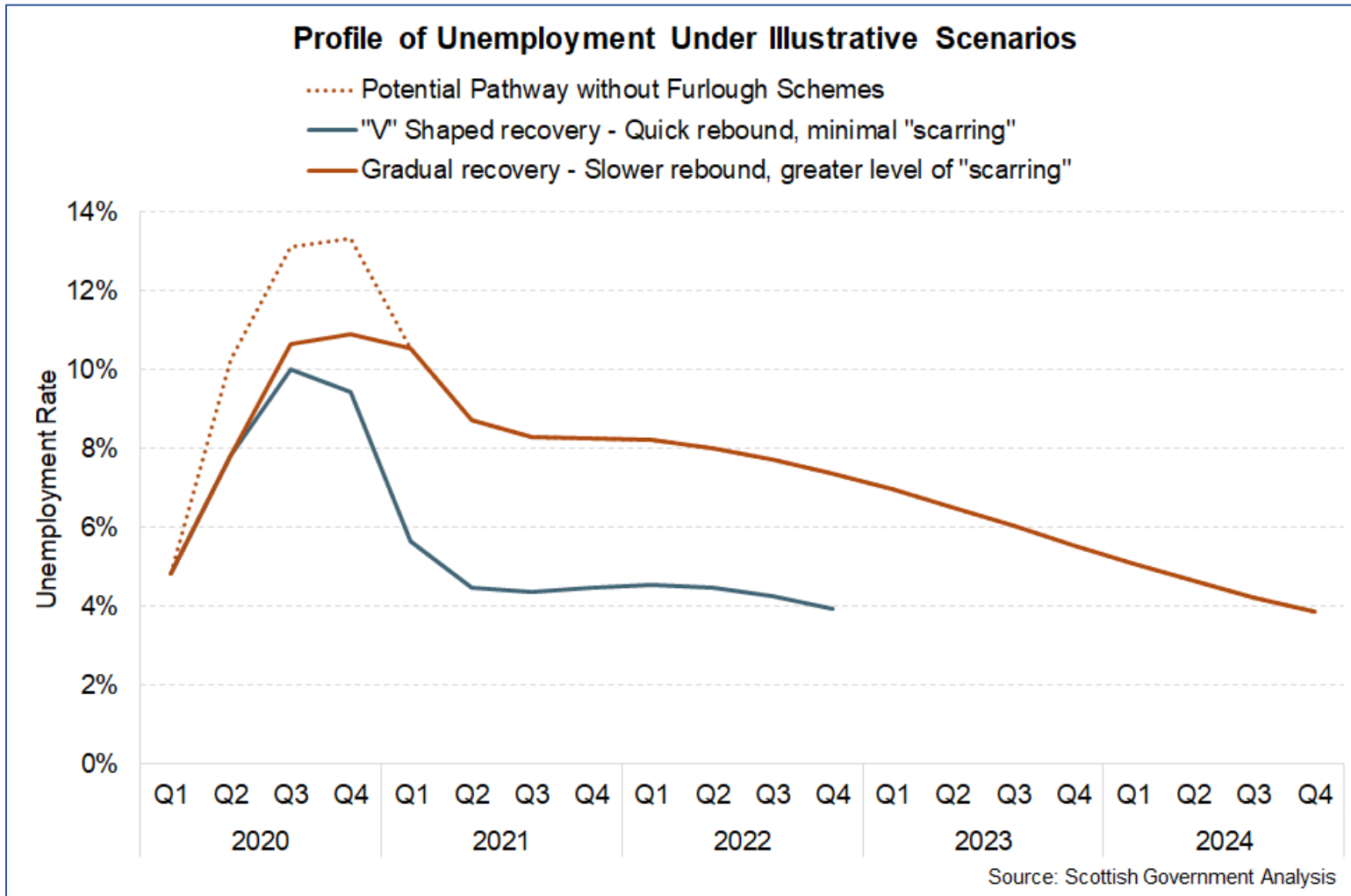


Figure 5 - Actual and projected natural change and net international and rest of UK migration in Scotland

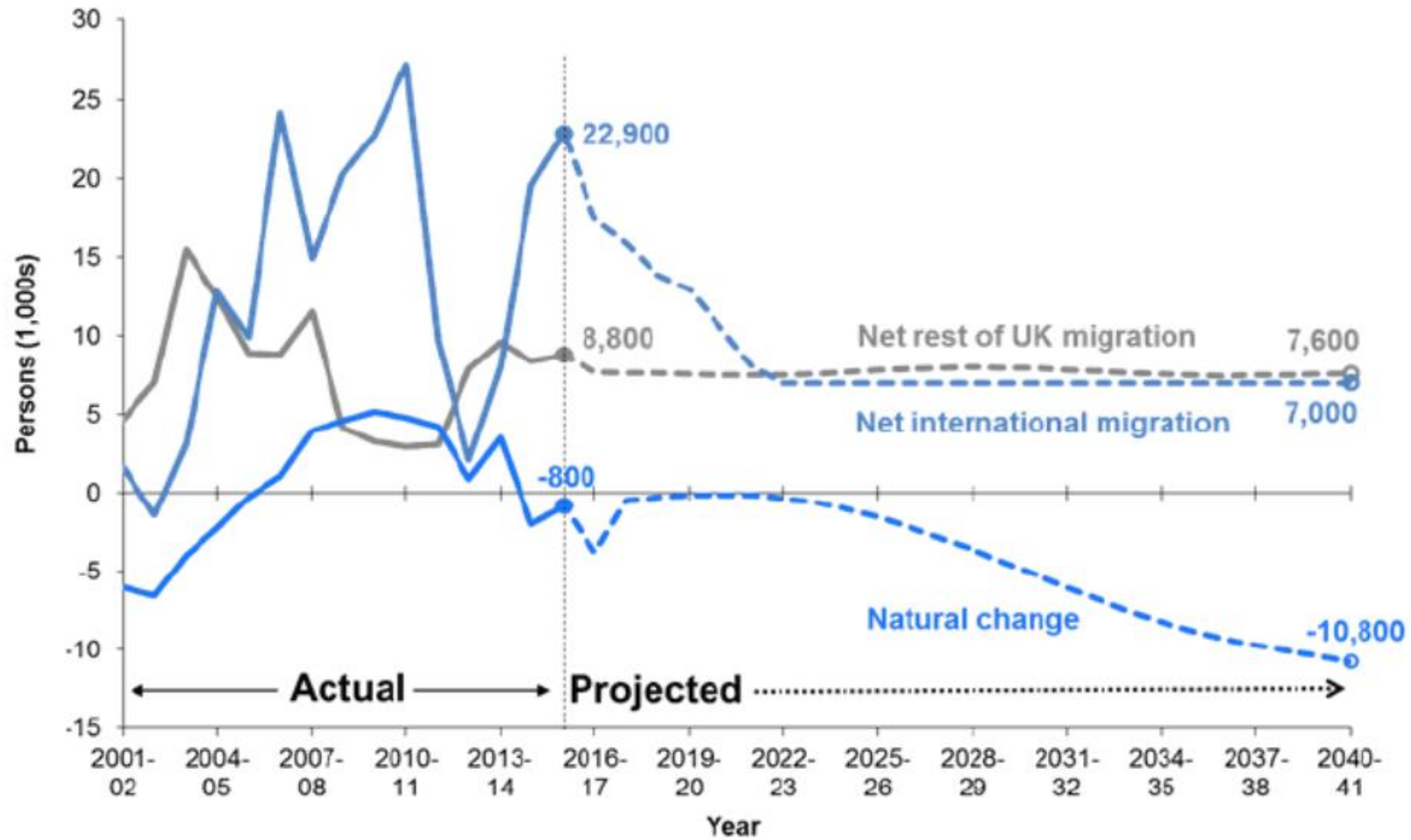


Figure 6 - The National Performance Framework



Figure 7 - The 4 Capitals



Towards a Robust, Resilient Wellbeing Economy for Scotland

Figure 8 - Summary of 4 pillars analysis

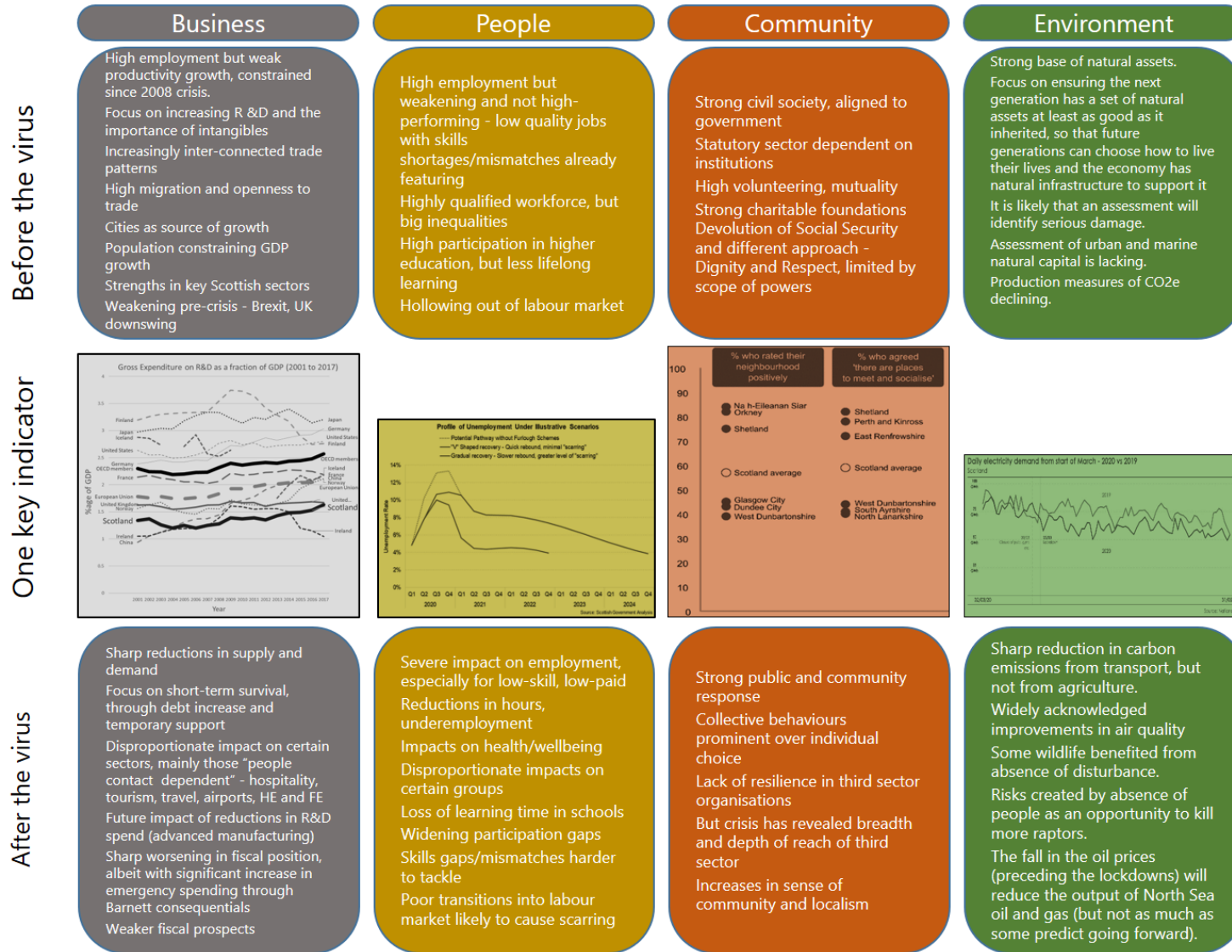
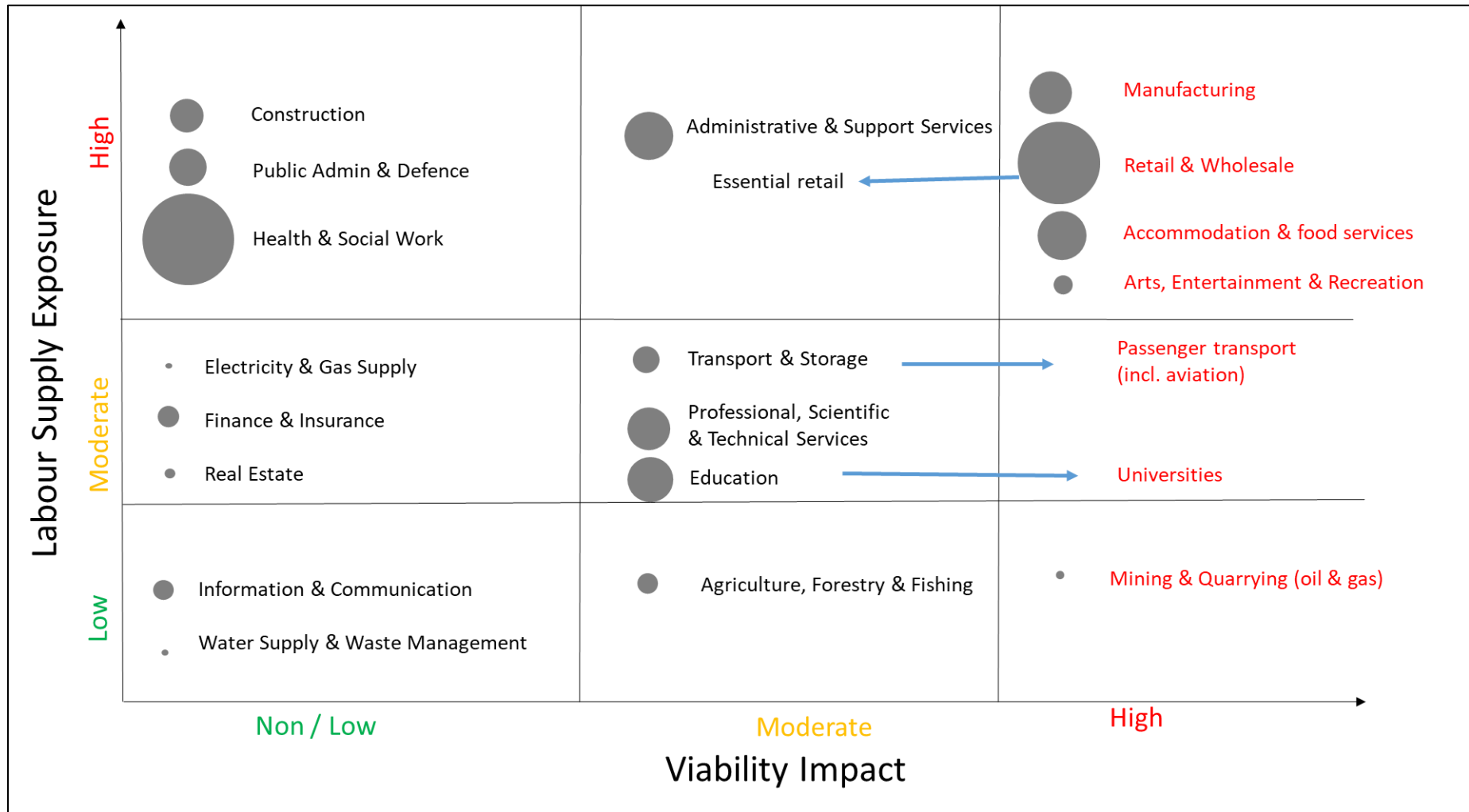


Figure 9 - Interaction of viability and exposure to labour market disruption



Towards a Robust, Resilient Wellbeing Economy for Scotland

Figure 10 - Interaction of viability and exposure to international supply chains

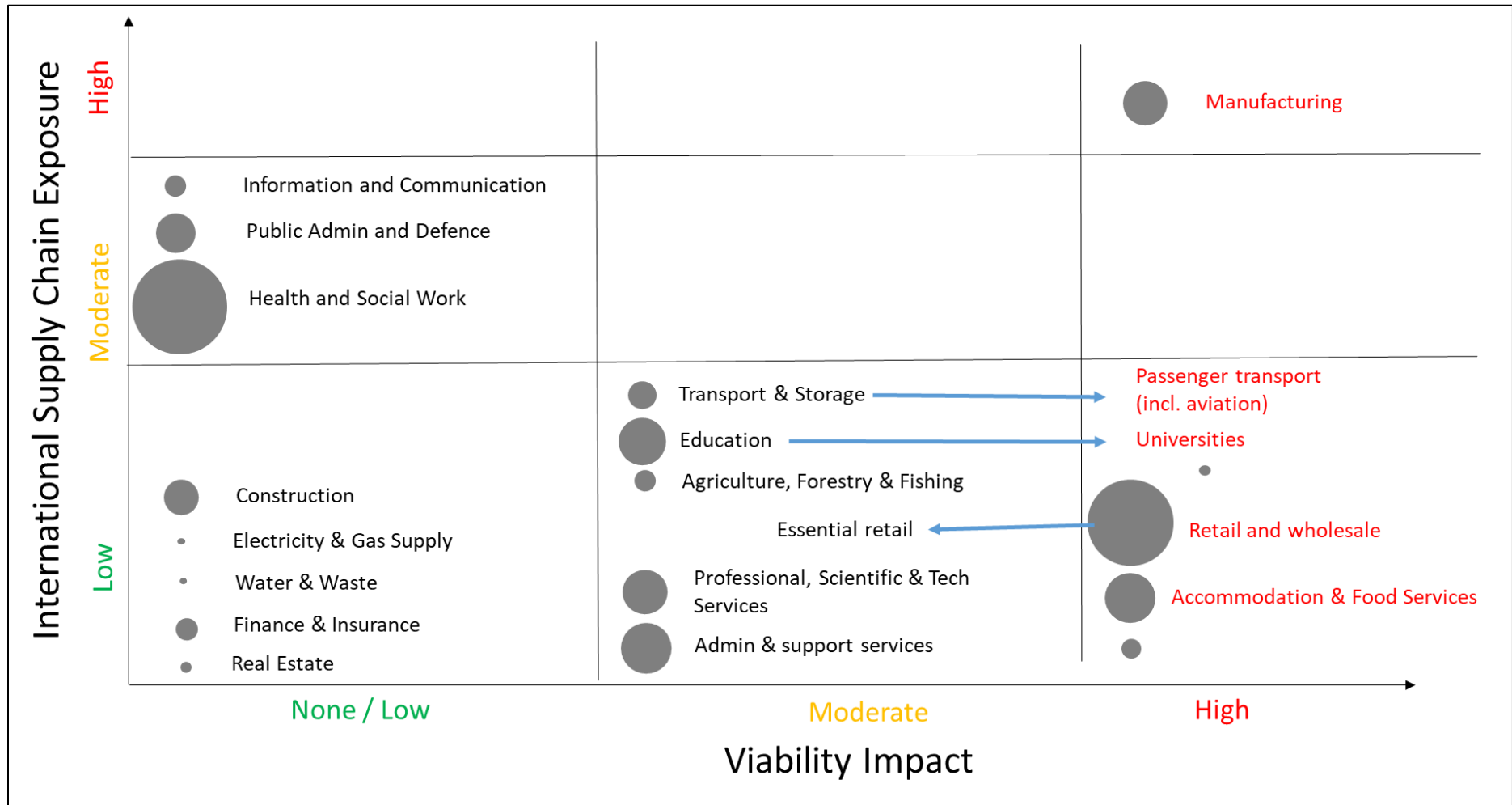


Figure 11 - Regional Indicators

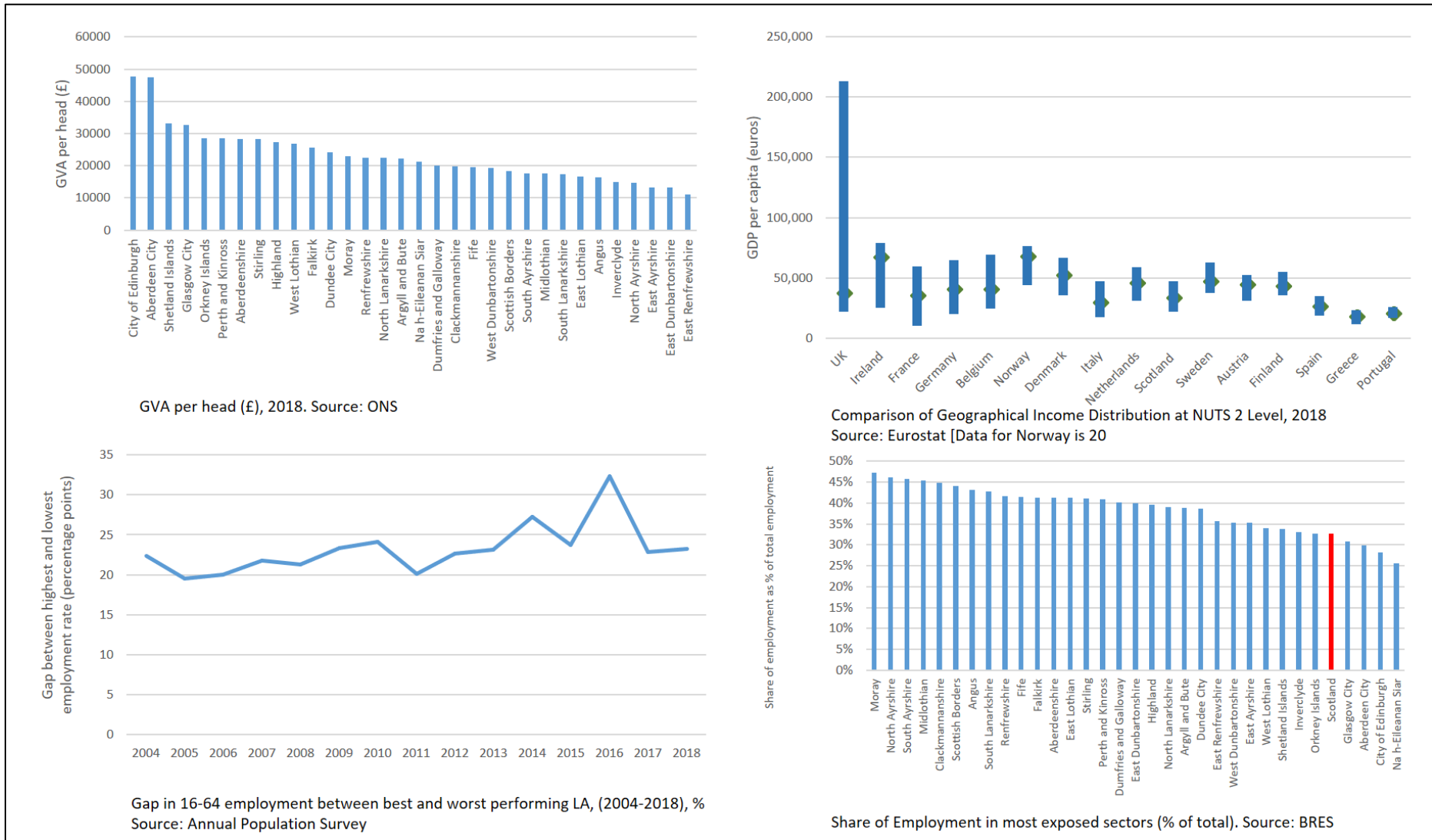
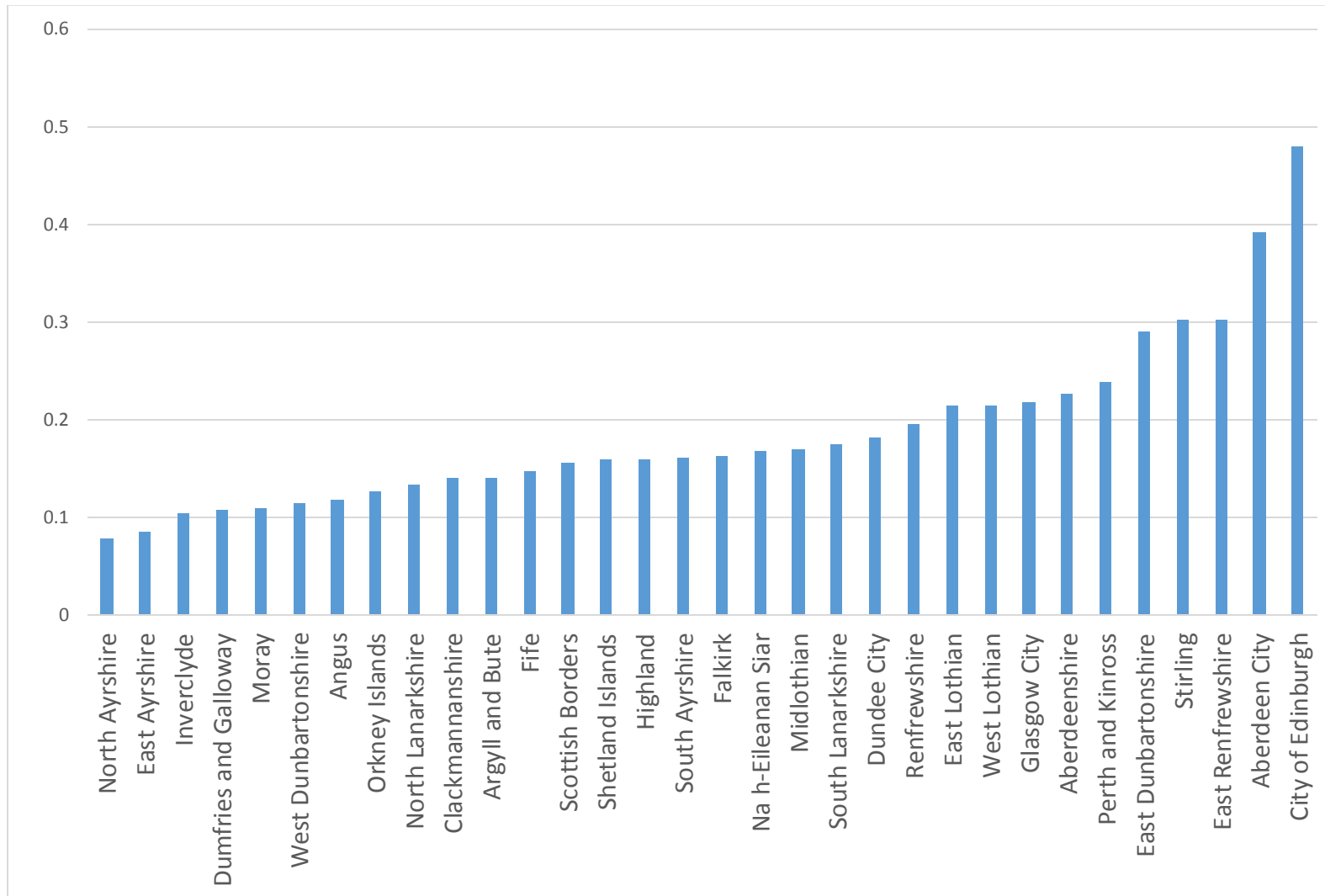


Figure 12 - Index of Regional Resilience





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