CBI SCOTLAND SCOTTISH BUDGET SUBMISSION

DRAFT BUDGET 2019-20

Executive summary

The prime challenge facing Scottish businesses today is the threat of a cliff-edge Brexit without a transition period and with no deal. A cliff-edge Brexit would be catastrophic for businesses and families and do long-term damage to the economy, leaving the UK poorer and less competitive.[1] However, while Brexit has been, rightly, dominating the political and economic agenda, businesses urge government not to lose sight of the domestic agenda. The longer-term concern for the Scottish economy is the need to ensure the private sector fires on all cylinders to grow the economy in response to a prolonged period of weak economic growth, a considerable demographic challenge and a volatile global trading environment.

With the uncertainties facing business, it is more important than ever to provide a clear sense of direction for the Scottish economy and give confidence to businesses and investors developing their plans for the coming years. That means plainly setting out how Scotland is the place to do business with a stable and competitive system of tax and regulation, alongside long-term commitments to strengthening skills, infrastructure and innovation. More than ever before, the Scottish Budget depends on the relative growth of the economy against the rest of the UK and the private sector is and will continue to be the source of that much-needed economic growth.

Business investment is a vital element of growing the Scottish economy, and with strong competition from the rest of the UK and around the world, the government needs to send clear signals to domestic and international firms that Scotland is an ideal destination for long-term investment and growth.

With an ageing workforce and technologies changing faster than most people could have predicted, greater business involvement in the education and skills system is becoming increasingly important. Funding needs to be more closely aligned to evidence of demand from employers if we are to build a resilient, inclusive and competitive economy that ensures everyone can benefit from technological change.

Ultimately, boosting our productivity holds the key to economic growth. All sectors have a responsibility to improve their productivity as the prize for success means more jobs are created, existing and innovative technologies are adopted, and wages, crucially, grow.

Key areas of business priority

- **Skills are the foundation for a competitive, productive economy and a resilient and fulfilled workforce**
- **Business investment depends on a competitive environment with a clear and stable approach to taxation**
- **Boosting productivity is a shared challenge which requires business and government working in partnership to strengthen the economy**

[1] CBI, *No Deal: The facts*, August 2018

Skills are the foundation for a competitive and productive economy

CBI Scotland's *Pursuing Prosperity* report identified education and skills as a key driver of productivity across Scotland.[2] Access to skills is consistently raised as one of the main challenges facing businesses of all sizes and from all sectors. The combination of an ageing workforce, the impact of automation and artificial intelligence, and Brexit makes it more important than ever that our skills system has greater business involvement, with funding more closely aligned to evidence of demand from employers. This will require greater collaboration between business, schools, colleges, universities and government.

While the skills system has understandably focussed on youth employment in recent years, now is the time to prioritise a more flexible and responsive system that recognises the importance of lifelong learning. Research shows over sixty percent of existing roles have a significant proportion of tasks that could be automated, while nearly 80% of the workforce of 2030 in Scotland have already left compulsory education.[3] A step-change in lifelong learning provision will therefore be required to build a resilient, inclusive and competitive economy that ensures everyone can benefit from technological change.

Short-term – Next year

Double the Flexible Workforce Development Fund and allow greater flexibility of delivery to support upskilling of current workforce

While addressing the challenge of the changing world of work requires a significant change in approach, existing mechanisms can be used to provide support for businesses in the immediate term. The Flexible Workforce Development Fund (FWDF) is one example of this and its introduction was a welcome step in providing support for businesses to upskill their existing workforce.

However, the fund continues to be limited to just £10 million, less than 5% of the Scottish Government's Apprenticeship Levy allocation. The cap on support of £15,000 per employer prevents businesses from providing the type of high-quality training the fund should be designed to support, while restricting delivery of the FWDF exclusively to the college sector limits the range of training opportunities employees are able to benefit from.

Businesses themselves must be the driving force behind an increase in upskilling investment but the FWDF can provide valuable support for employers across Scotland that have seen an increase in their expenditure following the introduction of the Apprenticeship Levy. Doubling the size of the FWDF to £20 million and opening it up to include all accredited training providers are steps the Scottish Government could take in this Budget to send a clear statement about the importance of upskilling the existing workforce to address the challenge of technological change.

Medium-term – During this parliament

Work with business to highlight the importance of ensuring the post-Brexit UK immigration system works for the Scottish economy

Recent workforce projections by Mercer showed Scotland and the North East of England as the only parts of the UK projected to see a reduction in total available workforce by 2025.[4] Furthermore, we know that all of Scotland's projected increase in population over the next 25 years is due to migration.[5] Both of these have significant implications for the Scottish economy and ensuring businesses in Scotland can continue to access workers from overseas after Brexit will be crucial.

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[2] CBI Scotland, *Pursuing Prosperity: Why regional productivity growth matters for Scotland's future*, June 2017
[3] IPPR Scotland, *Preparing for Automation and Ageing*, September 2018
[4] Mercer, *The Impact of Brexit, Migration & Ageing on the UK Workforce*, March 2018
[5] Scottish Government, *Scotland's Population Needs and Migration Policy*, February 2018

While access to highly skilled migrants will continue to be important, almost all business sectors require a combination of skill levels. A new immigration system must provide a controlled route to access European labour, which can both satisfy nuanced public opinion and allow businesses to meet their labour requirements.

CBI Scotland believes that businesses would be best-served by a single, UK-wide immigration system post-Brexit, provided it is flexible enough to meet Scotland's needs. Businesses operating in Scotland view preserving the single UK labour market and retaining the ability to move employees around the UK as a priority. However, the more restrictive any UK-wide system is, the greater the need will be for increased flexibility for Scotland to ensure businesses can continue to access the skills and labour they need to help grow the Scottish economy.

Long-term – Over the next decade

Commit long-term resource to the National Retraining Partnership to help businesses and workers prepare for technological change

CBI Scotland welcomes the recognition of our joint call with the Scottish Trades Union Congress to make upskilling and retraining a key priority in the 2018/2019 Programme for Government, with the announcement of a new National Retraining Partnership. Progress must be made quickly and matched with a long-term commitment to resourcing if we are going to address the impact of automation, which is already being felt by employers and employees across the country.

The skills system must be equipped to proactively support workers at risk of being displaced from the labour market, identify the roles and skills likely to be in high demand, and provide people with the advice they need at key points in their career. A successful National Retraining Partnership should form a key part of a wider shift towards a system that has lifelong learning at its heart to ensure that technological change can have a positive impact on national productivity as well as individual employers and employees.

Business investment depends on a competitive environment

Business investment is a key enabler of productivity and economic growth now and in the future. Weak investment is one of the factors dragging down our productivity performance. Right now, Brexit-related uncertainty is constraining business investment, with 80% of firms surveyed stating Brexit has had a negative effect on investment decisions.[6]

But weak business investment is not just a Brexit phenomenon. The UK has languished at the bottom of the G7 for close to four decades, and this gap has widened since the late 1990s. CBI analysis shows that after removing the impact of Brexit and other factors[7], business investment in the UK still underperforms the rest of the G7 – the UK at around 9% of GDP, compared to 13% across the rest of the G7.[8] While business has a key role in delivering investment, government sets the policy environment that can promote and encourage businesses to make investment decisions.

It is therefore particularly welcome to see actions taken by the Scottish Government, such as the Business Growth Accelerator for non-domestic rates, that aim to encourage more investment in Scotland. The growth accelerator is a prime example of how a business tax can be used as a lever to encourage more investment in Scotland, which brings with it wider economic and social benefits.

More broadly, taxation is a tool government can use to motivate or discourage investment and with relative economic growth being an underpinning factor in the Scottish Budget, the Scottish Government should do what it can to support the private sector in Scotland to continue to grow and prosper.

Short-term

Halt plans to impose additional levies through non-domestic rates on out-of-town businesses

The Scottish Government has a number of levers at its disposal in the Scottish Budget that will help provide clarity of direction and commitment when it comes to supporting investment. Non-domestic rates are a large part of the Scottish Government's tax take, but it is also a considerable cost to business that will have an effect on future investment plans.

Clarity and stability of direction will help businesses plan future investments against current and future costs. The switch from RPI to CPI has been welcome and something business has called for to ensure a more sustainable increase in the business rates multiplier.[9] We encourage the Scottish Government to make clear the switch is for the long-term. Another key priority should be to bring the Large Business Supplement into parity with England as the higher rate can make Scotland less attractive to international investment, particularly when that investment includes the acquisition of commercial property.

The Scottish Government should avoid introducing additional complexity and halt plans to impose additional levies through business rates on out-of-town businesses. CBI Scotland has made clear in our consultation response that such an additional local levy would risk hitting a range of local businesses across Scotland and create more complexity, unpredictability and cost to businesses that are already working hard to contribute to their local communities.[10]

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[6] CBI, Brexit business preparedness survey, October 2018

[7] Other factors removed were the decline in the UK's manufacturing base and measurement issues for intangible investment

[8] CBI, *Catching the Peloton: The business investment race and how the tax system can help the UK to catch-up*, August 2018

[9] CBI Scotland response, *Barclay Review of Business Rates*, October 2016

[10] CBI Scotland consultation response, *Barclay review implementation*, September 2018

Medium-term

Give business certainty by committing to no further changes on income tax levels

With Scottish household finances squeezed and consumer sentiment continuing to expect a weakening in the economy[11], the Scottish Government should use the opportunity of the Scottish Budget to provide certainty and commit to no further changes to income tax levels. While income tax will be the most significant source of funding for public services, it is also an important determinant of economic activity through its impact on consumer spending. The Scottish Government need to use the levers at its disposal to help wage growth and not dampen it further.

As in the UK, real wage growth in Scotland is weak, with real wages lower than they were a decade ago. There is an expectation that real wages will pick up slightly as inflation starts to fall back and wage pressures start to increase. The latest quarterly economic indicator highlights increasing recruitment difficulties for a number of firms across sectors of the economy, with retail, manufacturing and construction most impacted. As a result, firms are considering increasing wages, with just over 40% of firms looking to do so this quarter.[12] But these effects are likely to be limited, with consumer spending still expected to remain under pressure. With such a backdrop, we would encourage the Scottish Government to help support wage growth by committing to no further changes on income tax levels and prioritising widening the tax base, rather than potentially dampening it further.

One of the key determinants of wage growth is productivity. The Scottish Government has recognised the importance of productivity to the Scottish economy with its target to rank in the top quartile for productivity against OECD competitors.[13] Since the financial crisis (2008-2016), annual growth in Scottish productivity (output per hour) has averaged 0.9%, compared to 1.5% over the period 1999-2007.[14] This weakness in productivity ultimately limits our ability to generate wage growth without generating inflation, demonstrating the importance of boosting Scottish productivity.

Long-term

Use SNIB to encourage greater patient capital investment by pension funds to support infrastructure development

The Scottish National Investment Bank could have an important role in providing a clear sense of direction for the Scottish economy and give confidence to businesses and investors developing their plans for the coming years. There is a real need for patient capital to upgrade infrastructure, invest in science, research and innovation; and support businesses to start and grow to boost Scotland's competitiveness.

The development of the Bank is an opportunity to consider how the Scottish Government could encourage greater patient capital investment by pension funds to support infrastructure development in the long-term. CBI research highlights that continued investment is needed across the country, with only 23% of businesses satisfied with the infrastructure in Scotland.[15] Government investment can crowd private investment into patient capital if it is seen to signal good potential investments, supporting the development of major infrastructure projects that can help lift productivity.

The Bank could play a strategic role in engaging with the investment community to improve the flow of private capital into the next generation of priority infrastructure projects. Connectivity infrastructure, both transport and digital, is fundamental to future economic growth and business welcome a focus on infrastructure investment in light of the broader economic return it can deliver.

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[11] Scottish Government, State of the Economy: June 2018
[12] Scottish Chamber of Commerce, Quarterly Economic Indicator Q2 2018, July 2018
[13] https://www.gov.scot/About/Performance/scotPerforms/purposetargets/productivity#Chart
[14] Output per hour worked, Scottish Labour Productivity 1998-2017 Quarter 3 - 14 February 2018
[15] CBI-AECOM Infrastructure Survey, *Foundations for growth*, November 2017

Boosting productivity is a shared challenge

Improving Scotland's overall productivity performance will grow the economy and raise living standards**.** While we have caught up with the rest of the UK, we still trail international competitors on productivity. This is a shared challenge with no silver bullet – and requires business and government to work in partnership to address it across areas such as exports, investment, infrastructure and skills.

Creating the conditions in which businesses of all sizes and sectors can prosper is essential to generating the jobs and revenue needed to fund high-quality public services, and this begins with productivity. With the outlook for the Scottish economy subdued and Brexit-related uncertainty constraining growth in business investment, it is more important than ever to provide a clear sense of direction for the Scottish economy and give confidence to businesses and investors developing their plans for the coming years.

Since the publication of the report *Pursuing Prosperity*, analysing regional differences in productivity[16], CBI Scotland has focused on practical steps business can take to improve their own performance. Working with Strathclyde Business School and the 'Be the Business' initiative, CBI Scotland has highlighted ways to improve productivity to SMEs in Scotland.[17] Similarly, focus has been on how to encourage existing exporters to increase their ambitions, existing technologies firms can adopt now[18] and how businesses can do more to engage directly with schools[19].

Short-term

Work with business to increase exports by building on the strength of existing exporters and financially support them to increase efforts

Exposing firms to the competitive pressures of international markets not only forces them to become more competitive, it also encourages them to be more innovative – ultimately improving productivity and growing the economy.[20] Currently, approximately 70 companies are responsible for around half of Scotland's exports.[21] We need to increase this number if we want to see a more prosperous and productive Scotland.

CBI Scotland has welcomed the Scottish Government's commitment to increasing Scotland's exports as outlined in the Programme for Government through the new 'Trading Nation' export plan, and the commitment to working with business to achieve it.[22]

Overall, CBI Scotland believes that the exporting recommendations and ambitions set out in the Programme for Government are positive and a step in the right direction. However, as ever the devil is in the detail, and the Scottish Government must now work with business to drive this forward. We cannot stand still, and swift progress should be made by government to develop the export plan in collaboration with business, and start the intensive support, which includes finance support and business mentorship, as soon as possible.

Medium-term

Challenge businesses to invest in innovation by committing to an ambitious joint target for public and private R&D spend to reach 3% of GDP

Innovation is a key driver of productivity and central to our economic, social and cultural development. Addressing some of the key societal challenges we face, such as the transition to a low carbon economy and

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[16] CBI Scotland, *Pursuing Prosperity: Why regional productivity growth matters for Scotland's future*, June 2017
[17] SME Business Insight Conference: Productivity Through People – Scotland, Glasgow, 13 September 2018
[18] CBI, *From Ostrich to Magpie: Increasing business take-up of proven ideas and technologies*, November 2017
[19] CBI Scotland due to publish guide for Scottish business on interaction with schools, December 2018
[20] CBI Scotland, *Pursuing Prosperity: Why regional productivity growth matters for Scotland's future*, June 2017
[21] Scottish Government, Global Connections Survey
[22] http://www.cbi.org.uk/news/cbi-scotland-respond-to-the-programme-for-government/

rebooting productivity growth, will only be achieved by increasing collaboration on innovation between business, government and our universities.

However, Scotland's R&D performance lags behind the UK and the OECD. Looking at business investment specifically, Scotland ranked eighth of the twelve countries/regions of the UK. In total, Scotland's investment in research and development accounted just 1.5% of GDP in 2016, compared to the UK average of 1.7% and the OECD average of 2.4%.[23]

Setting an ambitious joint target for public and private R&D spend is an opportunity for Scotland to lay down a marker of intent to drive a step change in its R&D performance. It would emphasise the importance of collaboration to tackle shared challenges, send a clear signal to business that Scotland is the place to invest in R&D and present an opportunity for Scotland to lead the way as a forward-thinking, innovative nation.

Long-term

Help business support more women back to work through more flexible childcare support in the first years from childbirth

Businesses want to be able to draw on the whole talent pool of Scotland and too often women are underrepresented in senior positions. Childcare costs have a big impact on household budgets and career choices, often limiting the scope of parents returning to work and holding back career ambitions of young people and particularly women.

Business has long called for support to parents in order to make childcare affordable.[24] While the Scottish Government has made important strides to do that through increasing free childcare hours for 3 and 4-year olds, CBI Scotland would encourage a focus on how flexibility can be applied to help close the gap between maternity leave and the return to work.

Employers have a responsibility to support parents, and particularly women, returning to work after having children. Equally, the government can help ease the transition by offering more flexibility in the use of free childcare hours. By giving parents the choice of using their 30 free hours of childcare per week starting when they return to work after maternity leave, the Scottish Government could assist young families who are facing high childcare costs and the difficult choice of returning to work once 52 weeks maternity leave has ended. The introduction of flexibility to free childcare hours would give families the ability to use government supported hours when it is most needed and for many that will be in that crucial time when the woman is due to return to work after maternity leave.

[23] Growth Expenditure on Research and Development Scotland 2016, Scottish Government, March 2018
[24] CBI Scotland, *Accelerating our Ambitions: A business vision to drive success in Scotland*, October 2015

Summary of recommendations

	Short-term: Next year	Medium-term: During this parliament	Long-term: Over the next decade
SKILLS	Double the Flexible Workforce Development Fund and allow greater flexibility of delivery to support upskilling of current workforce.	Work with business to highlight the importance of ensuring the post-Brexit UK immigration system works for the Scottish economy.	Commit long-term resource to the National Retraining Partnership to help businesses and workers prepare for technological change.
INVESTMENT	Halt plans to impose additional levies through non-domestic rates on out-of-town businesses.	Give business certainty by committing to no further changes on income tax levels.	Use the Scottish National Investment Bank to encourage greater patient capital investment by pension funds to support infrastructure development.
PRODUCTIVITY	Work with business to increase exports by building on the strength of existing exporters and financially support them to increase efforts.	Challenge businesses to invest in innovation by committing to an ambitious joint target for public and private R&D spend to reach 3% of GDP.	Help business support more women back to work through more flexible childcare support in the first years from childbirth.

CBI Scotland, October 2018