



# **ABERDEEN ECONOMIC POLICY PANEL REPORT SUMMARY**

**2 NOVEMBER 2018**

## Economic Policy Panel Report Summary

1. The aim of the report is to provide an independent analysis of the Aberdeen City Region economy to support the Council's annual credit rating assessment by Moody's. This is a requirement of the Council's £370m bond issue to support its capital plan.

### The outlook for the Aberdeen City Region Economy is becoming more positive

2. Although the IMF revised its global growth forecasts down slightly in October 2018, growth is now expected at 3.7% in 2018 and 2019, and the steady expansion under way since mid-2016 is set to continue. However, the IMF states that downside risks to global growth have risen in the past six months, with particular concerns about rising trade tensions. For the United Kingdom, the IMF projects growth to slow to 1.4% in 2018 and 1.5% in 2019 (from 1.7% in 2017).
3. Despite the increased risks clouding the global economic outlook, the overall picture for the North East economy is one where it is emerging from a difficult economic period, precipitated by the fall in, and fluctuating, global oil prices, with the potential to a return to moderate growth in the coming years.
4. The Panel heard a consistent account during its fact-finding visits from representatives from across the North East economy of cautious optimism and signs that economic conditions were gradually improving. This assessment is supported by the latest data on the performance of the North East economy. In particular, the oil price has averaged \$71 in 2018 so far, compared with \$54 in 2017.

Figure ES1: The Fluctuating Price of a Barrel of Oil Equivalent in US \$ 2013-2018



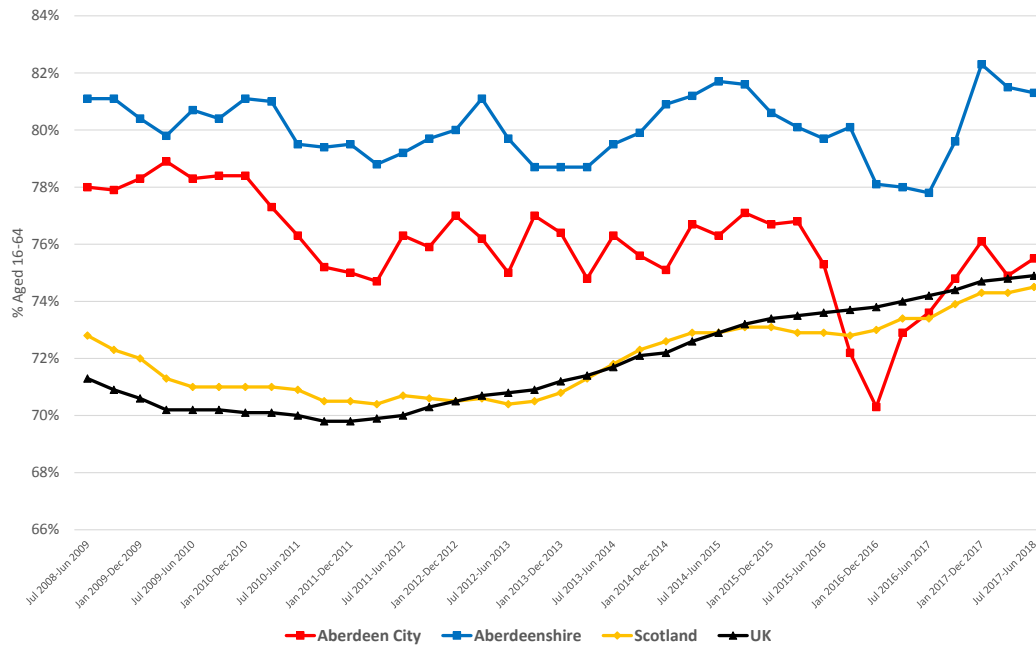
Source: Markets Insider <https://markets.businessinsider.com/commodities/oil-price?type=wti>

5. Oil and Gas UK forecasts predict that capital investment in the UK oil and gas sector will be relatively stable for the rest of the decade, after sharp falls during the downturn. Latest survey data (May 2018) from contractors in the sector also shows increasing levels of business confidence and activity into 2018, with the highest confidence reported since May 2013. More contractors also expect to increase investment (51%) than reduce (8%), while slightly more than a quarter of contractors are forecasting no change to their investment spend.
6. There are also emerging signs of improvement in the labour market with employment rates in Aberdeen City and Aberdeenshire recovering between 2016 to 2018 from 70% to 76%, and 78% to 80% respectively.



- 7. Unemployment rates have also fallen recently from 5.4% to 4.3%, and 3.8% to 2.9% respectively over the same period.

Figure ES2: Aberdeen City, Aberdeenshire, Scotland and UK Employment Rate (2008-2018)

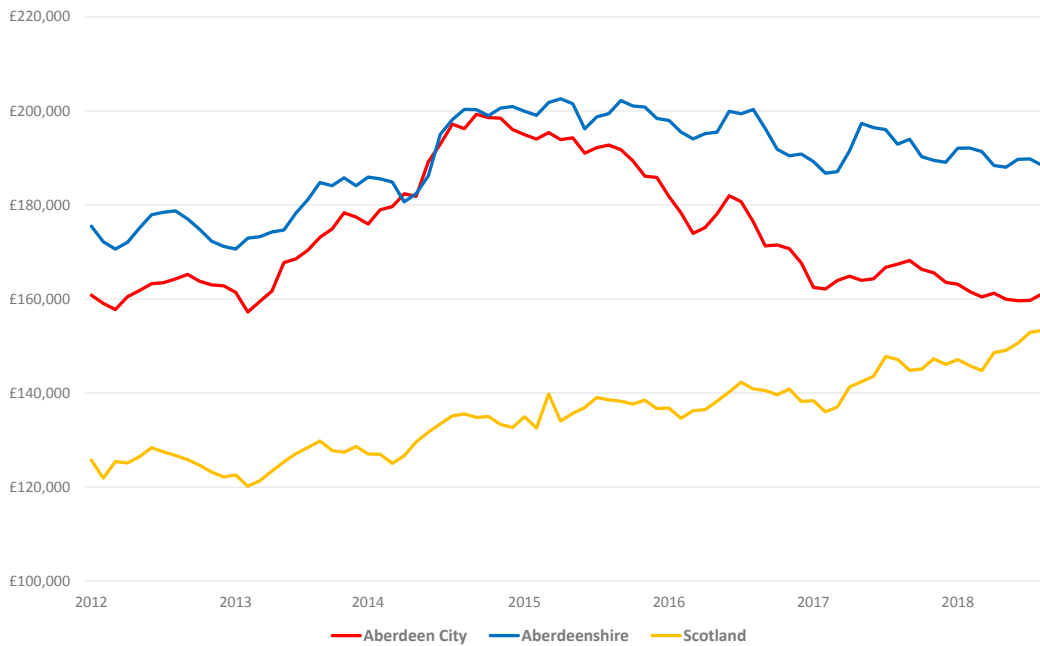


Source: Office for National Statistics. Annual Population Survey.

- 8. The UK offshore oil and gas industry supports more than 282,700 jobs in 2018, up slightly from 280,000 in 2017<sup>1</sup>. It is the first rise in the sector’s overall employment since the downturn in 2014.
- 9. Some stability appears to be returning to the local property market. Average monthly house prices in Aberdeen and Aberdeenshire had declined since 2014, but in 2018 the house prices in both local authority areas have been broadly flat, suggesting the decline in house prices may have bottomed out.

<sup>1</sup> Oil and Gas UK, 2018.

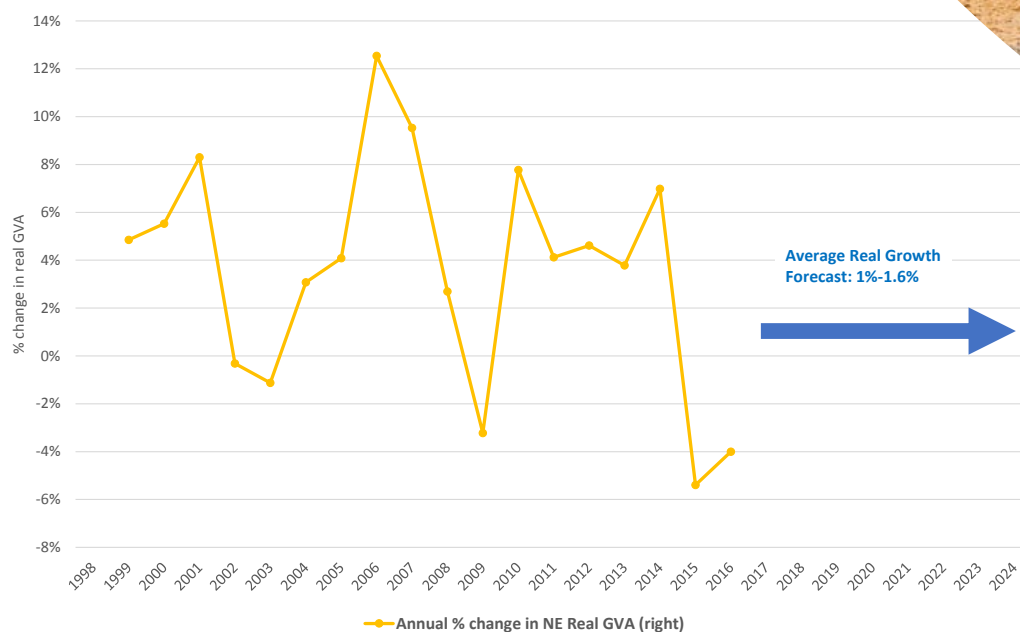
Figure ES3: Average Monthly House Price in the Region



Source: Registers of Scotland. Monthly House Price Index.

10. The commercial office space vacancy rate in Aberdeen reached a historic high with 14.6% of available office space unoccupied in Q4 2017, but has since fallen to 12.0% in Q2 2018, indicating more recent take-up.
11. Business birth rates started to increase in the region in 2016 after two successive years of decline. In 2016, the business birth rate in Aberdeen and Aberdeenshire was 59 and 56 new enterprises per 10,000 adult population respectively, compared to the Scottish national average of 50. Despite some increase in the number of business closures, five-year business survival rates remain significantly higher in the North East than Scotland and the UK.
12. Average hotel room rates have stabilised after a difficult period, falling to about £63 per room in 2017 from about £85 in 2015. Occupancy rates have remained relatively stable at about 63%-66%.
13. The latest independent growth forecasts (Oxford Economics, EY Item Club, Mackay Consultants) show that the North East economy is expected to have returned to growth in 2017 and average growth is forecast to be around 1% to 1.5% per annum until 2020. Growth in Scotland is forecast to be between 0.85% and 1.7% until 2020 and in the UK the range is 1.4% to 2.0%.

Figure ES4: Real North East GVA Annual Change 2017+  
(Data is Combined Forecasts\*)

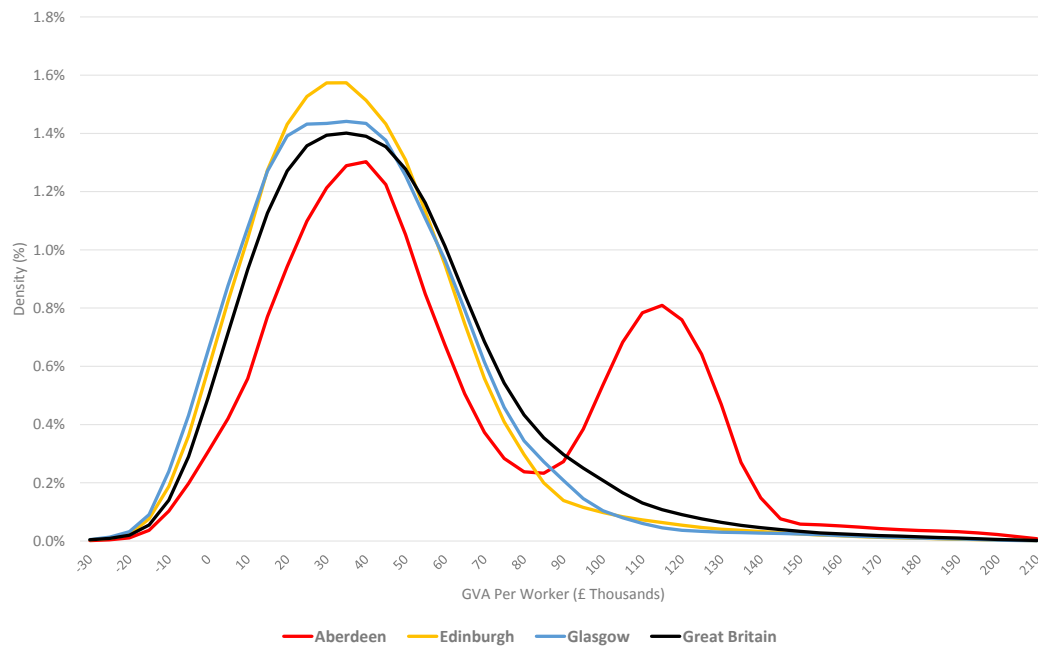


Source: Office for National Statistics; \*Forecasts - Oxford Economics, EY Item Club, Mackay Consultants  
\*2016 Constant Prices

**This indicates that the fundamentals of the Aberdeen economy remain strong**

- 14. GVA per head in Aberdeen remains the highest in Scotland and GVA per head in Aberdeenshire is fifth highest out of 32 Scottish local authorities.
- 15. 2016 nominal GVA per hour worked for Aberdeen and Aberdeenshire was £36.30, compared to £32.38 for Scotland and £32.58 for the UK. This high productivity is driven by the oil and gas sector and means Aberdeen has a different productivity distribution than other regions of Scotland and the UK.
- 16. Aberdeen has a far higher proportion of workers with a GVA contribution of between £110,000 and £120,000. Regions such as Glasgow and Edinburgh have a higher proportion of workers with a GVA contribution of approximately £20,000 to £50,000 than Aberdeen, although they have a far lower proportion of workers with a higher GVA contribution, indicating the productivity of the North East region.
- 17. The Aberdeen City Region had a larger proportion of workers with a GVA contribution above £100,000 than all other UK regions, demonstrating the high value-adding contribution from the energy sector.

Figure ES5: Distribution of Firm Level Productivity in the Aberdeen City Region



Source: Office for National Statistics. *Regions and City Region Firm-level Productivity Distribution Analysis for the Non-Financial Business Economy 2017*

18. In 2017, workplace-based median gross hourly pay for full-time employees in Aberdeen was £15.33 (second highest in any local authority in Scotland) and in Aberdeenshire was £12.27, compared to the Scottish average of £13.98 and the UK average of £14.00.
19. The region consistently continues to perform strongly in export markets, with about 21% of the value of Scottish exports coming from the North East and an established trend of attracting inward investment into the region.
20. The region hosts a significant number of the Scottish Government's growth sectors, including food and drink, tourism, life sciences and renewable energy.

**Although recent trends in the local economy have been more positive and the fundamentals outlined above remain strong, there is a number of challenges facing the Aberdeen economy, as is the case for Scotland, the UK and many other advanced economies.**



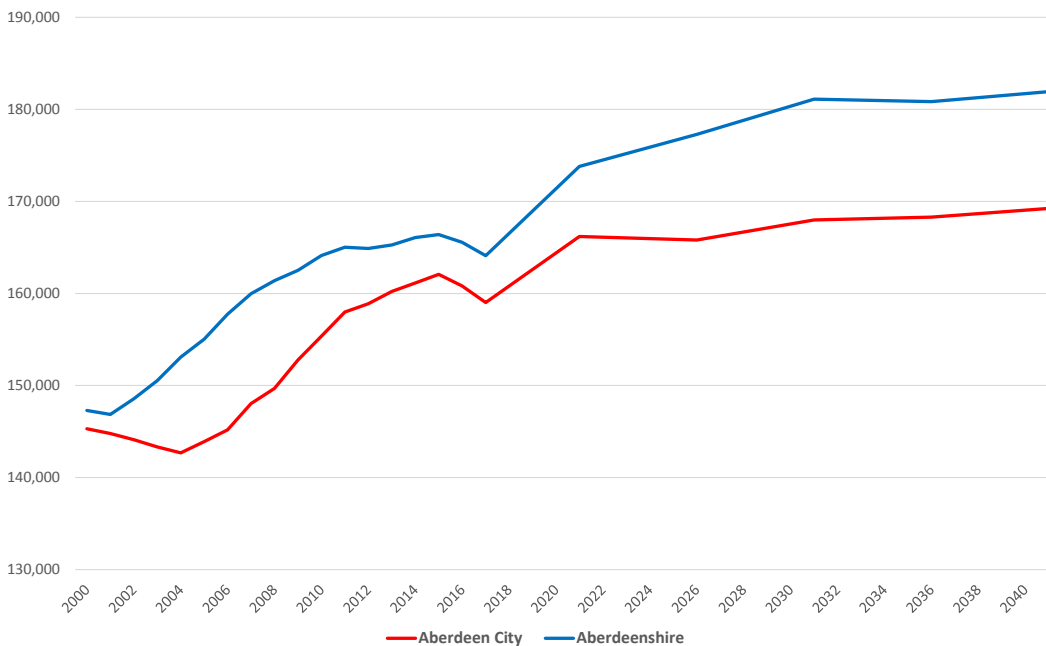
## Brexit

21. Brexit poses a number of challenges which may impact on business confidence and investment. These challenges are across sectors and include uncertainty around the ability to recruit EU nationals and future access to EU markets for imports and exports.
22. This uncertainty could see increased volatility in economic data as firms bring forward activity, such as stock purchases, to hedge against disruptions in supply chains, or invest to consolidate their supplies. With respect to employment, this may see increased automation or upward pressure on wages.

## An Ageing Population

23. Like the rest of the UK and Scotland, the North East is projected to have an increasingly ageing population in future decades. The number of people living in Scotland of pension age and over is projected to rise by 25.1% by 2041. In Aberdeen this rise is projected to be 12.5%, while in Aberdeenshire it is projected to be 28.7%. The rise is particularly pronounced among the over 75s. There are two key challenges that this demographic profile brings:
  - The demand for health and social care in later life could rise significantly, which has future implications for both the supply of health and social care and the need for social carers in the North East;
  - The growth in the working age population will slow in future years. This will have the potential to act as a drag on future growth prospects unless it can be compensated for by increased participation of those in the older age groups and/or by increased productivity.

Figure ES6: Working Age Population increases will Slow in Future Years



Source: National Records of Scotland. Mid-Year Population Estimates 2017; Sub-National Population Projections.



*'Poised' Marischal Square, Aberdeen*

*Credit: Muse Developments*



## Technological Change

24. The Centre for Cities has estimated the employment implications for UK cities from technological change reducing demand for some occupations and increasing it for others. Generally those jobs that are made up of routine tasks are at a greater risk of decline, whereas those occupations requiring interpersonal and cognitive skills are well placed to grow. Overall, one in five jobs in cities across the UK is in an occupation that is very likely to shrink by 2030.
25. This means that the labour market will continue to evolve; new occupations will arise and some occupations that already exist will become increasingly important. The Centre for Cities report finds that half of the jobs very likely to experience an increase in demand are in the public sector.
26. The Centre for Cities suggests the policy response to the changing nature of work in recent decades has not prepared those people and places most affected by these changes to adapt to them. Policy needs to focus on giving people the skills required to fill the non-routine occupations that have become, and will continue to be, increasingly common. An important part of this will be to provide them with the skills they need to be successful in a labour market that is likely to be ever more dominated by non-routine work.

## Productivity

27. Since the 2008 financial crisis, productivity growth across the G7 countries has been much lower than previously. However, the UK's productivity fall was steeper and its rebound weaker than in comparator countries.
28. It has been difficult to assess the factors that have contributed to the UK's weak productivity performance since the financial crisis. Possible contributing factors have been low capital investment, low skill levels, the high employment rate (and firms hoarding labour as a result), low interest rates (which may have kept some of the least efficient companies afloat) and weaker diffusion of knowledge and practice between firms and problems with measuring productivity, particularly in service companies.
29. Brexit could further hinder Britain's economy. The Office for Budget Responsibility (OBR) noted that while there isn't any meaningful basis on which to predict the outcome of the negotiations over the relationship between the UK and the EU after Brexit for economic forecasting, the economy appears to have weakened since the EU referendum vote. The fall in the pound has squeezed real household incomes and consumption, while providing only a modest boost to net trade. The average quarterly growth rate has slowed from 0.6% between 2013 and 2015 to 0.4% since the beginning of 2016<sup>2</sup>.
30. In the North East of Scotland, productivity has consistently been above the UK average and among the highest of all Scottish regions. The productivity distribution in Aberdeen, outlined in Figure ES5 above, and the future challenges to the oil and gas sector mean that the North East also faces a challenge to raise productivity to the extent required to generate the inclusive and sustainable economic growth at the heart of the Regional Economic Strategy (RES)<sup>3</sup>.

<sup>2</sup> <https://cdn.obr.uk/ExecutiveSummary.pdf>

<sup>3</sup> [https://www.aberdeencity.gov.uk/sites/default/files/Regional\\_Economic\\_Strategy\\_0.pdf](https://www.aberdeencity.gov.uk/sites/default/files/Regional_Economic_Strategy_0.pdf)



### The future of oil and gas/diversification

31. The cornerstone of the North East economy in recent decades has been the oil and gas sector. The sector is diverse and covers a wide range of activities. However, the region cannot rely on the oil and gas industry to deliver the same scale of benefits into the future, as UK oil production is expected to enter a period of decline in the 2020s. The ambition of the RES is to ultimately diversify the North East economy away from oil and gas in particular and towards the North East growth sectors.
32. If the Aberdeen economy is to diversify successfully in the long-term, in a way that supports productivity improvements and economic growth, then it will be critical that new activity in the growth sectors and/or other sectors on focused in high value-added activity. This is particularly vital to diversify away from a sector like oil and gas, which is very high value added and underpins the high productivity of the economy. The analysis in this report shows that productivity in some of the growth sectors in Aberdeen is below the average for the region, emphasising the need for the focus on high value-added activity within these sectors.

### Inclusive Economic Growth

33. Enabling as many people as possible to contribute to and benefit from growth brings additional challenges across the UK and in the North East. Despite the relative economic success there are considerable levels of deprivation in the North East. The Inclusive Growth Commission highlights that the required policy response includes: the creation of new institutions to connect business and industry, schools, training providers and universities; that cities become places of life-long learning; and mainstreaming inclusive growth in all public investments including physical infrastructure projects.

### Inward Investment

34. Ensuring the city and region retain existing and attract new inward investment is paramount to ensuring a vibrant, inclusive, sustainable, productive and diversified economy that develops and retains its skilled labour. This is core to the RES and City Region Deal and requires continued resources and development of the strategic approach to ensure Aberdeen can attract its share of this mobile and institutional investment.

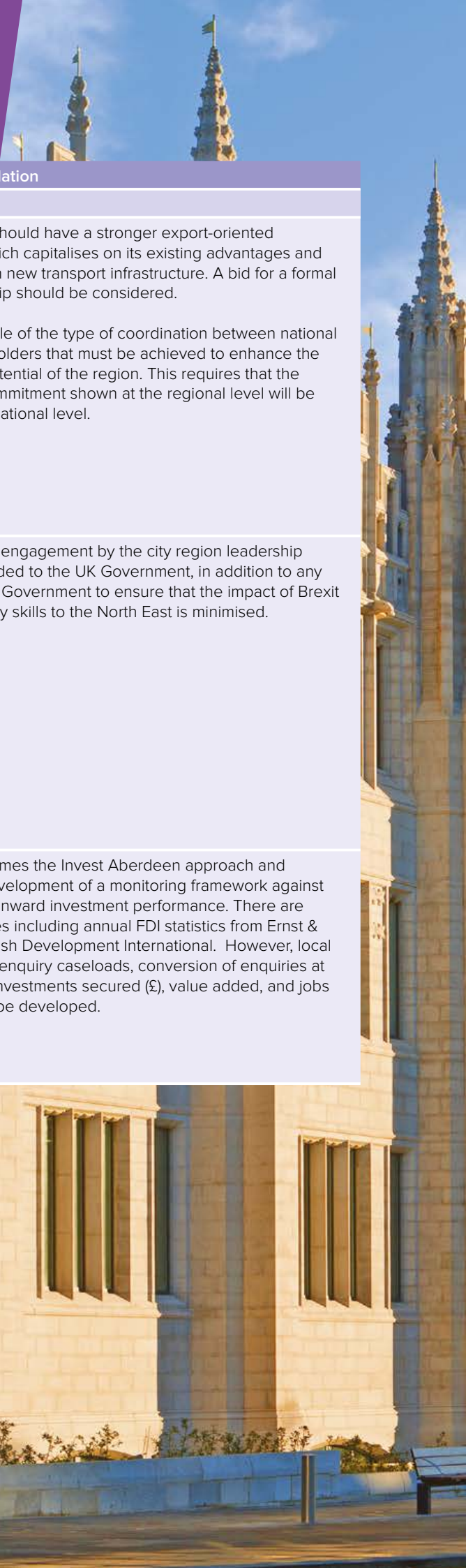
### Responding to the challenges

35. The significant economic challenges going forward mean the region must focus on raising productivity across all sectors, including outside the oil and gas sector, to maximise the opportunities for future economic growth that can be both sustainable and inclusive.
36. This challenge has already been recognised in the Regional Economic Strategy agreed by Aberdeen City Council, Aberdeenshire Council and Opportunity North East (ONE). The RES demonstrates the commitment between the two local authorities and ONE to working with all partners across industry, local and national government and the third sector to ensure that the North East continues to build on its economic success. The strength of this commitment and joined-up nature across local government, industry sectors and other stakeholders was notable during the Panel's factfinding visits. The 20-year vision is supported by a range of programmes to regenerate the North East economy, including the City Region Deal, City Centre Masterplan and major infrastructure projects.
37. The Panel welcomes both the ambition and direction of the Regional Economic Strategy, the recently refreshed and accompanying 2018-23 Action Plan and the range of programmes covering investment in infrastructure, innovation, inclusive economic growth and internationalisation. Building on this framework, the Panel recommends that the approach to productivity and regional economic growth is developed further as outlined in the recommendations overleaf.

**Table ES1 – Responding to the Challenges**

The position	The challenge	The recommendation
<b>Regional Economic Strategy</b>		
The Regional Economic Strategy provides the framework for a collaborative approach and diversification plan for the city and region.	Although there are significant oil and gas reserves, in the longer-term production will decline. There is a dependency on the sector in the short/medium terms.	The Panel endorses the overall approach and recommends the close monitoring of actual progress and implementation, and in particular a focus on raising productivity outside the oil and gas sector to maximise the opportunities for future inclusive growth.
The Panel welcomes the ambition and direction of the Regional Economic Strategy and the accompanying 2018-23 Action Plan Programme areas.	Success will depend on the successful implementation and delivery of the key initiatives.	<p>The Panel will monitor progress and make additional recommendations in future reports depending on how implementation progresses.</p> <p>To make it easier for the Panel to do so, it would be beneficial if the Regional Economic Strategy Action Plan could go further and set out the timeline and key measurable objectives for each action.</p> <p>The Panel recommends setting out an economic performance framework – The North East Economy Performs (similar to the Scottish Government’s National Performance Framework) which should include key economic indicators against which progress can be assessed covering economic, productivity, inclusive and sustainable growth. It should also include further analysis of the type of diversification that will be most conducive to achieving the RES objectives and how it will be monitored going forward.</p> <p>The Council should engage with the Centre for Regional Inclusive Growth to define inclusive growth metrics that can be monitored and reported on at the regional level as part of The North East Economy Performs Framework.</p>
<b>Infrastructure</b>		
The RES is being supported by a number of significant investments by the Councils and industry. These include current transport investments, The Event Complex Aberdeen, the City Region Deal, and the City Centre Masterplan.	<p>Infrastructure – delivery of major investments is, not unusually, lagging the local economic cycle.</p> <p>The coordination of major infrastructure decisions at the local and national level is not aligned.</p>	<p>The discussion around forming a strategic utilities or infrastructure group is welcome. This should be prioritised. That group, comprised of national and local infrastructure partners, must oversee a clear process for assessing the economic, social and environmental impacts of proposed projects and prioritising them accordingly.</p> <p>The Group should also be tasked with regional coordination, assessment and planning for the future infrastructure needs of the city and region, as well as identifying and working with stakeholders who will be critical to the delivery of the investment and leverage required.</p> <p>All infrastructure investments should be monitored through the Local Development Plan and the proposed The North East Economy Performs Framework.</p> <p>Progress on the digital programme within the Aberdeen City Region Deal is critical to the success of the Regional Economic Strategy and the Panel recommends continued close monitoring of progress through the proposed The North East Economy Performs Framework.</p> <p>The RES recognises that the region’s natural assets and clean environment must be safeguarded to support key sectors such as tourism, food, drink, agriculture and fisheries. This is consistent with the approach to maintain and enhance our natural capital in the Scottish Government’s Economic Strategy, but there is an opportunity for Aberdeen to take a lead by developing key actions for applying these principles at the regional level and monitoring them through the proposed The North East Economy Performs Framework.</p>

The position	The challenge	The recommendation
Housing, a key strand of economic growth policy, is not as embedded into the economic planning of the city as it should be.	A region-wide housing strategy and action plan is another aspect which is fundamental to laying strong foundations for sustainable and inclusive growth.	The commitment to develop a housing strategy and action plan should be actioned for 2019 annual reporting overseen by a strategic governance group.
<b>Innovation</b>		
R&D spend levels are among the highest in Scotland, and innovation is a major strand of the City Region Deal.	Successful places are ensuring that barriers to innovation are identified and addressed for businesses across all sectors. The benefits of the investments made by the city region and the two universities need to transfer to other sectors.	The Panel suggests that the delivery of Scottish Government Economic Action Plan proposals for piloting Productivity Clubs are implemented in the city region. Any further barriers to innovation in the regional economy should be identified and addressed for businesses across all sectors, considering such issues as availability of key skills and finance, the spread of knowledge and technology within the local economy, how businesses learn from global best practice in leading international businesses and maximising the opportunities for knowledge transfer.
<b>Inclusive Economic Growth</b>		
There is a focus on inclusive economic growth in the RES, which is welcome. However, it is not as embedded in wider plans.	Skills Development Scotland (SDS) needs to ensure that key actions in the Regional Skills Strategy are accounted for across partners.	<p>The skills challenges identified in this report around Brexit, future technology/automation, the ageing society, and diversification should be addressed as part of the local skills action plan, which should have clear SMART objectives. This should include actions to raise management and leadership skills within the regional economy.</p> <p>The focus on a strategic and coordinated Developing the Young Workforce with reference to future employment opportunities in the Skills Strategy is endorsed, which is particularly important given the potential implications of Brexit for access to key skills and resources in the region.</p> <p>Overall, if inclusive growth outcomes are to be achieved, interventions need to be future-proofed against the changing nature of the labour market, notwithstanding any Brexit effects, as set out in the Centre for Cities report on the employment implications of technological changes, globalisation and demographic change. This must include building on the need for life-long learning and ensuring that education provision can adapt to changing trends and that opportunities are provided at the right time for people to train or retrain in the skills of the future.</p>
The region continues to perform well in terms of business start-up and survival rates.	Part of the city region's inward investment strategy will be to attract and grow new businesses. Part of this includes business births and ensuring their access to venture capital and support.	The Panel recommends that steps are taken to ensure that the combination of existing services from Scottish Enterprise, Business Gateway (Elevator) and ONE combine to support young businesses with high growth potential and facilitate productivity improvements across all business sectors.



The position	The challenge	The recommendation
<b>Internationalisation</b>		
<p>The city region makes a disproportionate positive contribution to UK and Scottish international trade.</p>	<p>Given the challenges posed by Brexit we believe that the export sector needs to be protected and enhanced in terms of its importance in the Regional Economic Strategy. Dialogue is ongoing between AGCC, as the lead partner, and the Scottish Government for funding to establish an export partnership in the North East of Scotland between AGCC, Aberdeen City Council, the universities and other partners.</p>	<p>The city region should have a stronger export-oriented collaboration which capitalises on its existing advantages and the investment in new transport infrastructure. A bid for a formal export partnership should be considered.</p> <p>This is an example of the type of coordination between national and local stakeholders that must be achieved to enhance the future growth potential of the region. This requires that the ambition and commitment shown at the regional level will be matched at the national level.</p>
<p>The report also highlights the important role played by people who come to the North East from within the EU.</p>	<p>The approach to internationalisation must also extend to ensure that the regional economy can continue post-Brexit to access the key skills it requires for future growth from outside the UK. It is vital that the case is clearly made at the local, national and UK level so that whatever Brexit deal is agreed there is minimum impact on the flow of key skills to the North East economy.</p>	<p>A programme of engagement by the city region leadership should be extended to the UK Government, in addition to any with the Scottish Government to ensure that the impact of Brexit on the flow of key skills to the North East is minimised.</p>
<p>Invest Aberdeen has been implemented during the review period.</p>	<p>The city region has, historically, not had to be as active as other city regions in attracting inward investment. That has now changed, as the need to attract a wider range of inward projects, from new sectors, and the institutional investment for the next phase of the City Centre Masterplan grows.</p>	<p>The Panel welcomes the Invest Aberdeen approach and recommends development of a monitoring framework against which to assess inward investment performance. There are existing measures including annual FDI statistics from Ernst &amp; Young and Scottish Development International. However, local metrics, such as enquiry caseloads, conversion of enquiries at various stages, investments secured (£), value added, and jobs created, should be developed.</p>



The position	The challenge	The recommendation
<p><b>General</b></p> <p>The region has consistently delivered a higher level of economic growth than other parts of the UK and Scotland, and is a globally competitive location. Achieving the level of investment to deliver its priorities could be enhanced by further devolution of powers locally.</p>	<p>This report confirms that some challenges the North East region faces are specific to the local economy (such as the trends in future oil production/price). Under such circumstances a one-size-fits-all approach to economic policy is not going to be optimum and could risk undermining economic performance at the local and national level.</p> <p>The Aberdeen City Region Deal is the starting point of a long-term improvement programme to build further growth into the regional economy. However, the focus of this programme is on delivery of transformational economic projects and not specific powers or fiscal levers. Additional mechanisms are needed, beyond capital investment, to deliver the regional economic objectives.</p> <p>The Panel notes the ongoing discussion around the introduction of a tourism levy in Scotland. This is just one way in which greater flexibility could be created in economic policy at the local level. Others that could also be considered are Non-Domestic Rates, Air Passenger Duty and powers to vary Council Tax.</p>	<p>It is the Panel's view that greater flexibility to allow local authorities and other stakeholders to adjust policy at the local level to meet different economic trends, priorities and challenges would be beneficial at the local and national level.</p> <p>The Panel recommends that Aberdeen City Council encourages the Scottish Government to take the lead in generating a national discussion as to how greater autonomy in economic policy could be created in a way that will improve economic outcomes at the local and national level. The significant economic challenges facing the regional and national economies in the years ahead, outlined in this report, emphasise the need for a more innovative, flexible and bottom-up approach to developing economic policy in Scotland.</p>

