



**OFFICIAL REPORT**  
AITHISG OIFIGEIL

# Economy, Jobs and Fair Work Committee

**Tuesday 29 November 2016**

**Session 5**



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**ECONOMY, JOBS AND FAIR WORK COMMITTEE**  
**13<sup>th</sup> Meeting 2016, Session 5**

**CONVENER**

\*Gordon Lindhurst (Lothian) (Con)

**DEPUTY CONVENER**

\*John Mason (Glasgow Shettleston) (SNP)

**COMMITTEE MEMBERS**

\*Jackie Baillie (Dumbarton) (Lab)

\*Ash Denham (Edinburgh Eastern) (SNP)

\*Liam Kerr (North East Scotland) (Con)

\*Richard Leonard (Central Scotland) (Lab)

\*Dean Lockhart (Mid Scotland and Fife) (Con)

\*Gordon MacDonald (Edinburgh Pentlands) (SNP)

\*Gillian Martin (Aberdeenshire East) (SNP)

\*Gil Paterson (Clydebank and Milngavie) (SNP)

\*Andy Wightman (Lothian) (Green)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

Keith Brown (Cabinet Secretary for Economy, Jobs and Fair Work)

George Burgess (Scottish Government)

Gary Gillespie (Scottish Government)

Michael Russell (Minister for UK Negotiations on Scotland's Place in Europe)

**CLERK TO THE COMMITTEE**

Alison Walker

**LOCATION**

The David Livingstone Room (CR6)



## Scottish Parliament

### Economy, Jobs and Fair Work Committee

Tuesday 29 November 2016

[The Convener opened the meeting at 10:00]

#### Decision on Taking Business in Private

**The Convener (Gordon Lindhurst):** Good morning and welcome to the 13th meeting of the Economy, Jobs and Fair Work Committee. I remind everyone to turn devices either to silent or off, so that they do not interfere with the workings of the committee.

Agenda item 1 is a decision on whether to take in private items 2 and 4. Do we agree to take those items in private?

**Members** indicated agreement.

**The Convener:** In that case, we will move into private session. I apologise to the members of the public in the gallery, but I must ask you to leave.

10:01

*Meeting continued in private.*

11:00

*Meeting continued in public.*

#### Economic Impact of Leaving the European Union

**The Convener:** I reconvene the meeting and welcome Keith Brown, the Cabinet Secretary for Economy, Jobs and Fair Work, and Michael Russell, the Minister for UK Negotiations on Scotland's Place in Europe. The ministers have with them a number of Scottish Government officials to assist with questions. Those officials are Gary Gillespie, chief economist; Simon Fuller, from the economic analysis division of the office of the chief economic adviser; and George Burgess, deputy director for European Union and international trade and investment policy.

I ask the cabinet secretary to begin with the short statement that he has prepared, and we will then move to questions from committee members.

**The Cabinet Secretary for Economy, Jobs and Fair Work (Keith Brown):** Thank you for the opportunity to contribute to the committee's investigation of the potential economic impacts of the result of the EU referendum. I welcome the scope of the committee's considerations and look forward to receiving its recommendations in various areas.

When I appeared before the committee on 28 June, which was less than a week after the EU referendum result, I highlighted several points: the result had changed the economic climate in Scotland, the United Kingdom and the whole of Europe; it would inevitably lead to a period of economic uncertainty; and it would add to the already significant external headwinds facing the Scottish economy. However, I made it clear that the Scottish economy is facing those headwinds from a position of relative resilience and strength, and the experience of the past few months has underlined that point.

Scotland's economy grew by 0.4 per cent in the three months leading up to the referendum, which was the highest rate of quarterly growth since the start of 2015. Scotland's labour market has continued to perform strongly. The latest data shows that the employment level in Scotland is now 40,000 above its pre-recession peak and 166,000 above the recession trough. The unemployment rate in Scotland has fallen to 4.7 per cent, which is lower than the UK's rate of 4.8 per cent. Therefore, despite continuing economic concerns following the EU referendum result, it is encouraging that the underlying resilience of the Scottish economy remains strong.

However, if we look ahead to the next 18 months, we see that the outlook for growth in Scotland and the UK has weakened following the referendum. Economic forecasters have significantly downgraded their growth projections for 2017 to reflect the heightened uncertainty and increasing inflationary pressures following Brexit. All of that will start to dampen employment prospects, business profitability, household incomes and earnings.

In the longer term, independent economic forecasts point to a range of possible impacts on the economy from a redefined relationship with the EU. There is widespread agreement that a UK-EU trade relationship that relies on World Trade Organization rules—which is often referred to as a hard Brexit—represents the worst possible outcome for trade and the economy.

The path ahead is uncertain, but we are very clear that Scotland's relationship with the EU and its place in the single market must be protected. We have a small, open economy in a rapidly changing and globalised world, and our ability to create a more productive and fairer Scotland depends more than ever on trading with the rest of the world and attracting investment into our economy, businesses and assets. Being part of the EU makes the free movement of goods, services, workers and capital easier, and it opens up opportunities for citizens, workers, businesses and consumers. Any relationship with the EU short of full membership of the single market risks increasing barriers to trade, reducing exports and lowering migration, all of which will affect growth rates and reduce productivity.

The Fraser of Allander institute has estimated that leaving the single market under the WTO scenario could result in our economy being worse off overall by about 5 per cent—approximately £8 billion—after a decade, in comparison with our position if we were to remain in the EU. It would mean 80,000 fewer jobs and real wages reducing by £2,000 a head per year.

There is a rare consensus among economists—who do not often share a consensus—and various think tanks on Brexit. Analysis has shown that Brexit will be bad for exports, investment and jobs, which means that it will be bad for productivity, economic growth and tax receipts. That view is shared by the Office for Budget Responsibility and the Treasury, and it was set out quite clearly by the chancellor during his autumn statement. Brexit has lowered the outlook for economic growth, which has, in turn, led to forecasts of increased borrowing to the tune of more than £100 billion over the forecast period.

Ultimately, for households that are already dealing with the impacts of austerity, Brexit has led to a rise in inflationary pressures that, combined

with a benefits freeze and a weaker outlook for earnings, will squeeze incomes further. Crucially, analysis by the Institute for Fiscal Studies shows that, by 2021, wages will still be lower than they were in 2008. That implies 13 years without any growth in real wages, which is the longest period of stagnant wages since world war two.

There is, therefore, a pressing need for us to try to minimize that potential damage, which is why we have been unequivocal on the importance of membership of the single market and on our determination to retain that membership. That is not to say that we prioritise our trade with the EU at the expense of our trade with the UK; we are clear that we want to maintain our relationship with both vital partners, and the two are not incompatible. We have heard from David Davis that there will not be a hard border between Northern Ireland and the Republic of Ireland, and I am confident that the same would be the case between Scotland and the rest of the UK should Scotland be able to secure our relationship with the EU.

We are currently in the process of opening a trade and investment hub in London to attract further investment north of the border, building on recent post-EU referendum investments from companies such as Chevron Aircraft Maintenance and GlaxoSmithKline. Those investments are a vote of confidence in the economy, and the Scottish Government is clear that we remain open to investment from the rest of the UK, Europe and further afield.

However, as I have alluded to, it is not just the vote to leave the EU that is providing an unnecessary headwind for the Scottish economy. We are also hamstrung by much of the economic policy that is being led from Westminster. On oil and gas, the chancellor has chosen not to implement the strong package of support that is needed for the North Sea and affected communities, which continue to be impacted by low oil prices. More generally, our economic progress is hindered further by continued austerity and a protracted period of underinvestment in economic infrastructure.

Even with the increased investment that was announced last week, which is welcome, Scotland's capital budget will still be 8 per cent lower across the decade. What was announced last week was simply a moderation of existing cuts. In contrast, we have prioritised capital investment despite cuts to capital budgets. We have invested in major transport projects such as the Queensferry crossing; the M8, M73 and M74 motorway improvements project; and the continuation of the Edinburgh to Glasgow rail improvement programme. We will also invest £3 billion to build 50,000 affordable homes over the

current session of Parliament and, during 2016-17, we will invest £90 million in Scotland's digital infrastructure to help us towards our 2017 target of ensuring that 95 per cent of premises in Scotland have access to next-generation broadband.

All that investment is aimed not only at stimulating our economy but at improving our asset base in order to boost long-term productivity. We have made progress in improving productivity performance, narrowing the productivity gap with the UK since 2007. However, we know that further improvement is required, and our ambition is for Scotland to rank among the top-performing Organisation for Economic Co-operation and Development nations.

The vote to leave the EU is an unwelcome barrier on the road to fulfilling that ambition. That is why the Government's goal is to keep Scotland—and, indeed, the whole of the UK—inside the single market. I welcome the opportunity to listen to and work closely with MSPs from across the Parliament who share that goal. I have made that offer before. In the coming weeks, we will produce specific proposals to protect Scotland's interests and keep us in the single market, even if the rest of the UK decides to leave, because we believe that that outcome is in the best interests of everyone in these islands.

I look forward to the committee's forthcoming recommendations, and I am happy to take any questions that members may have.

**The Convener:** Thank you, cabinet secretary. You mentioned exports in your statement. Is the Scottish Government doing anything over and above what has already been publicly announced to promote Scottish exports across Europe and beyond?

**Keith Brown:** In addition to what has been announced, much of which you will be aware of, work is going on all the time, including a programme of visits by ministers. For example, I recently attended ADIPEC—the Abu Dhabi international petroleum exhibition and conference—which provides a huge opportunity for Scottish companies to export. A large number of companies at the conference were from the north-east, as you would expect. Interestingly, some of them told me that, although they had previously been focused on the North Sea oil market, which is the market that they knew, they are now reaching out to access different markets in the middle east. There is a recognition that we have to support that effort. We held a number of events in Abu Dhabi and helped a lot of quite small companies to establish a presence. However, the restricting factors will be the cost of setting up an office and, for many people, the 180 days that they are allowed to be there on a visa. A lot of work has gone on in that regard.

In addition, when ministers go on trips for other reasons, they promote Scotland. For example, the First Minister is in Dublin today, as you will know, where she will announce the filling of the extra position to boost Scottish Development International's presence in Dublin, in the new office that we have there. You will be aware of the other ambitions that we have for London and Berlin. We have also announced the establishment of a trade board, as part of the four-point plan that the First Minister announced last month, and we have begun the process of appointing members of that board, which I will chair. The board will harness expertise and experience from a wide range of business perspectives, which will enable us to focus our efforts more effectively.

There is a great deal of activity going on throughout the UK as well as throughout the EU and, indeed, in other countries to boost trade.

**The Convener:** Thank you, cabinet secretary. Gordon MacDonald has a question.

**Gordon MacDonald (Edinburgh Pentlands) (SNP):** I apologise in advance to the committee and witnesses for having to leave the meeting early due to a family commitment.

Over the past few weeks, we have heard about the lack of data on exports that would allow us to identify what constitutes an export from Scotland. Some of the evidence that we have heard has suggested that 50 per cent of our exports are being generated by only 50 companies. Is that the Scottish Government's understanding? Is there any reason why our export base is so small?

**Keith Brown:** A pretty good guide to how such products are defined and the different sources of those definitions has just been put on the Scottish Government's website. We tend to collect the data through a survey of companies that export.

There have been questions around the nature of exports to the rest of the UK, the extent to which they are then exported elsewhere and whether they are properly accounted for in our export figures. As you say, 50 per cent of Scotland's international exports are attributed to a very small number of businesses—and we are potentially talking about 130 businesses accounting for 60 per cent of exports. One of the reasons for our having the enterprise and skills review is that we realise that we have not done what we need to do on exports or on internationalisation.

However, more is being done, and we are seeing more companies—from the north-east in particular, as I have just mentioned—starting to look at export markets in a serious way. The review will give us a specific focus and will try to draw together the different resources that the Government has for ministers undertaking

engagements abroad or in the rest of the UK. The Scottish Chambers of Commerce has an active network that we want to tap into, and our university sector is active and has bases in places such as Dubai and Singapore. We are trying to bring those things together so that we can more effectively internationalise our companies.

One point to mention relates to productivity. If a company is exporting into a more competitive and productive market, the discipline of that market tends to be felt throughout the organisation. Internationalisation therefore also has that benefit. The enterprise and skills review is a recognition that we have not done as much as we could to expand the Scottish economy's export base—we are seized of that—but that is also true of previous Administrations and their ambitions.

As to the technical side of it, I recommend what has been put on the Scottish Government website today on exports. The chief economist may want to say something about that.

11:15

**Gary Gillespie (Scottish Government):** I reinforce the cabinet secretary's point that, although a small number of companies account for a lot of international exports, that is probably not uncommon in a small economy. International trade tends to be concentrated in larger international companies. There are a number of reasons for that; one is to capture the benefits internally—the internal knowledge that they generate. We have seen that in a lot of other places.

As the cabinet secretary has outlined, the challenge is to get a broader base of small and medium-sized enterprises internationally active, so that when they grow, they grow in international markets as well.

On the international trade statistics, as the cabinet secretary mentioned, we have put a note on the website that answers some of the questions that have arisen during the inquiry about re-exporting, the extent to which our export figures capture the final destination of trade and what we do not know in the context of imports from rUK and other trade flows. I am happy to say more about those in due course, but that information is now available.

**Gil Paterson (Clydebank and Milngavie) (SNP):** I would like to follow up on those points, on which we have heard from a number of witnesses. For example, David Williamson from the Scotch Whisky Association, said that

"Obtaining detailed and accurate Scottish export statistics has been a challenge".

Scottish Engineering's Bryan Buchan talked about flotation devices that are manufactured in

Aberdeen and are not counted as Scottish exports. Finally, James Withers of Scotland Food & Drink said:

"I am almost certain that the £1.1 billion of food exports undervalues what we export for precisely the reason that Gil Paterson gave in talking about the port of departure." — [Official Report, Economy, Jobs and Fair Work Committee, 8 November 2016; c 48-49.]

I know that the Office for National Statistics is reserved, but is the Scottish Government putting in resources to delve into those figures? It is quite fundamental that we understand where our exports go to and what their value is. We are talking in a vacuum because it looks as if the stats are not accurate.

**Keith Brown:** That is a very good point, and it has been made during the enterprise and skills review across the piece, not just in relation to exports. The quality and extent of the information that we have is not what we want it to be. We are now in phase 2 of that review, part of which will examine what stats, information and data will allow us to have a proper assessment.

Gil Paterson is right to say that in many—although not all—cases, we are reliant on figures from the ONS and others. That is not sufficient. If we are to make changes in terms of internationalisation, exporting and productivity, we have to have the figures that enable us to do that, and they have to be more accurate. For example, our labour market stats are three months out of date and are based on a survey of about 400 people in Scotland. In comparison, there are up-to-date and definitive figures on output from the US economy. There is more that we can do, and we have tasked the ministerial enterprise and skills review group to look at that specifically.

On exporting, I recommend the question-and-answer page on the Scottish Government's website—it has only just gone up, so members will not have had the opportunity to see it. There is sometimes more clarity than we realise on some of the figures, but Gil Paterson is right to say that other figures are partly disguised, so it is not possible to be as definitive as we would like to be about where exports to the rest of the UK then go. There is also what is called the Rotterdam effect; I will not try to explain that just now, but information on it can be seen on the question-and-answer page.

I concede that we need better data on which to base the decisions that we take and our judgments as to how the economy is performing.

**Gil Paterson:** Will the research be peculiar to Scotland, or will it be based on the ONS research?

**Keith Brown:** The enterprise and skills review investigation will be based on Scotland. The review group involves people from industry and



the organisations that are involved in providing enterprise and skills support, plus many others—I hesitate to use the word “experts”, but that is what they are—looking at the range of economic data that we have. It will be specific to the Scottish economy. If, at the end of that review, the suggestion is that we should be commissioning extra information that is specific and tailored to the Scottish economy, we should not be afraid to proceed with that.

I think that that work is necessary. One measure that Scotland does not have but which other economies have is the whole of the economy report—I think that that is what it is called. We need a root-and-branch review of the information that we have. Our approach should be designed to advise and inform the public and parliamentarians and make it as easy as possible for us to judge how the economy is doing, and we should be able to use the information as a basis for decisions about how to improve the economy.

That work in Scotland will not be undertaken by the ministerial review group, but—this was perhaps the point of Gil Paterson’s question—the review might result in our saying to the ONS, “This doesn’t suit us. Is it possible to do it in another way?” There is obviously a real value in having an objective analysis of the figures. However, I do not want to prejudge the outcome of the review.

**Gary Gillespie:** We rely on the ONS to produce a lot of economic data on a UK basis, with a disaggregated data set for Scotland. We typically pay for a boost to the sample, to allow greater analysis of the labour market and other areas.

In the context of this discussion, the data of interest is the global connections survey, which is a Scotland-based survey that is run by Scottish Government statisticians. The survey goes out to around 5,500 businesses and targets the large exporters. The crucial point is that it captures goods and services that are traded from Scotland with the rest of the UK. It is difficult to get intra-UK trade-flow data. Even at the UK level, there is only one source—the input-output tables.

The 2015 global connections survey will be published in January. It is the main source of Scottish export destination data, and we supplement it with HM Revenue and Customs data and monthly returns from the ONS, on a collaborative basis. However, as the cabinet secretary said, there are gaps in the data and further work is going on.

**Jackie Baillie (Dumbarton) (Lab):** Cabinet secretary, I welcome your clear comments about the importance of the UK market to Scotland. You will forgive me for saying that they stand in contrast with the comments of your colleague

Stewart Hosie earlier in the week—your clarity is welcome.

I know that you share my understanding that proximity to markets is a key driver in increasing exports. On that basis, I want to focus on SDI and its field ops and to tease out what you said in answer to a series of parliamentary questions that I asked. I understand that we have 29 offices across the globe, but only one in our biggest market, which is the rest of the UK. Will you explain the strategy behind having just one office in a market that is worth £48.5 billion and 28 offices in a market that delivers £26 billion?

**Keith Brown:** It will be apparent to anyone who gives the matter a bit of thought that the rest of the UK is unlike our other markets, in as far as we have a huge number of connections with the rest of the UK, at all levels and in all sectors. Therefore, the same imperatives do not apply. We have representatives in the UK Parliament and on UK trade bodies—there is a host of connections.

The further development of the London office has been important in boosting connections at a time of uncertainty as a result of the EU referendum vote, and I have said how valuable the UK market is to us—we have had recent successes in that regard. It is obvious that there are a number of connections across different sectors and that the relationship is unlike the relationships that we have with, for example, China, India and other parts of the EU.

**Jackie Baillie:** I note that the London hub is being created, so it is clear that you are not dismissing the importance of the UK market. How many people will be in the London hub? I ask because you are moving staff from London to Dublin—that is pertinent to the First Minister’s announcement today. I understand that eight SDI people and three Scottish Enterprise people are being moved across to Dublin. How many will be left in London?

**Keith Brown:** As you said, the unit in Dublin will be established and the extra staff there will mean that staff numbers in the EU will be doubled.

There is a relationship between Dublin and London, and you may be aware that there has been a lot of discussion—it is hard to know how much more than that it is—about the possible fall-out from the Brexit vote of companies moving to Dublin. Companies deem Dublin to be very attractive as it remains within the EU and it is English-speaking. It is true to say that the Republic of Ireland has been extremely successful in attracting businesses in recent years and a vital part of the First Minister’s itinerary today in Dublin is to meet with 100 business leaders. Perhaps Mr Burgess or Gary Gillespie could talk about the exact staff numbers for SDI.

Ms Baillie is right to say that we have recognised the importance of the UK market, which we have done by the creation of the London office. The vast majority of inward investment to the UK comes through London. That often bounces on to Scotland and we want to encourage that so we—along with the seven Scottish cities—have a presence at conferences such as the *Marché International des Professionnels d'Immobilier*. I have visited MIPIM myself in recent years.

Perhaps George Burgess would like to say something about staff numbers.

**George Burgess (Scottish Government):** In the Dublin hub, which has been established for some time, there are already two members of Scottish Government staff, who will be joined by a member of SDI staff. That is an early part of the doubling of SDI's presence in European markets. SDI is clear that that is additional resource—people are not being moved from one office to another. SDI will look at which people are best in which place, but there will not be a diminution of the London presence in order to create the extra presence in the other markets.

**Jackie Baillie:** Perhaps you could explain the answer to my parliamentary question S5W-03970, which indicated that, when the London hub

“opens in 2017, the 8 people working for Scottish Development International and the 3 people working for Scottish Enterprise in London will move to Dublin.”—*[Written Answers, 9 November 2016; S5W-03970.]*

I am happy to share the PQ as it is a matter of public record—the answer is in your name, cabinet secretary. I am not sure that that fits in with the answer that you just gave me.

**Keith Brown:** I think that it fits. We are saying that additional staff will move to Dublin. The last visit that I made to the SDI and Scottish Enterprise office in London was after the Brexit vote and eight or nine people were there—we intend to boost that. I do not know whether you have visited the office yourself, but it is often the case that the desks are used by staff from other parts of the Scottish Government, too. The intention is to boost our presence in London as it has been successful so far, but we believe that it can be more successful.

**Jackie Baillie:** It is important for us to understand the relative priority that the Scottish Government attaches to things. Are you taking staff away from London to Dublin? If so, are you replacing them? What will the complement be in London?

**George Burgess:** I suspect that there might have been a good old-fashioned typo in the answer. The intention is that the staff from SDI and Scottish Enterprise who are already in London

will move into the London hub. I have no knowledge of them being translated to the Dublin office, pleasant though that would be. Please allow me to investigate that and we can come back to clarify.

**Jackie Baillie:** That would be helpful. If you want to review any other typos that might exist, I am sure that my fellow MSPs would be very pleased.

I have one final important point on SDI's budget. It has been declining year on year and I am keen to know whether the additional staff that are talked about in Europe—the increase from 20 to 40 people—will all be new, additional staff. In that case, will SDI get additional budget or is it expected to cope with its existing financial envelope?

**Keith Brown:** No. Given SDI's activities, it would not be possible to take on that additional number of staff within the same budget. Two weeks and a bit in advance of the budget, I cannot tell you what the budget for SDI will be, but it is not expected that SDI will manage to get by on its current budget if the number of representatives in the EU is doubled—there will be an increase.

**The Convener:** Dean Lockhart has a follow-up on that point, before we move on to another subject.

11:30

**Dean Lockhart (Mid Scotland and Fife) (Con):** I thank our guests for coming along this morning.

The relationship between exports and productivity is important, as the cabinet secretary said. In his autumn statement last week, the Chancellor made it clear that he wanted the UK economy to be match fit. He announced a number of measures to increase productivity, as a result of which an extra £800 million of capital spend is coming to Scotland.

As I understand it, the Scottish Government's target for Scotland to reach the first quartile for productivity by 2017, as measured against our key trading partners in the OECD, has not been met. Scottish Enterprise has estimated that that has cost the Scottish economy roughly £45 billion in additional gross domestic product.

The Scottish Government has control of a number of policy levers for productivity, including enterprise policy, education, skills, training and export networks. How does the Scottish Government measure productivity and when will targets be introduced for productivity beyond 2017?

**Keith Brown:** Implicit in that question is a recognition from Dean Lockhart, perhaps for the

first time, that two Governments are involved in the economy in Scotland. His former colleague Gavin Brown made a statement to the effect that the vast majority of substantial levers on the economy rested with the UK Government. It is important that when we discuss productivity, export performance or other aspects of the economy, we acknowledge that two Governments are involved.

Dean Lockhart asked a question that I have answered previously in the chamber. As a result of the work of the enterprise and skills review, we intend to have a harder alignment of the agencies that are involved. The other A word is accountability in relation to that. We still have the overriding ambition for our productivity performance to be in the top quartile internationally, but we expect to come out of the review with refreshed targets and perhaps even more performance measures in relation to how we achieve the targets.

Perhaps the chief economist could answer the question on the productivity calculations.

**Gary Gillespie:** Since 2007, there has been a target to be in the top quartile of OECD member states for productivity. That is measured using output per hour worked, usually, and it is calculated on an international basis. Scotland sits just behind the UK on that measure at the top of the third quartile. It is around 19 percentage points behind Germany, which is at the bottom of the first quartile. In a sense, that shows the scale of the ambition.

As Dean Lockhart mentioned, productivity has a number of drivers, most of which are long-term drivers around education, skills, investment, innovation and the types of things that improve the underlying competitiveness of the economy.

It is rare for economies to close the productivity gap quickly. It tends to take effort over a long period. That is the scale of the ambition that the Government has set out in the economic strategy.

Alongside that there is a dual mandate to reduce inequality. The recent evidence from the OECD, the World Bank and the International Monetary Fund is that productivity and inequality are interlinked and that if a country does not address some of the socioeconomic challenges that its economy faces, it will not reach the same levels of productivity as the first quartile countries.

**Keith Brown:** Dean Lockhart mentioned the Chancellor's statement and investment in infrastructure, which we think is a vital part of improving productivity. Large-scale projects that we have just now include the Queensferry crossing and the M8 bundle, as a result of which we will for the first time have motorway between Edinburgh and Glasgow. Main street, Scotland, if

you like, is not yet a motorway but it will be once the project is complete. Each such project has an assessment, which I am happy to provide to Dean Lockhart, of the extent to which it should boost the productive potential of the economy. We have been doing that for many years.

I should say that the £800 million that the member mentioned represents a reduction in the cut, rather than an improvement in Scotland's position over the 10 years from 2010 to 2020. That should be the context in which that is taken. Although the productivity fund represents a number of different aspects from the chancellor, it is a recognition that some of the things that we have been doing on infrastructure in previous years, the UK Government is now also seeking to do. That is welcome. I just wish that we could do more; we certainly have no shortage of projects that we could invest in were we able to do more in terms of the capital available to us.

**Dean Lockhart:** Mr Gillespie, just to confirm: you did say that the Scottish Government, with new powers coming to Holyrood, has control over enterprise policy, education, skills, training and the export network, most of which are the drivers of productivity. So, while I agree with the cabinet secretary that, to some extent, two Governments are involved in the economy, I think that, when it comes to productivity, most of the levers now lie with the Scottish Government. Would you agree with that?

**Gary Gillespie:** Yes, in the context of the levers that you outlined. They are, essentially, all levers that impact on the underlying competitiveness of the economy.

**Dean Lockhart:** Thank you.

**Richard Leonard (Central Scotland) (Lab):** Scottish Parliament resolution S5M-00601 committed the Scottish Government to protecting Scotland's place in the single market. It also contained an undertaking to report back regularly to parliamentarians and to report to Parliament on progress. I wonder whether the Minister for UK Negotiations on Scotland's Place in Europe could take this opportunity to share with us where lies Scotland's place in the single market, as he sees it.

**Michael Russell (Minister for UK Negotiations on Scotland's Place in Europe):** I am pleased to do so. There have been regular reports, both to committees and to the chamber, and regular debates. This is a live and also fast-moving situation.

Convener, with your permission I will say very briefly where I think we are at present. Over the next few weeks, the Scottish Government will publish a paper that will outline the existing

options. From the debate that has taken place, it has been clear that they lie broadly in three areas.

At one end there is the undifferentiated option of Scotland leaving the EU in exactly the same way as the UK intends to leave. That is not entirely clear. I suspect that the clearest definition we have of it is from the scribbled notes visible in photographs on the front of today's newspapers. I have to say that those notes accord pretty closely with the information that I have been able to glean—we are not told things as clearly—over the past few months. This is a difficult time, in which the options in the UK are narrowing but the UK Government does not seem prepared to say so. However, I think that it is fairly clear that we are heading for what might be called a hard Brexit in that undifferentiated option.

Clearly, at the other end of the spectrum is the possibility that we will not be able to find any other adequate solution but to move forward with an independence referendum and to give the people of Scotland the choice.

In the middle, there is a range of differentiated options. The success of those will depend upon the willingness of the UK Government to include them in its negotiating position. Quite clearly, it is the UK Government that will negotiate with the other 27 nations. A lot of our work at present is fleshing out, examining, investigating and building evidence on those differentiated solutions. I will not go into great detail on those at the moment, because that is work that is on-going for the paper, but the First Minister has indicated areas in which, clearly, there are possibilities.

The EU has almost 30 arrangements with a variety of sub-states throughout Europe and elsewhere. Some of those include, for example, membership of the European Economic Area, although there is now some dispute as to whether or not the UK will exit EEA membership automatically. Of the options—membership of the EEA; membership of the European Free Trade Association; and membership of the customs union but without access to the single market—none is as good as remaining within the EU, and that is a very important piece of information.

We should look at the options in a hierarchy. The top of the hierarchy says that we should stay where we are, because that is the best possible arrangement that we could have.

The second level of the hierarchy says, quite clearly, that what the UK should do is to remain within the EEA and thus have full access to the single market, although not with the decision-making powers that it presently has.

The third level of the hierarchy says that, if we cannot do that, Scotland should find a way to remain within that sort of structure in order to

move forward. The priority is to remain in the single market, for economic reasons but also for many other reasons. Although it is an economic driver in many key parts of the Scottish economy, free movement of labour is not simply an economic driver. Free movement of labour also expresses something about how we see ourselves, how we see our relationships with others and how we want our society to look and feel.

We are working on those differentiated options. If you will bear with us and have the patience to wait a few more weeks, they will be even clearer and we will lay them out in much more detail. Then, of course, the Scottish Parliament will have to look at them closely, as indeed will the people of Scotland, who will have to decide what they can have.

**Richard Leonard:** Are you saying that a Scotland that is short of independent could be a member of the European Free Trade Association and, by dint of that, a member of the European Economic Area?

**Michael Russell:** I am saying that there is a range of options that we need to consider, and some of those will be hard to achieve and some will not be hard to achieve, but it is important to look at them all. I am ruling absolutely nothing out. I noted that the First Minister made that point this morning about something that Guy Verhofstadt said in relation to citizenship. He backed the proposal that, in parts of Europe, those people who were no longer EU citizens could pay to remain EU citizens. The First Minister said quite clearly that some people will have told Guy Verhofstadt that that is ridiculous and cannot be done, but that others will have said, "Actually, that's an interesting idea and we'd like to look at it."

We are in completely uncharted waters, and I do not think that there is anything that we should say is impossible. There may be some things that have not been done before and which need to be debated and discussed. However, the important point is that the key to this will lie in the willingness of the United Kingdom to fold into its negotiating position—whatever that turns out to be—deals and opportunities that exist for other parts of the UK. The cabinet secretary referred to Northern Ireland, and it is absolutely clear that there must be such a commitment. On Friday, I was at the British-Irish Council meeting in Cardiff, where it was made very clear by the Northern Irish as well as by the Taoiseach that there has to be a deal for Ireland, as an island that does not have a hard border, in those circumstances, just as there will have to be a deal—I suspect that many people realise this—for Gibraltar.

There must still be the possibility of special deals for Scotland, but I would not use the term “special deal”. I might even withdraw that, convener, because what we are asking for is what we have, and that is an important way of looking at the question. We are asking for the things that we already have and enjoy. That is not a special deal. That is a right that we should have.

**Richard Leonard:** You are talking about possibilities. Is there a willingness, at least of spirit, on the part of the UK Government to allow for those options that you are describing?

**Michael Russell:** Mr Leonard, I would never speak for the UK Government. I am certainly not qualified to do so. However, I am also an optimist, and I would hope that there is that willingness. I have had constructive discussions with David Davis—it seems as if we have had many discussions now—on several occasions and we will continue to meet through the mechanism of the joint ministerial committee on European negotiations. In fact, we are due to meet again within a few weeks.

I hope that that willingness exists, and I hope that we can take the Prime Minister at her word. She said that she wanted Scotland to be fully engaged and fully involved, and she also said that she would not trigger article 50 until a position had been agreed by the devolved Administrations. I am accepting the word of the UK Government, and I am sure that we should all try to do that.

**Liam Kerr (North East Scotland) (Con):** I have a quick question to follow up on Richard Leonard’s. During our evidence sessions, we have heard from some sectors in which it seems that most of their members voted leave and/or can see positives from what the cabinet secretary has termed a hard Brexit. They expressed concern about their sector’s voice not being heard and about opportunities being missed. What reassurances can you give that those industries’ needs will not be forgotten and that their vote will be as important as the one that you are listening to?

**Michael Russell:** Which sectors are those, might I ask, so that I am clear about what I am commenting on?

**Liam Kerr:** I have in mind the fishing industry.

**Michael Russell:** That is one. Which other ones?

**Liam Kerr:** So—[*Interruption.*]

It is not really for me to answer the questions, but we have taken a lot of evidence.

11:45

**Michael Russell:** That is interesting. Well, let me address fishing, as that is the only sector that you have been able to mention. Along with Fergus Ewing, I have met representatives of the Scottish Fishermen’s Federation, and I have made it absolutely clear to them that their view is respected. I have asked them, as has Fergus Ewing, to come forward with their views on how they would structure fisheries management in Scotland after the common fisheries policies is no longer in force, and they are engaged in that task.

Yesterday, I met another group of fishermen in my constituency to have the same discussion. I am not only showing respect for their view, but I am asking them how they would see this working. That is the right thing to do in any sector. I have spoken to people in many sectors, and if people in any sector say, “We think that there are advantages in this situation,” I am very willing to listen and to try to understand them.

The real question is about the balance of advantage. For example, the Scotch Whisky Association has indicated that it can see a way in which it might operate without a customs union. That is because rules of origin are not particularly important to the Scotch Whisky Association; there is not much in a bottle of whisky that has been manufactured outside Scotland or the EU, so I can understand that perspective—whether there is a customs union or not does not make life easier one way or the other. However, there are other sectors for which the lack of a customs union would be immensely problematic. We have to balance between the sectors.

We also have to balance within sectors. Fishing is a good example. Most people in the catching part of the fishing industry believe that the common fisheries policy has not worked well for them. There are many reasons for that—some blame other fishermen; some blame politicians—but it is clear that they have had difficulties with it. Other people within the sector—in processing, for example—are very nervous about what might lie ahead and believe that the difficulties with markets will be problematic for them.

I am trying to listen constructively to every sector and I am debating and discussing with every sector. I am open to what they say and I am folding it into my thinking as I take forward the negotiating task.

**The Convener:** On that point, minister, and going back to what we just discussed, I think that you said that in two weeks’ time there will be a paper referring to the various options.

**Michael Russell:** Not in two weeks’ time—at some stage soon.

**The Convener:** At some stage soon—sorry. I am not trying to tie you down to a timescale; I thought that you said in two weeks' time.

Have you made requests to the UK Government regarding specific aspects of the negotiations? If those were in writing, can you share them with the committee, or can you not do so at this stage?

**Michael Russell:** Three things govern this situation, convener, which I think it might be helpful for me to explain. First, the JMC operates under the terms of the memorandum of understanding that underpins the JMCs' structure, and it requires confidentiality in the process. To the greatest degree possible, we have tried to ensure that information is always made available from JMCs in the spirit of openness and transparency on which the Parliament is based. We juggle that, therefore; but the MOU requires—rightly so, in certain circumstances—confidentiality.

Secondly, we are in the process of negotiations. Although I am very keen to be as open as I can—and this meeting is an example of that—it is difficult to go into the detail of those negotiations, and there is detail in all the discussions that are taking place.

The general answer that I would give you is that we are not really at the stage of doing that. There has been only one meeting of the JMC(EN)—my reference to a fortnight was to the fact that the second meeting will take place within the next fortnight; and we plan to meet on a monthly basis. Therefore, the ability to have done a great deal of detailed work in that time is limited. We are moving towards that stage, but we are not at it yet.

**The Convener:** Is the answer, then, that there is not written detail that you could share with the committee at this time?

**Michael Russell:** I have spent a very long time saying exactly that. There is no written detail that I can presently share.

**The Convener:** Thank you.

**Jackie Baillie:** We are all aware that the First Minister is in Dublin. John Bruton, the former Prime Minister of Ireland and EU ambassador to the United States, said in relation to Scotland's seeking of a special deal—call it what you will—to remain in the EU single market:

"I think it's technically, administratively and politically ... impossible."

Is he wrong? What option do you believe offers the best alternative to deliver on the Scottish Government's ambitions?

**Michael Russell:** The difficulty with John Bruton's point, and with other points on that matter, is that it deals with a past view of what the

EU does and how it operates, and not with the present realities. There has never been a withdrawal from the EU—with the exception of Greenland, which was in a very different set of circumstances.

In the current circumstances, nothing is off the table—that is absolutely clear, because the table has not yet been set. The UK has not defined its negotiating position and will do so only, to a greater or lesser extent, in the article 50 letter, which is likely to be at the end of March, although we are still not entirely sure.

I would say that John Bruton is probably correct given a retrospective look but not correct given a prospective look, because the type of Europe that we are entering, how it is organised and the relationships in it are entirely new and different.

There is another agenda that it is important for us to understand. Brexit is not the only thing that is happening in the European Union. Many other things are happening to its shape and dynamics, so we cannot say with any confidence or certainty what is or is not possible. I said in response to Mr Leonard—it is a point that needs to be made—that there are a lot of big difficulties ahead. Nothing that we are talking about here is simple or easy, but I do not think that we should use the term "impossible" in these circumstances, just as we should not use the terms "red line" or "non-negotiable", because in a sense everything is up for grabs.

**Jackie Baillie:** I do not think that it is so much about the UK setting the table. The reality is that Europe will set the table for us, and the difficulty is that although "impossible" is not a term that we are using, it is one that it is using. John Bruton is not alone but is one among a number of EU members. I understand that you cannot be drawn on your negotiating position, but there is a danger that, as we focus on our view and the UK view, we are forgetting the European view.

**Michael Russell:** I very much agree. I have the greatest respect for Jackie Baillie—I used to sit on a committee with her—and she raises an important point on the European view. The European view is hard line and is getting harder, and that is an attitude towards the UK. It is increasingly fed up with not understanding what is going on and hearing things that are, in the words of the Dutch foreign minister about Boris Johnson, "intellectually incoherent".

However, we have to remember the four pillars that Michel Barnier has set himself for the negotiations, the last of which is the exceptionalisms—the Northern Irelands and Gibaltars that he has named. It is acknowledged that special circumstances will require to be established or arrangements made—and not only

by the UK Government in how it talks about Northern Ireland but by the Commission and the Council in respect of Barnier's pillars.

There is an opportunity to continue to debate and discuss the matter. I genuinely do not believe that anything is unlikely or impossible, because the European Union has always been flexible. However, there are extraordinary circumstances and we must continue to talk about them.

**The Convener:** Dean Lockhart may come back in with one last point on that before we move on to another subject.

**Dean Lockhart:** Thank you, convener. I have a brief question for Mr Russell.

The Welsh First Minister has said that he cannot see how there could be separate arrangements for market access to the UK in different nations within the UK and that if Scotland has separate arrangements for market access to the EU, there would have to be customs borders between Scotland and the rest of the UK.

I appreciate that a number of different scenarios might play out, but if you had a choice between membership of the UK single market or of the EU single market, which would you prioritise? I appreciate that you would probably want the best of both worlds, but in a scenario in which you had to choose between retaining EU membership or having full access to the single market in the UK, which would you prioritise?

**Michael Russell:** As you will imagine, I am not going to be drawn on that because I do not believe that such a situation is a real choice. I was with Carwyn Jones on Friday morning and I discussed the issue with him. In every sense, he and Mark Drakeford, his minister who is undertaking the negotiations, understand the complexities, the difficulties, the requirement to have a flexible approach and the ability to say that nothing is going to be easy but everything remains on the table. That was his position on Friday morning and it will remain his position.

We are working closely with the Welsh, Northern Irish, Irish and UK Governments to find a way through these issues. One of the important things is not to be drawn on false choices and to try to make real choices.

**Dean Lockhart:** As this is the economy committee, can I ask what—

**The Convener:** Sorry, Mr Lockhart. The minister cannot speak for the Welsh Administration any more than he can speak for the UK Administration, so I would like to move on to another subject. Ash Denham has a question.

**Ash Denham (Edinburgh Eastern) (SNP):** I would like to turn to the possible effects—which

we are already seeing—on the Scottish economy of the EU referendum in June. We have seen a sharp drop in sterling, the impact of which has been rising costs for Scottish households. Has the Scottish Government done any modelling of the impact on Scottish households of rising energy or food costs?

**Keith Brown:** You are right to say that that has occurred to us. It is estimated that there will potentially be a 5 per cent increase in prices next year, which may have an impact on inflation, interest rates and disposable income. I will ask the chief economist to talk about the modelling.

We are very aware of the impact of the EU referendum, and I have given the example previously in the chamber of a company in Ayrshire that I visited recently, which produces double glazing, patio doors and so on. At that point, it had not seen a huge impact from the Brexit vote—it should be borne in mind that we do not have Brexit yet—but its Irish glass suppliers had just told it that there would be a 15 per cent increase in its costs. That is one example of what we have seen across a number of different sectors. On the other side, there are some beneficiaries—especially those who have benefited from the change in the exchange rate.

I ask the chief economist to talk about the modelling that has been undertaken.

**Gary Gillespie:** As was illustrated in the budget statement last week, we expect to see a rise in inflation in the UK over the next year or two, which will impact on household consumption and affordability. We know, from the data, the key components of household expenditure by different income groups, and we regularly look at those to see the impacts in the different sectors.

It is probably worth saying a bit about the context of the depreciation. The markets have taken a view on the extent to which the UK's competitiveness will be impacted, and the movements in sterling reflect the view that the UK's competitiveness will be impacted by its exit from the EU. The depreciation is a mechanism for adjustment following a shock, except that we have not had the Brexit shock yet—the current depreciation is the result of the uncertainty that exists at the moment, and the price effects will take some time to come through. On the upside, there are potential benefits for certain exporters, inward investment and stuff.

The impacts will feed through to households, earnings and consumption, and the uncertainty around prices will have a big impact on future investment.

**Ash Denham:** I suppose that if food and energy prices go up and families on lower incomes have to spend more money on things that they cannot

afford, they will have less disposable income to spend in other parts of the economy, which will have a wider impact.

**Keith Brown:** There is a similarity with the argument for the real living wage. If we increase the incomes of people on very low incomes to at least that level, they will have more disposable income to spend, which will benefit the economy.

You are absolutely right in what you say. The Resolution Foundation estimates that, by 2020, low-income working families will be £2,200 a year worse off as a result of Brexit and the cuts. That is a huge amount of money for people on low incomes. You are also right to say that they will have to pay first for necessities before using any remaining income for other purposes.

**Gary Gillespie:** We track household consumer confidence by running a survey of 2,000 households each quarter. We started in Q2 of 2013 and, when we ran the survey in 2016, that was the first time that it was negative, which reflected households' view that the outlook was more uncertain for their finances and the wider economy. If that uncertainty translates into lower household expenditure, particularly on bigger-ticket items, it could have a substantial impact on the economy.

12:00

**Michael Russell:** There is a survey from last week about positivity and negativity among people in Scotland and the rest of the UK over the medium and long term. It shows a considerable worsening in expectation since July, and Scotland is the most negative of all. There has been almost a doubling of pessimistic view, particularly for the longer term. The view for the medium term is declining but, for the longer term, it is pretty dramatic. I am happy to provide that information so that members see it.

**The Convener:** Was the survey conducted on a Monday?

**Michael Russell:** I do not know. Most people do not like Mondays—I am not going to break into song, but that is the case.

**Gary Gillespie:** The survey also considered people's expectations of where they would be in 10 years, so it was quite different from the shorter-term surveys, because it got a sense of future expectations. It is in the public domain, so we can provide it.

**John Mason (Glasgow Shettleston) (SNP):** I have a follow-up question on import costs. Has the Government considered particular sectors that might be more adversely affected by the lower pound? Representatives from the engineering sector that we had at the committee expressed

particular concern, presumably because that sector imports quite a lot.

**Keith Brown:** Yes, we have done.

To finish off the previous point about necessities, the Treasury has estimated that a 12 per cent fall in the price of sterling would increase the cost of the typical food and drink shop for a household of two adults and two children by around £120 a year and result in a £100 increase in the cost of clothing and footwear.

We believe that all sectors will suffer as a result of the lower pound. Sterling depreciation presents an opportunity and a threat for some companies. For some sectors with low variable input costs, the depreciation offers the opportunity to sell more products and services to foreign markets. However, for others, it will be felt mainly in increased input prices, which squeeze margins and will affect profitability. However, the rise in input costs will affect all sectors, although the extent will vary. We have a dialogue with individual sectors, whether Scotch whisky through the Scotch Whisky Association, engineering—you are absolutely right to say that that sector has expressed particular concerns—or higher education, which is another sector in which there are substantial concerns.

We expect sterling depreciation to affect every sector across manufacturing and the service industries but to a varying degree.

**John Mason:** Is it your feeling that, although the pound has fallen already—that is historical fact—we have not really seen the impact yet because many companies hedged sterling? We are getting some indication from witnesses that it might be into 2017 or even beyond before the fall really hits them, because that is when they will have to pay the higher prices.

**Keith Brown:** You are right to say that the Brexit vote did not have an immediate impact on many companies. On the day after the vote took place, I had discussions with senior industry representatives, a number of whom said that they expected the first real effects to come through six months out. Either William Hill or Gary Gillespie would be best to answer how it will go in future. If I knew how it would go, I would be one up on everyone else because it is a hard thing to predict. Gary Gillespie will perhaps want to add something about what economists are saying.

**Gary Gillespie:** In his opening remarks, the cabinet secretary mentioned that the economy through quarter 2 this year was still dealing with the aftershocks of what happened to oil and gas in 2015. One of the comments that we got back from the company base that year was that the high value of sterling was making it difficult, particularly for the manufacturing and engineering sectors,



which were selling into the European market—it was cited in a number of plant closures—so the reversal of that provides a bit of a margin back to those businesses. However, contracts are set in different time periods and the full impact of that reversal will not come in until new contracts for supplies are negotiated, so there is a lag effect, as the cabinet secretary alluded to.

The other point that is worth mentioning is that, in a single market, trade is very competitive and, from a Scottish perspective, the depreciation may provide opportunities for import substitution. That will not be appropriate for a lot of key sectors that require international components or goods but, in food and drink, for example, we might see supplier chains looking to domestic markets as a way of hedging against the sterling effect. As I said earlier, in traditional economic terms, depreciation is seen as a channel through which the economy can adjust to a shock. Part of that adjustment is in making import costs more expensive and rebalancing the economy.

I will not answer the question about what is going to happen in the future, but that is some more context.

**John Mason:** We will move on to the labour force next. Last week, a witness said that if they could not bring in labour from eastern Europe, rather than there being import substitution there would be an increase in imports—in effect, if they could not grow fruit here, they would have to import fruit from overseas. I take Mr Gillespie's point, but the substitution is not going to be one way, is it?

**Keith Brown:** No. For some farmed produce, the feed is brought in externally and that presents a different side of the equation. It is true for all the different sectors—and sometimes for individual companies—that there are pluses and minuses in relation to Brexit. As I said in my opening statement, the situation is not unremittingly bad. However, there seems to be a real and almost unique consensus among economists that Brexit will have—and already is having—a very detrimental effect on the economy. If individual companies see opportunities for import substitution, we should encourage that to happen—I say that whenever I travel around the country, and the enterprise and skills review that we are undertaking should be designed to ensure that we maximise that.

On balance, we believe Brexit to be an extraordinary act of self-harm to the economy, but that does not absolve us of the responsibility to mitigate its effects and grow the Scottish economy.

**Gillian Martin (Aberdeenshire East) (SNP):** That leads on nicely to my question, which is

about the labour market. We have heard from a range of sectors that have grave concerns about the labour pool that they have been able to employ to grow their businesses. You will be familiar with some of them, as you speak to all the sectors. James Withers of Scotland Food and Drink gave the example of Walkers Shortbread, which is based up in Aberlour where there was a very small labour market. Walkers Shortbread was able to grow substantially because of an increase in the labour market due to migration from eastern European countries.

Dean Lockhart has pointed out, rightly, that the Scottish Government has certain levers that enable it to increase our productivity. How are we responding where there is growth potential but not the access to the labour that is required? I am thinking not just of the people who might stay here but of future labour. What is our main ask of the UK Government to ensure that we still have access to the EU labour market, which would help us to increase Scotland's productivity? I suppose that the first question is for the cabinet secretary and the second question is for the minister.

**Keith Brown:** Mike Russell might want to respond on post-study work visas and the UK Government's demands.

You are absolutely right to say that there is potentially a huge impact. In my area, some of the major projects that are being undertaken just now rely extremely heavily on people from the rest of the EU working on them. As such projects approach completion and start to run down, people decide where the next project should be, and—as I have told the committee before—we have anecdotal evidence that they are not sure about the UK's future status in relation to the EU, so they are deciding to go elsewhere.

As you hinted, the situation is even more pronounced in the agriculture sector, which is very heavily reliant on EU nationals. I have also read of a hotel in London—I think that it was mentioned in the chamber—where 200 of the 208 staff are EU or non-UK nationals. I appreciate that that is in London, where the situation is slightly different. Nevertheless, the figure shows that in some sectors we are extremely reliant on individuals from outwith the UK. That is a vital part of our productivity. There has been an increase in our productivity; it is not nearly as much of an increase as I would like—it is about 5 per cent since 2007—but it has coincided with our having a more open economy and attracting people from across the rest of the EU.

Dentistry is another sector in which it is probably true to say that there is a huge impact.

There are challenges, and the issue has been a central feature of our representations since the EU

referendum. Perhaps Mike Russell is more able to answer your question about particular asks of the UK Government.

**Michael Russell:** The issue has been and remains a major topic for discussion. We can look at the effects right across the economy. This afternoon we will debate the effect on the tourism sector. The tech and digital sector, particularly in Edinburgh, is strongly affected, because there is a big interchange of younger people, in particular. About 20 per cent of the financial sector's workforce comes from other parts of the EU. In the health service, 9 per cent of doctors are from the rest of the EU. As for the food and drink sector, the statistic that stops us short is that 60 per cent of the staff who work in abattoirs come from the rest of the EU—that might mean compulsory vegetarianism unless we get it right.

There is a huge impact, right across the board—that is the extraordinary thing, because most people tend to think of the impact as being on one sector. The evidence that the committee had from the berry-growing and fruit-picking sector was dramatic, because there is the potential for people to say, "If we can't get the labour, we'll take the bushes elsewhere", which is worrying.

The issue of migration seems to feature very large in the views of the UK Government and to be a key driver in the Brexit process. Of course, the UK cannot be within the single market, either as a member of the EU or as a member of the EEA, unless it accepts free movement. If it will not accept free movement—I see no indication that the UK Government wishes to accept that—it will not be in either of those economic arrangements.

We will continue to press very strongly the need for involvement in the single market—the Welsh use the phrase "full and unfettered" involvement, but there are many terms that we can use—which is built on the need for the Scottish economy to have workers come here, at various levels and in almost every sector, from other parts of the EU. Without that, Scotland would be very severely impacted indeed. That is a key part of the discussions, but the present indications from the UK Government are not promising.

**Gillian Martin:** I want to pick up on some of what the cabinet secretary has said about skills. The situation has probably exposed some of the skills gaps that we have in Scotland. What are we doing to address those gaps with the powers that we currently have?

**Keith Brown:** Work is being done on the new labour market strategy, which is being produced by my colleague Jamie Hepburn, and there is a related piece of work on the enterprise and skills agencies, which is about how we can quickly scale up in areas that we understand to be challenges

for us. There are some obvious areas to mention, from the very particular issue to do with heavy goods vehicle drivers, which has been an issue for some time, not just in Scotland but across the UK, to digital skills. When we look at sectors in which a preponderance of people come from elsewhere to work here, we can see that there are particular challenges for some of the construction trades.

The work that has been done to date is the production of the new labour market strategy. That is bolstered by our review of the enterprise and skills networks: the four agencies in that regard are Scottish Enterprise, Highlands and Islands Enterprise, the Scottish Further and Higher Education Funding Council and Skills Development Scotland. The review will try to identify ways of making the interaction between SDS, the funding council, which includes colleges, and local authorities more effective.

On how we try to boost particular sectors, that is laid out in the labour market strategy that Jamie Hepburn produces.

**Gillian Martin:** Is it fair to say that, in parts of Scotland where there is a tight labour market, there will still be an issue? For example, Liam Kerr and I went to the fish processing company Denholm Seafoods the other week and learned that 95 per cent of its workforce is from eastern Europe.

12:15

**Michael Russell:** I wonder whether I might not just agree with that, but indicate the problem that exists in substitution. If there is a view—for whatever reasons, although they may be difficult to fathom—that positive input of labour should not be allowed to continue, the question is how to substitute it. There simply are not enough people in Scotland to do that, and there are undoubtedly skills gaps—I will not interfere in that policy area, but having been education secretary for five years I am aware of the issue—but are there other places where we will find workers who will come here?

Look at the experience that the Prime Minister had in India just a few weeks ago. It is obvious that the Indian Government continues to press for greater migration into this country, particularly in the skilled sector, as India has a lot of very skilled young graduates. That was refused, and the failure of the Prime Minister's visit to India was essentially built around that, as there was no give. She described the present migration system as highly satisfactory, which means that in all those circumstances there is no substitution, if those workers are not here and cannot come here, because the labour market is not static. There is an absolute need to guarantee the rights and

residency of the 191,000 people who are here, but that is not a static situation. People come and go, and if it becomes that much harder to come here, it simply will not happen.

I have heard it argued that there will be a different migration system that will be sectorally based. Many of us, as MSPs, have experience of dealing with the UK Border Agency and the Home Office on issues of migration. If there were a sectorally based system in an area that depends on seasonal work, such as berry picking, the berries would have rotted on the bush by the time that the system had come into effect. A very serious problem is emerging for the economy, and there are no answers to it as yet.

**Dean Lockhart:** I am not suggesting that I have all the answers, but a number of the witnesses who have been in front of the committee have suggested that we have an opportunity now to reinvigorate our domestic workforce. Youth unemployment in Scotland is at 12 per cent; there are some 70,000 young people in Scotland between the ages 16 and 24 who are not in employment, education or training; and the Fraser of Allander institute has highlighted an increasing level of inactivity in the workforce by 54,000 this year. Would there not be policy measures in place whereby we could retrain these people and bring them into the workplace to replace limited free movement of nationals coming from the EU, if indeed that transpires? I am not suggesting that we could make those 70,000 people job ready overnight, but surely we should start now and we should already have policies in place to bring them into the marketplace.

**Michael Russell:** I am no expert and that would clearly be a matter for the cabinet secretary and his team. However, I think it highly unlikely that you would substitute, in the numbers or skills required, in anything like a reasonable period of time. Given what we have seen today in terms of the indication that there is not to be any transition, in case people thought that they were not leaving, the problem that is being created for Scotland, even though Scotland did not vote for it, is enormous and likely to be incredibly damaging if the present trajectory is followed.

**Keith Brown:** I substantially agree that we should be looking to reskill those people. It is worth putting the question in its correct context. With 40,000 more people employed at above the pre-recession peak that we had before, and 166,000 more above the recession trough, as I mentioned in my opening statement, a 4.7 per cent unemployment level across Scotland has variations within that, as you can imagine, and the figures could be substantially higher in some localities or well below that in other localities. To some extent, that may be coincident with some of

the areas that Gillian Martin raised. There could be unemployment of between 1 and 2 per cent in some areas, and the question is where to draw in the additional labour. That does not mean, of course, that we should not try to ensure, as we are doing through the labour market strategy and the skills review, that we have a better fit, and we must also ensure that industry is much more involved in how we deliver the skills that will be required in the future.

Against that, I must say that the dampening of employment prospects, which has been cited by virtually every economic expert there is, is a bigger issue. The effect of Brexit on the economy will be a substantial risk. That is not to say that we should not do as you suggest and make sure that we have people ready for the jobs market—there is no question but that we have to do more in that respect. However, the bigger issue is the general impact on the economy. Gary Gillespie may want to come in on that point.

**Gary Gillespie:** I will add a couple of thoughts. Going back to a previous question, the labour market is very dynamic. We have flows in and out, such as people moving from employment to inactivity. Not all inactivity is necessarily bad—some of it is to do with further or higher education, or with family or personal reasons, such as looking after children or other family members. There are dynamic flows all the time, with people entering and leaving the workforce. There is also the dynamic with the rUK and EU migrants. In a sense, this economy of devolved skills demands change over time as well.

On the question about youth unemployment and the current unemployment rate, it is interesting to reflect that, before the financial crisis, we had record low unemployment—I think that the figure was around 4.6 per cent. At that time our youth unemployment rate was 12 per cent. That higher rate reflected the structural issues around new entrants to the labour market of their particular age, circumstances and transition path. A lot of work is being done to make the transition smoother for that group, following a series of reviews.

The key point about the labour market and how to reduce the structural rate of unemployment goes back to the economic strategy and its focus on competitiveness, reducing inequality and reaching out to those who are furthest from the labour market. That is how we bring those people into employment, and having more people engaged is how we boost the long-term capacity of the economy.

The question was whether we can have direct substitution in a dynamic market, and the answer is probably not, for reasons of location and specific skills. There is an on-going process. The key point

is that the labour market is dynamic. Only two or three years ago we faced different skills shortages, in oil and gas and engineering. Skills shortages evolve all the time. Skills Development Scotland tracks the shortages, speaks to employers and shifts the resources to meet those demands.

**Dean Lockhart:** Thank you. I think that we have a degree of consensus. Some witnesses have suggested that there should be even further flexibility in the labour market to encourage what they have referred to as “internal migration” to deal with the different regional patterns of economic supply and demand. I suggest that the Government look further into patterns of internal migration, if there is indeed to be a limit to EU nationals coming into Scotland.

**Andy Wightman (Lothian) (Green):** My question is about inward investment. We heard evidence from the Royal Bank of Scotland’s chief economist, Stephen Boyle, who said:

“if we have a fixed pot of money for the purposes of promoting internationalisation, that money will likely be more productively spent on export promotion than on the attraction of foreign direct investment.”—[*Official Report, Economy, Jobs and Fair Work Committee*, 1 November 2016, c. 59.]

Yet Professor Jeremy Peat said:

“A lot of the high-productivity, high-skill, export-oriented businesses are based on inward investment as much as domestic investment.”—[*Official Report, Economy, Jobs and Fair Work Committee*, 16 November 2016, c. 10.]

What work is the Government undertaking to adapt its strategy around inward investment to reflect the uncertainty, but also the possibilities, of improving exports by increasing inward investment?

**Keith Brown:** To both of those witnesses, I would say that both of those things are important. Inward investment can often bring new skills and new productivity gains into the market and the domestic economy, which is extremely important. We cannot become complacent about the fact that inward investment often brings with it well-paying jobs, which are vitally important to people. Therefore, we want to continue to bring in inward investment.

In addition to what we are doing, we recognise that there is an interdependence with, and complementary assets that are shared between, for example, Scotland and London, in key sectors such as financial services and technology. As I mentioned in response to a previous question, London is very important to us. The vast majority of inward investment in the UK comes into London. The actual investment often then goes out of the UK altogether, but we also tap in to a substantial degree.

We are trying to present a more effective team Scotland approach. We work with the seven cities that have their own pitch book of investments; those are driven by the cities themselves based on what they want investment in. I mentioned already the doubling of the number of SDI staff across the EU. The number of offices in India has grown from one to three; we recognise that for India and China we are starting from a low base and are building up relationships, which tend to depend on being built over a period of time—certainly in China and, in my limited experience, in the middle east.

With regard to exporting, we are increasing our activity and trying to increase its focus so that we do not have people representing Scotland, or parts of Scotland, pitching for investment and tripping over one another; the effort is more co-ordinated. Similarly, with inward investment, we do not intend to take a backward step from the position that has seen Scotland achieve the second-highest per capita investment in the UK in two years of the past three, second only to the area south-east of London and then to London itself. That has been extremely successful, according to the EY study.

As has been mentioned a number of times, we recognise the challenge of the economic environment that we are going into; in that context, increasing our inward investment will be extremely important, as will exporting more of what we produce. There are efforts in both those areas.

**Andy Wightman:** I will follow up on inward investment. To what extent are you aware of companies or investors that are interested in investing in Scotland but whose investment is conditional on membership of the single market? Are you having to deal with that issue?

**Keith Brown:** To be honest, it is hard to say. A person who has made a decision not to invest in Scotland or the UK because of what they perceive to be uncertainty about membership of the single market is not necessarily going to tell you about that.

I have some anecdotal evidence. Three or four months ago, after the vote, I went to a company on the outskirts of Edinburgh that is involved in 33 countries and which said that it was aware of an investment decision that was going to Frankfurt instead of Scarborough because of the Brexit vote. It did not say that the investment was huge, but that was what it had seen. I would be interested to hear of others’ experiences. The situation is hard to quantify as the evidence tends to be anecdotal and it is perhaps not fair to offer up a position. Often, we do not hear about what has not been achieved; companies will just make the decision to go elsewhere.

There is other anecdotal evidence that I could give you; I do not know whether Gary Gillespie or

Mike Russell have more to say. For example, Mike Russell and I have jointly met with the major Japanese companies that are involved in Scotland. Some are very substantial companies, and some have a number of divisions in Scotland. Many are very large employers and very happy to be in Scotland, but one or two are not so much expressing threats as raising question marks—I think that it is fair to put it that way—over continued involvement in Scotland without the current EU arrangements.

**Michael Russell:** The situation is not static; the Hitachi report that came out earlier this month showed that something like £6.5 billion-worth of investment in the economy is being withheld at present because of uncertainty. Existing companies are either holding back on investment—some of that is within that figure—or are beginning to ask whether investment gives them the access to the single market that they required when they were established.

The climate is changing, and the possibilities are changing for those who are investing in that climate. It is worth reading the letter on Brexit that the Japanese Government issued in August or early September. It remains one of the key documents on the issue; it considers what is required for companies to continue to have confidence. The two most important factors are transition, which the UK Government appears to be setting its face against, and transparency in letting people know what situation they are in—and whatever else we can say about the present situation, it is not very transparent.

12:30

**Gary Gillespie:** If I may, I will add two quick points on that subject. There are two basic types of company that are looking at investing in the UK or Scotland. For the first, market access around the four freedoms is key, as they are looking to come to the UK or Scotland to service that market. The second type, which is probably more important, is the stock of EU, UK and foreign-owned businesses that are in Scotland at present. Their on-going investment tends to go under the radar but, in a sense, there is potentially more of a threat if those companies are thinking about future scenarios for where they could operate.

There was a question earlier about the concentration of exports in a small number of sectors. On that subject, I note that companies now tend to be much more global and more integrated in their supply chains, and they have opportunities and networks in different outlets. That is the risk around the potential loss of capacity down the line.

**Keith Brown:** When I asked the company in the west of Edinburgh that I mentioned about the impact of the Brexit vote, which at that time was about two months old, it said that the most difficult thing that it was having to deal with was trying to explain the vote to its counterparts in the 33 countries around the world that it is active in. It was being asked why the UK voted for Brexit. As an export-driven international company, it could not explain that.

**Jackie Baillie:** I have tiny question, but it is one of substance. The Scottish Government has an economic strategy, which was published some time ago, and a trade and investment strategy, which was published in early 2016. In the light of Brexit, are you reviewing both of them to ensure that we are properly focused on what we need to do?

**Keith Brown:** There was a lot of potential for discussion of the economic strategy during the review of the enterprise and skills agencies, the report on phase 1 of which was published recently. There were more than 300 responses, and in a lot of that feedback people did not seek to question but instead supported the current strategy for inclusive and sustainable economic growth.

As Jackie Baillie said, we have changed our trade strategy, and I have mentioned a number of elements of that. The four-point plan that the First Minister laid out includes increasing our representation, increasing the number of people who are involved in promoting the strategy and making sure that there is a sharper focus among all ministers on promoting it.

We have reflected the changed circumstances, given the continuing uncertainty as to what the outcome of the discussions will be, which Mike Russell laid out. We will need to keep our eye on that and adapt as we go along, but we have made changes in relation to the growth scheme that is being developed, the enterprise and skills review, the beefing up of the trade side of what we are doing, and the attracting of inward investment. We have responded to the situation, but we have not changed the economic strategy.

**Jackie Baillie:** I am curious about that. Professor Graeme Roy, in a former employment, had a direct hand in shaping that strategy, and his view is that the strategy should be reviewed to reflect the severity of the challenge that Brexit poses. Will you take that away and consider it?

**Keith Brown:** As I have said already, we all know that we are in a rapidly changing situation and the outcomes are uncertain. The changes that we have made in relation to investment and trade perhaps reflect the different emphasis underneath that strategy, but we will always want to look at

these things and take a view on them as circumstances develop.

**Richard Leonard:** You mentioned in your opening remarks your previous appearance at the committee, on 28 June. On that occasion, you said of the manufacturing action plan:

"I would like it to be extended further to turn it into the kind of industrial policy that used to be fashionable ... There are certain things that I will be able to make public shortly that will demonstrate that we are taking a more holistic approach."—[*Official Report, Economy, Jobs and Fair Work Committee*, 28 June 2016; c 18-19.]

I wonder whether, five months and a day on, you can elaborate on that.

**Keith Brown:** Yes. One example of what I meant then, which has become public but was not at the time, is the work that is being done, largely by my colleague Fergus Ewing, on the Rio Tinto Alcan developments, which includes safeguarding about 150 jobs, with the potential for many more. I mention that because of the links between that and proposed work that is being done there and the other parts of industry that can support it. For example, if we were to move from using steel to using aluminium for cars, instead of moving steel from steel production plants to car production plants, we would have a domestic source for the raw materials used in car production.

In much of that work, and in a number of other areas, people are thinking about the whole industrial strategy: they are not thinking about just one production facility; they are thinking about how the raw materials can be produced. That is the kind of thing that I had in mind.

Of course, we have produced the strategy and we are looking to establish the manufacturing centre of excellence. There are other areas in which, if we are successful, you will see the linkage that I mentioned.

It is interesting that, since the last time we discussed the issue, the UK Government is now saying something very similar. We have not seen a lot of evidence of this, but in my discussions with UK ministers—I think that Liam Fox was the last one—they talk about the UK Government wanting to develop an industrial strategy.

To return to a point that Dean Lockhart made, we may have some of the tools, but export guarantees for overseas companies are provided by the UK Government. It is a mixed picture, and I am genuinely keen to work with the UK Government on it—I have made that offer. Shipbuilding is one sector in which that discussion is on-going. Instead of seeing one plant produce something, we can see a whole supply chain moving into a customer base that is sustainable in the longer term.

Those are some of the things that we are trying to do to ensure that we have a coherent industrial strategy.

**Richard Leonard:** Do you plan to publish a paper?

**Keith Brown:** We can do that, but what we are doing now is working on the immediate challenges that we face. However, that work will link to the establishment of the manufacturing centre of excellence in due course.

**The Convener:** You mentioned Dean Lockhart, so I will let him come back in with a minor point as we draw to a close.

**Dean Lockhart:** Last week, John Swinney announced that the individual boards of the enterprise agencies and other agencies would be replaced by a board of trade. When will that take place, and how will you ensure that the board of trade has an understanding of the very different remits of those agencies?

**Keith Brown:** Perhaps there is some confusion around the board of trade and the strategic board, which is to be established as a result of the enterprise and skills review. The board of trade is something separate, and we are in the process of agreeing its membership. The strategic board will replace the boards that the member mentioned.

The member asked about the timescale. It is estimated that phase 2 of the enterprise and skills review will take us through into March next year. The review group met last week and one of the first tasks that it has been given is to look at the governance arrangements for the agencies.

I want to be very clear that Highlands and Islands Enterprise will remain as a statutory agency, as will the other agencies. The question of their governance and how they will relate to their local areas and the strategic board is being discussed by the group. That work is necessary for the hard alignment that I mentioned.

We expect the review group to come back over the next six months. It is not the case that we have to wait until the review is done—some things can be announced during the process—but that is the timescale that we are working towards.

**The Convener:** Andy Wightman has indicated that he has a very small question to ask. This will be the last question.

**Andy Wightman:** Cabinet secretary, to help clarify things, will you say whether it is your view that, after the review has been completed and the changes have been implemented, HIE will continue to have its own legal personality?

**Keith Brown:** The agency will remain, and it will remain in law. It is established in law—under

primary legislation, I think. That is not intended to change.

**The Convener:** I thank the cabinet secretary, the minister and their officials for attending. We move into private session.

12:39

*Meeting continued in private until 12:45.*





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