

HOW PRODUCTIVITY COULD DELIVER INCLUSIVE GROWTH IN SCOTLAND

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Across the UK, productivity rates have been close to flat since the financial crash in 2008, with a resultant stagnation in living standards and economic growth. How to restart productivity growth, and how to solve the 'productivity puzzle', has been foremost in policymakers' minds at the UK level, and with devolution of new tax powers, a crucial policy objective in Scotland too.

In 2015, the Scottish government refreshed its economic strategy, placing inclusive growth as a key aim at the centre of its strategy. Inclusive growth is the idea of delivering stronger economic growth that in and of itself narrows inequalities, rather than relying solely on government intervention to redistribute the proceeds of growth. Rather than being blind to the shape and direction of economic growth, inclusive growth is an attempt to shape growth to deliver the social outcomes we wish to see. Given the importance of productivity to the strength of the economy, it will be important to consider how productivity growth in Scotland could maximise our ability to reduce inequalities, boost tax take, drive out low pay and ultimately deliver inclusive growth in Scotland.

INCLUSIVE GROWTH AND PRODUCTIVITY – WHAT DID WE FIND?

We found evidence of a 'long tail' of low productivity firms in Scotland with a small number of frontier firms with very high productivity levels. Equally, Scotland sees significant variation in productivity by sector and region. This points to the need to spread productivity and innovation within sectors and across regions, as much as the need to drive new innovations in the economy.

In recent years average pay growth has been lower in Scotland than in the rest of the UK. With the devolution of a range of taxes to Scotland, wage growth differentials are important in affecting Scotland's budget. In future years, if projections are accurate, we will see significant amounts of tax revenue 'lost' in Scotland due to weaker growth in income tax per head in Scotland compared to the rest of the UK. In 2019/20, this will see Scotland lose all of the additional tax revenue raised by income tax rises, and just under £1.8 billion lost in lost in cumulative terms between 2019/20 and 2023/24. This means that despite welcome and necessary income tax rises in Scotland in recent years, much of this additional revenue from income tax rises is being counteracted by weak income tax revenue growth in Scotland.

Equally, boosting pay rates could be more effective at raising revenue over the long term than increasing tax rates. Boosting wage growth in Scotland by one per cent above forecast in each of the next three years could see around £750 million additional income tax revenue by 2022/23 rather than around £400 million through a 1p income tax increase on all bands. Similarly, boosting pay by one per cent above forecast for the bottom half of taxpayers could raise £150 million per year by 2022/23. Increasing pay for the lowest earners could be a crucial way to deliver more inclusive growth. Boosting productivity growth in the right way therefore has potential to boost pay and to boost tax revenues in Scotland.

HOW CAN INCLUSIVE GROWTH BE DELIVERED THROUGH PRODUCTIVITY POLICY?

It is clear that to shape economic growth to deliver a more inclusive economy, we need to shape productivity growth to that aim. To do so we have outlined a number of recommendations:

- Encourage the Scottish government to focus economic strategy on the 'everyday economy'.
- Implement a new Committee on the Future Inclusive Economy (CoFIE) for Scotland.
- Establish new sector-based social partnership bodies.
- Ensure Scotland's national and local tax policy promotes increased productivity growth.
- Pilot tax revenue assignation within Scotland to boost productivity and inclusive growth.
- Increase investment in in-work learning for lower-paid workers in Scotland.
- Include an explicit focus on driving productivity in the everyday economy in the Scottish National Investment Bank (SNIB)'s 'mission' in order to drive inclusive growth in Scotland.

DELIVERING INCLUSIVE GROWTH THROUGH PRODUCTIVITY GROWTH

Through its 2015 refreshed economic strategy, the Scottish government continued its focus on six growth sectors. However, these do not include many of the everyday parts of the economy where most people work and where low pay is concentrated. We would need to see unprecedented employment growth in Scotland's growth sectors if the aim is to deliver inclusive growth by reducing the size of lower pay sectors and increasing the size of growth sectors. To absorb 20 per cent of retail jobs, we would need to see growth sector employment as a whole increase by 6.5 per cent. This is more than the employment growth seen in Scotland's growth sectors since 2009.

It seems clear that relying on job creation in Scotland's 'growth sectors' to boost pay and prospects for the vast majority of Scotland's labour force is not a realistic or sustainable strategy for realising inclusive growth. Instead, Scotland's productivity strategy needs a dedicated focus on high-employment, low-wage sectors in order to drive up productivity and pay across the breadth of the Scottish economy.

Through the macro-modelling we undertook with the Fraser of Allander Institute, we found that a one-off productivity shock to lower-pay sectors in Scotland as a whole could deliver an increase in Scotland's gross domestic product (GDP) of £1.5 billion and an increase in Scottish government spending of £161 million per year. It would also deliver progressive outcomes benefiting the poorest households the most. This may point to the need to focus on lower-pay sectors to drive productivity growth and with it inclusive growth. A productivity shock to the wholesale and retail sector, a lower-pay and high employment sector, could see an increase in Scotland's GDP of £600 million over the long run and a £55 million increase in Scottish government spending over the long run, again benefiting the poorest households the most.

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