Finance and Public Administration Committee

17th Meeting, 2022 (Session 6), Tuesday 31 May 2022

Skills Development Scotland: trends behind the income tax forecasts

Purpose

1. The Committee is invited to take evidence in relation to labour market participation, demographic challenges, productivity, skills planning, and sectoral and geographical trends, from:

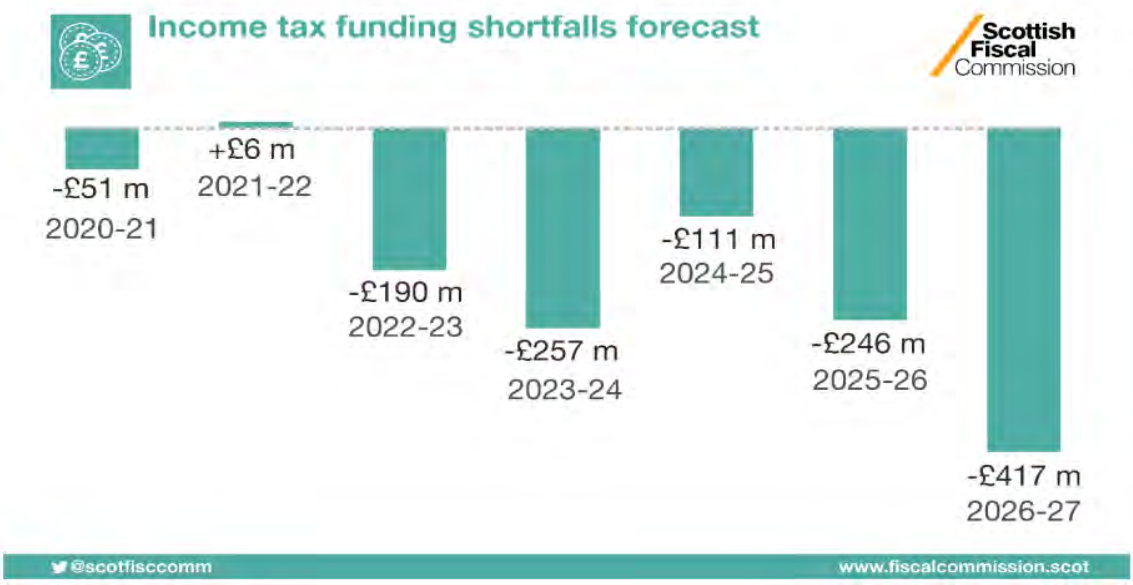
- Chris Brodie, Director of Regional Skills Planning and Sector Development, Skills Development Scotland, and
- Andrea Glass, Head of Regions and Enabling Sectors, Skills Development Scotland.

2. This evidence session is part of the Committee's continuing work on the trends behind recent forecasts showing income tax receipts in Scotland falling behind the Block Grant Adjustment and will inform future pre-budget scrutiny.

3. This paper provides background information on the Committee's areas of interest, as set out in its report on the Scottish Budget 2022-23 and highlights some recent related UK and Scottish data. A written submission provided by Skills Development Scotland (SDS) is attached at Annexe A.

Background

3. In its report on the Scottish Budget 2022-23, published on 21 January 2022, the Committee said it was "particularly concerned to note the latest SFC Economic and Fiscal Forecasts showing Scotland's income tax receipts falling behind the Block Grant Adjustment, which we consider could, if they come to pass, put Scotland's future fiscal sustainability at risk". The figure below taken from the December 2021 Forecasts shows the forecast shortfall in income tax funding to 2026-27.



4. The SFC highlights several underlying factors contributing to the emerging negative income tax net position, including:

- Scotland's changing demographics and a faster growing share of the population among older age groups,
- falling labour market participation of younger age groups,
- slow growth in Scottish average earnings, particularly in North East Scotland relating to oil and gas activity, and
- more rapid growth in earnings in the UK, driven in part by strong growth in financial services in the UK.

5. At Annexe B, Boxes 3.1 and 3.2 from the SFC Forecasts are reproduced, showing trends on labour market participation, including demographic challenges, and regional labour market data during the pandemic.

6. On productivity, the SFC states that there is "reason to be optimistic about the capacity for future productivity growth, with the pandemic potentially accelerating the adoption of new technologies and business practices". However, the Committee, in its Budget 2022-23 report, noted the recent CBI/KPMG Productivity Index using 2020-21 data which found that "Scotland lags behind other parts of the UK or international competitors in 9 out of 13 productivity indicators for which comparable data was available (down from 11 out of 15 in 2020), including on business investment, exporting and innovation". While the Index does show some improvements, including on entrepreneurial activity, and business research and development spend, the CBI concludes that "improving Scotland's productivity performance is a long-term challenge and remains the only sustainable way of increasing wages and ultimately improving living standards", adding "Scotland needs to keep improving productivity to build a stronger economy".

7. In Scotland's Productivity Challenge: Exploring the Issues, published on 2 December 2021, John Tsoukalas, highlights that "the story of Scotland's productivity performance is one of puzzles and apparent contradictions, with strength in some areas but below average performance elsewhere". He notes that "Scotland has had great success in high productivity sectors such as energy, finance and other

knowledge intensive service industries". However, "the majority of Scotland's business base is clustered at low levels of productivity, … employers report various skills gaps that hold back their growth potential [and] overall, levels of private investment in the Scottish economy are typically lower than in the best performing countries".

7. During evidence to the Committee on the Scottish Budget 2022-23 in January 2022, the Cabinet Secretary suggested that "one of the primary ways" of addressing the productivity challenge was through the Scottish Government's upcoming 10-year National Strategy for Economic Transformation. This, she noted, would include core data on productivity and look at "the need for public investment in core infrastructure, at private investment, or how we incentivise business to invest in businesses, and, lastly at skills, or how we ensure that the workforce are in the right jobs, for the right businesses, during the right times". This Strategy was published on 1 March 2022 setting out "five bold new policy programmes of action", including creating an entrepreneurial nation, developing new markets and industries (and well-paid jobs in the just transition), enhancing productivity and innovation, skills growth, and delivering high rates of employment and wage growth.

8. On 21 April 2022, the Scottish Government announced that Business Minister Ivan McKee had chaired the first meeting of the Industry Advisory Group for rUK Talent Attraction (a priority in the National Strategy for ET), which "will initially focus on 'high value' sectors, and occupations within those sectors, as a sub-set of the wider Population Strategy, to increase inward investment, stimulating economic growth and making Scotland a more attractive proposition for anyone to move here".[1] Priority growth sectors highlighted include life sciences, technology/fintech, advanced manufacturing – mechanical and electronics – financial services, Space and renewables. In response, Director of Industry and Enterprise at SDS, Gordon McGuinness noted that "an inclusive, resilient and skilled talent pool is central to Scotland meeting its economic ambitions, and SDS is committed to working with businesses so they can develop the workforce required to drive innovation, entrepreneurial thinking and productivity".

9. The Fraser of Allander Institute, in a blog on Trends in Economic Activity, of 1 April 2022, explores how these trends have changed through the Covid pandemic, with increases in the overall level of economic inactivity in Scotland. While it suggests that this appears in part to be because more younger people are in full-time education and a greater number of older people are choosing early retirement, "there are now over 20,000 more people economically inactive because of long-term sickness than we had pre-pandemic". The blog notes that this "may well become the key legacy of the pandemic, and in the months ahead should be a key priority for government".

10. The Scottish Fiscal Commission is due to publish its next Economic and Fiscal Forecasts on 31 May 2022, at the same time as the Scottish Government's fifth Medium-Term Financial Strategy and Resource Spending Review.

[1] Expanding Scotland's talent pool - gov.scot (www.gov.scot)

Recent UK data

9. The Office for Budget Responsibility's (OBR) latest Economic and Fiscal Outlook, published alongside the Chancellor of the Exchequer's Spring Statement on 23 March 2022, highlighted that household energy bills were set to rise by 54% in April and a further 40% in October, "pushing inflation to a 40-year high of 8.7% in the fourth quarter of 2022". The OBR suggests that "higher inflation will erode real incomes and consumption, cutting GDP growth this year from 6.0% in our October [2021] forecast to 3.8%". It goes on to state that, "with inflation outpacing growth in nominal earnings and net taxes due to rise in April, real living standards are set to fall by 2.2% in 2022-23 - their largest financial year fall on record – and not recover their pre-pandemic level until 2024-25". The Office for National Statistics (ONS) data on Consumer Price Inflation (CPI) for April 2022, published on 18 May 2022, shows that CPI rose by 9% in the year to April, up from 7% in March.

10. In its March Outlook, the OBR maintained its assumption from the October forecasts that the pandemic has led to economic scarring of 2% of GDP, but in the medium-term it "revised up the contribution to scarring of lower labour supply (due to a smaller population and lower labour force participation) from 0.8 to 1.2 percentage points and made an offsetting downward revision to the hit to productivity".

11. The (ONS) Labour Market Overview, UK: April 2022 (published on 12 April 2022) notes that the UK employment rate was at 75.7%, while in Scotland it was at 75.6. The UK unemployment rate was 3.7% compared to a record low rate of 3.2% in Scotland, and the economic inactivity rate in the UK was 21.4%. In Scotland it was 21.9%.

12. A report from Sheffield Hallam University on The Real Level of Unemployment 2022: the myth of full employment across Britain, published on 23 May 2022, however provides an alternative set of unemployment figures, suggesting that the real level of unemployment in Britain is 2.3 million, 1 million more than official figures suggest. The report estimates that there are 790,000 'hidden unemployed' on incapacity benefits. It states that "these are men and women who might have expected to be in work in a genuinely fully employed economy", adding "they do not represent fraudulent claims and they account for slightly less than a third of the headline total of incapacity claimants of working age". It suggests that there are 102,000 'hidden unemployed' people on incapacity benefits in Scotland, compared to 122,300 unemployment benefit claimants.

Skills Development Scotland: written submission

13. The Skills Development Scotland (SDS) submission attached at Annexe A states that it is "a data-led organisation and is committed to maintaining its role of providing robust evidence on the labour market to help inform policy direction and investment in response to economic and labour market conditions".

14. The submission provides data and commentary on labour market challenges, changing demographics and migration patterns, labour market participation and productivity, before going on to highlight some of its work to help inform policymaking and investment. These include: monthly Labour Market Insight Reports, a Skills

Action Plan for Rural Scotland recognising that "rural Scotland faces its own specific skills challenges", Regional Skills Investment Plans (working with local authorities), Sectoral Skills Assessments for "all of Scotland's key and growth sectors, looking at current and future skills demand", and a Climate Emergency Skills Action Plan, "ensuring that the workforce has the skills required to make the transition to net-zero a just transition, fair and inclusive to all".

15. SDS has also highlighted its Covid-19 Labour Market Insights April 2022 publication, which notes that "immediate labour shortages remain a dominant issue in Scotland's labour market [and] the shortage of workers, alongside supply chain challenges, inflationary pressures, the cost of living crisis and the conflict in Ukraine, may lead to subdued economic growth".

Next steps

13. The Committee has agreed to continue to explore the trends behind the income tax forecasts as part of its pre-budget scrutiny 2022 and will consider next steps at a future meeting.

Committee Clerks
May 2022

ANNEXE A

Written submission from Skills Development Scotland, May 2022

Thank you for inviting Skills Development Scotland (SDS) to give evidence to the Finance and Public Administration Committee as part of pre-budget scrutiny focused on understanding and growing the tax base.

SDS is the national skills agency. Our purpose is to drive productivity and inclusive growth through investment in skills, enabling businesses and people to achieve their full potential.

SDS administers Scottish Apprenticeships on behalf of the Scottish Government, which incorporates Foundation Apprenticeships (FAs), Modern Apprenticeships (MAs) and Graduate Apprenticeships (GAs). The Scottish work-based learning system is responsive to the dynamic nature of employer and industry needs, with investment that is demand-led and directed by skills intelligence.

We also deliver Careers, Information, Advice and Guidance (CIAG) services which focus on equipping Scotland's current and future workforce with the Career Management Skills (CMS) they require to achieve their potential.

Through increased understanding of demand in the economy, and responsive skills planning and provision, SDS aims to ensure that the broader skills and learning system effectively meets the current and future demand of Scotland's economy, employers and people.

SDS is currently in the process of developing our new Strategic Plan, which will be published later in 2022. This will focus on Scotland's recovery from the pandemic and the dimensions of change which were facing the country before the onset of COVID-19, such as exit from the European Union, significant demographic change, the global climate emergency, the uncertain nature of the future of work and Industry 4.0, in which automation and artificial intelligence seem certain to play a bigger role.

1. Labour Market Challenges

The combination of an ageing population, changes to the pattern of inward migration due to COVID-19 and Brexit and rising economic inactivity have created a tight labour market.

Changing demographics and migration patterns

Scotland has a distinct demographic challenge. Over the next 25 years, Scotland's population is expected to decrease by 1.5 per cent compared with the growth of 5.8

per cent across the UK.[2] Scotland is the only UK nation with a projected decline in population.

By 2045, the number of people of pensionable age in Scotland is expected to increase by 21 per cent, whilst the working-age population (WAP)[3] is projected to decline by two per cent and the number of children (0-15 years) is expected to fall by 22 per cent.[4] Analysis of this data shows that the decline in WAP has been mitigated by the increase in pensionable age. However, the absolute volume of people aged 16-64 is projected to decrease by 192,200 between 2020 and 2045. Across the UK, only Scotland's WAP is projected to decrease, whereas all other nations in the UK are projected to see an increase.[5]

Scotland's dependency ratio[6] is expected to increase by one percentage point from 54 per cent in 2020 to 55 per cent in 2045.[7] This means that for every 100 people of working age in 2045, there could be 55 people of non-working age in Scotland. Based on previous projections, there will be disparity by region, with rural areas expected to have the highest rates of dependency of up to 80 per cent, placing additional pressure on public services and finances.[8]

Brexit and COVID-19 have impacted Scotland's demography. Specifically, population growth between 2019 and 2020 was the slowest since mid-2003.[9] This was mainly due to negative natural change (more deaths than births) and low net migration rates. The overall net migration remained positive for 2019/20, meaning more people were coming to Scotland than leaving. However, net migration had decreased by 44 per cent compared to 2018/19, resulting in the lowest level of net migration since 2012/2013.[10] Almost twice as many people left Scotland and moved overseas (31,300 out migration in 2019/2020 compared to 19,700 in 2018/2019).[11] In 2019/20, the majority of people[12] who come to Scotland from overseas were aged between 16 and 64 years old (86 per cent), with people aged 25 to 54 years old

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[2] National Records of Scotland (January 2022). Projected Population of Scotland (2020-based)
[3] Please note, the figures for working age and pensionable age populations are based on State Pension age (SPA) for the given year. Women's State Pension age increased to 65 between April 2016 and November 2018. From December 2018, the SPA for both men and women increased to reach 66 by October 2020 (Pensions Act 2011). Between 2026 and 2027 SPA will increase to 67 years for both sexes (Pensions Act 2014). SPA will increase to 68 years for both men and women between 2044 and 2046 (Pensions Act 2007).
[4] National Records of Scotland (January 2022). Projected Population of Scotland (2020-based)
[5] National Records of Scotland (January 2022). Projected Population of Scotland (2020-based)
[6] The dependency ratio considers the non-working age population compared to working age population. The dependency ratio is important when considering the demand for public services and the funds available to provide these services - the income from taxes and National Insurance.
[7] SDS calculation based on NRS Projected Population of Scotland (2020-based)
[8] Scotland level data is only available at NRS Projected Population of Scotland (2020-based). Previous projections (Projected Population of Scotland 2018-based) had data available at regional level. From this data, it was anticipated that some rural areas could have the dependency ratios up to 80%.
[9] National Records of Scotland (June 2021). Mid-2020 population estimates, Scotland
[10] National Records of Scotland (June 2021). Total Migration to or from Scotland
[11] National Records of Scotland (June 2021). Total Migration to or from Scotland
[12] Including asylum seekers and refugees

accounting for the largest proportion, 43 per cent.[13] Also, children aged 0 to 15 years old accounted for 12 per cent of in-migration from overseas.

Labour market participation

At the beginning of the COVID-19 pandemic, forecasts anticipated that employment would be negatively affected, and high levels of unemployment would materialise. Whilst both have been affected, the feared tsunami of unemployment has not occurred. This is largely due to the business and employment support schemes, such as the Coronavirus Job Retention Support Scheme and Self-Employment Income Support Scheme.

Initial forecasts suggested that Scotland's unemployment rate could rise to 7.6 per cent after the furlough scheme was scheduled to end in April 2021.[14] However, the unemployment rate did not reach forecasted figures and at its highest during the pandemic, unemployment peaked at 4.9 per cent between May and July 2020.[15] Since then, the unemployment rate has decreased and returned to below pre-pandemic levels. Between January and March 2022, Scotland's unemployment rate was 3.2 per cent, 0.5 percentage points lower than that of the UK.

Scotland's employment rate was 75.6 per cent between January and March 2022, slightly lower than that of the UK (75.7 per cent).[16] The employment rate has increased by 1.4 percentage points compared to the previous quarter (October - December 2021).

Despite Scotland's low unemployment rate and relatively high employment rate, labour market participation declined over the pandemic, and there has been a notable increase in the number of economically inactive people[17] in Scotland.

The number of economically inactivate people aged 16-64 has increased by 5.4 per cent over the course of pandemic,[18] This level of economic inactivity means that approximately one in every four persons aged 16-64 were economically inactive in Scotland. Across the UK, the number of people who are economically inactive has also increased over the same period, but to a lesser extent, by 2.3 per cent. The rate of economic inactivity was higher in Scotland (23.8 per cent) compared to UK (21.8

[13] National Records of Scotland (June 2021). Migration between Scotland and overseas by age
[14] Scottish Government (February 2021), Monthly Economic brief
[15] Office for National Statistics (17th May 2022), Labour Force Survey
[16] Office for National Statistics (17th May 2022), Labour Force Survey
[17] Economically inactive people are not in employment, but do not satisfy all the criteria for unemployment. This group is comprised of those who want a job but who have not been seeking work in the last 4 weeks, those who want a job and are seeking work but not available to start and those who do not want a job. For example, students not working or seeking work and those in retirement are classed as economically inactive. It can be useful for some purposes to consider only those who are both economically inactive and not of state pension age.
[18] Annual Population Survey, accessed via NOMIS. Data is covering the 12 month period January 2019 to December 2019 and 12 month period January 2021 to December 2021.

per cent) between January and December 2021.[19] Economic inactivity in Scotland has been higher than in the UK since 2015/16, and this gap has widened throughout the pandemic.

Interest in working is at the lowest amongst the inactive population. Fewer than one in five (17.6 per cent) of those inactive indicated they would like a job despite not currently looking[20], which is below the 18 year average of 24.1 per cent.

Students and the long-term sick[21] form a large part of the inactive population in Scotland, 25.9 per cent (211,000) and 29.4 per cent (239,600) respectively. The increase in long-term sick, retirement, and students has driven growth in economic inactivity over the past two years. The number of working-age people inactive due to long-term sick increased by 22,100, followed by an increase of 13,900 inactive people due to retirement and an increase of 13,600 due to studying.

The number of inactive people 'discouraged'[22] has risen sharply during the pandemic but is starting to fall. People who were discouraged had the greatest percentage growth, 89.3 per cent (an increase of 2,500). The only category of economic inactivity that contracted over the duration of the pandemic was those looking after their family or home.

The Resolution Foundation cites UK wide evidence of some individuals reducing labour market participation due to COVID related reasons, but at the same time point to the fact that long-term sickness was already increasing as a reason for economic inactivity before the pandemic, and *'that exits from the workforce due to COVID-19 have been offset either by reductions in other health problems or by changes to work (such as remote working) supporting those with other conditions to remain in employment*.'[23]

Even though the economic inactivity rate for females was higher than males, more men became economically inactive during the pandemic than women. Over the long term, inactivity has been rising amongst men and falling amongst women.

Commentators have suggested that by supporting people who are 'inactive' into work there could not only be benefits for the individuals; but also benefits for employers though an increased pool of labour supply, and for policy objectives by

[19] Annual Population Survey, accessed via NOMIS. Data is covering the 12 month period January 2021 to December 2021.
[20] Annual Population Survey, accessed via NOMIS. Data is covering the 12 month period January 2019 to December 2019 and 12 month period January 2021 to December 2021.
[21] The criteria for long-term sick is to have been off sick from a job (employed or self-employed) for four weeks in a row or longer in the past 12 months.
[22] Those who are not looking for work because they believe no jobs are available.
[23] Resolution Foundation (2021) Begin again?

supporting inclusive growth.[24] Conversely a decrease in workforce participation 'could have a lasting impact on the labour market, leading to scarring that affects those individuals' future living standards, and potential future economic growth rates'.[25]

Productivity

Productivity is an important determinant of the country's living standards, wealth, and competitiveness. [26] It can help to build a strong and resilient economy that can deliver inclusive and sustainable growth, by providing high quality jobs and higher levels of income to support public services.[27] According to Scotland's National Strategy for Economic Transformation (2022), economies with strong productivity also score highly on the indicators of a wellbeing economy.[28]

The Scottish Government has an ambition for Scotland to be in the top quartile for productivity in OECD (Organisation for Economic Co-operation and Development) countries. In 2019, Scotland ranked in 16th place out of 37 OECD countries, which equates to the bottom of the second quartile. Scotland's productivity has remained in the second quartile since 2000 and has been in 16th position each year since 2008.[29]

Since the global financial crisis, productivity growth has slowed down across many developed nations, including UK and Scotland. Scotland's real term productivity has been experiencing a weak growth since 2008/09, in line with UK. This minimal labour productivity growth has been labelled as the "productivity puzzle".[30] The Scottish Government estimated that productivity levels could have been 30 percentage points higher in 2018 if the growth rate prior to the financial crisis had continued. [31]

The most recent data shows that Scotland's labour productivity increased by 0.5 per cent in 2019 compared to 2018, following an increase of 3.2 per cent in 2018.[32] The data for labour productivity during the pandemic is not currently available, however, the pandemic has led to the largest annual fall of Scottish GDP on record, a ten per cent decline in 2020 compared to 2019.[33]

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[24] OECD (2019), Trends in economic inactivity across the OECD; Centre for Cities (2019) Where are the missing workers?; Social Market Foundation (2020), A new Safety net: Guaranteeing jobs and training after the crisis.
[25] Resolution Foundation (2021), Begin again?
[26] Kelly, J-F., Mitchell, M., Zymek, R. (2018) Wealth of the Nation. David Hume Institute.
[27] J. Tsoukalas (2021), Scotland's Productivity Challenge: Exploring the issues. Productivity Insights Paper No. 006, The Productivity Institute.
[28] Scottish Government, (March 2022), Scotland's National Strategy for Economic Transformation
[29] Scottish Government, National Performance Framework, Economy
[30] Office for National Statistics (July 2015) What is the productivity puzzle?
[31] Scottish Government (March 2022) Scotland's National Strategy for Economic Transformation, Evidence paper
[32] The labour productivity statistics release has been put on hold during the Covid-19 pandemic. The next planned release is for 2020 Q4
[33] Scottish Government (March 2021) GDP Monthly Estimate: January 2022

There is a significant disparity in productivity levels across Scotland. In 2019, the GVA (Gross Value Added) per hour varied across Scotland, from £41.9 in City of Edinburgh to £28.3 in Na h-Eileanan Siar. [34] Only eight regions (defined as ITL3 Subregions) out of 23 were above the Scotland average of £34.4 in 2019, with five of them concentrated in the east of Scotland. The variance of the productivity across different areas across Scotland can be explained due to different sectoral mixes and the nature of growth in cities and regions. For example, the North East of Scotland is dominated by the oil and gas sector, while Edinburgh has a strong presence of the financial, public sector and professional services sector.[35]

According to Scottish Fiscal Commission's December 2021 forecasts, the trend productivity is forecasted to grow from 0.6 per cent in 2021/22 to 1.5 per cent in 2025/26.[36] However, the longer-term scarring of the pandemic on the economy could mean that trend productivity in Q1 2025 will be 0.9 per cent lower than their pre-pandemic forecast.

Productivity is complex and economists agree that the productivity growth can be influenced by many different factors. Some of these factors are:

- *Business Base*: The businesses and the creation of new businesses are the key drivers of productivity growth.[37] The lack of entrepreneurial skills, opportunities, and ambition and low business starts up can hinder productivity growth.[38]
- *Investment and Innovation:* Business investment in physical and tangible capital (machinery, equipment, building) and Research and Development are critical for productivity growth as it allows firms to access new technologies, services, products and creates higher-wage jobs.[39]
- *International competition*: The high levels of competition can help to create incentives for firms to innovate and ensure that resources are allocated effectively. [40] Exporting allows businesses to find new sources of growth, which in turn creates new jobs and increases productivity.[41]

[34] Office for National Statistics, 2021, Subregional productivity: labour productivity indices by UK ITL2 and ITL3 subregions
[35] J. Tsoukalas (2021), Scotland's Productivity Challenge: Exploring the issues. Productivity Insights Paper No. 006, The Productivity Institute.
[36] Scottish Fiscal Commission (2021). Scotland's Economic and Fiscal Forecasts – December 2021.
[37] L. Abramovsky, S.Bond, R. Harrison, H.Simpson (2005), Productivity Policy, Election Briefing, The Institute for Fiscal Studies
[38]J.Tsoukalas (2021), Scotland's Productivity Challenge: Exploring the issues. Productivity Insights Paper No. 006, The Productivity Institute.
[39] National Institute of Economic and Social Research (2021) From ideas to growth: Understanding the drivers of innovation and productivity across firms, regions and industries in the UK. BEIS Research Paper
[40] Fraser of Allander Institute (2018), Scottish Policy Foundation: The role of skills and education in boosting productivity.
[41] J. Tsoukalas (2021), Scotland's Productivity Challenge: Exploring the issues. Productivity Insights Paper No. 006, The Productivity Institute.

- *Institutions and Governance:* Macroeconomic and microeconomic policies, such as business tax, access to finance, support for business start-up, infrastructure, education and skills system, can help to deliver the growth of the productivity. [42]
- *Human Capital and Skills*: The skills level of the workforce is a key determinant of productivity. Skilled workers are generally more productive in their work than less-skilled workers and the availability of skilled workers may provide incentives for firms to invest in new technologies that require a skilled workforce.[43] Also, the skills mismatches (having people in the wrong role or not being able to fill vacancies) can be a barrier to productivity growth.[44]

2. SDS work to understand and respond to economic challenges:

SDS is a data-led organisation and is committed to maintaining its role of providing robust evidence on the labour market to help inform policy direction and investment in response to economic and labour market conditions. Our understanding of the issues affecting Scotland's labour market is enhanced by direct engagement with Industry Leadership Groups (ILGs).

Our Labour Market Insight Reports are informed by deep engagement with industry bodies and stakeholders and are shared with partners on a monthly basis with further tailored regional datasets. We recognised that our previous schedule for publishing labour market information needed to be enhanced to assess the immediate or short-term impacts of the pandemic. This evidence is used by SDS to help inform and shape its service offer in conjunction with Scottish Government and partners including the enterprise and skills agencies, local authorities, employers, industry groups, training providers and trade unions.

Regions

SDS's Regional Skills Planning Leads (RSPLs) manage relationships with regional partners and work with them to ensure a coordinated regional response to skills challenges and opportunities. Although each region is different, the RSPLs offer support on regional skills needs and provide a consistent message around the national skills landscape.

To address the varying skills needs of regions across Scotland, SDS publishes Regional Skills Assessments (RSAs) which provide a coherent evidence base to inform future investment in skills, built up from existing datasets and forecasts. The most recent RSAs were published on 1 April 2022.

[42] J. Tsoukalas (2021), Scotland's Productivity Challenge: Exploring the issues. Productivity Insights Paper No. 006, The Productivity Institute.
[43] L. Abramovsky, S.Bond, R. Harrison, H.Simpson (2005), Productivity Policy, Election Briefing, The Institute for Fiscal Studies
[44] Fraser of Allander Institute (2018), Scottish Policy Foundation: The role of skills and education in boosting productivity.

RSAs are developed and published by SDS in partnership with Highlands and Islands Enterprise, Scottish Enterprise, the Scottish Funding Council, Scottish Government, the Scottish Local Authorities Economic Development Group, and South of Scotland Enterprise. RSAs are available for all Regional Outcome Agreement areas, Rural Scotland and all City and Growth Deal Regions, and offer the most detailed picture yet of the effect the COVID-19 pandemic is having on regional labour markets across the country.

Rural Scotland faces its own specific skills challenges. For example, in terms of demographics rural areas not only face issues of limited population growth and an ageing population but experience significant out-migration of young people driven by issues such as a lack of affordable housing, the need to move for opportunities in higher education and graduate employment prospects or 'good jobs'.[45] Levels of productivity are also lower in Scotland's rural economy than the Scotland average.

To help ourselves and partners address these skills challenges, SDS developed a Skills Action Plan for Rural Scotland. SDS has also produced an RSA for Rural Scotland, which provides further robust evidence base for skills investment.

Skills have a key role to play in underpinning inclusive economic growth in rural areas, but need to be viewed alongside wider social, economic and environmental considerations that serve to enhance or constrain development and inclusive economic growth. These include a supply of good quality, affordable housing, good transport and digital infrastructure, overall place attractiveness linking to talent attraction and retention and the reinforcing links between different industrial sectors and cross sectoral opportunities

For example, the Western Isles Charter launched in 2019 formalised a commitment to employment, education and skills in the Western Isles by SDS and Comhairle nan Eilean Siar (CnES). In an effort to tackle depopulation across Eilean Siar, the Charter presented school leavers with the combined offer of an apprenticeship and housing, enabling them to earn, learn and live in the Islands.

Regional Skills Investment Plans (RSIPs) are a mechanism through which SDS is committed to working collaboratively with partners across Local Authority boundaries to embed an evidence-based approach to skills planning, investment and delivery that is aligned to the needs of employers and the regional economy. To date RSIPs have been published for Highlands and Islands, Glasgow City Region, Tay Cities, Aberdeen City and Shire, Edinburgh and South East Scotland and the South of Scotland. Work is currently underway to develop an RSIP for Ayrshire, which is due to be published in summer 2022.This work builds on Regional Skills Assessments to take account of the particular challenges, opportunities and drivers at a regional level and present a partnership response to these.

SDS Regional Skills Planning delivery includes:

[45] Scottish Government Social Research (2008). Drivers of Youth Out-Migration from Rural Scotland. Available online at: https://www.gov.scot/binaries/content/documents/govscot/publications/research-and-analysis/2010/09/factors-influencing-rural-migration-decisions-scotland-analysis-evidence/documents/0104365-pdf/0104365-pdf/govscot:document/0104365.pdf

- Delivery of SDS commitments in Regional and City Growth Deals.
- Implementation of Regional Skills Investment Plans.
- Supporting implementation of regional partners' plans/strategies with skills implications
- Using insight gathered from stakeholders, along with our knowledge of our respective regions and SDS 'products', to influence skills investment activity and support regional economic need.

Our CIAG services also understand and use the regional evidence base, so that individuals are supported to make informed choices.

Sectors

Skills Investment Plans (SIPs) describe the skills challenges and opportunities across Scotland's key sectors. They give a picture of the economic and labour market situation, trends in skills and qualification supply and employers' perspectives on the big skills issues affecting sector growth.

On behalf of the Scottish Government, we worked with Industry Leadership Groups and other key industry players to develop these plans. They were created through a process of labour market and skills supply research and analysis, industry consultation and action planning with industry and partners across Scotland's education and skills system.

Each SIP is tailored to the needs of the sector. We also ensure that SDS services for individuals and employers line up with the SIP recommendations. With the plans in place, SDS will continue working with industry and partners to carry out the actions and monitor progress.

More recently, SDS has developed Sectoral Skills Assessments (SSAs), which cover all of Scotland's key and growth sectors, looking at current and future skills demand. From 2022/23, the SSAs will be published by SDS on an annual basis, and will continue to review new data, evidence, and insight.

SDS also contributes to sectoral planning, for example, sitting on the steering group of the Scottish Government's Retail Strategy for Scotland. One of the actions for SDS outlined in this strategy is to develop a Skills Audit and Action Plan, with support from partners and oversight from a retail Industry Leadership Group (ILG), that will highlight which roles and demographics are most likely to be affected by changes in retail over the medium-to long term and identify growth areas for staff to move into.

Climate Emergency

Although the Climate Emergency presents an enormous challenge for Scotland, it also presents opportunities to develop new green jobs, embed green and circular economy skills, and stimulate growth of regional economies.

Published in December 2020, the Climate Emergency Skills Action Plan (CESAP) sets out our plan to maximise the transition to net-zero for Scotland, ensuring that the workforce has the skills required to make the transition to net-zero a just transition, fair and inclusive to all.

The CESAP also emphasizes the need for action to ensure that current and future skills investment in support of net zero is strongly evidence based. This includes:

- Strengthening the evidence base on current and future demand for skills for net zero.
- Clearly articulating emerging skills needs to the skills system through the creation of a Green Jobs Skills Hub.
- Understanding current skills provision to support the transition to net zero across education, training and work-based learning.
- Understanding the supply of people with skills to support the transition to net zero.
- Creating upskilling and reskilling opportunities to ensure a Just Transition.
- Given the breadth and long-term nature of the transition to net zero, taking a highly collaborative approach to ensuring that the skills system is responsive to changing demands.

ANNEXE B

Extracts from SFC Economic and Fiscal Forecasts, December 2021

Box 3.1: Labour market participation

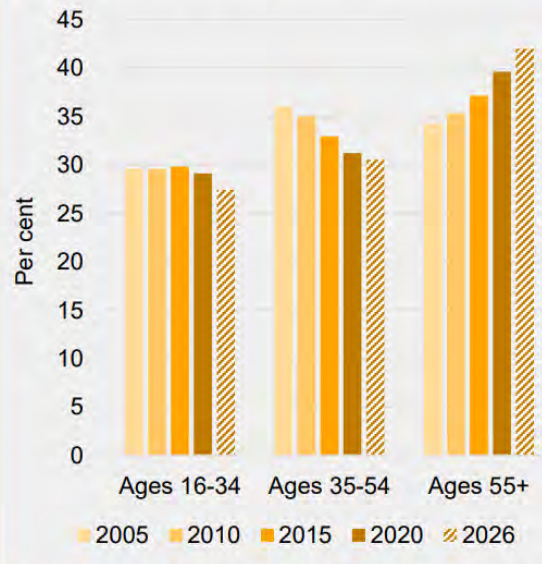
Scotland's labour market participation rate has been declining relative to the UK because of a mixture of demographic changes and changes in labour market participation in different age groups, and the decline is likely to be persistent.

As shown in Figure 3.9, the proportion of Scotland's population aged over 55 is increasing because of lower migration, historic decline in the birth rate, and improved life expectancy. As older age groups have much lower labour market participation rates, this puts downward pressure on the whole economy participation rate.

There have also been significant changes in the labour market participation of different age groups as shown in Figure 3.10. Economy activity rates are increasing in the 55+ age group. This trend has been driven in part by the staggered increase in state pension age to 66 for men and women by October 2020. Since 2016, however, there has been a marked slowdown in the growth of participate rates of those aged 65+ as the participation rate uplift from the increasing pension age diminishes.

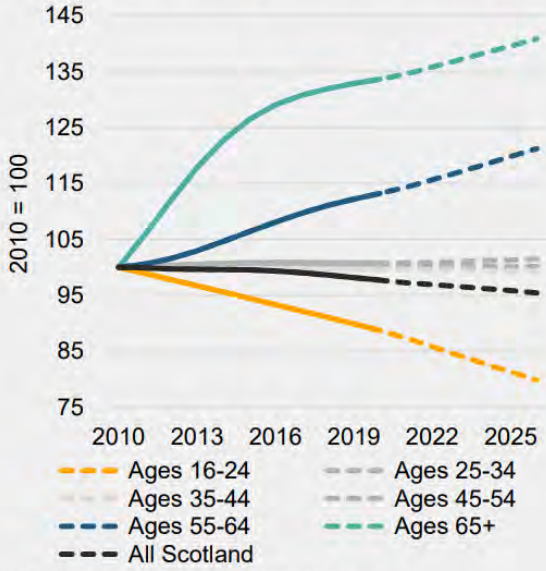
Labour market participation of those aged 16-24 has been declining since the mid-2000s reflecting growing enrolment in tertiary education.

Figure 3.9: 16+ population composition



Source: Scottish Fiscal Commission

Figure 3.10: 16+ trend participation rates



Source: Scottish Fiscal Commission

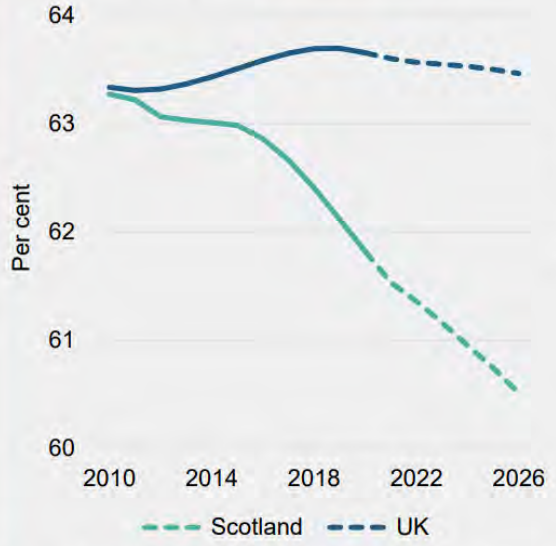
Taking these trends together, Scotland's whole participation rate has been falling over the last decade, particularly since 2016. In addition, the increasing population

share and participation rates of those aged 55+ means that older age groups account for a growing share of the labour force.

Falling labour market participation rates coupled with a slowdown in population growth means that we expect a decline in the size of Scotland's labour force over the forecast period and falling employment by 2024.

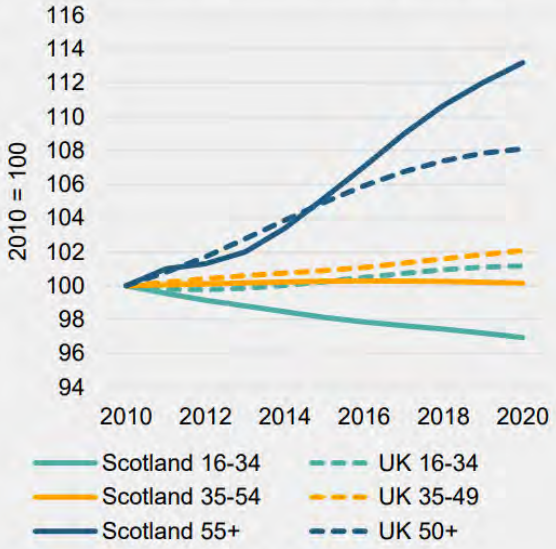
Differences in Scotland's population, demographics and labour market trends mean participation trends in Scotland and the UK have diverged in recent years, and the gap is set to widen over the forecast period. This has important implications for our forecasts of the economy and also Scottish tax revenues.

Figure 3.11: 16+ economic activity rates



Source: Scottish Fiscal Commission, OBR (2021) Economic And Fiscal Outlook – October 2021 (link).

Figure 3.12: Economic activity rates by age



Source: Scottish Fiscal Commission

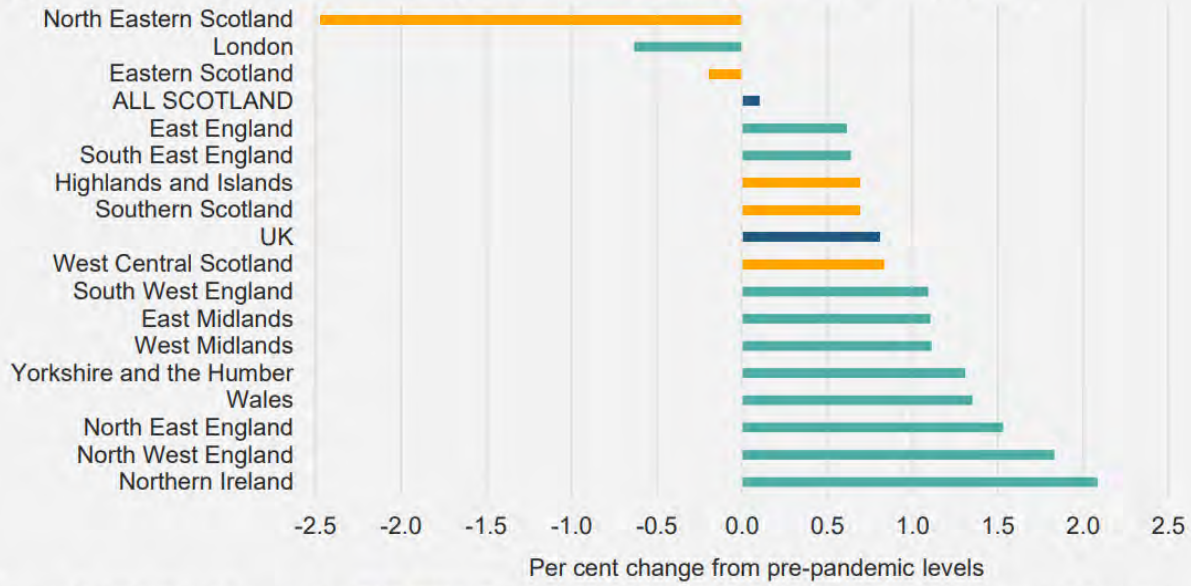
Box 3.2: Regional labour market data during the pandemic

Analysis of HMRC Real Time Information (RTI) shows Scotland lagging behind the UK on PAYE emplyoment and pay growth during the pandemic although, on pay, the gap is partly driven by strong earnings growth in London. In Scotland, pandemic-related effects are adding to existing long-term factors, such as the oil and gas sector being on a downward trajectory and contributing to weakness in the North East. There are also adverse long-term demographic trends in Scotland, which we discuss in depth in Box 3.1. In this Box, we first look at payrolled employees the move on to earnings.

As shown in Figure 3.16, PAYE employee numbers are back to pre-pandemic levels in most parts of the UK (such as Northern Ireland and North West England) but still

lagging behind in others (most notably North East Scotland and London). At NUTS2 level, four of the five regions covering Scotland are below the UK average.

Figure 3.16: Change in PAYE employees between February 2020 and October 2021



Source: Scottish Fiscal Commission, ONS (2021) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – November 2021 (link).
Scotland at NUTS2 level (orange), rest of UK at NUTS1 level (teal), Scotland at NUTS1 level and UK average (blue).

Adzuna online job advert estimates, available at NUTS1 level, suggest a similar geographical variation in labour market recovery. There are various factors that may explain these regional differences.

The local industrial mix is one possible explanation. North East Scotland is particularly reliant on mining and quarrying activities (as part of the oil and gas supply chain), where output and PAYE employment are still significantly below February 2020 levels. Oil prices have increased as global economies reopened and worldwide oil demand picked up, but this has yet to fully feed through to a labour market recovering in North East Scotland.

In addition, Scotland and London are top destinations in the UK for international tourism. With foreign travel still subdued, this is one possible reason why other Scottish regions, as well as London, have relatively weak PAYE employment growth.

At NUTS3 level, PAYE data in Figure 3.17 indicate that employee numbers in coastal or rural areas such as Cornwall and the Scottish Borders have been among the fastest to bounce back, especially during the summer thanks to the boost from domestic tourism. Meanwhile high-wage, urban areas such as London, Aberdeen City and the City of Edinburgh have been among the least likely to experience a jobs recovery. One reason for slower employee growth in cities is that people are visiting city centres less than before the pandemic. Weekday visits are relatively subdued,

suggesting that cities are mostly being hit by lower levels of commuter footfall, while weekend leisure trips haave largely recovered.

As shown in Figure 3.18, when it comes to PAYE mean pay growth relative to pre-pandemic levels, the Scottish regions are slightly more spread across the distribution but all are below the UK average. London emerges as an outlier, with mean pay growth outpacing that of all other regions. This reflects both compositional effects, to the extent that lower-paid jobs lost during the pandemic have been slower to come back in cities, and strong PAYE mean pay growth in the financial services sector which is central to the London economy.

When looking at total pay growth since the start of the pandemic is illustrated in Figure 3.19, the Scottish regions are clustered towards the bottom half of the distribution with North East Scotland significantly underperforming the rest of the UK, largely mirroring the pattern in 3.16.