

## 2017 Trades House of Glasgow Lecture

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‘Opportunities for Scotland in an unsettled world’

### Introduction

- Thank you Keith and to your colleagues for the honour of asking me to speak with you this evening - it is a great pleasure.
- I know that the University strongly values the relationship with the Trades House of Glasgow.
- When I first met with Keith to chat about the topic for this evening his words were, *“the world economy’s looking a bit iffy what with America going off on one, the UK leaving the EU, and the increased concerns about what might happen in Asia with the Chinese economy and North Korea, any chance you could make sense of it for us and what it might mean for Scotland”*.
- I must confess, that if the challenge is to make sense of Donald Trump, Nigel Farage, and Kim Jong Un then please don’t set your expectations too high!!
- But I was delighted to accept Keith’s invitation and to discuss the “Opportunities for Scotland in an unsettled world’.
- Much of recent debate has understandably concentrated on big political questions such as Brexit and IndyRef2, so it is nice now and again to take stock of where the Scottish economy is and to lift our gaze to the wider global environment.
- With that in mind, I want to do two things.
- Firstly, to set out our take on the current economic context both here in Scotland and further afield.

- Secondly, after a year of major political and economic shocks, it's quite easy – even for an upbeat economist likely myself(!) – to jump to a pessimistic outlook for our future growth prospects. And whilst it is true that we are living through a period of uncertainty, it's important to also acknowledge that with change and upheaval comes new opportunities.
- Ultimately, our future success will depend on how well we capture the opportunities from growth in emerging markets, take advantage of the new technologies of the 4<sup>th</sup> industrial revolution and support the transition to an economic model that is environmentally and socially robust.
- And it is vital that we do this.
- **The Scottish economy**
- Firstly, the Scottish economy – as I'm sure most of you know – contracted in the final 3 months of 2016.
- This means that we're just one data release away from re-entering recession.
- Last year, the UK economy grew 1.9%. Scotland grew 0.0%.
- And whilst unemployment is back to pre-financial crisis levels, we've seen a rise in part rather than full-time work, an increase in underemployment, greater job insecurity and weak – if any – growth in many household's income.
- Some of this undoubtedly stems from the challenges we're seeing in oil and gas, but it's hard to escape a sense that Scotland is in a challenging period in the growth cycle more generally.
- But secondly, and despite recent challenges, Scotland is without question a rich and successful nation.

- We're in the OECD top 20 in terms of income per head and we consistently rank near the top in the UK on most long-term indicators behind London and the South East.
- We have substantial natural resources and a skilled workforce.
- We have key strengths in sectors such as food and drink, energy and tourism and have companies competing at the highest level from photonics, precision manufacturing through to financial services.
- We outperform most other parts of the UK in attracting international investment.
- We have world-class Universities leading the way not only in pioneering research, but in institutions like my own, transforming the way academics interact with industry through initiatives like the Technology Innovation Centre on George Street and the wider Innovation District in the Merchant City.
- But it's been widely recognised by successive Scottish administrations that we lag behind many of our competitors in key areas.
- Back in 2007, the Scottish Government published an economic strategy which aligned the public sector toward supporting sustainable economic growth.
- It contained a series of targets – for growth, productivity, participation and population; and for levels of inequality and environmental sustainability.
- 10 years on, pretty much on all of them – with the exception of population where we now have a record number of people living in Scotland – we've been treading water.
- On productivity for example, the gap in 2007 with the top performing OECD countries was 20% - it's still 20%.

- Or in other words, France can produce in 4 days what it takes us to produce in 5.
- Whilst we have seen a rise in levels of innovation activity, on business R&D, we currently rank 9<sup>th</sup> out of the 12 English regions or devolved nations in the UK. We're also 9<sup>th</sup> in terms of new business registrations.
- On the labour market, the gap between the top and worst performing local authorities is still a massive 15 percentage points.
- Now given recent challenges – from the upheaval in financial services through to the downturn in oil and gas – the fact that we have *maintained* our position could be viewed as a success.
- But I think most of us would agree that our ambitions are much greater than to stand still.
- And if we believe that the short-term economic winds will be more of a headwind rather than a tailwind, then it becomes all the more vital that we re-evaluate that performance.
- And the third important contextual factor is that – from this year – our public services will depend on the performance of the Scottish economy like never before.
- Over the next few years, the Smith powers will start to come on stream. Holyrood will soon oversee a budget of over £40 billion.
- This will mean over 60% of public spending for the benefit of the people of Scotland will be controlled either directly or indirectly by the Scottish Parliament.
- It includes major new welfare powers, soon to be worth around £3 billion.
- And crucially, around 40% of the Scottish Budget will be funded by revenues raised in Scotland – rising to 50% by the end of the decade.

- One of the key objectives of Lord Smith's Commission was to bring a greater risk and reward into Holyrood decision making.
- And we now have that – for better or worse!!
- Under the complex way in which the new framework operates, what matters is not how well the Scottish economy is faring per se, but how we are doing relative to the rest of the UK.
- The scale of the powers being transferred are such that even very small variations in performance could turn out to benefit or cost us hundreds of millions of pounds.
- As an illustration, if Scottish devolved tax receipts were to grow just 0.5% points faster than in the UK in each year, by the end of 10 years this gap will have opened up to an additional £1 billion boost to the Scottish Budget.
- Of course, the effect is entirely symmetrical – if we grow slower that's a pretty big black hole to be filled.
- So these three factors – the current economic outlook; the long-term challenge to catch-up with our key competitors and our new powers, provide the backdrop for any discussion of our long-term economic potential.

### **The global context**

- A feature of what I want to talk to you about is the global context and the apparent outlook of a more unsettled world.
- I'm from a generation where – in the main – we have been fortunate to live through a time of relative global stability that has been supported – and in turn itself driven – by ever closer international cooperation.

- This international policy cooperation was supported by an economic interconnectedness on a scale never before witnessed.
- This evolution has not always been smooth – the dot.com bubble and the Asian Financial Crisis are two examples – but the global economy’s coping mechanisms proved resilient.
- Global average real incomes per head rose by nearly 300% between 1990 and 2015.
- But, particularly in recent years, there have been growing concerns about some of the wider consequences of this global economic model – inequality, the loss of skilled jobs in advanced economies (so-called ‘hollowing out’), and the impact of globalisation on climate change.
- Now there’s a debate about whether or not inequality is rising. As with all these things the answer isn’t clearly cut.
- Following big increases in the 1980s, some measures of inequality have actually remained stable.
- Irrespective of trends, what we do know is that the richest 10% in Scotland are in households with a net income of more than £900 per week. The equivalent figure for the poorest 10% is less than £240. It’s £2,600 for the richest 1%.
- And within income groups, between generations, and across geographies, there have been sharp rises in inequalities.
- The financial crisis only accentuated these trends.
- Our economy contracted sharply and unemployment – whilst not rising by as much as many feared – still increased by 130,000.
- What has been arguably more damaging has been the weak recovery.

- Talk back in 2008 and 2009 was of a lost decade.
- Over the last 10 years, output per head in Scotland – a key measure of economic progress – has grown by just over 1%.
- That's not an annual growth rate, that's the total.
- To put in context, over the 7 years to 2006, output per head in Scotland grew by 17%.
- But Scotland hasn't been unique.
- Most advanced economies have been plagued, to varying degrees, by weak growth, poor levels of productivity and unemployment.
- Average real earnings in the UK are still over 3% lower than before the financial crisis.
- It is therefore understandable that many people's confidence in the model that has been the foundation of our economy over the last few decades has been shaken.
- And it is clear that this has – in part – driven the political shocks we have seen both with Brexit, Trump and to an extent across Europe.

### **Global Context: the key risks**

- The decision just over a year ago to leave the European Union, will have a profound impact on Scotland's economic future.
- £12bn or nearly 45% of international Scottish exports are to the EU. That's more than we export to North America, Asia, South America and the Middle East combined.

- As a market, it provides access to over 500 million consumers not just through direct exports but also through highly integrated supply chains.
- There are around 180,000 EU nationals living in the Scotland – half of the recent net increase in Scotland’s population has come from people born in EU countries.
- There’s understandably concern in some sectors about the outlook for employment – whether that be in agriculture, or in universities and technology firms recruiting from a global talent pool.
- More generally we know that labour mobility can help tackle demographic challenges in countries – like Scotland – with an ageing population.
- All of these – on balance – are expected to be impacted by our decision to leave the EU. But as with any change there will be winners and losers.
- In such an environment, effective and well-informed policy becomes all the more important and urgent.
- Market access will undoubtedly be the next UK Government’s top priority.
- The current government has indicated that it intends to obtain the ‘best’ trade deal possible. And I think they are genuine in working to achieve this. But given that we currently have the ‘best’ trade deal, it’s clear that we’re going to face an adjustment – possibly difficult – in the near to medium term.
- It is right to make a virtue of new trade deals with other countries and this must be a priority. But we do need to manage expectations a little about their impact or deliverability.
- For example, trade deals with Australia and New Zealand are all well and good. But even if we double trade with these two countries, it would be equivalent to 6% of our current EU trade.

- There are also questions about how open potential partners – e.g. in China or India – will be to such deals, particularly if we are unwilling to budge on key issues such as student visas or access for skilled workers.
- It is also true that leaving the EU means that we can – in principle – ‘remove the burden of red tape’, but again this needs to be put in context.
- When you have the 2<sup>nd</sup> lowest levels of product regulation in the OECD and are only behind New Zealand, the US and Canada in terms of how flexible (or lax depending upon your viewpoint) your employment protection rights are, the scope to gain much advantage is likely to be much less than people expect.
- But to an extent, we need to get on with it!
- Brexit is happening irrespective of your views in favour or against. It will be the new normal and it’s vital that businesses and policy makers respond and adjust.
- We now need a rational programme of work to identify the sectors and areas of the economy most impacted and the best mitigation strategies, the policy opportunities that may open up and how we can implement them as quickly and decisively as possible, and we may need to reassess existing policy priorities and commitments now that we are going to be outside the EU.
- Many have interpreted Brexit as just one example – perhaps the starkest – of a wider suspicion toward globalisation.
- Indeed, there have been well documented concerns that the global economy is running out of steam.
- We have a US President sympathetic to protectionism – as demonstrated by his cancellation of the Trans-Pacific Partnership, the opening back up of NAFTA and his late night Twitter activities!

- In certain parts of Europe, anti-Brussels sentiment has been rising.
- And further afield, the repositioning toward a multi-polar world with Russia exerting increased influence in the Middle East and along its borders and China playing a much greater role in Asia and the wider Pacific, pose their own uncertainties.
- Exports increased from around 18% of global GDP in 1986 to 30% in 2008 but have slowed sharply in recent years, so that this ratio has fallen.
- Foreign direct investment flows are down 20% on 2007 levels.
- In part, this is undoubtedly a hangover from the financial crisis, but it also reflects a gradual – and in some cases structural – re-setting of globalisation.
- Twenty years have elapsed since the Uruguay Round – the last big multilateral trade agreement. The prospect of any future deal is remote.
- And one is needed. Many aspects are no longer fit for purpose or are not properly enforced.
- If you take all this together, you can see why many people are concerned about the outlook for global growth and demand.

### **So where do we go from here and what are the opportunities?**

- In a more unsettled world, what are the opportunities and what can we do to take advantage of them?
- **Firstly**, I think that it's important not to overstate either the risks to the global economy or their impacts.
- Brexit will be a headwind, but the fundamentals of the global economy are stronger than they have been for many years.

- And without tempting fate, the most serious political threats in Europe seem to have passed at least for now.
- Overall global activity is picking up with investment, manufacturing, and trade all growing.
- The IMF forecast world growth to rise from around 3% last year to nearer 3½% this year and next – the average growth rate since 1960.
- All countries in the EU are expected grow in 2017, the first period of sustained growth since the euro crisis.
- Global stock markets – despite slipping back recently – are also at near records.
- Unemployment in America is at the lowest in years whilst the UK economy – whilst slowing down – is still projected to grow this year and next.
- Moreover, we should be wary – mindful yes but not panicky – of attributing too much influence to individual electoral results, the consequences of which are still unknown.
- Congress remains pro-trade. And when you have US companies like Apple selling more iPhones in China than in the US, the strength of corporates to act as an important advocate of trade should not be underestimated.
- And for every sceptic, there are others who remain more supportive.
- A quote

*“globalisation has powered global growth and facilitated movement of goods and capital, advances in science, technology and civilisation, and interactions among people”,*

- is the kind of thing you would expect a US President to say but this was President Xi as they press ahead with their One Belt One Road initiative opening up Eurasia.
- So I'd argue that yes, the world is highly unsettled, but it's always been that way. We live in a world of 24hr news that makes it seem even more so.
- And when you look at where we are in the global growth cycle, many fundamentals are positive. That's not to say there aren't risks, but context is important.
- **Secondly**, whatever happens with the political landscape over the next few months we can be confident of certain long-term trends.
- In 30 years' time, China will be the largest economy in the world by a significant margin, followed by India. Indonesia will rise to fourth.
- China's increasing footprint on the world stage is having numerous impacts on the dynamics of the world economy – and I'd encourage you to read the outputs of Asianomics run by Jim Walker a great supporter of the Fraser of Allander.
- Lord Jim O'Neill – the person who coined the phrase BRICS – was at the Business School last week arguing that the growth of Asia – will pardon the pun – 'Trump' all else.
- And it's not just Asia, Mexico is predicted to be larger than the UK economy by 2030.
- If Brexit forces us to do anything, it might get us to lift our ambition to trade on a much more international scale.
- As a country we still trade over 60% more with Ireland than we do with China. We trade as much with Luxembourg as we do with India.

- If you rank the top 10 countries by size of population in the world, only 3 of them also appear in the top 20 export destinations for Scotland – USA (#1), Brazil (#10) and China (#14). In the top 20, you can add in Japan and Germany.
- Securing even small market shares there – particularly as their households become wealthier, demand more services, quality products and brands – like Scotch Whisky – and new technologies – provides significant opportunities.
- The fall in the value of Sterling provides an opportunity to enter into these new markets – provided we have the ambition to take advantage.
- Clearly there will be an important role for government in helping here.
- But businesses themselves need to adopt flexible, dynamic and patient strategies to navigate these markets.
- Evidence shows that the businesses that tend to be successful in emerging markets those that are prepared to adjust their brand and market positions to local preferences and are able to ride out short-term economic and political storms that will occur from time to time.
- They also need to invest – and take time – in understanding how the economy operates, the different commercial regulatory and law practices, not to mention language and culture.
- For many more complex markets, there is also much to be learned from other countries – most notably Germany – who are world leaders at coordinating entry into such markets across a number of firms and sectors, creating hubs, building deep levels of trust and confidence with their hosts, pooling together expertise and sharing costs.
- **Thirdly**, many of the factors, which lead to concerns about a rapidly changing outlook for our economy, themselves create extraordinary opportunities.

- The last 20 years have been dominated by a move toward globalisation, the next 20 will be dominated by the exponential rise in technology.
- The prospects of a 4<sup>th</sup> industrial revolution marked by breakthroughs in technology create massive opportunities for Scotland.
- The commercial possibilities of billions of people connected by mobile devices, with unprecedented processing power and access to knowledge, are actually quite hard to fully comprehend.
- Transportation and communication will become cheaper, with logistics and supply chains much more effective.
- Many industries are already seeing technology changing the way they operate.
- Market disruption is flowing from agile, innovative competitors who, thanks to more effective use of technology can oust well-established firms faster than ever – as in the case of Uber and Air BnB – or create entirely new markets.
- Major shifts in demand are also occurring, as consumer behaviours adapt to technology. We see that perhaps most obviously in retail. It may surprise you to know that I'm dressed entirely by the internet this evening!!
- In looking at the opportunities, there are two key elements.
- Firstly, as a country we need to position ourselves to take advantage of the new developments as they emerge. That means investing in our digital infrastructure – including as we've seen in recent weeks, cyber-security – and the skills and training required to be able to make full use of technology as it develops.
- Businesses themselves will need to be much more open to change. None of this will be easy, digital solutions don't come neatly bundled out of the box.

- We also need to boost levels of entrepreneurship – not just in start-ups but in scale-ups, so that we can capture the market opportunities that will emerge.
- In the Business School, we have developed a Growth Advantage Programme to do just that and we have Entrepreneurial Scotland based in TIC providing leadership and networking opportunities for new and established entrepreneurs.
- Secondly, as a country we also need to lead the development of these new technologies themselves.
- Clearly our Universities have a vital role to play.
- At Strathclyde for example, we have established the Advanced Forming Research Centre to support world leading advanced manufacturing, working with businesses large and small.
- We have also recently launched the first ever postgraduate qualification of its kind in the UK around Fintech.
- We also need much greater collaboration across industries – with traditional economic sectors often no longer relevant.
- Driverless cars are a perfect example: auto-motive firms working with experts in photonics, technology, and artificial intelligence – not to mention financial services who are pulling together the insurance for them!
- Technology is increasingly making manufacturing more digital rather than machine based and innovations are making once traditional manufacturing companies more service based. Companies like Rolls Royce for example, are just as much – if not more so – ‘service’ companies as they are manufacturing.
- **Fourthly**, there is an important opportunity to use recent developments to tackle head-on the genuine concerns people have about how prosperity is shared and the long-term sustainability of our planet.

- Our economics 101 course teaches students about how the 'gains from trade' are unlikely to be shared equally.
- We need to get better at recognising this and putting in place policies and businesses practices – whether that be supporting areas of the country impacted by industrial decline or a more concerted effort to delivering inclusive growth – that can enables everyone to fulfil their potential.
- Ultimately how you do this, and by how much, is, in part, politics. But I think you'll find few people disagreeing that more can be done.
- At the same time, it's not possible – or desirable – to talk about the opportunities from technological change without acknowledging the implications for jobs or ignore the challenges of an ageing population or climate change.
- Gaps between those with and without skills, or with and without jobs, may widen.
- The BBC website contains a handy app for calculating the probability of your job being automated.
- I checked this morning, as an economist I have a 15% chance.
- Are there any accountants here? It's 95%.
- The Bank of England suggest that up to 15 million jobs could be at risk in the UK.
- In a world of technological change, a focus on developing the skills that will give our workers a comparative advantage is crucial.
- Education has tended to focus on developing core cognitive competences – reading, writing and arithmetic.

- But with machines going to dominate such tasks, the importance of non-cognitive skills are ever more important.
- So we need to equip people with the tools for a much more automated world.
- Increasingly, if you look at the types of teaching that we're now doing, alongside giving our students a grounding in a subject, we're investing in giving them the skills to engage with each other, to learn from themselves, to be more entrepreneurial and to gain experience of the real-world.
- More generally, as a society we need to move away from viewing education and skills development as high intensity activity for a short period of time to lower intensity activity spread over a longer period throughout someone's working life.
- We also need to be mindful about how the benefits of wealth from automation are shared, suggesting some difficult conversations about the role of taxing capital vis-à-vis labour in the future.
- And just as technological change is an opportunity that comes with challenges, so some of the big challenges that we face – an ageing population and climate change – come with opportunities.
- Population ageing is one of the greatest achievements of the past century.
- But as our working-age population falls so will our economic potential putting a strain on government resources.
- Similarly, we know that we can't keep using our planet's resources in the same way that we have in the past.
- First and foremost, these are challenges that every other country is facing. So to the extent that we can cope with them more effectively, the better placed we will be – not just economically but socially.

- That means learning from the Nordic countries on how to develop flexible work practices that can make older workers thrive.
- It's about creating workplace environments for the growth industries of the future – particularly in care for the elderly – that reflect not just the economic value that we put on such activities, but also the social value.
- Secondly, these challenges are in themselves an opportunity for businesses to grow into new markets and create new products.
- Here at Strathclyde we have the Digital Health and Care Institute looking at how we can solve some of the big health challenges of the next few decades and CMAC which is looking to revolutionise the way in which pharmaceuticals are made.
- And we know that renewable energy is something that Scotland has a distinct advantage in. Our team – led by Grant Allan – modelled the potential economic benefits of the possible 1.6 GW of wave and tidal energy believed to be possible to harness, estimating it could support up to 25,000 jobs.
- **Finally**, and whilst I don't intend to stray too much into the policy debate this evening, I'd argue that if we are to fulfil our potential we need to look beyond short-term economic and political cycles to how we can better support the long-term drivers of growth.
- Economics is relatively straightforward.
- Sustainable growth comes from making better quality things more efficiently and making full use of the skills and talents of everyone.
- Most policymakers in Scotland agree strongly on these. And we've seen them discussed in various strategies, targets and glossy action plans.
- But we struggle with how best to define policies that actually stimulate these drivers and to really know 'what works'.

- And even when we do, the task of actual delivery and, quite often, the need to shift scarce resources from one area to the next, pose a challenge
- I'd argue that we need a much more rigorous approach to evaluation than we currently have.
- Scotland spends over £100 per head more each year on 'Enterprise and Economic Development' than in the UK as a whole.
- This year, the Scottish Government will be spending close to £1bn on activities that you could broadly define as directly targeting 'economic growth' – that's before accounting for things like transport, the school budget or even UK Government spending in Scotland
- Why then do we lag behind our competitors in many areas?
- Are we getting value for money?
- What programmes are more efficient than others?
- Are we joined up – are our research investments in future health manufacturing and pharmaceuticals fully aligned with current NHS activities in the most effective way?
- Do we have actual measure success?
- Answering these questions isn't easy. And ultimately it'll require difficult trade-offs.
- But a greater role for independent analysis will undoubtedly help.
- Firstly, every policy intervention should be underpinned, as a matter of course, by a clear evaluation framework that is open and transparent.
- This will help avoid policies being designed, expanded, and defended upon assertion rather than evidence.

- The Small Business Bonus costs around £170m – but has yet to be evaluated.
- Secondly, as every major policy is being designed, again, as a matter of course, we should set out how it will be monitored and assessed.
- This might mean we have to collect new data that proves controversial – e.g. as the government are doing in school education with the National Improvement Framework – but it must be the case that knowing if something is working is a good thing.
- And there are good lessons we can learn. Productivity commissions in Australia and New Zealand provide independent research, advice and performance monitoring to government and the general public on a much more effective scale than we do here.
- In other countries, such as South Korea, major policies must prove they are having an impact – if not, funding is stopped. They set out clearly what the likely effects of policies are in advance and what the consequences are once enacted. And did they deliver what they said we would?

## **Conclusions**

- In conclusion, it's clear that we are living in an unsettled world.
- That being said, it's important not to overplay the risks that we face. The truth, as usual, lies somewhere between despair and over confidence.
- The global economy and geo-political system have always been uncertain. Scotland is a rich and prosperous economy and well placed to take advantage of exciting new global economic trends.
- That being said, many of the opportunities that face Scotland in the upcoming years – from rapid technology change, the opportunities from solving key

global trends like demographic change and environmental sustainability through to emerging markets – won't be easy to realise.

- The onus is really on business and policymakers to respond. But if we do, Scotland has much to gain.