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Official Report

ECONOMY, ENERGY AND TOURISM COMMITTEE

Thursday 8 October 2015

Session 4

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CONTENTS

ECONOMY, ENERGY AND TOURISM COMMITTEE
25th Meeting 2015, Session 4

CONVENER

*Murdo Fraser (Mid Scotland and Fife) (Con)

DEPUTY CONVENER

Dennis Robertson (Aberdeenshire West) (SNP)

COMMITTEE MEMBERS

*Chic Brodie (South Scotland) (SNP)
*Patrick Harvie (Glasgow) (Green)
*Johann Lamont (Glasgow Pollok) (Lab)
Richard Lyle (Central Scotland) (SNP)
*Gordon MacDonald (Edinburgh Pentlands) (SNP)
*Lewis Macdonald (North East Scotland) (Lab)
Joan McAlpine (South Scotland) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Crawford Beveridge (Council of Economic Advisers)
Professor Sara Carter (Council of Economic Advisers)
Jim McColl (Council of Economic Advisers)
Professor Anton Muscatelli (Council of Economic Advisers)

CLERK TO THE COMMITTEE

Douglas Wands

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Economy, Energy and Tourism Committee

Thursday 8 October 2015

[The Convener opened the meeting at 10:01]

Decision on Taking Business in Private

The Convener (Murdo Fraser): Good morning, ladies and gentlemen, and welcome to the 25th meeting in 2015 of the Economy, Energy and Tourism Committee. I welcome members, our witnesses and our guests in the gallery. I remind everyone to turn off, or at least to turn to silent mode all mobile phones and other electronic devices so that they do not interfere with the sound equipment. Apologies have been received from the deputy convener, Dennis Robertson, and from Joan McAlpine.

Under item 1 on the agenda, I ask members whether they are content that we take item 3 in private. Is that agreed?

Members *indicated agreement.*

Council of Economic Advisers

10:01

The Convener: Item 2 is evidence from the Scottish Government's Council of Economic Advisers. I welcome Crawford Beveridge, the chair of the council, Professor Sara Carter, Jim McColl and Professor Anton Muscatelli. Thank you for giving up your time to come along. We have about an hour—maybe a little bit longer—for evidence this morning, and we are interested in hearing from you on a range of issues to do with the Scottish Government's economic strategy, the national performance framework, internationalisation, manufacturing, Scotland's tax regime, the Scottish Fiscal Commission, the current state of the economy and the Government's agencies. I am sure that we will rattle through those subjects in no time at all. Given that there are four of you, please do not feel that you all have to chip in and answer every question. We will let you decide among yourselves how you want to handle the questions. If you want to agree or—which would perhaps be more entertaining for us—disagree with each other, please feel free to do so.

Before we begin our questions, do you want to say something by way of introduction, Mr Beveridge?

Crawford Beveridge (Council of Economic Advisers): Yes, I will, if you do not mind, convener. Thank you for giving us the opportunity to come and speak to you today. I last appeared before this committee in 2012 in my capacity as chair of the council as it was formulated at the time, to give evidence on the council's role and work. I and several other members have given evidence on aspects of policy several times since then.

I remind the committee that the council's role is to be an independent advisory group to the First Minister. We are mainly a sounding board for ideas, and we act as a critical friend to the Government and put forward suggestions that we think might make a difference in areas that the First Minister has invited us to consider.

Following publication of the Government's programme for government last year, the council's remit was refreshed. Whereas previously we had been tasked with advising the then First Minister on issues such as the economic recovery, jobs, economic levers and internationalisation, our remit now is somewhat wider and we have been asked to advise on actions to improve the competitiveness of the Scottish economy and on actions to tackle inequality.

Alongside that, as you would expect, the council's membership was refreshed, and there has been both continuity and change in that. The First Minister asked several previous members to continue to serve on the council, some of whom you have met before. Joe Stiglitz, from the United States, remains a member, as do Jim McColl, who is here today, Sir James Mirrlees, Frances Ruane and myself. The First Minister also invited several new members to join the council. We have been joined by Sir Harry Burns, whom most of you will know as the former chief medical officer; Sara Carter, from the University of Strathclyde; Professor Mariana Mazzucato, from the University of Sussex; Amanda McMillan, whom you might know as the managing director of Glasgow Airport; and Professor Anton Muscatelli, who is also here today.

I warn the committee that it is pretty early in the life of the council to be able to tell you very much about what we are going to achieve. We had our first meeting here in March and we aim to have two formal meetings of the whole council each year. We will have several meetings in between times by telephone, either one-on-one, with officials or as a group through teleconferencing.

I am keen that we continue to engage with others who are involved in improving the performance of the economy, and we look for opportunities to do that. One of the areas that we have been tasked with looking at by the First Minister is innovation. The committee might know that the Deputy First Minister chairs an innovation forum called the can do innovation forum, which had a meeting yesterday that I attended in my capacity as chair of the Council of Economic Advisers to ensure that we are aligned and that the officials who service both groups are aligned with each other so that we do not run into each other all over the place.

At the council's first meeting in March this year, the First Minister asked us to focus our work on specific areas within our broad remit, including inclusive growth and innovation, as well as on measurement of the economic strategy and its ambitions through the national performance framework. Those areas will form the bulk of the work that we will consider over the course of the next two days while we are meeting here in Edinburgh.

That is probably enough background for now, convener, but I am happy to take questions. We have not rehearsed anything, so you might hear differing arguments after all.

The Convener: Thank you. I remind members to keep questions as short and to the point as possible, and I would like responses to be the same because we are keen to cover a number of topics. I will start by picking up the point that you made about the Scottish Government's economic strategy, which was launched earlier this year. Were you involved in drafting that or were you consulted on its content?

Crawford Beveridge: The current council was not particularly involved in that because we were only forming in October, November and December of last year. However, a lot of the strategy came from work by the prior council. We cannot draw a direct line to all of it, but much of what went in to the economic strategy had already been discussed to a reasonable extent by the prior council—for example, innovation and inequality.

The Convener: Okay. One of the interesting aspects of the new economic strategy that is quite a departure from the previous one is that the previous commitment to cut corporation tax has gone. Was that something that you suggested? If not, do you know where it came from?

Crawford Beveridge: As you will probably know, the prior council had the fiscal commission working group as a subcommittee, which was made up mainly of economists but which I chaired. We spent some time talking about corporation tax, and when we gave evidence to the Finance Committee, Andrew Hughes Hallett and I tried to give the committee the understanding that there are various ways to look at corporation tax—for example, looking not just at the rate but at where allowances happen and how much the take is. We gave examples of countries where the rate is low but take is high, and vice versa.

So, we had some discussion around whether corporation tax could be tailored in some way towards activities that we might want to encourage, such as research and development. It would be too strong to say that we made a proposal, but we had those debates inside the council.

The Convener: Do you think that that is reflected in the new economic strategy?

Crawford Beveridge: Yes.

The Convener: I ask Jim McColl the same question. I know that you are quite an evangelist for cutting corporation tax.

Jim McColl (Council of Economic Advisers): It is not so much about cutting corporation tax as it is about having control of it, which means that specific initiatives can be targeted at certain industrial sectors. My company sees that in other countries that we are involved in, where the headline corporation tax might be the same but there is flexibility in order to encourage or stimulate specific industries or specific activities in companies.

With regard to allowances against corporation tax, we can look at research and development, for example, because how R and D is handled just now is very inefficient and companies do not really engage in it as I think they should. I will compare the situation here with that in Canada, where we have a business. Companies there put R and D through their accounts and the auditors are charged with checking whether the qualifying rules for R and D allowance are met. The amount is then deducted so that the corporation tax is based on the net number.

We seem to have a complicated system in the UK where the matter is handled by the tax authorities and you do not get back the allowance. I have given the example before of when we had a claim for R and D refused. We employed PricewaterhouseCoopers to appeal. We won the appeal, but it cost us more to pay PWC than we got in the allowance. We took the action on principle, but we have not tried to claim any allowance since because it is too complicated. If the Scottish Government had control of corporation tax, it would be possible to play about more efficiently with how you handle such things. It is about control of corporation tax rather than control of the absolute rate.

The Convener: Okay.

Lewis Macdonald (North East Scotland) (Lab): I want to understand what the shift means for the Government's economic strategy and what the view of the Council of Economic Advisers is on that. The Scottish Government has said—it did not say this when Alex Salmond was First Minister—that there is no intention to have a "race to the bottom". Those words are explicit in the strategy. The previous emphasis on a corporation tax cut has been replaced by the proposition of targeted tax changes. What is meant by that?

Jim McColl: I suspect that it is what I have just said—the ability to vary the rate. I surmise that the Government would still want control of corporation tax and—rather than necessarily wanting to reduce its headline rate—to have the flexibility to be more targeted.

Lewis Macdonald: Should we understand that as being a proposition around corporation tax exclusively?

Jim McColl: As an adviser to the Government, that is what I would be saying—

Lewis Macdonald: That is what the Government says to you when you discuss the matter.

Jim McColl: The Government has not specifically said that to us.

Crawford Beveridge: In the current council we have not so far discussed corporation tax. As I said, we discussed it in principle in the prior councils, and said that there are options. As Jim McColl rightly said, the point is that if the Government has control of corporation tax, it can make logical decisions about what to do with the take.

Lewis Macdonald: Is it your understanding that when the Government talks about targeted tax changes to promote competitiveness and reduce inequality, that is essentially about taking a more nuanced approach to cutting corporation tax.

Crawford Beveridge: Correct.

Professor Anton Muscatelli (Council of Economic Advisers): I would echo what has been said. If you read the relevant page of "Scotland's Economic Strategy", you will see that it is exactly that—it is not about taking a blanket approach. It looks particularly at R and D, investment in capital and encouraging growth of small and medium-sized enterprises. A much more differentiated approach can be taken if you have all those tools at your disposal.

We have seen from other countries that employment can be targeted. That would fit well with an inclusive growth mechanism by creating employment as part of the investment. There is an attempt to tie that together with corporation tax. Jim McColl has given a good example of where R and D tax credits can work effectively and, more important, efficiently.

The Convener: It seems to me that you are suggesting a more nuanced approach, rather than the previous approach, which was a headline cut in corporation tax of 3p below the UK rate. There has been a bit of a shift.

Gordon MacDonald (Edinburgh Pentlands) (SNP): You said that you have been asked to tackle inequality. That obviously includes income inequality. That must be tied to employment growth and connected with economic performance. Yesterday's figures for Scotland were pretty poor in comparison with the rest of the UK. Is there an underlying reason for that? Why did we grow by 0.1 per cent when the UK grew 0.7 per cent over the quarter?

Crawford Beveridge: I saw the numbers only yesterday evening. Anton Muscatelli might have more of a clue about why that was the case. At the moment, I do not have an idea about why the growth level was at 0.1 per cent.

10:15

Professor Muscatelli: The total numbers are lower than they were previously. On the other hand, it is the 12th consecutive quarter of continuous growth.

We can always expect such fluctuations, depending on what is happening in the different sectors. The other thing to bear in mind is the fact that the figures can be adjusted. One element that might have depressed Scotland, when compared to the rest of the UK in this particular quarter, is the onshore part of the oil and gas industry. The UK figures were boosted by increased oil and gas production, which is attributed to the UK rather than to Scotland. You need to dig below the figures to see what is actually happening.

One thing that has been particularly strong and has helped to maintain the figures at their level is construction, which has been fuelled by public investment.

I would not set too much store by one quarter's figures. Gross domestic product tends to fluctuate. The key thing is the trend in the rate of growth, not what we see in a single quarter.

Gordon MacDonald: Will you clarify what you said about oil? Are you saying that the growth in oil figures feed into the UK numbers but not the Scottish numbers?

Professor Muscatelli: The figures for oil and gas production feed into the UK numbers. However, onshore economic activity that is related to oil and gas production in the Aberdeen area would add to the Scottish figures.

Gordon MacDonald: You said that growth in Scottish construction is tied to economic policy. We are expecting further cuts to Scotland's budget. What impact will that have on economic performance, if we are so dependent on construction to hold up our percentage?

Professor Muscatelli: Again, I would not set too much store by one set of figures. If there is going to be a cut to capital spending in the public sector, that will feed through to the Scottish block grant and will have an impact on growth. We have to look at things in the round and not just at one quarter's figures, but clearly if the next UK spending review led to a cut in public spending on the capital side that would have a negative impact.

Gordon MacDonald: Scotland is an exporting country and we export mainly to the euro zone. We have seen the strength of the pound compared to the euro—it is at its highest level since about 2007. Given that the UK has a balance-of-trade deficit and Scotland has a balance-of-trade surplus, what impact is the policy of having strong sterling having on Scotland's exports?

Professor Muscatelli: That can create competitiveness issues, although we must take into account the fact that between 2007 and 2013 the value of Scotland's non-oil and gas international exports increased by about 40 per cent. Scotland is holding its own.

Exporting is about not just currency but having a competitive offering. Jim McColl can talk about that, given his knowledge of the industrial base in Scotland. However, what happens to sterling relative to the euro will be important.

For us, a prosperous Europe is more likely than currency to be a strong pull on our exports.

Lewis Macdonald: Is it your analysis that were it not for the growth in construction activity, the Scottish economy would have contracted between April and June?

Professor Muscatelli: Arithmetically, that is clearly the case, but I stress again that the various sectoral elements tend to go up and down. One tends to offset another, so we cannot draw conclusions from one quarter's figures. We need to look at the trends.

Lewis Macdonald: I understand. I am interested in your views and the advice that you are giving to Government on the oil and gas supply chain and service sector, particularly regarding its impact on the north-east—although clearly it has impacts across Scotland. What scale of risk does the Scottish economy face as a result of reduced oil and gas activity?

Professor Muscatelli: I stress that we have not provided particular advice on that. One of the key things is that many companies in oil and gas are diversifying; we have heard such announcements by the Wood Group and similar companies. It is important that, over time, engineering expertise has been built up in the north-east of Scotland, which can be used to diversify so that activity is not based just on oil and gas.

Oil prices are incredibly volatile. We have seen a decline; I would not put any bets on what will happen in the next couple of years. The lesson of the past year or two is that diversification is hugely important, even in that sector.

Lewis Macdonald: You are right to emphasise the importance of the expertise that has been built up. I do not think that anyone in the sector expects prices to go up any time soon, so I am particularly keen to understand the impact. The industry body Oil & Gas UK has said that around 65,000 jobs have already been lost across the UK and, because of the importance of oil and gas to the Scottish economy, more than half of those jobs were in Scotland. I presume that that must have an impact on demand for services across the economy, including in manufacturing. I am keen for the Government or its advisers to carry out an assessment of that. Have you had any conversations with the Government about the significance of the scale of job losses for the Scottish economy?

Crawford Beveridge: So far, we have not had a discussion on that. I stress that we met for the first time in March and we are still trying to build up thoughts on where we might be useful. That assessment might well happen, but we have not done it to date.

Lewis Macdonald: I presume that Jim McColl, as a man with great experience of the manufacturing sector, will recognise the importance of the issue.

Jim McColl: There has been quite a big downturn in employment. However, we have recently been looking at the underlying drivers and, in our business, the North Sea and the middle east are actually holding up quite well, whereas the Gulf of Mexico is the hardest hit. The reason why all this is happening is that we have an oversupply of oil and demand is lower than supply. We have an oversupply because the Americans have done all this fracking and, in the middle east, the countries in OPEC—the Organization of the Petroleum Exporting Countries—are ramping up their output to keep their market share. The fracking in the US has now turned down and the utilisation rate of jack-up rigs in the Gulf of Mexico is down at 20 per cent now. All the indications are that, when we work through the current oversupply and surplus, demand will overtake supply in around 2017 or maybe 2018, the price will go back up and activities will start again. It is a huge shock in the short term, but the North Sea is still a viable area. The prices will go back up.

Lewis Macdonald: The issue is more the short-term impact on the wider Scottish manufacturing supply chain. That is what I am concerned about, and I think that you said that it is significant.

Chic Brodie (South Scotland) (SNP): That last point that Jim McColl made is interesting. The Brent crude projections for the next three years and the economic activity survey reflect exactly what he said. For example, seven rigs have closed in the Gulf of Mexico.

Anyway, my question is about internationalisation. I ask this with some apprehension, as I am speaking in a debate tonight about how Scotland's ethical strategy on trade can open up North Korea—I hope that I am able to leave the debate.

Crawford Beveridge: How did you ever get into such a complicated-sounding debate in the first place?

Chic Brodie: Somebody said that I look Chinese.

We have heard that Scotland's economic success depends on strengthening links with the global economy. The question, which is specifically for Jim McColl and Crawford Beveridge, is on manufacturing. The committee has been looking at internationalisation of the Scottish brand and Scottish products. Although we focus on food and drink, I believe that manufacturing is one of the key areas.

We do not seem to be able to deliver the increase in exports of manufactured goods and services that we perhaps might deliver. I heard Professor Muscatelli say that the value of international exports has risen by 40 per cent, but that is the cash value. The percentage of output figure has remained fairly stable over the past few years. On the basis that a new trade and investment strategy is to be developed, what are the key factors or tenets that would encourage us to secure a greater proportion of investment, particularly in manufacturing?

Crawford Beveridge: I remind everybody that most of our companies in Scotland are small and medium-sized enterprises. My experience from my erstwhile career in Scottish Enterprise was that many of those companies were very worried about exporting at all—they just did not know how to do it. For a long time, we provided them with help into only a couple of markets: Europe and North America. As markets in the other parts of the world have expanded, my ex-colleagues have set up offices in many places, as members know, and are now working an account management system with a strong drive to try to help SMEs to understand how they can go into places such as China and South America. It takes time to convince people that they should get out of their comfort zone of manufacturing in Scotland, that they really could tackle the wider world and that there are no huge legal problems if they just get some help in the right directions. It is really a matter of education, and people are focused on trying to help with that exact problem.

Jim McColl: I agree with that. Those companies did not really know how to break into the markets.

Another issue, which is serious, is financial support. With what has happened to the banks, it is not easy for those companies to get debt finance. More important, if a company is selling overseas, it often has to put up a bank guarantee that covers the cost of its exports. That is treated by the banks now as core debt, and a small company might not be able to get it in within its debt capacity.

The UK has the export credit guarantee system. We had a particular involvement in that when I was in the pumps business. When I was on a trip to China with David Cameron, I said that it was great that we were trying to drum up business for the UK, but it was a pity that we would not be able to exploit that, because when we got the orders we would not be able to raise the bonds to support them.

David Cameron followed up on that. I got a call from the Export Credits Guarantee Department to say that number 10 had been on to it and had given it three months to get a trade support package in place. Six months later, that was in place, and we got support for a pump order for China. However, such support is very difficult to get. Our support was just given to showcase that the package had been put in place. The system is not efficient, and smaller companies find it absolutely impossible.

It would be much more appropriate if the Scottish Government had control of something like that for Scottish companies. Support also has to be offered for domestic jobs. I see an example of that in a business that we are in. One of the biggest companies that we have, in respect of the money that is committed to it, is in Finland. The Finnish Government has a Finnish investment bank—Finnvera—that can lend to small companies of up to 250 employees, I think. It will lend to them, put bonding in place for export jobs and domestic jobs, and give support to them. It works with banks, but it stands behind companies and provides guarantees.

When I was in the pump business, I explained the matter to the Government when we went to China. I had to move one job to France because the French Government gives 80 per cent backing to its industrial businesses, and another to Canada, where there is 100 per cent backing by Government guarantee.

Those are contingent obligations. You do not have to give cash—you have to stand behind the businesses—and I have never heard of one of them being called. However, such support would make a significant difference to the opportunities of small companies, or to their ability to exploit the opportunities that exist overseas—and there are plenty of them.

10:30

Chic Brodie: We need new products and services to go to market, and the international aspect is very important.

This question, which follows on from the previous one, is for Professor Carter and Professor Muscatelli. We had a conversation only two weeks ago with representatives of the universities regarding wages, work and wellbeing, and the need for innovation. Innovation in partnerships is at the heart of our exports, which are critical to economic success.

When we asked about what involvement universities might have, the response was surprising. You will know, with regard to Stanford, for example, about the level of equity participation that universities take in new products to ensure that they get to market.

We were told that universities would look at that in Scotland, but they had not already done so. A lot of the research and development that we require comes out of the universities. Is there not a need for a greater involvement in and understanding of the business and internationalisation of the products that are developed?

Professor Sara Carter (Council of Economic Advisers): I will answer that question from the perspective of SMEs. Much of the innovation that is undertaken in universities is exploited by spin-outs or local companies. Many of Scotland's universities give a huge amount of support to the SME sector, whether that is through innovation, support for management or connecting small firms with funders, bankers or the corporate sector.

Chic Brodie: Yes, but there is no risk as far as they are concerned. They give all that support, but equity participation and involvement seem to be lacking.

Professor Carter: I invite Anton Muscatelli to respond to that.

Professor Muscatelli: One thing that is scarcer not only in Scotland but across Europe, compared with the US, is the availability of venture capital in such circumstances. Having said that, I note the attempt to draw universities and companies closer and ensure that there is co-investment.

I will give you two examples. Recently, a US venture capital organisation decided to establish Epidarex Capital, a fund for investing in Scottish life sciences. Three of the Scottish universities, including mine, put money into that, and some of that money is now being invested back into a number of businesses, not all our own. It is not an exclusive fund in any way—it is investing across the whole of Scotland. It is a good example of pump-priming capital, which has now led some companies to grow quite substantially.

Let us consider other ways in which we need to feed the interface—this goes back to a point that Crawford Beveridge mentioned, about trying to join up the innovation ecosystem in Scotland through the can do forum. Public money is being put into innovation centres through the Scottish Further and Higher Education Funding Council, and that is an interesting experiment.

My university provides the base for two of those centres: one in stratified medicine and the other in senses and imaging. In stratified medicine, much of the initial spadework to translate the amazing research that is happening in Scotland requires public investment. There is no other way to do it. The techniques are new, and there is no way that people are likely to get private money into that phase.

The whole idea of the innovation centres is that the initial public investment creates a number of exemplars, which, hopefully, will lead to investment, jobs and growth. There are different examples, depending on the different innovation centres.

There are no easy answers in this space. If there were, we would have discovered them by now. We need to feed off the fact that Scotland's universities provide two thirds of our R and D, if we consider our total R and D figures. I think that we are fourth in the Organisation for Economic Co-operation and Development in terms of the amount of R and D that comes out of our universities as a percentage of GDP. That is not reflected in business R and D, but we need to use that base. That has to be the point of departure in order to grow it. We have a fantastic asset, but we need to consider the interface between that R and D and the business sector.

Jim McColl: There are higher levels of R and D in companies overseas, but in those places there are different systems to support that. I would put that forward as the reason why we get more R and D there. Also, innovation is not just about products or technologies. We also have to look at innovation in processes, marketing and the softer areas like them, where there is perhaps not enough attention just now.

There is one big difference between Scottish and American universities. Stanford, which Chic Brodie mentioned, is an investor in our business, so I go to see it regularly. It has an endowment fund of more than $20 billion and it invests from that. That is not a luxury that the Scottish universities have, so it is difficult to compare the two. That proves that, if we invest—

Chic Brodie: However, you agree that the concept is right. I am not suggesting that we can start with $20 billion, but we can at least start it.

Jim McColl: Absolutely. It proves that, if we invest, we get better results.

Chic Brodie: Okay. Thank you.

Patrick Harvie (Glasgow) (Green): Good morning. I want to explore with you whether the Scottish Government's economic strategy has the context right. Section 1, on the economic context, begins:

"Scotland has strong economic foundations".

Perhaps understandably, there is an emphasis on the positive, but I wonder whether the strategy ought to include greater recognition of the risks that the Scottish economy faces. Do you have any general comments about whether the strategy properly assesses the risks that we might face in the future and what those might be?

Crawford Beveridge: My reading of the strategy is that it does a reasonable job of balancing those things out. As you know, part of our remit is to consider how we deal with inclusive growth, and we need to be mindful that there can also be downsides to how we put in place policies for things such as that. We need to find a balance that enables us to be mindful of both the risks and the opportunities driving in that direction.

In the implementation of the general theme, a lot of attention is being paid to ensuring that we understand exactly how much risk there is in what we are going to do. You might be right that it is not spelled out enough in the document, but people are mindful of the risks as well.

Patrick Harvie: I have heard a number of people comment that the combination of wealth and income inequality in the UK along with the level of debt—the UK Government is focused on public debt, but the level of private debt is vastly higher—and the operation of the finance sector indicate that the conditions could be right for another economic crash. You are right in saying that wealth and income inequality are addressed in the strategy, but there is nothing about debt or about how finance is operating. Should there be greater recognition of what the risk might be of a further crash or recession and of the necessity for resilience in the face of that possibility?

Professor Carter: That is a really interesting question, and we might well discuss it within the Council of Economic Advisers over the next two days. What impressed me about the economic strategy is that, although it does not articulate all the risks that it might have done, it does a good job of mitigating those risks. One way in which we can mitigate the future risks to an economy is by including more people, having more participation and ensuring greater growth. The element of inclusive growth goes some way towards mitigating the risks.

As has been mentioned, much of our business structure is made up of SMEs, and another way in which we can mitigate risk in the economy is by having a thriving and diversified SME sector. To me, that is a very important way of mitigating the risks.

Patrick Harvie: I agree with the point about diversification and having more small and medium-sized businesses instead of having a handful of multinationals dominating many sectors. I will not pursue the question of growth because, ideologically, I bore my colleagues rigid on that question frequently.

One other risk that I would like to ask you about was addressed in the speech that Mark Carney gave last week about climate change. He said:

"Take, for example, the IPCC's estimate of a carbon budget that would likely limit global temperature rises to 2 degrees above pre-industrial levels."

You will be aware that such a rise is regarded not as a safe level but as the maximum tolerable level of damage. He continued:

"That budget amounts to between 1/5th and 1/3rd world's proven reserves of oil, gas and coal. If that estimate is even approximately correct it would render the vast majority of reserves 'stranded'—oil, gas and coal that will be literally unburnable without expensive carbon capture technology, which itself alters fossil fuel economics."

He later said:

"a wholesale reassessment of prospects, especially if it were to occur suddenly, could potentially destabilise markets, spark a pro-cyclical crystallisation of losses and a persistent tightening of financial conditions."

He had me until "pro-cyclical crystallisation", but I assume that Mr Carney thinks that that would be bad.

The Scottish Government's economic strategy seems to regard the oil and gas sector's dominance in our economy only in positive terms—as a positive value rather than a potential liability or a vulnerability. Does that view need to be broadened, especially in the light of the argument that fossil fuel divestment is no longer just an ethical concern but an economic one?

Professor Muscatelli: The solutions to the problems that you set out must be global, as they are not problems that a small country can solve by itself. However, you are right to say that any measures that were taken globally to counter climate change would have to be factored into any country's economic strategy.

I think that the governor of the Bank of England was right to issue that warning. It is one of those unknowns, but the global economy faces huge risks. To be honest, it is difficult for a small country to act unless any actions are considered within an overall global framework. Diversification is certainly the right thing to do but, by itself, this country could not take any action that would make a substantial difference to the global climate change challenge.

Patrick Harvie: You are right to say that our impact on the climate requires a global solution and that every country must be a part of that. However, the issue of economic vulnerability as a result of a carbon bubble is relevant to the way in which a domestic economy operates, and Scotland's economy is more exposed than most to the overvaluation of an industry that is sitting on what will become stranded assets.

Professor Muscatelli: That needs to be watched. Earlier, you pointed out that the whole world is in a delicate condition in respect of the financial situation, which is also something that we do not control. However, as José Viñals from the International Monetary Fund recently pointed out, although many OECD countries have taken action to shore up their banking sector, the same thing has not happened in many emerging markets. All that we need is another shock in that regard and we will all be in a difficult position.

I see the situation in a similar light to you. We absolutely need to build resilience and think about diversification. However, we are where we are in terms of how the economy has developed.

Professor Carter: I completely agree with Professor Muscatelli's comments. One of the great attractions of the new economic strategy is the focus on SMEs and inclusive growth, which includes the participation of women, our black and minority ethic population and our refugee population. That is important not only economically but for social integration, the risks to which must also be considered. I support everything that Professor Muscatelli has suggested and echo the point about the focus on SMEs.

10:45

Lewis Macdonald: I want to follow up Anton Muscatelli's agreement with Patrick Harvie on carbon and hydrocarbons. If you take the view that resilience and diversification are urgent—Jim McColl talked about the short-term impact of the current oil and gas downturn—will you offer advice to the Government about how it should respond to the current oil and gas downturn, or will you wait to be asked?

Crawford Beveridge: As you know, we respond when the First Minister asks us to give advice on issues. So far, we have not been asked to give advice on that area, but we stand ready to help in any way that we can.

Lewis Macdonald: We have just heard from one of your colleagues a recognition of the seriousness of the situation. Do you have no mechanism to allow you to draw issues to the First Minister's attention?

Crawford Beveridge: Absolutely. We will start the meeting today at 1.15, and we can bring your comment to the Government's attention and say that it is a big issue that was raised by the committee.

Jim McColl: The Government is looking at how to grow the industrial manufacturing sector, which is what we need to do. We are too dependent on construction, oil and gas and financial services, so we need to grow other sectors. The Government is focused on growing the manufacturing sector.

Johann Lamont (Glasgow Pollok) (Lab): I have a question on process, which follows on from Lewis Macdonald's question. Am I right in saying that, although you are the Council of Economic Advisers, you do not actively offer advice but wait to be asked?

Crawford Beveridge: It is not so much that. In every meeting that we have had, from when we were first set up in 2008, the First Minister has said, "Here are the things that I would like your advice on". That does not mean that we cannot go back and say—as we will today—that some issues have been raised that we think the First Minister might want us to consider. Generally speaking, though, we respond to what the First Minister wants us to do.

Johann Lamont: You are saying that, when the Scottish Government revised its economic strategy, it did not test it against its independent advisers. It published the strategy and you made some comments, but you did not have a role in saying, "We might not do this because that would be the consequence." That did not happen.

Jim McColl: In the previous council, we had a process whereby we met the night before, without any Government people present, to discuss issues that we thought it was important to raise. A number of issues came out of that, which we raised with the First Minister. They were not all accepted, but—

The Convener: Do tell us which ones were not accepted. [*Laughter*.]

Johann Lamont: That would lead to a whole other set of questions.

Is it right to say that the Scottish Government can establish a new economic strategy with a nuanced approach—as opposed to a very clear one—on taxation without testing that against your views?

Crawford Beveridge: The Government would have pre-tested the strategy. We have talked about most of the things that are in the economic strategy at some point during the work of the council, but it would be unreasonable for us to ask the Government to run it by us and ask us to review and approve it. The Government has to do its own thing; all that we can do is talk to the Government in advance about those areas in which we have confidence.

Jim McColl: There were individual phone calls to bounce ideas off some of the economists and so on.

Johann Lamont: It is entirely the role of Government to develop an economic strategy, but my question was whether there is a transparent process by which the Government tests its decisions against its own economic advisers. However, that is not your responsibility.

I take it that you support the notion of inclusive growth. My understanding of inclusive growth is that it ensures the creation of good-quality jobs and that people who are further away from the job market have access to those jobs. If that is the case, would it be worth exploring or reviewing the role of Scottish Enterprise, which moved from having responsibility for people and place to simply looking—and there is an argument for this—at the growth sectors that we want to see investment in? If Scottish Enterprise is part of the strategy for inclusive growth, should it have a responsibility for identifying groups of people who are far away from the job market or areas where we should ensure that there is access to good-quality jobs?

Crawford Beveridge: I understand that Scottish Enterprise has a remit around inclusive growth that covers both bringing more people into the workforce and geography. We want to be inclusive by geography—we do not want all the jobs to turn up in the central belt while the rest of the country is ignored. I know that Scottish Enterprise is working very hard on the geographical aspect of that growth.

Professor Carter: In the past, Scottish Enterprise has, possibly quite rightly, focused mainly on its account managed companies. They are the companies that have met a certain threshold of business growth and have the potential to grow further, innovate and internationalise their offering. I think that Scottish Enterprise's focus on such companies is appropriate. However, from the perspective of inclusive growth, when we look at those companies and the people who run them, we see that they do not seem to be totally reflective of all parts of the economy and that they leave some people excluded. That poses an economic risk, because Scotland loses out through the exclusion of people or the non-participation of people, sectors and geographies.

My understanding is that Scottish Enterprise has embraced the notion of inclusive growth and does not see it as in any way conflicting with economic growth. Rather, it sees those as the two pillars on which the Scottish economy will grow. Because of that, we have seen a greater involvement of people who perhaps have not been supported by Scottish Enterprise but who are now being included in the economic agenda.

Jim McColl: Inclusive growth is a bigger issue for the welfare side. Skills Development Scotland deals with a devolved issue but Jobcentre Plus and so on are to do with reserved issues, and they are not tied together. Inclusive growth is a matter more for Government policy than for Scottish Enterprise. I think that Scottish Enterprise would contribute most by helping more companies to internationalise their business and grow.

There are also young people at the bottom end, just coming out of school, who do not have equality of opportunity and who face challenges that are not being addressed just now. We need to support those young people and get them into good jobs. There is also the issue of wages. I do not think that the Government should be subsidising low pay. Employers should be paying enough for people to live on—people should not have to get support through tax credits to subsidise low-paying companies. A load of things need to change that are not Scottish Enterprise issues.

Professor Muscatelli: The economic strategy is a framework that has two pillars with cross-cutting themes, and inclusive growth is a relatively recent concept that the OECD and other international agencies have embraced. The task is to construct a framework that measures how the country is progressing against the agenda of inclusive growth. For example, a number of indicators will show the multidimensional aspects of living standards, which are about not just the economy but health and other dimensions. I imagine that we will provide the Government with advice on inclusive growth and that it will come up with a more granular way of measuring progress against aspects of inclusive growth, which we will then see filtering through Government agencies including Scottish Enterprise.

The economic strategy provides a framework but we can provide advice on international best practice in developing the more granular measuring of inclusive growth, seeing how different measures impact on different indicators, and that will influence the Government's policy choices.

Johann Lamont: I do not think that the whole job around inclusive growth has to be done by Scottish Enterprise, but it has left just 10 per cent of its budget for addressing inclusive growth. How can Scottish Enterprise have a twin-track strategy if most of its work is focused on identifying investment opportunities in key sectors? We all know that it is possible to grow the economy but leave some people as far away from being involved in the job market as a low-growth economy would. If Scottish Enterprise is in favour of the twin-track strategy, is it acceptable for it to use only 10 per cent of its budget on inclusive growth? If Scottish Enterprise asked for your advice on that, what would you say?

Crawford Beveridge: I am not sure that we are qualified to figure out how the Scottish Enterprise people should spend their budget, but they know that inclusive growth is an important part of the Government's economic strategy. I therefore assume that they have taken pains to make sure that they are spending enough to be able to do what they can do in that respect.

Johann Lamont: So, on the twin-track approach, which is different from the old approach and involves inclusive growth, your view is that it looks like a fair split for Scottish Enterprise to spend only 10 per cent of its budget on that. If you were asked, you would say that 10 per cent would cover it.

It does not feel as if Scottish Enterprise is talking about identifying economic and social risk and shifting to dealing with geographical areas, communities and groups that are excluded; it feels as if it is largely the same as before—10 per cent of the budget is really a very small percentage.

Professor Carter: Personally, I would support a further focus on inclusive growth.

Johann Lamont: One of your jobs must surely be to lift the strategy off the paper and say what needs to happen in the Scottish Government and all its agencies for there to actually be inclusive growth.

Professor Carter: As Professor Muscatelli has described, we are talking about a framework. We are asked for advice and we will give that to the best of our ability, based on our expertise. Maybe the issue will come up in discussions in the next couple of days.

Professor Muscatelli: Another important element is that, where countries around the world have attempted to put in policies for inclusive growth, they are not simply exercised by Government through single policies, either on tax or benefits. It is about joining agencies up and making them work better together.

It is difficult for me to answer your question about Scottish Enterprise, partly because I would need to look at the detail of how that 10 per cent of spend interfaces with other elements of spend across the Government. That will no doubt be part of our discussions.

Jim McColl: It will be part of our discussions at 2.30 today.

Crawford Beveridge: Governments everywhere are feeling their way through this. For example, the OECD sees Scotland as an incubator for inclusive growth. It thinks that the things that we are starting on are correct, but nobody has all the right answers. Lots of countries are trying to tackle the issue at the same time. We are learning from each other about what countries can and cannot spend and what differences they can make. It is going to take some time to do it.

Johann Lamont: Do you have a role in scrutinising other organisations that might be involved in inclusive growth, such as education organisations? When somebody leaves school without basic skills, further education and Skills Development Scotland become critical. Will you look at their budgets and the emphasis in Scottish Government budgets on being inclusive around the development of skills in order to deliver inclusive growth?

Professor Muscatelli: My personal opinion, which I have already stated in public, is that there is absolutely no doubt that one of the biggest positive impacts in reducing inequality is through investment in early years education. All the evidence from round the world shows that it is about bedding that in through early years education and childcare. Such policies take a long time to have an impact, so let us not pretend that they will solve things immediately, but they are exactly the sort of things that could have a transformative effect on employment and growth in the long run, as we have seen in Scandinavia and other European countries. That is my personal view, and I will certainly articulate it in any engagement that I have with the Government on inclusive growth.

As you say, further on in the education system, matching skills properly to the needs of the economy is another important element. However, we know from most economic evidence that the biggest bang for our buck comes from investment in the very early years.

Johann Lamont: We can also invest in the parents who are supporting their children, and we could argue that second-chance education is critical as well. We do not want to write off a whole generation who did not get that benefit in the early stages.

Professor Muscatelli: Indeed.

The Convener: We have been running for an hour, but two members still want to come in.

Lewis Macdonald: The witnesses will be aware that Scotland's devolved Government will be moving into a new phase in the next few months and years as a result of fiscal devolution, the responsibility for setting tax rates, opportunities for borrowing and the creation of a new fiscal framework. Part of the structure around that is the Scottish Fiscal Commission. I am interested in what advice you might offer to ministers on a couple of aspects of the Fiscal Commission. One is its ability to initiate its own economic and fiscal forecasts and the other is its independence. Have you taken a view on those two important issues, either individually or collectively?

Crawford Beveridge: I will start on that, and Anton Muscatelli may wish to come in later.

The Fiscal Commission grew out of the fiscal commission working group that we had as part of the prior council. If we consider what fiscal commissions do throughout the rest of the developed world, as we did at the time, we find that most of them have some degree of independence. Ideally, they have total independence, which is where we would have come down on that. Most of them take an independent view of the economy and where it is going. Those are a couple of the pillars on which we built the commission.

A wide range of views were taken by Governments throughout the world when they set up their own fiscal commissions—I am sure that information on that will be available on our website. In the working group, we came down on the side of both independence and independent review of fiscal affairs.

11:00

Lewis Macdonald: That is very helpful. You will be aware of the views of a number of bodies. That of the Institute of Chartered Accountants of Scotland is the one that I have in front of me at the moment, and it says that, given the way in which the Fiscal Commission is proposed to be set up, it does not have the appearance of independence, because it is being set up within the Scottish Administration and it will provide reports and accounts at the request of ministers. Furthermore, the functions of the Fiscal Commission can be changed by statutory instrument. In that respect, would you agree with the suggestion by the Institute of Chartered Accountants and other bodies that the proposal falls short of the level of independence that you advised was the best way forward?

Crawford Beveridge: To be fair, I have not read what the accountants have been saying about it, but the more independent we can make these things, the better. Experience from around the globe seems to tell us that the quality of the people who are put on to commissions helps dramatically. Even if they are within Governments, if strong-minded, competent people are running things, it is likely that a reasonably independent view will be obtained.

Lewis Macdonald: It is clear from the draft proposals that the Fiscal Commission will be asked to comment on the Government's forecasts but will not be empowered to make forecasts of its own. Is that different from what you had concluded?

Crawford Beveridge: No. I would not like to second-guess the Government on that. It needs to make its own decision about how things come across. We gave the Government a wide range of views about how different fiscal commissions work, and it is for the Government to take it forward in the way that it thinks will work best.

Lewis Macdonald: The final point that I want to ask about is closer to home. In its evidence to the Finance Committee, the Royal Society of Edinburgh said that the Fiscal Commission's independence would be strengthened by ensuring that a commissioner may not serve as a member of the Scottish Government's Council of Economic Advisers at the same time. Does that seem sensible?

Crawford Beveridge: We discussed that at some length in the council and that is what we thought, too.

The Convener: I will raise an issue that is slightly tangential to that line of questioning. We are entering an interesting time in Scotland with much more fiscal power being devolved, and the Scottish Government will have many more levers at its disposal as regards the economy. How well served are we by way of objective economic analysis of Government decisions? I am not thinking about the Fiscal Commission specifically; I am thinking about the academic world, for instance. Do we need more think tanks to advise Government and test Government policies and proposals?

Professor Muscatelli: You will find that there will be much more interest from existing think tanks and from academics. For instance, the Institute for Public Policy Research has set up a base in Scotland, and think tanks such as the Institute for Fiscal Studies will probably spend more resources on this. There is no doubt in my mind that, as devolution progresses, independent academic economists will find what is happening here a really interesting thing to analyse.

In the past, Scotland has perhaps not had its fair share of think tanks. A lot of them have been London-centric and have tended to pay too much attention to national matters as opposed to what is happening at a country or regional level. I have no doubt that there will be a response because, as you say, these are really interesting times.

The Convener: If you know of any wealthy entrepreneurs who want to fund think tanks to do that work, you might suggest their names to us.

Professor Muscatelli: Absolutely.

Chic Brodie: That was a good question.

Earlier, we were dwelling on oil and its impact on the Scottish economy. Although I have a lot of sympathy with my colleague Patrick Harvie's view on the impact of oil, it is of course a major ingredient in many products that are used in medicine and so on.

I have just spent three and a half years on a project to get the UK Government to consider the issue of oil and gas in the Clyde and the Atlantic margins—that is now progressing. However, one thing that we have not done is to consider the rare earths that are available in Scotland. I want to ask you about the issue in order to get it on the agenda. In 2005, Northern Ireland spent £6.5 million on the tellus project, which was designed to consider the area's geological assets. When it had established what was there, it issued licences for exploration to the tune of £37 million and now it is developing exploration for gold, silver and cobalt. The geological structure runs across into Scotland. In fact, I have just introduced some guys to entrepreneurs to get funding to licence drilling for gold, silver and cobalt in the south-west—I cannot say where, because I have signed a confidentiality agreement, but I have a rock with some gold in it in my office.

I ask that, when we look at the assets of Scotland—particularly given the global situation regarding rare earths—we get some idea of the benefits and the assets that Scotland has in the rare earths that are below our feet.

Crawford Beveridge: I would never have thought of that, but I will raise that, too.

Chic Brodie: If you do, I will tell you where the gold is.

The Convener: There will be a gold rush.

That is the end of our questioning. I thank the witnesses for giving us an insight into the work of the Council of Economic Advisers. We appreciate the input and I hope that we—or our successor committee in the next session of Parliament—can repeat the meeting.

This is our committee assistant Lynsey Mackay's last meeting with us. She is moving on to the Presiding Officer's office, and we wish her well.

11:07

Meeting continued in private until 11:13.

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