Presentation to Scotland's Futures Forum
15 June 2018
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A SUSTAINABLE FUTURE FOR SCOTLAND'S PUBLIC FINANCES: PANEL CONTRIBUTION

Good morning. I'm really pleased to be part of this event.

As a founding director of Scotland's Futures Forum, it's gratifying to see it focussed on such an important topic……working with the Finance and Constitution Committee which holds my Fiscal Commission to account.

And, as a Fellow of the RSE, it's great to see those two bodies joining forces *here* – all good.

Now, someone has to raise the World Cup today, so, unlikely as it might seem, I thought I'd do it.

The *Economist* magazine recently modelled why some nations regularly qualify for the World Cup…..and others not…….noting that everyone's hopeful but *many* never get there.

They measured such things as how many children play football, investment in facilities, relevant google searches and so on.

And, as you'd expect, they found a correlation between wealth, size and interest with qualifying…..but only in relation to 40% of the quaifiers.

So they also looked at the outliers, the exceptions…… at the countries which are successful *without* some of these factors…….they did some more analysis and then made some judgements.

When you think about it, this isn't too far away from what economic forecasters do.

The Scottish Fiscal Commission, working *independently*, provides the *official* forecasts to inform much of the Scottish budget.

I want to say something about how we go about our work……and what it's telling us just now.

The publication of the Government's Fiscal Outlook……*and* our *own* forecasts just over a fortnight ago……mark an important point in the evolution of the Scottish Budget process, which is now spread throughout the entire year.

Like others, the Commission is supportive of the changes to the Budget process and we look forward to playing our part as it continues to develop.

This was our second set of forecasts and, as you might expect, some of our judgements evolved since our first report last December.

This is of course a natural part of forecasting.

As new information, analysis, advice, come to light, it's proper that we develop our forecasts to reflect what's new.

We're as transparent as possible about *how* our judgements have changed…….and *why*……and we welcome debate and challenge….even if that leads to more change.

Forecasting is an iterative process of intelligence-gathering, learning from previous forecasts, reflection and refinement.

Testing conventional wisdom……looking at outliers.

We draw *widely* on expertise and insight when making our judgements.

Despite *all* that hard work, our understanding of the economy will inevitably be imperfect, and of course, we're not alone in this.

We know that events unfold in unexpected ways…….and that the data we use will be revised over time.

Our job is to make the best possible forecasts with the information we have available at a given *point* in time.

In addition to what we're now calling our winter and summer forecasts, each September, we'll bring out a report that evaluates the accuracy of our previous forecasts, and comments on how our models are performing……..

And, based on this evaluation, we'll review and refine our approaches……. again..….transparently.

To the extent possible, we use Scottish data……new territory for us all.

This July, for instance, will see the publication of the *first* administrative outturn data for Scottish income tax………we'll analyse those data by September…..and consider what that could mean for our Budget forecast come December.

But what does the forecast look like *now*? *Last* December……we described the outlook for growth as subdued.

Our view of the overall outlook is broadly unchanged since then.

Someone asked me the other day for the *good* news in our forecasts.

Well, the economy *is* growing and that's surely better than the opposite…..it's just that the *rate* of economic growth has been slower over the last decade than historic average rates.
Also, unemployment's expected to remain low, with employment continuing to increase over the next five years – that's good news for people who are capable and want to work.

Not quite so good, however, if the country is operating near capacity, and you're a business wanting to expand and looking for additional people to hire.

But, for various other reasons, our view remains that an overall pattern of slower growth is likely to persist over the next five years.

Poor productivity growth, *and* a declining population aged 16 to 64, are the *most* significant factors, although Brexit also contributes to this outlook.

Now conventional wisdom tells us that real wages – that's what you can buy after inflation is stripped out – would move in *line* with productivity over the long term.

However, the evidence suggests that real wage growth over the last ten years has been *weaker* than would be *expected*……in relation to productivity growth……

And, more recently, to the relatively tight labour market.

Our conclusion is that other factors have been holding back wage growth.

Some of them uncertainties, some of which may be temporary, faced by businesses.

But others, such as a loss of high-skill, high pay jobs, such as we've seen in the oil and gas sector, are more structural.

As a result of our analysis, we dampened the link *between* productivity and real wages…….and that resulted in a reduction in our real wage forecast.

Real wages are now anticipated to *fall* by 0.5 per cent this year, before gradually levelling off in 2019 and then starting to grow slowly from 2020 onwards.

As a consequence of the revision to this outlook for wages, our income tax forecast was revised down from our previous one, by £209 million in 2018-19, or 1.7 per cent of total liabilities.

These iterations are all part of the natural evolution of forecasts.

In some cases, refinements to a forecast result from the availability of new data, as with the case for our productivity forecasts.

In the case of our forecast of real wages, however, the refinement was principally the result of new *analysis*……and an evolution in our judgements following that analysis, rather than any *single* piece of new data.

People have been keen to understand the drivers for the changes in our wage forecasts.

We've provided *that* analysis in our report which is available on our website, but I'll say a bit just now.

In part, our updated outlook for real wages reflects broader judgements about how the labour market is changing.

It's possible that, with a low supply of available labour, businesses looking to expand will invest in new capital instead.

This would raise overall production and income, but the *additional* income would flow to the business owners in the form of profits and dividends………rather than to employees as wages.

So, while total income and GDP may go up, the amount flowing to employees would remain relatively flat.

This is what we've begun to observe and what our forecast reflects…….though it's not eyt something to which we've given *significant* weight.

Nevertheless, in the early part of our forecast, we have a small shift in the overall distribution of income from employees to business owners…….

And this is what allows for the downward revision in real wage growth while total income growth, or GDP, stays relatively unchanged.

Our report also contains detailed forecasts for receipts of the full range of devolved taxes and devolved social security spending……..

Including our *first* costing of the Scottish Government's planned expansions in social security.

As and when the Government provides further details on the benefits to be devolved and *expanded*, we'll produce costings of those policies as well.

The *Economist* isn't predicting the winner of the World Cup, but it believes it has a handle on what countries might continue to qualify over the year. There or thereabouts.

But I suspect they wouldn't have come close to being able to predict that Scottish Cricket would beat England at their one-day international on Sunday.

Even with the best models in the world, there *are* surprises out there……and sometime they're even good.