

Understanding the Skills Implications of Brexit

1. Introduction and Background

Just over one year ago, on 23 June 2016, the UK Government held a referendum to remain or leave the European Union (EU). The UK chose to leave the EU after membership of 24 years. Article 50 of the Treaty of Lisbon, the official process to leave the EU, was triggered on 23 March 2017. Formal Brexit negotiations began on 19 June 2017. The UK has until April 2019 to discuss and formally agree the procedure of leaving the EU.

At the time of writing, it is important to note that there is no certainty in what the outcome of the Brexit negotiations will be. The Brexit negotiations have begun against the backdrop of several unanswered questions including the rights of EU migrants to live and work in the UK, future trade options with EU members and the impact on ongoing and new inward investment. This uncertainty makes it difficult for individuals, businesses, and public sector agencies to prepare for the future. Working within an uncertain environment is and will continue to be an issue for those in the skills planning environment.

The Brexit decision also cannot be viewed in isolation but should be considered in the context of a range of other economic, labour market and policy issues such as:

- An ageing workforce and a high employment rate, resulting in a tight labour market;
- Policy changes that affect costs to employers such as the introduction of the National Living Wage, the introduction of auto enrolment for employees into company pension schemes and the Apprenticeship Levy;
- Changes to working patterns – increase in zero hour contracts, self employment;
- The rise of automation and the potential for this to be accelerated in the face of a tight labour market and rising costs for employers; and
- Alignment of skills and the 5 stage planning model being developed by Scottish Government, SDS and SFC.

Within this climate of uncertainty, at the current time, SDS has taken a fairly 'light touch' on the Brexit issue which has included:

- The Evidence Base team, within the Skills Planning and Sector Development function, undertaking an ongoing literature review of emerging research, data and evidence; and
- We are represented on a national Brexit response group led by Scottish Enterprise. We are represented on the Strategic group and the sub groups on Research and Communications. This grouping is increasingly looking to SDS as a leader on labour market/skills implications.

Moving forward the Board will want to take a decision on the extent to which it prioritises further work in the Brexit field. Options include:

- **Do nothing – other than continue our work in monitoring research and participation in the Brexit response groups.** Whilst being light on resource implications this could carry a reputation risk when other partners are looking to SDS to offer leadership;
- **Do 'a lot' - Significantly invest resources to position SDS as leader.** Given the level of uncertainty within the Brexit discussions, it is proposed that this is not a sensible option. In any case, other partners have their part to play in this agenda;
- **Do 'a little more' – Based on the research undertaken to date, identify a small number of areas of focus for SDS itself, and for our work with partners.** It is recommended that this option is pursued. It shows SDS as a leader in the area but ensures our commitment and investment of resource is commensurate with the extent of uncertainty on Brexit implications.

This report outlines (1) emerging issues arising from a review of existing research (2) Proposed areas of focus for SDS and (3) Recommendations for ELG/the Board.

2. Issues Identification

Based on a review of research (References listed at end of report and Appendix 1 provides a full literature review), this paper outlines implications for three areas:

- The Economy;
- The Labour Market; and
- The Skills System.

2.1 The Economy

The review of evidence suggests there are four key issues that have the potential to impact on the economic performance.

Firstly, there is the potential **impact of new trade arrangement across sectors**. Some 125,000 jobs in Scotland were supported by trade with the EU in 2013¹ - accounting for 5.7% of the total workforce. Undoubtedly there will be **trade winners and losers** resulting from Brexit however at this moment there is limited data available at the Scottish level. The impact of new trade tariff regimes could impact in some economically significant sectors. At a UK level the top three sectors that will face the greatest absolute tariff increase² (in terms of value) are:³ Vehicles (£1,348m), Meat (£378m), Dairy produce (£331m). Focusing on the percentage of tariffs against value of UK exports, the highest average tariff estimates by sector are:

- Tobacco and the manufacture of tobacco products (43.7%);
- Preparation of meat or fish (39.9%); and
- Dairy produce (39.4%).

Secondly, the **establishment of new regulation regimes** is a particular challenge for the Financial Services and Life Sciences sectors (to name but two). As examples:

- If the UK leaves the European Drug Agency, will Scotland still be a viable location for companies involved in drug testing, development and production?
- Will Scottish banks and their subsidiaries be able to sell financial products across the EU?

Thirdly, **investor confidence** has been tested over the past 12-18 months since the announcement of an EU referendum, the referendum itself, and then a general election. In Scottish Enterprise's most recent report on economic trends (April-June 2017), Lloyds Bank Ltd's⁴ monthly survey details an increase in investor sentiment in recent months which may be aligned to devaluing of the pound sterling.

"61% of companies had the same outlook for the Scottish economy as in the previous six months with uncertainty continuing "

Scottish Enterprise, Economic Trends
April-June 2017

¹ <https://www.sbs.strath.ac.uk/economics/fraser/20170420/Exports-and-Employment-Scotland.pdf>

² The tariff (or customs duty) paid on goods imported to the EU is calculated by applying the tariff to the value of the good imported.

³ <http://www.civitas.org.uk/content/files/potentialpostbrexittariffcostsforeuuktrade.pdf>

⁴ <http://www.lloydsbankinggroup.com/media/press-releases/press-releases-2017/lloyds-bank/june-investor-sentiment-index/>

The **value of sterling** slumped to a 31 year low on currency market in light of the news that the UK had voted to leave the EU⁵. Over the past year, the pound has improved however has fluctuated in light of Brexit and the general election announcement.

Fourthly, the UK experienced an increase in **inward investment** in the UK as a percentage of GDP, from 31.4% in 2005 to a high of 55.6% in 2013. In recent years however, inward investment has fallen. A slight decrease was experienced in 2014 (54.3%) and inward investment has continued to decrease, dropping 9.9 percentage points from 2013 to 2016. It is unclear if the recent decrease in inward investment is related to Brexit.

2.2 The Labour Market

With regard to the labour market, of most significance is any **changes or removal of free movement that could have an impact on the pool of appropriate and available EU migrant labour in Scotland**, and the UK, further exacerbating current and potential future skills shortages. A total of 150,000 EU migrants are reported to come to the UK to work each year. In 2015, 115,000 EU nationals aged 16+ were in employment in Scotland, accounting for 4.5% of total Scottish employment.

As the labour market contracts (resulting from the implications of Brexit as well as an ageing UK population and workforce), demand for labour in certain sectors and/or regions is likely to increase and could outstrip supply:

- Sectors which are likely to be affected include, but are not limited to: Food and Drink, Tourism, Manufacturing. As examples, the undernoted shows sectors with more than 5% of their workforce that are of EU origin:
 - Food and Drink (11.3% - EU Workers); Tourism (10.8% - EU Workers); Creative Industries (7.3% - EU Workers); Manufacturing (7.1% - EU Workers); Distribution, hotel and restaurants (6.9% - EU Workers);⁶
 - Construction (13% non-UK workers, 6% EU workers) - UK Wide⁷; and
- Areas most likely to be affected include the Highlands and Islands given the high proportion of EU nationals employed in what is already a very tight labour market.

“Two thirds of small businesses are concerned about the access to people with the right skills post-Brexit (67%). More specifically, almost three in ten businesses have concerns about filling roles (29%) whilst four in ten have worries about business growth after Brexit”

Federation of Small Business, 2017

In some sectors, there is evidence of the impact of the Brexit decision already being felt. Data gathered through SDS S,D&I team (based on data from the Nursing and Midwifery Council) registration for Nurses shows a marked contraction in the net number of nurses (taking into account joiners and leavers) in the service that are EU/EEA nationals in 2016/17 compared to previous years i.e. after the Brexit decision.

It should also be noted that 31% of working age EU nationals (equivalent to 35,000) are employed in elementary occupations in Scotland, compared to 11% of all elementary occupation employment in Scotland. Elementary occupations include: cleaners, hospital porters, labourers.⁸

⁵ <https://www.theguardian.com/business/2016/jun/23/british-pound-given-boost-by-projected-remain-win-in-eu-referendum>

⁶ Labour Force: EU nationals living and working in Scotland (March 2017) – Annual Population Survey (2015)

⁷ CITB - Migration and Construction: The View from Employers, Recruiters, and Non-UK workers

⁸ <http://www.gov.scot/Topics/Statistics/Browse/Labour-Market/Publications/EUnat>

Any tightening of the labour market could have implications for employers in terms of increasing the cost of employment for employers alongside other cost implications outlined above – National Minimum Wage, the Apprenticeship Levy, and auto-enrolment of employees in workplace pensions.

There is a case to be made that the combination of increased employment costs and reduced availability of labour might provide strong incentives for firms to increase the pace or scale of automation. These pressures are likely to be most sharply felt by those industries that are currently reliant on both low wage models and migrant labour.

Similarly as competition for labour increases, businesses may look to **increase the attractiveness** of their **employment offering through increased salaries and/or benefits**. Whilst this may be a viable option for some businesses, the additional costs associated may force others to look elsewhere for labour.

Retention of employees may also become more of a priority for businesses in response to Brexit. Businesses may choose to up-skill existing workers and/or employ young people through a youth initiative and “grow their own” talent.

For policy makers, Brexit implications should be considered alongside existing and emerging policies on:

- **Broadening labour market participation** – i.e. increase the pool of labour to counteract the anticipated decline. While labour market policy has often been framed as a social inclusion activity, there may be equally strong economic drivers for increasing the participation of low engagement groups such as older workers, BAME, single parents in the labour market;
- Other complementary activity might include **an increasing focus on policies that encourage life long working and retention/return** of individuals who may face additional barriers to employment.

“... the decision to leave the EU has come at a time when the UK labour market was already at a ‘tipping point’ in the light of ... wider changes in the UK economy and labour market ... without a coherent policy response, the UK economy and labour market is likely to face serious consequences in light of the end of free movement throughout the EU”

The Resolution Foundation, 2017

2.3 The Skills System

A joint SDS/Scottish Funding Council paper produced in September 2016 for the Joint Skills Committee outlined a range of potential implications for the skills system as a result of the Brexit decision including funding and other implications for the college and university sector.

SDS is the lead partner for the **Developing Scotland’s Workforce Strategic Intervention** under European Social Fund. The activity includes expansion of MAs to 30,000 places and development and delivery of Foundation and Graduate Level Apprenticeships. Within the 2014-2020 programme funds of £53.13 million are in place to support this activity. SDS is on track for delivery and spend on this activity although it is known that there is an underspend in the overall programme. SDS is also the lead partner for the National Third Sector Fund. SDS administers this on behalf of Scottish Government, with delivery undertaken and match-funding contributed by the contracted third sector organisations. This is due to end by Dec 2018.

SFC is the lead partner for **Developing Scotland’s Workforce**, within which there is transitional funding for the Highlands and Islands and the **Youth Employment Initiative (YEI)**. The YEI has been

approved from 2015 – 2018 with total expenditure of £41.9m. The DSW has expenditure of £25m. In addition to this:

- Through EU Government bodies, Charities, Industries and other sources, Scotland's Universities secured £94.1 million in research income (2014/15) – 12.2% of total research income. As examples £26m was secured by the University of Edinburgh and £12m the University of Glasgow;
- Horizon 2020 (H2020) is the EU's main programme for funding research and innovation projects. Scotland has secured some €217 million in total to date and estimates suggest that Scotland's Higher Education Institutions and Research Institutions could receive approx. €260M over the remainder of H2020. Over the next ten years this figure could be €865m. There is a question around how current H2020 awards that span multiple years would be managed after the UK leaves the EU; and
- SFC is also a Lead Partner for the delivery of the 2014-20 ERDF programme; and
- Some 1,600 Scots go abroad to European countries with Erasmus every year (an increase of 50% compared with seven years ago). Erasmus is an EU student exchange programme and the single largest source of funding for Scottish/UK students wanting to study or work abroad.

With regard to **students**:

- For Universities:
 - 17,286 EU students studied at a Scottish University in 2014/15 – 12.3% of the total student total; whilst three years out of date the data provides insight into the student composition;
 - EU students were reported to account for 26.2% of research postgraduates, 24.3% of taught post graduates and 10.5% of undergraduates in Scotland; and
 - Aberdeen and St Andrews Universities were reported to have higher concentrations of EU students than the Scottish average;
- For Colleges, the numbers of EU students are smaller - 131 FTEs 2014/15 –but this can still be significant for some colleges.

Finally, with regard to **staffing**, further and higher education, and particularly the university sector, has benefitted from freedom of movement as a result of membership of the EU. The UK has benefitted from access to a pool of international talent. 16% of all academic staff at UK HE Institutions are non-UK EU-domiciled (in total 28% of academic staff are from outside the UK). Within the Scottish university sector, 26% of research-only staff are from other EU countries. Ease of travel has meant the opportunity to do field research within Europe, enabling UK postdoctoral researchers to find research and teaching jobs abroad, facilitating international collaboration. A reduction/loss of research funding from the EU is anticipated to impact on the movement of academic research staff.

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

- [REDACTED]

- SDS currently has a strong focus on increasing the diversity of our workforce and this could be hampered by changes or removal of free movement; and
- The other area for consideration for SDS is in terms of our Young Talent Programme, particularly in relation to Interns and Post Graduate Students. Internships are a fixed term opportunity that have been valuable in terms of succession planning and a Post Graduate Qualification is required for the roles in Operations. Again, numbers are small but if there was an impact on EU citizens studying in the UK this could also have a detrimental impact.

3. Areas of Focus

It is proposed that there are four areas where SDS could play a leadership and/or supporting role:

- Developing the evidence base;
- Building resilience within SDS itself;
- Supporting business resilience; and
- Influencing policy and practice with partners.

3.1 Developing the Evidence Base

Considering the implications of Brexit will be an ongoing issue for SDS and partners and it is proposed that:

- The Evidence Base/Skills Planning Team continue to monitor and keep up to date on literature and research on the issue; and
- SDS continues to play a part in the national Brexit response team.

In addition to the above, there is an opportunity for SDS to play a role in commissioning work to develop and enhance the evidence base on Brexit. This work could look to fill gaps in the evidence base for Scotland (nationally, regionally, sectorally) and, given the uncertainty around the impact of Brexit, could look to model some scenarios around impact on the labour market. This work could help inform some follow up pilot work in one or more sectors/regions. Examples of issues that could be considered in this modelling could include:

- Decisions on the extent of free movement following Brexit;
- Demographics (ageing population, tight labour market) – to help identify geographic areas of vulnerability; and
- Composition of workforce that are EU nationals – to identify vulnerable sectors.

Similar scenario planning could also be undertaken on wider economic implications. SDS would play more of a supporting role rather than a leadership role in this with leadership coming from Scottish Enterprise and Highlands and Islands Enterprise.

In addition, engagement should take place with the University/FE sector on plans for mitigation of negative effects arising from Brexit.

3.2 Resilience of SDS as a Business – Maximising Opportunities: Minimising Threats

There are two particular areas that SDS requires to consider to ensure that it is resilient to any impacts of the Brexit decision for us as a business:

- Funding – to maximise existing opportunities and plan for future decline/termination of EU funding; and
- Human resources – to plan for any potential impacts relation to the free movement of people.

With regard to funding it is proposed that we:

- Continue to deliver our existing approved programmes, which are currently on track;
- Through a cross directorate grouping, identify potential proposals for our products and services that fit with Structural Fund objectives with a view to securing a share of the known underspend in the current programme; and
- Continue to build a funding model which takes into account the end of EU funding – this is in progress.

With regard to human resources, our HR team have identified some risks and challenges for our workforce planning. Although numbers of EU nationals in our workforce are small, it is proposed that implications arising from Brexit are included in our risk register with a view to putting in place plans for mitigation.

3.3 Supporting Business Resilience

In the same way as SDS is considering how it might build its resilience in the face of the Brexit decision, there may be an opportunity for SDS to work with others (such as Scottish Enterprise and Highlands and Islands Enterprise) to support businesses in the face of the Brexit decisions and other drivers (political, economic, social, technological) that affect the labour market. Within existing services to employers, there could be an opportunity to support businesses/organisations currently employing EU migrants in addressing their concerns regarding Brexit such as:

- Understanding their workforce and likely skills issues (do they currently have or anticipate skills gaps and shortages);
- Scenario planning in advance of changes/removal of free movement;
- Review business operations/employee roles; and
- Promotion of SDS services – Apprenticeship family, support to up-skill existing workforce.

3.4 Influencing Policy and Practice with Partners

Finally, it is proposed that SDS continue its work with partners on influencing policy and practice. Whilst decisions on Brexit will not be the only driver, this along with other drivers (economic/financial, demographic) will require our active influencing of policy and practice for Scotland to achieve its ambition of inclusive growth. Four key policy areas are suggested:

- **Migration** - Although not a direct responsibility for SDS, consideration needs to be given as to how we might influence Government to ensure that migration policy supports the ambition of the Scottish economy and retains quality staff in our skills system;
- **Broadening labour market participation** – working with groups under represented in the labour market to develop their skills and meet the needs of the economy/labour market;
- **Pay and progression** – In the light of potential increased costs of labour, might there be a need for employer incentives to attract and retain employees
- **Skills system responses** – such as:
 - Potential policy implications vis a vis Youth Employment Strategy and policy levers to support the over 25s and in work training;
 - Increasing Work Based Learning through incentives; and
 - Making use of institutional capacity to meet shifting labour market needs.

4. Recommendations

ELG/The Board is requested to:

- Review the paper and make comment on its content, highlighting any potential gaps/further information required;
- Discuss the issues identified and proposed areas of action and offer guidance on next steps.

 Date: 17 August 2017

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⁹ Internal document – not available in the public domain