OFFICIAL REPORT
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Economy and Fair Work Committee

Wednesday 14 December 2022

Session 6

The Scottish Parliament
Pàrlamaid na h-Alba

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ECONOMY AND FAIR WORK COMMITTEE
30th Meeting 2022, Session 6

CONVENER

*Claire Baker (Mid Scotland and Fife) (Lab)

DEPUTY CONVENER

Colin Beattie (Midlothian North and Musselburgh) (SNP)

COMMITTEE MEMBERS

*Maggie Chapman (North East Scotland) (Green)
*Jamie Halcro Johnston (Highlands and Islands) (Con)
*Fiona Hyslop (Linlithgow) (SNP)
*Gordon MacDonald (Edinburgh Pentlands) (SNP)
*Graham Simpson (Central Scotland) (Con)
Colin Smyth (South Scotland) (Lab)
*Michelle Thomson (Falkirk East) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Professor Jagjit Chadha (National Institute of Economic and Social Research)
Emma Congreve (Fraser of Allander Institute)
John Mason (Glasgow Shettleston) (SNP) (Committee Substitute)
Susan Murray (David Hume Institute)

CLERK TO THE COMMITTEE

Anne Peat

LOCATION

The James Clerk Maxwell Room (CR4)

Scottish Parliament

Economy and Fair Work Committee

Wednesday 14 December 2022

[The Convener opened the meeting at 09:00]

Decision on Taking Business in Private

The Convener (Claire Baker): Good morning and welcome to the 30th meeting in 2022 of the Economy and Fair Work Committee. Our first item of business is a decision on taking items 3 and 4 in private. Do members agree to take those items in private?

Members *indicated agreement.*

Scotland's Economic Outlook

09:00

The Convener: Our next item of business is an evidence session on Scotland's economic outlook. The purpose of today's session is to consider the key economic trends that our economy faces and to look towards the challenges of 2023. We will have further sessions on this before the end of the parliamentary year.

I welcome Professor Jagjit Chadha, director of the National Institute of Economic and Social Research; Emma Congreve, deputy director of the Fraser of Allander Institute; and Susan Murray, director of the David Hume Institute.

As always, if members and witnesses keep their questions and answers as concise as possible, we will get through a lot of questions and business.

I will start by asking the witnesses about inflation. This morning, we had the news that inflation has dropped slightly from where it was last month. A few weeks ago, the committee took evidence from the hospitality sector that the inflation rate is having a huge impact on many areas of the economy and on hospitality, in particular. Although there has been a slight decrease in the inflation rate, it is anticipated that it will come down to about 7 per cent next year. When will that have a positive impact on businesses? Is it likely to start to make those sectors that are under huge cost pressures more affordable? When is that likely to happen?

I will ask Professor Chadha to give an overview of the situation at United Kingdom level. That would be helpful.

Professor Jagjit Chadha (National Institute of Economic and Social Research): Thank you for inviting me to give evidence. I apologise for not being able to be there in person, but the transport problems that the UK faces mean that it was beyond us to arrange travel, so thank you for allowing me to give evidence online.

The inflation shock that we are suffering is extremely unusual, given the backdrop of the past 25 years. Between May 1997 and the early part of this year, the average inflation rate was around 2 per cent. People are therefore experiencing inflation levels that they did not expect or are not necessarily able to understand. An important part of the process for the past few months has been explaining the causes of this large increase in inflation and how it is very much associated with the increase in gas, energy and food prices that was directly caused by the Russian invasion of Ukraine. That elevated prices in international markets, which are set in dollars, against a rather volatile sterling rate this year. That has led to a large escalation in domestic prices and has generated inflation in double digits.

We do not think that the inflation rate will come down to something associated with normal levels of around 2 per cent for a couple of years yet. We are perhaps looking at 2024-25, which means that, throughout next year, inflation will be very high compared with what we now consider to be normal standards. As you have said, that will put pressure on many households and industries in terms of containing their costs and thinking about where they set their final costs for consumers, who are also in the bottom part of the distribution and suffering from the cost of living crisis. These are difficult and precarious times.

The Convener: Emma Congreve, would you like to talk about the Fraser of Allander Institute's work on the impact of inflation on the Scottish economy and how pressure on sectors such as hospitality can be relieved?

Emma Congreve (Fraser of Allander Institute): Of course. Obviously, we face the same pressures that the rest of the UK faces, so nothing is different in that sense. We are thinking about how the key drivers of inflation affect the economy and what is in place to mitigate some of the impacts of high inflation. The drivers of inflation are outwith the control of the UK and Scottish Governments.

A key thing that we will be looking at in the new year for businesses and consumers, although I appreciate that business is the key question here, is what will happen to the support for energy costs in April. We do not know what that will be as yet, and it is a huge concern for businesses, particularly those in the hospitality sector because they are facing a difficult winter and will have to make decisions about whether they can stay open during that period. They will also be thinking ahead to what will happen after that.

The key unknown of the outlook and how inflation will affect business is what support might or might not come through for energy costs come April.

The Convener: I will come to Susan Murray and change direction to talk about the impact that inflation is having on employment. Figures out today show that Scotland has really high employment, and I have also seen figures that show that women's employment is higher than it has been for quite a long time. The labour market is therefore buoyant, but it is also tight.

The papers also seem to suggest that unemployment is starting to creep up. There are concerns that the labour market is tight but that businesses are under so many cost pressures that, even in areas where the labour market is quite buoyant, businesses will start to contract because of other pressures in the economy, and that could lead us to more unemployment. Could you do some forecasting around what we can expect to see in employment next year?

Susan Murray (David Hume Institute): There are lots of different forecasts out there and it depends on who you speak to. However, the general consensus is that people are a bit scared about what might be coming down the line. We have done more work with the labour market and the workforce than we have with businesses.

Businesses know that they need to recruit labour, but they are not necessarily sure that they want to because they are worried about a recession coming next year. When we look at the predictions about people cutting back on spending and everything that we track in the "Understanding Scotland" survey, we see that most people plan to cut back spending on everything that people might spend money on. Nine out of 10 Scots believe that general economic conditions will get worse next year.

The thing that worries me most about the labour market is that one in four people is losing sleep over their finances. If you express that in terms of the labour market, it means that your labour force will become less productive. If we think about how businesses stay profitable and continue to thrive, we see that, if large numbers of people in the workforce are more anxious and losing sleep over their finances—the figure rises to 35 per cent of people who have children—businesses will thrive less.

The Convener: I will go back to Professor Chadha for my final question. Do you have any comments to make on employment and where employment levels might be next year?

Professor Chadha: It was interesting to hear Emma Congreve. We undertake a devolved nations analysis every quarter as well as the UK analysis, and I hear the concerns of households about finances and increasing mortgage and food costs.

However, employment in Scotland is doing pretty well compared with the rest of the UK; employment growth here is about 1 per cent higher than it is in the rest of the country. Scotland has relatively high levels of productivity compared with the rest of the country, if we take out London and the south-east. As a result, employment growth in Scotland looks more resilient than we might have anticipated. There is therefore some good news in the middle of all that bad news. Employment growth looks reasonably robust in Scotland.

That was partly kicked off last year by the 26th United Nations climate change conference of the parties—COP26—but it seems to continue over our forecast horizon. For example, we do not expect positive employment growth in the whole of the UK until the end of 2022, but we see positive employment growth for Scotland right across our forecast period of 2022 to 2024.

Graham Simpson (Central Scotland) (Con): I am going to ask another question about inflation, and I will start with Professor Chadha. First, I congratulate you on managing to get the word "hipster" into a recent report that you wrote. Well done for that.

The Bank of England published its monetary policy report recently, and it predicted that inflation could fall to 1.4 per cent by the end of 2024. That is quite a dramatic drop. What is that based on, and is there any prospect of it actually happening?

Professor Chadha: Where inflation goes is absolutely a function of where the bank rate goes, and the Bank of England was clear that there are a number of scenarios for bank rates. One of those would be that the bank rate rises in line with market expectations, which, as you will recall, were fairly broiled last month as a result of the mini budget—we might want to come to that a little bit later. Expectations that the bank rate might rise to 5 per cent or more and stay there had some advantage of leading to a faster fall in inflation and, at the same time, a deeper and more prolonged recession as demand, which is particularly sensitive to rapid increases in interest rates and them staying at a high level for a long time, falls more quickly than the bank would have ideally wanted.

The overall sense from the Bank of England is that inflation, which is the change in prices, will start to move out of the window of comparison. The large increase in prices came in the early part of this year and, as we move forward over time, that 12-month window of comparison will disappear. As a result, inflation will start to come down. The danger is that, if we raise interest rates too much, the core level of demand in the economy will fall too quickly, and that will lead to inflation also falling too quickly.

Overall, therefore, there is the possibility of inflation coming back in line with price stability by about 2024, which is not inconsistent with a rate of around 2 per cent at the end of 2023. We would not want that to happen too quickly, however, because that would suggest that we have a deeper recession with more unemployment that we would want.

Graham Simpson: That is fair enough. Although inflation is the big issue, you are saying that we need some inflation. We do not want to choke off inflation altogether because that could have harmful effects.

Professor Chadha: That is right. We do not want to bring down inflation that is caused by external factors too rapidly because that would imply a deeper and longer recession than would otherwise be the case. A lot of the inflation that we are seeing will work its way out of the system as the one-off increase in prices moves out of the frame of comparison, which will happen as we move through next year.

That said, there is some possibility of what economists call second-round effects, whereby people who are setting wages and prices—we have talked about hospitality—start to factor in higher inflation expectation to their processes, which would mean that inflation would stay a little bit higher for longer. That is essentially why the Bank of England has to raise interest rates to show that it is targeting an inflation rate of 2 per cent a couple of years down the line and it will set bank rates accordingly. That is still the most likely scenario. We will get there in about a year and a bit rather than in the next few months.

Graham Simpson: I will widen the question for the other two witnesses. How confident are you that the economy in general can recover in the next year to 18 months, say? I will ask Susan Murray that first, and then Emma Congreve. Can you give us any Christmas cheer? Everyone seems to be a bit gloomy at the moment.

Susan Murray: I am not sure that I can. I feel a bit like the people who answered the "Understanding Scotland" survey in that I am a bit nervous about what is coming down the line. Although we have had several unprecedented shocks in recent years, we are now moving into a period of more global instability than we have had previously. We can look at all the variables now and think that we might be okay in a year to a year and a half, but what if something else happens? That is what worries me, and it is also coming through in lots of surveys. How do we build people's confidence so that they feel a bit more resilient if there is another shock down the line? We cannot guess what those shocks might be. A few years ago, a volcano erupting in Iceland threw everything off for a good few months. The bigger question is about how to make Scotland and the people in Scotland more resilient so that we can cope with whatever is thrown at us in the future.

09:15

Emma Congreve: I cannot give you too much in the way of Christmas cheer, but the number of shocks that the economy has had in the past few years is considerable. The economy, particularly the labour market, has been a bit more resilient that we might have expected because some policy from the UK Government—and the Scottish Government, too—has been quite effective.

What we are hoping for in the way of Christmas cheer is that policy will do what it needs to do to mitigate the worst impacts of inflation, which are energy costs, and provide the right kind of support to households and businesses so that they can get over this hump in the next couple of years.

The autumn statement and the Office for Budget Responsibility forecasts were a little bit more optimistic than the Bank of England was a couple of weeks earlier, partly in recognition of some of the measures that were in the autumn statement about putting a bit more money into the system to ensure that the recession is as shallow as possible. I guess that that is good news. The Government can do things to help.

However, as I said earlier, there is a bit of a gap in knowing what decisions are going to be made. We have had so many changes of policy that businesses and people at home are uncertain; there are reasons for not being sure that the Government will do the right thing, but I hope that it will.

The Convener: Mr Simpson, you can have one more question, but Professor Chadha wants to come in, so perhaps you could invite him.

Graham Simpson: Okay. John Swinney is making a statement tomorrow. If you were to speak to him today, what is the one thing that you would ask him to announce tomorrow?

Professor Chadha: I would not like to ask a political leader to make any announcement. However, I go back to the point that I made a moment ago. The one important development in the British labour market of the past couple of decades is that employment rates have continued to be high. After the financial crisis, even during what has been anaemic economic growth in the past 12 years, the Brexit process—let us call it that—Covid and the war, employment has remained high and stable, and unemployment rates are below the 4 per cent to 5 per cent that we expect to see in our economy.

It might help the economy more if we think about inactivity rates. Why is it that older people have left the workforce? There are some good reasons for that, including concerns about Covid and about interacting. Younger people around the country also seem to have left the labour force because of long-term illness, and I would like to think about how we can address that and whether we can get people back into work. Work is much more important than income. Social interactions, learning by doing and connection with society are all so important in the world of work. I would therefore like our political leaders to think harder about why inactivity rates are increasing across the country.

The Convener: We have high employment, but quite a lot of people are in low-wage employment, are living on the breadline and are requiring greater support from the Government. Obviously, it sounds positive when we say that we have high employment rates, but a significant number of people are not earning enough money to keep their families, pay their mortgages and put food on the table. What kind of changes do we need to make in the economy? That is a huge question.

Professor Chadha: If I may, I will answer very briefly. Of course, you are absolutely right. Am I online? I am not sure. Can you hear me?

The Convener: Yes.

Professor Chadha: We have been terribly concerned, despite the increase in employment, about the increase in destitution across the country among people in lower income brackets. The cost of living crisis is amplified for those households because they tend to spend a much larger fraction of their income on food and energy, so there is a need to provide support for them. We have also seen a worrying increase in the number of people accessing food banks.

If we move a bit further up the income distribution, there is concern that for people with mortgages higher interest rates might leave some families unable to meet their interest payments, and there is concern that others who are renting might not be able to pay their rent if rents go up. A higher level of support is needed, there.

However, on getting real wages up in the long run, the national living wage has helped, but a living wage is not what we want to aim for. That is not the best; it is okay, but to raise wages in the longer term, we need to think about productivity and how the return from an hour of work could lead to more output than we currently see in a large number of industries across the country. That is a big problem facing the UK economy, and it is about lack of infrastructure, skills and broadband connectivity.

Underpinning that, we have also learned from the Covid crisis that it is important that healthcare, social care and education services are also supported in a way that they might not have been supported during the past 12 or so years. All those issues lead to low productivity and lower real wages for households that lie in the lower part of the income distribution.

That said, for people who are lucky enough to have high levels of education or human capital and the appropriate networks, wages at the top end of the distribution have done exceptionally well. That level of inequality is, however, a severe problem that is facing society and must be addressed. We cannot address it tomorrow, but it is important that we discuss it and think about appropriate policies that are consistent with and which address the narrative that I have just outlined.

Fiona Hyslop (Linlithgow) (SNP): Thank you all for joining us this morning. I would like to ask the same question of you all, but I will start with Emma Congreve. Is Brexit already baked into UK and Scottish economic performance or will it have a continuing and latent impact? If so, what do you think that will be?

Emma Congreve: Part of the problem is that when Brexit finally occurred, we were in the depths of the pandemic. It has therefore been difficult to separate the impact of Brexit from what was happening in the economy anyway. That is the first caveat.

We are often challenged on this. People have very different views, and because the evidence is not clear it is hard to have a lot of certainty, but it is difficult to see where Brexit has not had an impact because of the friction that it has introduced in trade and the restrictions on freedom of movement. That might have been exacerbated by Covid because people who came from elsewhere in Europe might have gone home during the pandemic and could not come back as they would have done, had Brexit not occurred. I expect that all that will feed into inflation and gross domestic product.

On whether Brexit is baked in, many of the effects will be in the system and will be among the issues that we are facing. In some ways, Brexit was a shock when it happened, but it will also leave a legacy. That means that the loss of things that we took for granted before Brexit—for example, free movement of labour, flexible supply chains, goods being moved without friction—will continue to be an issue. It will take quite a long time for the economy to adjust to the new normal.

Because of what we have been through in the past few years, it is difficult to separate things. I know that that is frustrating because it means that we do not have a black or white answer, but that is where our work at the institute has got us in terms of the impact of Brexit. It might be possible do some more comparative analysis with other countries in Europe once we have a bit more outturn data that will help us to disentangle some of the issues.

Fiona Hyslop: I am conscious that it is a big question. I will come to Susan Murray. Feel free to do a top-line summary, if that is helpful.

Susan Murray: Emma Congreve summarised the situation really well. I am mindful of time, so I will not add to what she said. It is too early to tell whether Brexit is baked in, although we are seeing some effects. That is my top-line summary.

Professor Chadha: It is a great question, if I may say so. We should not forget that we had a number of years of uncertainty that held back many investments and foreign direct investment plans before Brexit was announced because there was no sense of what would happen and how it would happen.

The overall view of the Brexit process is that we have a form of Brexit that will not be the final form of our relationship with the European Union. We have also not established with other parts of the world trade agreements that it was said could be done much more quickly than has turned out to be the case. That continues to inject uncertainty into our trading relations for manufactured goods and services, and in terms of capital allocation around the world. That continues to act as a drag on our economic performance. The NIESR and other places think that the overall impact of the Brexit that we have gone through on gross domestic product, which is our measure of output, is between 4 per cent and 6 per cent.

To go back to a point that Emma Congreve made a moment ago, Brexit is also interacting with the next set of shocks to make them worse than they would otherwise be. Labour has not returned after Covid. The shocks in food and energy prices have been exacerbated by domestic inflation and they have exacerbated the negative impact on GDP, because of the Brexit process. Even though Brexit has happened, it continues to interact with the other shocks that we are facing and to make them worse than would otherwise be the case. So far, Brexit has not been a great story for the UK economy.

Fiona Hyslop: I will stay with Professor Chadha to address investment. Each economic crisis can be different. After the financial crash, the Scottish Government embarked on a construction-led investment recovery. In 2010, it was estimated that around one third of all construction that was being done in the UK at that time was being done in Scotland. That was underpinned by building of the Queensferry crossing, by rail construction and so on.

Inflation and other aspects affect capital investment and the ability of businesses to invest. What is your take on where we are with business investment and the impact of the UK Chancellor of the Exchequer’s recent budget statement on business investment? Renewables are particularly important to the Scottish economy, as they are to the rest of the UK economy. What impact will the measures in the chancellor’s statement have on investment for recovery? Is that a route forward from the crisis or will progress be constrained by inflation?

I ask Professor Chadha to answer first then, if we have time, I would be interested to hear the perspective of the other witnesses.

Professor Chadha: I will keep my answer brief and give Susan Murray and Emma Congreve time to answer. Following 2016, the level of business investment was 15 per cent to 20 per cent below where we had anticipated it would be based on the previous trend. Businesses clearly deferred investment plans as a result of the uncertainty over Brexit and trade relations, and have done so because of the economic and political uncertainty that we have faced in the past few years. That is a major cause of our economic prospects being worse than was anticipated, and it very much needs to be addressed.

09:30

At the same time, public investment has improved to some extent in the past couple of years, but has not yet offset the decline in long-run secular public investment in the UK in the past 40 years, which has averaged 1.5 per cent of GDP when it should have been around 3 per cent of GDP. As you hinted, even though there are plans in the autumn statement to continue with the nominal amount of public expenditure, the inflation shocks will mean that over the course of the planning horizon, public investment will fall once again to far below 3 per cent of GDP.

That will be problematic in the longer run because public investment helps the economy, and it interacts with and provides support for businesses and private investment. Those are not separate things, although they are sometimes treated as though more public investment means that taxes will go up and businesses will not invest. That is not the right way to think about it. If the two interact positively, there will be positive spillovers from the right form of directed public investment of the type that you described in Scotland, and they will increase confidence in business investment.

We are not there yet. There is an attempt to unlock the financial sector to provide more investment, but there is concern because we are not entirely sure where that will end up. The financial sector has a tendency to look towards London and the south-east. Will that help with levelling-up or the economic prospects of the devolved nations? It is not entirely clear that it will, because we are not sure that the financial sector looks after the whole country rather than just London and the south-east. That is a question that we need to ask policy makers in Westminster.

Finally, foreign direct investment has not done particularly well in the past couple of years. It is very lumpy, so a small number of changes can lead to a large change in the pattern of FDI, but it has been affected by all the things that we have been talking about. Again, the Government in Scotland might be able to reach out to people overseas to get them to invest directly in the country. That could be an important avenue for the Scottish economy.

Fiona Hyslop: Susan Murray, where do you see business investment going as a result of the UK chancellor’s statement? What would you expect from the Scottish budget that would help business and investment, and what is the potential impact of public investment on private business?

Susan Murray: I was struck by the recent call from Liz Cameron at Scottish Chambers of Commerce’s annual dinner that encouraged everyone to have confidence and to invest. So much business investment is about what people think is coming down the line. Are they confident that we are will have a short recession? Is now the time to invest so that they are stronger and more ready to take advantage of the situation when we come out of the other side of higher inflation?

I am also struck by how that links with the general population. Business owners are people who are also seeing the effects of inflation on their lives. We should never underestimate that circle.

The earlier question about what we want to see in the forthcoming budget is linked to that. If we are to attract foreign direct investment, we need to stay the course with the things that we have said we are going to do—in particular, our targets on child poverty. We know that this is a really challenging time in which to do that, but we also know that it will be a good thing for the economy because we will end up with a better-equipped workforce, parents who are more able to support their children, and children who grow up able to go into work. The long-term commitments that we have made on child poverty and climate change must still be part of the plan, even though we are facing immediate crises. It is tricky to do that difficult juggling act when the spending envelope is constrained, but that is what investors want.

Fiona Hyslop: Finally, can Emma Congreve address business investment, particularly around renewables? A pipeline that has certainty encourages people to invest, but issues from the UK chancellor’s statement might impact on that. I am interested to know whether you think it will. It will clearly have implications for certainty for the Scottish Government and for where businesses can invest, in particular to deliver renewable energy and net zero.

Emma Congreve: You are absolutely right. The growth in the renewables industry during the past decade or so is an example of where certainty in Government policy over a long-term horizon has led to investment. That is an important point. Government policy can be effective, but when there is uncertainty about what might be the next decision or U-turn or whatever, it puts businesses in a difficult position.

I cannot talk specifically about renewables; it is not my area of expertise. We have, however, done a lot of work with hospitality businesses to understand what the big barriers are to their having certainty about investment in the future. The top two things that came out for the next decade were uncertainty about energy security, which relates to what is going on now, and the need for long-term investment to ensure as much certainty as possible.

Those businesses were also concerned about the effectiveness or otherwise of Government policy in their sector. Again, they need to feel more confident that the industry is doing the right things. I should mention that one of the things that came up in terms of not giving certainty was the deposit return scheme that is coming in next year. They feel that the implications that the scheme will have for their businesses have not been thought through. Again, there are a lot of conflicts around policies on net zero and day-to-day business.

The one thing that I would say about tomorrow's statement is that we should hear a decision on non-domestic rates. We are going through a rates revaluation that will come into force in April 2023, which is a huge concern for businesses. They know what rateable values will be for the year ahead, but are waiting for tomorrow to hear the decisions on poundage and on whether any more reliefs will be coming through the system. Some were announced in the autumn statement for the rest of the UK that might come through into Scottish policy, but that is an important part of businesses' bottom line. Certainty and good evidence-based policy on the reliefs in that system will be important.

The Convener: I will change the order and bring in Gordon MacDonald, but Michelle Thompson has a supplementary. Could you direct it to one of the panellists, please?

Michelle Thomson (Falkirk East) (SNP): My question is for Professor Chadha and it picks up on the Brexit point. I am on the Finance and Public Administration Committee and we had representatives of the Office for Budget Responsibility in yesterday. The OBR commented on Brexit in its economic and fiscal outlook report of November 2022, in which it said that Brexit had had "a significant adverse impact", and it quoted various statistics about trade volumes falling 8.3 per cent below the present level by quarter 4 of 2023.

The OBR also made an interesting comment about trade intensity being

> "15 per cent lower ... than if the UK had remained in the EU."

Trade intensity is a measure of a country's interaction with the world economy. I asked what the outlook was for that to continue, and they said that they anticipate that that will continue for at least another 15 years, despite the trade deals that have been done. Are you aware of those figures, and do you have any further reflections on the outlook as outlined in the OBR's comments to committee yesterday?

Professor Chadha: The Brexit process has reduced trade intensity with the huge economic bloc across the channel, and it is difficult to see right now why that would not stay at the lower levels that we are now seeing for quite some time to come. As a starting point, therefore, the assumption is that the OBR's view is about right.

However, I am hopeful that, over time, some of that fall in trade intensity might reverse as we come out of and recover from Covid and the oil and gas and food price shocks that we are currently absorbing. I see that, as a central case, being quite sensible, but I also see the positive risks on the upside, if you see what I mean. The world might be better than what we are envisaging, but, for planning purposes, I very much agree with the OBR's view.

Gordon MacDonald (Edinburgh Pentlands) (SNP): To start with, I will address my questions to Professor Chadha. We have talked about the labour situation, and I want to come back to a couple of things that you have mentioned. You quite rightly highlighted that employment remains high and that Scotland has record employment levels. The unemployment and inactivity rates are also lower than they are in the rest of the UK. Could you therefore say something about the record vacancy levels in the economy? I do not have a number for Scotland, but across the UK it is about 1.2 million. What impact is that having on the economy, and how do we address that?

Professor Chadha: Vacancy levels are very much driven by the inactivity that we have talked about, where people are withdrawing from the labour force following the Covid pandemic, as well as the tendency for people from overseas who had jobs in hospitality, recreation and other areas not returning after the Covid period, meaning that there are gaps. In the longer run, one can hope that further education colleges in particular could be deployed to train people to work in the areas that seem to be short. However, in the short term, not a lot can be done other than to consider the wages that are being offered that may provide more of an incentive for people to close some of those vacancy gaps.

It is a major concern that we have vacancies at the same time as inactivity rates are rising. To balance that would mean putting some upward pressure on real wages, and that would be no bad thing if it could help to alleviate some of the cost of living crisis. Many vacancies are in the lower income or wage areas or industries in which wages have historically been low, and that might be addressed as a result.

Gordon MacDonald: You have touched on inactivity rates a couple of times. I do not know whether you have the Scotland numbers, but I like looking at the long-term trends. In May 2007, the inactivity rate in Scotland was 21.4 per cent, and the activity levels for October 2022 is 21.4 per cent. The percentage is exactly the same as it was 15 years ago. Has there been any change to inactivity levels, given that 87 per cent of those who are considered to be inactive are students, have family commitments, are long-term sick or are retired? Has all that changed since 2007, when the percentage was exactly the same as it is now?

Professor Chadha: You are asking about the composition of inactivity levels. My comments just now were focused on the changes that we have seen since the Covid cloud started to lift. Off the top of my head, I do not know what the inactivity rates were during the late part of the previous decade, in 2018-19, but my guess is that they were lower than now. The most recent trend therefore is for inactivity to increase, and you are quite right to say that it is among students and people who have been unwell for a long time, as well as older people who are leaving the workforce.

It is still a little bit early after the Covid crisis for us to say that those people will not return to activity. My guess is that, once we get past this winter and go into spring, people will reassess their prospects and we might well see them re-entering the labour force, particularly as the cost of living crisis will continue to hit during next year. It is a great fact to hear that Scotland has the same inactivity level as 15 years ago, but again, my guess is that that rate will start to fall throughout next year.

09:45

Gordon MacDonald: Emma Congreve, what are the links between a growing population and productivity?

Emma Congreve: Three main drivers are linked to the labour market and economic growth: population, participation, and productivity. They are all interrelated, but they are also drivers of productivity in and of themselves.

Productivity is very much about how the people who are in the labour market at the moment can perform their work, and various things come into that. You are right to talk about long-term health as a driver of inactivity. That not only impacts participation but affects productivity in the workplace, which Susan Murray touched on earlier. We are starting to make links between the statistics that we see on issues in the health sector such as long waiting lists and people potentially living with chronic pain and ill-health for longer than otherwise would have been the case, and the impact that those things have on their productivity in the workplace as well as on their ability to work in the first place. The pressures on the social care system and the impacts of people needing to do more unpaid care as a result of the care system not being able to cope with all the need that exists also have an effect.

I am probably not saying exactly what you want to hear. Productivity and population are interrelated, but population is also a driver of productivity.

Gordon MacDonald: The reason for asking the question is that we might well be able to increase employment among the inactive, but that will not fill all the vacancies that are available. The European Union unemployment rate is 6 per cent, with Spain at 12.5 per cent, Greece at 11.5 per cent, and France at 7 per cent. That is a readily available workforce of people who previously came to the UK and Scotland to fill vacancies in hospitality and so on—we know that we have a problem there. What impact has the loss of freedom of movement had on the economy?

Emma Congreve: As you have laid out, it is a fact that we have record vacancies and people no longer have the ability and flexibility to move across borders in the way that they could previously. That has been a big shock to the economy, especially to those sectors that relied on that labour, but they will adjust in the long term. They will have to.

The situation might lead to some businesses no longer being viable, and rural areas are particularly vulnerable to that because businesses there required people to relocate and they sometimes needed to provide housing for their staff to be able to afford to live in the area. There are a lot of factors going on there, but that is certainly part of the story. It is not the only issue that is driving the level of vacancies, but it is a big part of the story.

Gordon MacDonald: Susan Murray, I want to ask you about the number of registered businesses in Scotland and how important those are for growing the economy and providing new jobs. If we look at the time series data for the number of registered businesses in Scotland by all different sizes, we see that there were 147,000 in 2006 and 175,000 in 2022, which is a growth of 19 per cent. Similarly, for all businesses, whether registered or unregistered, that number has grown from 267,000 in 2006 to 360,000 in 2022. What impact will the contraction of labour have on the growth of companies, and on Scotland's GDP?

Susan Murray: That is an interesting question. Other trends are hidden in the numbers that you have quoted, such as the number of businesses that employ a single person—director-led companies—which massively skews those numbers. We have seen that in the past 10 years. If we take those out and look at the number of businesses that employ other people, you will see a different pattern, but I cannot remember it off the top of my head. [*Interruption*.] You do not? Okay. If we have a contracting labour market, we are going to have a problem. Emma Congreve has already covered that and I know that we are short of time so I will not go into that too much.

Gordon MacDonald: Okay. Just to be clear, every single category of employer has shown an increase since 2006.

Susan Murray: Okay. That is great.

Maggie Chapman (North East Scotland) (Green): Good morning to the witnesses. Thank you for joining us this morning, for your comments so far and for the materials that your organisations have provided. I want to follow up on some of Gordon MacDonald's questions about the interaction between the economic outlook, the budget discussions that we will have tomorrow, the broader recovery that Professor Chadha and other witnesses have talked about and the consequences of Covid and Brexit.

Emma, I will come to you first. In the Fraser of Allander Institute's "Scotland's Budget Report 2022", which was published this week, there is a very stark comment about social security, the consequences of some of the labour trends that we have been talking about and the increased reliance on social security. We know that social security spend is going up for significant policy and other reasons, but will you say a little more about how you see those things interacting and potentially leading to a more unstable or volatile economy in the future if people cannot get the social security support that they need even though the spend is increasing?

Emma Congreve: There are two main types of social security spend. Means-tested support is largely governed by the UK Government, although the Scottish Government, with its new powers, has moved into that area with the Scottish child payment. Non means-tested benefits such as disability and carer support are designed to cover the additional costs of ill health.

In Scotland, from the plans that were set out in the spending review back in May, the projected increase in social security spending is quite stark, as the graph in our report shows. A lot of that is around the Scottish child payment. Because the amount is ramping up this year—it is now up to £25 per week per eligible child—and it is now open to all children rather than being limited to those who are under the age of five, that payment is a big part of the increases that are happening in Scotland.

There might be more shocks tomorrow on the disability side. There are signs in the OBR forecast that an increased case load is coming through for personal independence payments, which is a UK benefit. In Scotland, we are transitioning to the adult disability payment, but we still have a PIP case load and it has been increasing this year. That is another reason for the increase. Some of that was in the May forecasts, but there might be more to come. It mirrors what is happening in the labour market with inactivity and ill health showing up in the social security statistics.

There are concerns about whether all social security needs are being met, mainly because of the years of austerity and the reductions that happened then, which meant that social security fell behind and people could not keep up the same standard of living. In the autumn statement, the UK Government increased the uprating of those benefits to be in line with inflation, so they will increase by around 10 per cent in April. We expect the Scottish Government to do the same with the benefits for which it has responsibility, apart from the Scottish child payment. Because the Scottish Government has only just increased that, we are not sure that we will see a 10 per cent increase to its current value come April.

Social security is such an important part of the system. It seems to be sort of keeping up with things, but because of what has happened in the past 10 years, it is probably behind where we would like it to be in giving equivalent support to what we hope we would have had if we had not had austerity.

Maggie Chapman: I suppose that the trends that we have seen in the past 10 to 12 years, since the financial crash, might come back in part to one of Gordon MacDonald's other points, which was about the composition of labour market inactivity and a potential increased reliance on social security.

Do you have any comments or pointers for us around that focus on employment of people who have chosen to take themselves out of the employment market or have come out of it for health reasons, caring reasons and so on? Do we need to focus more on getting more people, such as single parents, back into employment?

I am not talking about the employability figures, because we know that the current employment figures are high. It is about the untapped potential of a group of economically inactive people who probably want to work but cannot for a whole range of other reasons, social security being one of them. How can we tease that apart and make a connection that is economically positive rather than an economic drain in the long term?

Emma, I do not know whether you have any more to say on that, but I will come to you first, and then Professor Chadha.

Emma Congreve: As you say, there are many reasons why people are inactive. Some of them want to work, and there is evidence that, for some people, the social security system is a barrier to that, particularly for those who are on some of the disability benefits.

Some of this is in the sphere of people feeling that, if they try to go back to work when they have been ill, the fact that they have tried to work, even if it does not work out and they have to stop, will mean that there might be implications for all their benefits—not just the means-tested ones, but the additional cost ones. There is a lot of fear and uncertainty about the system, although I think that the Scottish social security system is trying to address that and assure people that it is there to support them and not to hinder them in their lives.

When we look at the statistics for parents in couples, we see very few examples of parents not working when there is no disability or ill health issue. For single parents, the figure is a bit higher, but that is also linked to the age of their child and the availability of pre-school childcare support and wraparound support for school-age children. The big barriers are therefore around treatment for long-term ill health, including mental ill health, and it is also about removing barriers for parents.

From looking at a lot of data on the subject, my feeling is that, although there are some examples of it, on the whole, the social security system is not holding people back from re-engaging in the labour market.

Maggie Chapman: I understand that. Professor Chadha, there is something interesting about not necessarily the social security system, but the labour market being a barrier by not enabling flexible work, part-time work or shorter working weeks, for example. What are your comments on that? We often talk about employment and the labour market separately from all the other support mechanisms, but I am trying to make the connections.

10:00

Professor Chadha: That is an incredibly interesting discussion. The idea that support through social security alone might provide a disincentive to work—I do not think that anyone here is arguing that—is a simplistic way to think about why people might not participate in the workforce. There are clearly a number of barriers to people working, outside of their direct receipt of social security benefits. I will point to a few.

The cost of childcare in the UK is considerably higher than the cost in many of our trading partners. That is a great issue for people who want to get back into the labour force having started a family. At the other end of the age spectrum, significant numbers of people later in life are caring for older parents or older family members, which can also reduce the incentive to work if the replacement costs are higher. That leads to some really important questions for our schools and our health and social care systems. Can they be redesigned to facilitate support at both ends of the spectrum in order to make it much easier for people who are of working age, however we want to define that?

As we hinted earlier, we have a world in which people with higher levels of human capital can adapt to changing workplaces and continue to find employment. Scotland is a place with high levels of human capital, relatively speaking, but the world is always changing.

One thing that we have learned from the Covid period is that we can provide education, training and support services online. More of that ought to be available for people who want to get back into work. We could imagine a world of grants or subsidies to encourage that. Many areas of higher and further education developed ways of teaching online during Covid and they could be redeployed to workforces to help them to train themselves. Firms ought to participate in that as well. Many firms are positive towards training employees or prospective employees but, somehow or other, we are still behind what we often see in our major trading partners, such as Germany and countries in east Asia, where firms seem to want to participate in that process much more persistently.

There are also genuine hurdles to travelling at the moment, as my appearing online today demonstrates. It is hard for people if they are re-entering work and they have to commute. Train travel has become more expensive. We have a strange world in which a significant fraction of people can work from home but, in certain industries, many people cannot.

All those things add up to a set of rigidities that might not be helping to get higher levels of participation in the economy. I suppose that that is an argument for thinking things through carefully and deciding on a set of policy measures that will make it easier for people to get into work and stay in work. I have listed only a few. I am sure that my colleagues will want to suggest others. As you can see, the situation requires a set of interventions and some robust thinking.

Maggie Chapman: I have a last question on a different tack. Emma Congreve, I will come back to you for it.

The Fraser of Allander Institute published an article about the economic context for businesses in Scotland. Something that struck me in that was the difference between the impact of the broader economic situation on small and medium-sized enterprises and its impact on larger businesses. Turnover has fallen much more for SMEs than for larger businesses, relatively speaking.

What is your analysis of the long-term consequences for local and regional economies, of which SMEs are often the bedrock? How do we ensure that the disproportionate negative impact on SMEs does not continue to drag? If it carries on in the same direction, the situation of our local economies will just get worse and worse.

Emma Congreve: SMEs have been the bedrock not only of local economies but of the Scottish economy. The question is, therefore, incredibly important. It is easy to understand why smaller businesses are struggling a bit more with some of the frictions that are going on. They have fewer economies of scale, particularly in dealing with trade at the moment. During the financial crisis—and, no doubt the issues will come through again—we saw issues with the ability of firms to refinance on good terms, with larger firms able to go to the market and smaller firms relying more on financing from the financial sector itself. There are a lot of issues in there.

Given the large number of businesses domiciled in Scotland that are SMEs, it goes without saying that it is incredibly important to ensure that they are able to withstand what is going on. I come back to the point that I made at the beginning, which is that energy costs are the most pressing issue that is coming through in our business monitor. We need to ensure that SMEs, particularly in the hospitality sector, have certainty about what is going to happen to their energy costs come April, so that they can at least plan for it. That might mean that they have to reduce opening hours, but the key point is that they have to be able to plan in order to get through.

The other issue that is really pressing for SMEs—which I have also already mentioned—is non-domestic rates and the impact of revaluation and what will happen to reliefs in particular in the next wee while. It is worth mentioning that we have the small business bonus scheme in Scotland, which takes a lot of smaller businesses out of non-domestic rates entirely. However, it is felt that giving the reliefs based purely on the rateable value in non-domestic rates terms of those businesses is not necessarily always the most consistent approach or the right approach. Hospitality businesses are valued in a slightly different way than other premises and feel that they are potentially a little bit disadvantaged by that system. The revaluation of NDR is necessary, but other reforms within that system are also necessary to ensure that it is getting the most support out to those who really need it, which things such as the small business bonus scheme are probably not quite doing at the moment.

Maggie Chapman: That is helpful.

Jamie Halcro Johnston (Highlands and Islands) (Con): Good morning. I will ask one question before I come to my main line of questioning. A number of my colleagues have asked about the impact of leaving the EU on our economy, and the general answer seems to be that we can see some impact but that it is quite hard to tell because of Covid and other aspects.

One of the focuses of the Scottish Government at the moment is another referendum to leave the United Kingdom, with all the potential questions around borders, debt level and currency that have not been answered. We have estimates of deficit, but nothing that is agreed.

I will go to Professor Chadha first and then to Emma Congreve. How might that constitutional and political uncertainty impact? We might find ourselves out of the UK—that is certainly the intention of the Scottish Government—while also having been out of the EU for a number of years. I wonder how that might impact on business confidence and economic recovery.

Professor Chadha: To be clear, I was trying to say that the Brexit process—where we had uncertainty about future economic relations as well as the political imbroglio that resulted—seems to have led to a drag on business investment and atrophy in political decision making that affected businesses as well as dragged on FDI. It also subsequently seems to have had an effect on our labour and employment levels, as well as on shortages across many industries and some reduction in the ability of businesses to plan in the medium to long run. We think that all of that has reduced GDP output as measured by between 4 per cent and 6 per cent in the very long run. That is an estimate of where we sit.

If we entered into further political uncertainty of whatever form, whether that be Brexit or other referenda, that would lead businesses and other organisations to introduce further clouds of uncertainty into their planning horizons. In the short run, that would almost certainly detract from the kinds of things that I have just talked about, such as business investment and the deployment of labour. Of course, that would then become an issue for whatever political configuration that we have in the future to address.

It seems to me that the biggest tragedy of the past six years is that, rather than political frameworks solving, reducing or providing answers to uncertainty, we have had a world in which the political firmament has been adding to it and, often, making things worse, rather than better. From any settlement in the future, we would want there to be sensible policymaking on an on-going basis that helps businesses, individuals and households to deal with uncertainty. The classic example is the events around the mini budget in September and October, when the uncertainty that was created led to some devastating economic spillovers from which we are recovering, but have yet to fully recover. More uncertainty would be a problem, but if we ended up with the right set of policies, that could be offset substantially.

Emma Congreve: It is an interesting question. As I say, we find that there can be big differences of opinion about the impact of Brexit and a potential referendum in Scotland. Our institute has not recently conducted specific analysis on the impact of Brexit, but I would very much agree with what the OBR and the National Institute of Economic and Social Research said, in that there are impacts that are there in their forecasts. It is very hard to see where Brexit cannot have had an impact.

In terms of the possible impact of an independence referendum or a potential move to an independent Scotland, if we follow through on the fact that Brexit is having an impact, you would think that an independent Scotland may run into similar issues. Of course, it will depend on what settlement would be reached in that scenario. We could have had a much softer Brexit—that is the terminology that is often used—that did not put up the barriers that the economy is grappling with, and which might have meant that the economy was not disrupted in the same way that we are seeing now. However, the Brexit agreement that is in place at the moment has led to those impacts. A key issue will be what the settlement would be in an independent Scotland. Obviously, it is very difficult to know that, because there would be a negotiation, but there is the potential for disruption in the same way that we have seen has been created by Brexit.

As you say, the rest of the UK is a very strong trading partner, which would mean that the impact of an independent Scotland would potentially dwarf the impact of Brexit. However, it all depends on what the negotiated settlement would be. What is unavoidable is the uncertainty that it would bring for businesses and the economy, which do not like uncertainty. However, it is inevitable that, when we have a constitutional debate, we will have uncertainty, and we will have that for a long while yet, I imagine.

Susan Murray: Emma Congreve has summed it up very well by saying that it depends. There is uncertainty now for a whole range of reasons. One of the things that I notice when I am speaking to people is concern about the timeframes in which decisions are being made. A good example is European funding, which was decided on for a much longer timeframe than the kind of funding that is now coming from the UK Government. We are down to three-year timeframes, whereas business and society need something in the longer term. We need to think about how we work so that we can provide certainty over a longer period of time.

Jamie Halcro Johnston: The issue that has been raised is about what we want the Scottish Government to do in terms of its competencies to help deal with current economic uncertainty, including the cost of living crisis and the like.

I will not ask what you want John Swinney to say tomorrow, but can you outline some of the areas that are within the competence of the Scottish Parliament in which the Scottish Government can act to deal with the impact of the challenges that we face over the next few years?

10:15

Susan Murray: We can look at the most urgent needs that are coming through in our work on the understanding Scotland survey, which tracks over time people’s perceptions about the economy and their spending habits, which gives us a good threshold. From that survey, we know that roughly a third of people are really struggling and are losing sleep over financial stress in their life, which affects their ability to participate in the labour market whether they are in work or not.

There are other things that we can consider. We have a big problem with changing demographics and an ageing population, but the focus has to be on how we stop more people becoming absolutely destitute, to use the words that Professor Chadha used earlier. The Scottish child payment is going some way to help the 35 per cent of parents in the previous survey who were losing sleep. As more people enter challenging financial circumstances, their situation will become more difficult, so that figure is likely to rise.

I come back to the point that was made in the earlier discussion about changes in the labour market—I will squeeze that in, if that is all right. On the voluntary decision of people in the late-50s/early-60s bracket to retire, it would be really good to get some of those people back into the labour market.

The Institute for Fiscal Studies analysis is interesting, because lots of presumptions have been made about inactivity rates rising because of ill health, and that analysis challenges those presumptions. Skills Development Scotland analysis shows that organisations running high vacancy rates causes pressure on the rest of the employees to rise. We should not underestimate that that might be a driving factor in why some people are deciding that working is too stressful and are drawing down on their pension. Pensions need to last for up to 30 years and perhaps even longer, so that might be a short-term gain but a long-term pain. We need to think about all those long-term issues as well as the short-term ones when we are looking forward on the economy.

Jamie Halcro Johnston: I come to Emma Congreve on that point. If you have any specifics on how we get people who are out of work back into the labour market, that would be very helpful.

Emma Congreve: The ill-health issue is interesting, and I will come back to that in a second in relation to Scottish competences. On people voluntarily leaving the labour market in their late 50s and early 60s, I hear what Susan Murray says in relation to their long-term financial support, but if it is a voluntary decision and people feel that they have the financial ability to do that, it is difficult to think what an effective Government policy to reel them back in could be. That is the nature of the job market, and it is a personal decision.

The area that the Government could and should think about is—I kind of explained this earlier—getting the basics right, including what Susan Murray talked about in relation to ensuring that people do not have to face destitution. A lot of social security powers are reserved to Westminster, but the Scottish Government has powers to top up benefits and create new benefits, so it could do that, although there could be a long lead time in terms of getting those systems set up and ready to deliver.

The other area is around health and social care. We need to understand the linkages between those sectors, the issues that they face and the economy, and ensure that there is money to keep those systems functioning well. It is not just about one thing. For example, we hear a lot about bed blocking as the key thing that the Scottish Government is trying to do everything that it can to limit, but that is not the only important issue. It is symptomatic of huge issues to do with unpaid care and the wellbeing of workers in the health and social care system, and, of course, public sector pay comes into that. There is a huge range of issues that require deep thought and understanding about how, in the short term, anyway—over this winter—those pressures can be eased so that we do not have people not being able to work or work well because they are caught up with delays in the health and social care system.

Jamie Halcro Johnston: Professor Chadha, if you have anything to add to that, your thoughts would be helpful.

Professor Chadha: Susan Murray and Emma Congreve have been through all the things that I would have wanted to say.

There is an extent to which destitution at the very bottom is a concern and is concentrated in certain post codes or regions of Scotland. We are also interested in the extent to which the cost of living crisis is affecting people at the bottom of the income distribution.

There is a concern that we have not expressed about the dwindling level of savings that households have. Following the Covid crisis, household savings increased but they are concentrated in households at the top of the income distribution. That means that households towards the bottom—some 11 million across the country—will find in the next 18 months or so that they have no savings left. In a world in which they will continue to have to pay higher energy and food bills, they will have no savings to help them offset those costs. They will need support through universal credit or the other forms of support that have been described.

It is important that we have a measure of those issues in Scotland at a disaggregated level. At the level of the devolved nation, Scotland does not look that much worse off compared to many of the other regions in the UK but I guess that, as is the case everywhere else in the country, there is a lot of heterogeneity once you drill down to a more local level. It is important that we are aware of that.

One thing that a number of policy makers missed earlier this year is that, if you do not have any savings, you cannot ride shocks. You hit your budget constraint and there is nothing more that you can do. Those of us who are more fortunate with savings can draw on them when shocks come along. However, the significant number of households without savings immediately find that they cannot pay their bills in such a situation, and they have to go back to their provider for some form of credit agreement and potentially go to their landlord or mortgage provider for forbearance, which is not always forthcoming and might not be supported by legal frameworks. Alternatively, they have to go to other forms of credit supply, which are incredibly problematic, as you will understand.

Work has to be done to get the measure of that problem at a refined scale so that we can address it in real time. We cannot wait a year in relation to households that have no savings. It has to be addressed as quickly as possible.

Gordon MacDonald: I have a question for Susan Murray. She talked about the number of people who were retiring and changes in the labour market. What impact have UK Government changes to pension regulations had on that?

Your mic is muted, Ms Murray.

The Convener: It is fine, Susan. Broadcasting will sort it out. Go ahead.

Susan Murray: I was just thinking that I had not unmuted, but it was not me, so that is okay.

The Institute for Fiscal Studies has some really good work on that, which I can share with the committee afterwards. It has also done a podcast on the people leaving work.

In a way, it is not a matter of Government policy; it is almost down to the businesses that Gordon McDonald talked about. How do businesses make themselves attractive when they have gaps in their workforce so that older people might want to come back and work for them? Some of that might be about making changes to flexible working. If people are balancing grandparent care with also wanting to work, they would still be part of the labour market. There is a skilled proportion that could come back if they wanted to but I think that, at the moment, we are storing up problems for the future.

Professor Chadha mentioned the rundown in savings. People are also stopping paying into their pensions because they are worried about putting food on the table and heating their houses today. We have already gone way below the rate of what the Resolution Foundation call the living pension. We need to think about how we avoid a problem in 10 or 20 years' time because of the cost of living crisis now. What is coming down the line for people who are on the breadline now really worries me.

John Mason (Glasgow Shettleston) (SNP): Thank you for the opportunity to be here in place of Colin Beattie. It is a privilege.

Energy has been mentioned a few times and I will spend a little bit more time on that. The witnesses and others have made the point that the energy prices, which are largely outwith the UK's control, have gone up dramatically. That has fuelled inflation and that is damaging the economy. I wonder, and some of the public wonder, whether we are doing energy the best way that we can. As I understand it, Scotland produces five times as much gas as it uses. We are also producing a lot of renewable electricity, which is meant to be cheaper—certainly in the long run—but people are not seeing the benefit of that. Is it something inevitable that we have to accept or could we do energy differently to support the economy better?

I will start with Susan Murray.

The Convener: I recognise that none of the panel members is an expert in energy but, if they wish to answer the question in broader terms, they should go ahead.

Susan Murray: I am not an expert in energy. However, I am aware that, over the years, how the Office of Gas and Electricity Markets regulates the market has been subject to much discussion. It feels like the energy crisis has brought that into sharp focus. The fact that prices are still fixed on gas rates when so much is now produced by renewables needs to be fixed reasonably quickly.

The other point for Scotland is that I have heard many stories over the years of people wanting to do microrenewables schemes and not being able to get grid connection. That has held back adoption and we could have even more generation.

I do not want to comment any more than that because I am not an expert on energy policy.

John Mason: My apologies. I realise that I am not speaking to energy experts. Neither am I an energy expert, of course.

Do the other witnesses want to comment on that?

Professor Chadha: I would certainly say that I am not an energy expert, but non-renewable energy sources going up in price provides an important incentive for furthering our move to renewables, as well as for thinking about energy security. Our ability to have inventories of energy in this country has been undermined over the past couple of decades. We need to think carefully about how we provide security of energy supply.

The direct question of the increase in energy prices is also interesting. We would want the higher prices to lead to people being more careful in their use of energy and realising that it is a scarce resource. However, it is a damaging set of prices for people who are at the bottom of the income distribution. Therefore, we have argued for some time for a different approach from fixing the price per unit, which, in principle, is helpful to those who use more energy, who tend to be at the top of the income distribution rather than at the bottom.

I should say that many people who are at the bottom of the distribution use a lot of energy and might be living in older housing stock that requires insulation or support to make it more energy efficient. That, of course, could have been undertaken with direct interventions to help the poorest families. We generally regret that the energy price guarantee as outlined did not address those issues as well. It would have been less damaging to the fiscal position and would have provided more support to poorer households.

The energy price rise has raised a number of questions that good Government policy ought to address. We are thinking about those now as a result.

10:30

John Mason: I come to Emma Congreve. Professor Chadha touched on types of support, and that is where I will go next. What kind of support should the UK Government, or potentially the Scottish Government, give, particularly to businesses? I am getting £400, but I am ridiculously well paid, so it seems crazy for me to get that when other people are really struggling. Can you comment on the bigger picture and the local picture?

Emma Congreve: What you have touched on is important, because there are many reasons why you would want to better target support for energy costs. People who might not need it are receiving income to help with energy costs, but other people need a lot more help.

Obviously, when it comes to the feasibility of support systems, a universal approach can often be easier, but is not necessarily cheaper, given the sums that we are thinking about. Policy makers need to weigh a lot of factors against each other when deciding what is the right way to get support to people so that it gets to those who need it. The consequence of that might be that support also goes to some people who do not need it, but that might be the most efficient way of supporting people.

However, from what we have most recently heard from the UK Government, we know that it is considering a different approach from April that it is not so universal. It has rolled back from saying that the support that is in the system at the moment and the energy price cap will continue beyond April. We will wait and see that approach will be.

There could be some interesting interaction with the inflation measure depending on what type of support package the Government puts out there. At the moment, the support system does not count towards the inflation measure, but a more targeted support might count towards it, which has implications for inflation expectations and all that kind of thing, so there are potential unintended consequences there as well. I am afraid that there is not a simple answer to that. There are a lot of factors to weigh up to work out what the most efficient and effective support system would be, but we need to know what that system will be fairly soon, as I have said, to enable people to plan beyond April.

John Mason: I will push you a little further on that issue, especially where businesses are concerned. Professor Chadha made the point that we want people to become more efficient—that is true of businesses as well—and not use energy that they do not need to use, although some do need to use a lot of energy for a variety of reasons. Do you have any thoughts about how we could target businesses to get that balance right?

Emma Congreve: Other than analysing and taking an evidence-based approach to where support is most required in the system, which is what we would expect to happen, rather than it necessarily being a blanket support, I am afraid I cannot comment much more specifically on that.

John Mason: My apologies for pushing you on that one. Susan Murray, would you like to come back in on where support for energy costs and so on should be targeted?

Susan Murray: We have not done specific work on that area. You said that you do not need your energy grant, so I will take the opportunity to mention the GIVE400 campaign. I do not know whether anyone is aware of that, but it is a movement in Scotland to get people who do not need their energy support package to donate it to charitable causes. We have seen in the "Understanding Scotland" survey that charities are likely to lose 40 per cent of their donations this year, so please donate your energy grant if you do not need it.

In relation to Emma Congreve's points on targeting, I go back to Gordon MacDonald's initial question on businesses. It could be that the decisions and choices that are made on which businesses are supported and which are not might be the difference between businesses surviving and not surviving. We will see businesses close as a result of energy costs.

John Mason: Thank you for your answer and for your suggestion that I give my £400 away—my colleagues are all pointing at me.

The Convener: We have gone beyond the time that we had estimated. If the witnesses are happy to continue for 10 minutes or so, I will bring in Michelle Thomson. I understand that Professor Chadha wants to come back in on the questions from John Mason—Professor Chadha, you can add that to the response to Michelle, if you wish.

Michelle Thomson: Because I am aware of the time—and I appreciate the witnesses giving up their time—I will direct my final question to Professor Chadha only.

In talking about uncertainty, we talked about how to disaggregate data—Emma Congreve touched on that. Arguably, however, the past is a good predictor of the future. Given that the session is an overview of the current macroeconomic climate, it is worth pointing out some of the statistics about the UK. In 1999, only four of the 12 small advanced economies had a GDP per capita higher than the UK; by 2019, the figure was 11 out of 12. Even since the economic crisis, if the UK had matched the economic growth rates of other large economies, its economy would have been 4.4 per cent larger; if it had matched the growth rates of small advanced economies, its economy would have been 7.7 percent larger. We have considerable certainty, because we can look at the past.

Given those economic stats, to what extent can we be certain of continued decline—if the past is a good predictor of the future—and to what extent is our economy a "hipster" economy or otherwise?

Professor Chadha: The relative decline of the UK economy has been in train for well over 100 years. It was the largest economy in the world in the later part of the 19th century. We are used to that relative decline. However, you are right also to point out that that has been more marked during this century than we would have wanted. We have fallen further behind what economists call the productivity frontier—the set of countries that are moving very quickly ahead with productivity improvements.

We put such weight on productivity because it tells us how much return people get for every hour that they work, and it is a very good way of summarising wellbeing: if people are getting more return for every hour that they work, they can have more leisure or more consumption as a result.

That secular trend is associated with a lot of factors, as you would expect—it involves the whole system. Arguably, the economy has been overly centred on the financial circulation of capital out of London and the south-east; has been inappropriately prepared for the 21st century, in human capital and other skills; has exhibited an absence of infrastructure across wide parts of the country; and has lacked the siting of internationally competitive firms outside of London and the south-east—for example, in Scotland—providing local pools of demand that would bring in people with high levels of human capital and, in association, would raise the wages of people further down the skills levels in those areas. A range of things have required attention from successive Governments but have not been addressed, and that is the main reason for that rather larger fall and relative decline than we might have anticipated a quarter of a century ago.

The result of all that analysis is that the situation cannot be addressed very quickly—certainly not in the statement that will be made tomorrow, and not in the next year or two. There is a persistent need for the revamping of our institutions and of the objectives of our policymakers to drive us into a better space.

That is not going to be easy. It is going to require a consistent approach that we have not had for some time. That is why I am chairing the productivity commission: to try to understand how we can bring about policies to which not only current but future political leaders can commit. The classic problem that we have in the UK is that the horizon of politicians in Westminster is determined by the next election—which, today, is some two years away—but the problems that we have outlined have developed over a quarter of a century or more, so we need much longer horizons in planning and thinking.

That is where we desperately need to go as a country. It seems to me that moving to more powers for the devolved nations is part of the answer, but we have not arrived at a full answer for dealing with the problems that we face.

I have tried to keep that answer relatively short.

Michelle Thomson: There are multiple further questions, but I will leave them just now, in the interests of time.

The Convener: I thank all three witnesses. That was not the cheeriest note to end on, but it has been a productive session. We appreciate the time that you have given us, which will help to inform our work in the coming weeks.

I move the meeting into private session.

10:40

Meeting continued in private until 11:29.

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