OFFICIAL REPORT
AITHISG OIFIGEIL

European and External Relations Committee

Thursday 28 July 2016

Session 5

The Scottish Parliament
Pàrlamaid na h-Alba

Thursday 28 July 2016

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EUROPEAN AND EXTERNAL RELATIONS COMMITTEE
3rd Meeting 2016, Session 5

CONVENER

*Joan McAlpine (South Scotland) (SNP)

DEPUTY CONVENER

*Lewis Macdonald (North East Scotland) (Lab)

COMMITTEE MEMBERS

Jackson Carlaw (Eastwood) (Con)
*Bruce Crawford (Stirling) (SNP)
*Ash Denham (Edinburgh Eastern) (SNP)
*Ross Greer (West Scotland) (Green)
*Rachael Hamilton (South Scotland) (Con)
Richard Lochhead (Moray) (SNP)
Tavish Scott (Shetland Islands) (LD)

*attended

COMMITTEE SUBSTITUTES

Daniel Johnson (Edinburgh Southern) (Lab)
Margaret Mitchell (Central Scotland) (Con)
Andy Wightman (Lothian) (Green)

THE FOLLOWING ALSO PARTICIPATED:

Bertie Armstrong (Scottish Fishermen's Federation)
Colin Borland (Federation of Small Business Scotland)
Stephen Boyd (Scottish Trades Union Congress)
Hugh Chater (Virgin Money)
Gordon Dewar (Edinburgh Airport Ltd)
David Frost (Scotch Whisky Association)
Kenny Richmond (Scottish Enterprise)
Dr Graeme Roy (Fraser of Allander Institute)
Mike Rumbles (North East Scotland) (LD)
Alastair Sim (Universities Scotland)
Clare Slipper (NFU Scotland)
James Withers (Scotland Food and Drink)

CLERK TO THE COMMITTEE

Katy Orr

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

European and External Relations Committee

Thursday 28 July 2016

[The Convener opened the meeting at 09:30]

Decision on Taking Business in Private

The Convener (Joan McAlpine): Good morning and welcome to the third meeting in session 5 of the European and External Relations Committee. I remind members and the public in the gallery to turn off or set to silent their mobile phones and other electronic devices, as they can interfere with the sound systems.

We have received apologies from Tavish Scott, Richard Lochhead and Jackson Carlaw. However, I welcome Mr Mike Rumbles to the meeting. Mr Rumbles is welcome to take part in the meeting, if he so chooses, after committee members have asked their questions of witnesses.

Agenda item 1 is a decision on taking in private items 4, 5 and 6. Item 4 is a review of the evidence heard; item 5 concerns the posts of adviser to the committee; and item 6 is consideration of the committee's call for written evidence. Do we agree to take those items in private?

Members *indicated agreement.*

The Convener: Thank you.

Implications of Brexit

09:32

The Convener: Agenda item 2 is an evidence session on the implications for Scotland of Brexit, particularly the economic implications. I welcome Dr Graeme Roy, director designate of the Fraser of Allander institute; Colin Borland, senior head of external affairs at the Federation of Small Business Scotland; Kenny Richmond, senior director of Scottish Enterprise; and Stephen Boyd, assistant secretary to the Scottish Trades Union Congress.

Members will have seen that Dr Roy has kindly provided some additional materials to the committee. Although we do not have a lot of time for introductory remarks, I would like to give Dr Roy the opportunity to outline some of his findings before we enter into a general discussion.

Dr Graeme Roy (Fraser of Allander Institute): Thank you very much, convener. I thought that it would be helpful to run through—quite quickly—from an economics perspective, the key issues that Brexit throws up for the Scottish economy. I will not talk about those issues in a positive or negative way; rather, I will mention the types of issue that will need to be resolved over the next wee while and what will drive the impacts on the economy that people like me are saying are likely to happen.

I have grouped the issues into long and short-term effects. On the long-term effects, there are probably five key issues that the committee would want to think about. The first of those issues is the trading relationships that are thrown up by the decision to leave the European Union. Obviously, within the European Union is a single market. Moving away from that single market means that a new trading relationship will have to be designed. Just over 40 per cent of Scottish exports go to the European Union. That is an important fact that needs to be taken care of.

There are lots of different models that could be designed for having new trading relationships. The committee will have heard of what being a member of the European Economic Area entails, which is the Norway-type model. There is the Swiss-type model, which is more about having in place bilateral arrangements. There are also more alternative versions around free trade areas and moving completely into the World Trade Organization, under which the country would operate with normal tariff barriers.

That is the first set of issues. The second set of issues concerns the implications for investment. Scotland has been quite a successful area within the United Kingdom in attracting international investment. A large part of that has been because of the skills and the wider infrastructure of the Scottish economy, but we know that international investors come to the UK and to Scotland to access the single market.

The third set of issues concerns the population and the labour market. Over the past few years, Scotland has had net migration coming in from different parts of the European Union. The European Union has also been quite strong in putting forward regulations not only on the labour market, but on the product market. If we move out of the European Union, those issues will need to be thought about and resolved.

The fourth issue is fiscal contributions. During the referendum there was quite a lot of debate about the United Kingdom's net contribution to the European Union and the difference between gross and net contributions. Gross contributions are the total amount that is paid into the EU, but once we take off things such as the rebate and the other revenues that come into the United Kingdom and Scotland through research funding, the common agricultural policy and various other elements, there is a set of issues that needs to be considered around what the potential fiscal implications of leaving the EU would be.

The final issue—it is probably the one that economists are a bit more interested in and concerned about—is about what we would call the dynamic effects. We know that we have companies that export and we know that inward investment tends to have a positive impact on things such as productivity and skills. If our exports and investment were to change over time, that could have implications for such things as productivity, our overall growth rate and competition. There is a set of issues in there that might be quite significant over the long term.

On balance, the view of most independent economists would be that, in the long run, leaving the EU would tend to have a negative impact on output and jobs, all else remaining equal. Obviously, policy choices could flow from that that might change all that. The thing that is probably more uncertain and a bit more complex is what might happen in the short run.

We have published some forecasts this morning that try to estimate what we think will happen to the Scottish economy over the next three years. It comes down to two key issues, one of which is the impact of uncertainty on the economy. We know that, in an uncertain world, investors and businesses tend to put off decisions. In the short run, that can largely be temporary and, when clarity comes in, they start investing again. The impact is therefore largely short term and there is a bounce back. However, the longer that the uncertainty goes on, the more likely it is that decisions to postpone investment turn into cancellations and changes in plans.

There is also policy uncertainty. We do not yet know what the end result from the negotiations will be. We do not know whether we will have access to the single market or be outside it. That injects another element of uncertainty into the mix, which has implications for how businesses will respond.

Financial markets have been volatile and are likely to continue to be so as the negotiations go forward, which in itself can have an impact on business decisions. It is more likely that risk premiums will be added to borrowing costs as people factor in potential volatility and uncertainty.

The final issue is that, linking back to the long-term adjustments, over time people will start to make decisions about what the relationship will be with their trading partners in the EU. We would expect that businesses will gradually start to change their decisions and investments. We think that, on balance and in the short term, that will have a negative impact on Scottish growth over the next three years.

This morning, we have revised down our forecasts for each of the next three years. However, I would offer a note of caution by saying that we also believe that the situation is quite different from the financial crisis, so we are not predicting an immediate, long recession; all that we are predicting is a period of relatively slow, flat growth while we adjust to the new relationships.

The Convener: Thank you very much. The material that you published this morning certainly makes quite grim reading for Scotland. A number of committee members recently returned from Brussels, and the message that we got there was very much that access to the single market is very different from a free trade arrangement, which is why most businesses and inward investors want access to the single market. Do you think that there is a lack of understanding that access to the single market is not the same thing as a free trade arrangement?

Dr Roy: Yes. There are quite significant and important differences between the single market and a free trade area. In essence, a free trade area removes tariffs between two trading partners, particularly for goods. Largely, however, it does not give access through services. For example, although Switzerland has a special, bilateral relationship with the EU, that does not exist in services and Swiss financial services companies have to incorporate separate bodies within the European Union in order to trade as entities within the EU.

All that the free trade area does is remove tariffs, but it largely does not remove tariffs on services and it does not remove non-tariff barriers.

It is important that the single market means that, provided that they satisfy the regulations that are common across the EU, somebody who produces a good in the United Kingdom or in Scotland can sell that good easily in the rest of the EU. A free trade area does not guarantee that, because a producer then has to comply with all the various regulations that apply.

Another point that is quite important is about the difference between the single market and the European Economic Area. The EEA requires proof-of-origin rules to ensure that a good that is produced in the EEA is actually produced in that area and has not been passed from another country into somewhere such as Norway to be traded into the EU. All goods that come from outside the single market must go through a process of proving the country that they were produced in before they can be traded into the single market, which adds a small cost of 1 to 2 per cent to trading. When margins are tight, adding in proof-of-origin rules, non-tariff costs and other compliance issues before we even get to tariffs makes a significant difference between a free trade area and a single market.

The Convener: Of course, it is not possible to have the single market without free movement of labour—that came across loud and clear during our visit to Brussels. Does your forecast for the Scottish economy suggest that Scotland could be more sharply hit? We have received evidence that shows, for example, that businesses with European owners make up a larger proportion of the Scottish economy. We know that foreign direct investment levels are higher in Scotland, and you have outlined a big threat to that investment. Do particular aspects of the Scottish economy make us more vulnerable? I am interested in hearing the other panellists' views on that, too.

Dr Roy: It is too early to say whether Scotland will be more impacted than the rest of the UK. The different sectoral make-up of the Scottish economy could mean different results. A big issue for the UK is the City of London and the importance of passporting rights, which have a disproportionate effect there.

Relative to other parts of the UK, Scotland has always struggled with its gap in productivity performance. Although that has narrowed in recent years, Scottish productivity has tended to lag behind that of the rest of the UK. There is strong evidence about the link between exports, inward investment and productivity. If our inward investment and export levels shrank further as a result of leaving the EU, improving our productivity would be much more difficult.

From a macro perspective, one of the biggest risks is the long-term impact on Scotland's productivity. We know that a lack of productivity is a reason why our performance has differed from that of the UK and is a reason why the UK's economic performance has lagged behind that of many other EU countries. That is a key concern and a key issue for us to consider.

Kenny Richmond (Scottish Enterprise): We have spoken to a lot of companies—a lot of our customers—in the past few weeks and it is encouraging that few have said that they are putting investment or research and development plans on hold. That reflects the Fraser of Allander institute's business survey, which suggested that few companies are stopping doing things at the moment, which is encouraging.

As I am sure the committee is aware from the statistics, Scotland does well within the UK on inward investment; that is because of our assets, such as our people, our skills and our research base. We have lots of assets to continue to build on for inward investment.

Lewis Macdonald (North East Scotland) (Lab): I will go back to Graeme Roy's evidence, but my questions are more widely for the other panel members, too. Graeme Roy explained succinctly the differences between being a member of the European Economic Area or having access to the single market on the one hand and establishing free trade agreements on the other hand.

The other big question for us and for the Government concerns the difference between membership of the European Union and membership of the single market. The Parliament's intent is to retain the benefits of our relationship with the European Union, including access to the single market. How far would those benefits be protected if Scotland and the UK remained fully engaged with the single market, even without membership of the European Union?

09:45

Dr Roy: From an economic perspective, we have said in our report that membership of the single market is key. The issue, which strays less into my territory, is how we can retain access to the single market without being a member of the EU. I guess that that is one of the big things that needs to be resolved and dealt with. As I said, the European Economic Area retains quite a lot of access to the single market. However, one of the big issues there is that, if you are not a member of the EU, you do not get an opportunity to shape the rules and regulations that govern the single market. Norway does not have an opportunity to input into the single market process and all the rules and regulations that are part of that. That is probably quite an important policy difference between being a member of the EU and having access to the single market.

Lewis Macdonald: What about the benefits for business? I am thinking in particular of labour rights and human rights, many of which are delivered in EEA countries such as Norway as part of the single market arrangements. In order to be protected, how far do those rights require membership of the EU as opposed to membership of the single market? Stephen Boyd and Colin Borland might have views on that.

Stephen Boyd (Scottish Trades Union Congress): I absolutely agree with Graeme Roy's analysis. There are a couple of major unknowns, such as the timing of article 50 and what the UK Government's preferred approach will be.

It is important to be clear that we are looking at least-bad scenarios. Whatever we end up with is likely to be significantly worse than what we had before as full members of the EU. The extent to which labour rights would be protected by EEA status depends on the deal that is negotiated, but they are very unlikely to be strengthened by that process. Given who is likely to do the negotiating on behalf of the UK, there is a risk that those rights could be diminished in some way, shape or form.

As I said, we are looking at least-bad scenarios, and EEA status would offer a degree of protection that would not be there under other scenarios. However, it is important to emphasise that whatever we end up with is likely to be worse than what we have under full membership.

Colin Borland (Federation of Small Business Scotland): We have said that there are some immediate priorities, the top one being simple access to the European single market. Allied to that is our need to retain the ability of businesses to hire the right people for the job. The tourism industry in Scotland, which is worth £9.7 billion annually, relies on seasonal migrant labour. As the convener said, we have a substantial non-UK EU citizen entrepreneur community in Scotland, and we would be very concerned about such entrepreneurs leaving. As other panellists have said, where we end up will depend entirely on what sort of deal is struck, but those are the two things that we are very clear must be prioritised in the negotiations.

Turning to Mr Macdonald's specific points about rights and regulations, clarity on the regulatory framework must be a priority. Of course, nothing will change on day 1, because a lot of the law, particularly relating to employment, is incorporated into UK law anyway. However, given that that law can be changed by a UK Government or interpreted by the UK Supreme Court—as opposed to the European Court of Justice—there is scope for divergence. Again, it depends on what sort of deal is done. It remains to be seen whether businesses that trade only within the UK or within Scotland have to be subject to the same rules as those that are selling into the single market. The potential certainly exists for some quite interesting practical issues to be thrown up if we begin to diverge.

Lewis Macdonald: Graeme Roy mentioned the long-term challenges regarding trade and foreign direct investment. In those two areas, will membership of the single market deliver the level of benefits that we have at the moment or something close to it, or will we face a significant loss?

Dr Roy: It is probably best to think about a sliding scale. The closer that we are to remaining in the single market, the lesser the impact will be on trade and investment. The difference between the sort of arrangement in which we would meet all the various regulations and have no tariff barriers or non-tariff barriers, if that can be secured, and the current arrangement is relatively small. The question is whether such an arrangement can be delivered.

On that scale, if we move towards membership of the EEA, for example, we would have proof-of-origin requirements, and customs checks are needed between EEA members and the EU. Further along, the Swiss model would not give us access to the services of the single market and the Turkish model would not give us any access to services at all. Something like a free trade arrangement would mean that we would not have any tariff barriers, but it would not give us full access to the single market. If we were to come out completely, into a WTO type of model, we would have tariff barriers. We are thinking about the issue on that scale.

Lewis Macdonald: If you were a Japanese, North American or Chinese investor who was making an investment decision, what signal from the UK Government about its negotiating position would be most likely to encourage you to consider investing in the UK?

Dr Roy: Access to the single market is by far the biggest and most important factor.

The Convener: Bruce Crawford has a supplementary question on that point.

Bruce Crawford (Stirling) (SNP): If having access to the single market is the most preferential position for Scotland to be in, how do we best achieve that? If we do not have that, we will be back to the least-bad position.

Dr Roy: It is about where we can position ourselves on that scale, which will come down to the negotiations that take place between the UK and the EU, including the input by the Scottish

Government and the Scottish Parliament into that process. How it happens is ultimately up to policy makers and politicians. The central thing in the process must be that we press for as close as possible access to the single market. The closer to the single market that we end up on that scale, the better.

Stephen Boyd: We are now in the realm of politics rather than economics, but it is important to remind ourselves of what seemed to work for the leave campaign during the referendum campaign. The two things that the leave campaign consistently came back to were the UK's financial contributions to the EU and the free movement of people. At this moment, it is very difficult to envisage any circumstances in which the EU would give the UK full access to the single market without the UK retaining both free movement and a very significant financial contribution to the EU.

If you look at the analysis that the Bruegel think tank published last week, you will see that countries in the EEA currently pay a higher proportion of their GDP as a financial contribution to the EU and take a higher level of migrant workers, as a proportion of their workforce, than the UK currently does. It is difficult to see how those conditions could be satisfied in a politically acceptable way in the post-Brexit world.

Bruce Crawford: I recognise that. The reason that I asked the question was to find out about the least-bad position. If we are in the least-bad position, how realistic is it that we could access some sort of EEA agreement? How widely known and understood is it within industry and the economy in Scotland that every member of the EU, and probably Norway and Iceland, would need to sign up to that EEA agreement? How widely is it known in business circles that that is the mechanism that would be required to be used and how realistic is it to believe that that would be achievable?

Colin Borland: I cannot comment on how realistic it is, but it is fair to say that the understanding of the mechanics of it is sketchy.

It is a matter of regret that we did not get the opportunity to tease out some of these issues and talk about them in a bit more detail during the campaign. I have cast my mind back, and I think that I spent more time talking about the practical implications of membership—or non-membership—of the EU during the 2014 independence referendum. At that time, we looked stuff up when we received inquiries about the issue. It is regrettable that we are only now getting down to the practical brass-tacks discussion and that it did not take place before the vote. Unfortunately, however, we are where we are and we must deal with it.

The Convener: The European Free Trade Association EEA agreement, which has been touched on, does not give the UK access to the customs union. In the debate that we had during the referendum, the Brexit side talked about the bureaucracy of the EU. However, it seems to me that the EFTA EEA agreement—or any alternative to it—will actually bring more bureaucracy and complication for small and medium-sized businesses than the EU currently brings.

Colin Borland: That is certainly a risk. In a different context, when we were talking about the transatlantic trade and investment partnership—I suppose that that debate is academic now—we discussed with the US negotiators how, for example, a whisky exporter would get into the US market and the number of hurdles that they would have to overcome. It is a simple matter of getting stock and products through customs and, whenever something extra is added, there is the potential for that to add a bureaucratic burden.

The other thing that we are talking about is the free movement of people. Of course, it is possible to hire people from outside the EU, but that involves going through a fairly lengthy and complex process whereas hiring people from the EU is fairly straightforward. In the UK, we would need to put in place something that would allow such movement of goods and labour with the absolute minimum of extra bureaucracy if that is where we end up, depending on whatever deal we finally sign up to.

The Convener: Yet the only bespoke arrangement that currently exists is for Switzerland, which has about 120 different bilateral deals with the EU. That sounds pretty bureaucratic, does it not?

Colin Borland: Graeme Roy also made the point that that does not include the service sector. Learned colleagues will correct me if I am wrong, but I think that that sector makes up something like 80 per cent of the Scottish economy. That is significant. Whether we like it or not, we are a service-based economy and that is something else that we need to take into account.

The Convener: Would other members like to come in at this point?

Bruce Crawford: Not everybody has responded to the question that I asked, convener.

The Convener: Does anyone else want to respond?

Dr Roy: You asked about the understanding of all this. Anecdotally, we found it surprising when our business survey showed that 85 per cent of the firms had done very little or no preparation whatsoever for the UK exiting the EU. Businesses are only now beginning to react and think about things such as the different models. You are correct in saying that being in the EFTA EEA does not make a country part of the customs union. The concept of proof of origin is really important—to be clear, that means that everyone who exports from the EEA or EFTA to the European Union has to prove that the good has been produced in that country and has not been produced or supported by a third country such as China, for example. It means that every small and medium-sized business must go through a process of proving that the good is locally produced, and that costs money. That process does not apply to countries that are in the single market.

10:00

Stephen Boyd: There are a few things that I would like to come back on. On the point about the level of understanding, within the trade union movement it is certainly deeper than it was six months ago but it is not great.

That brings us to a much wider point about the huge glaring lack of capacity at all levels across the UK to deal with complex trade issues. There is much written about the yawning chasm in Westminster at the moment and that is inevitable, given that there has been no responsibility over those issues for about 40 years. It goes much deeper than that: across all institutions in the UK that have an interest in economic matters, trade has been underdiscussed for an awful long time and it is only now that people are really beginning to think about the deeper issues involved. Up until now, we have been discussing what our relationship with the EU will be like, but we have relied on the EU to negotiate free trade agreements with more than 50 other countries. We have to recognise that the UK's lack of capacity for negotiating such agreements and Scotland's capacity to monitor them in our interest is a real problem.

I return to the bureaucracy point, because it is really important. During the Brexit campaign, we all paid the price for the actions of a number of organisations over a prolonged period of time in exaggerating and distorting the issue of EU red tape, which has always been massively exaggerated. I have sat on the Scottish Government's regulatory review group for over 10 years and we have rarely seen a genuine problem with EU regulations that has not been easily dealt with at the Scottish level—very often there is no problem at all once we get down to the details. The convener is absolutely right to raise the point that, if the UK is now to access the single market in an effective way, bureaucracy will increase significantly.

Graeme Roy mentioned the proof of origin—he outlined that problem very well—and I was reading some stuff last night that suggested that that is not just a problem for small and medium-sized businesses. Given the length and complexity of global supply chains, even large organisations in Scotland will struggle to meet the proof-of-origin requirements that are likely to be introduced if we access the single market in the future.

Kenny Richmond: Lack of understanding is probably a factor for a number of companies. We have been asking companies what assistance we can provide and one of the most common responses has been for them to ask us to provide information on what is happening and what the implications are going forward. We are looking at having a bank of information on that as part of our services to companies.

The Convener: We have a question from Ash Denham.

Ash Denham (Edinburgh Eastern) (SNP): Good morning. A number of you have mentioned the idea of uncertainty being a problem for businesses and for the economy. I wonder whether any of you has seen the Institute of Directors survey of businesses, which asked what the optimal arrangement would be going forward. A majority of businesses—40 per cent—said that they preferred a bilateral free trade agreement like the one recently agreed between the EU and Canada. Is the idea of ending uncertainty and the fact that bilateral agreements can take such a long time to negotiate—the Canadian agreement has been about seven years in the making—compatible? Do businesses think about that? It could take a long time to be resolved so are those two ideas compatible?

Dr Roy: I am happy to go first. With our survey, most companies replied that access to a single market was highly important for them. That is a slightly different result but the key thing is that access to trade is more important for companies.

The point that Stephen Boyd made was quite right: bilateral arrangements are not easy to make. There are a large number of countries with which to make them—the EU already has 50 trade arrangements, plus there are the 27 countries in the EU. Adding those up becomes very complex and difficult, and the average length of time that it takes to negotiate those arrangements is years—it does not tend to get done overnight. It is not just about the impact on trade; issues about distributional impacts and the impact on sectors also need to be carefully thought through.

I know that some of the economic models that people used when arguing in favour of Brexit were based on the idea of essentially doing away with tariff barriers entirely. The implications of that on the agricultural sector, the manufacturing sector and others are quite massive—I am sure that you will hear more about them later. People need to think through not only the macroeconomic impacts of various trade policies but the distributional impacts. Obviously, there has been quite a lot of controversy around issues such as what TTIP might mean for public services. Negotiating trade deals takes a long time, which touches on the point that we were making about the uncertainty effect kicking in. It also links back to Lewis Macdonald's point about a Japanese or American investor who is looking to invest somewhere in Europe. Such investors will compare the continuing uncertainty in the UK with the situation in places such as Ireland or elsewhere in Europe. That puts us at a disadvantage.

Colin Borland: From a business point of view, we are clear that the priority is access to European and other markets, but I do not think that we are yet in a position to say how that should be achieved. We will commission some work over the back end of the summer and the beginning of the autumn to consider the options that are available. If one option stands out, we can back that, but it is early days at the moment—just over a month in—so I would not want to make any definitive pronouncement on that just yet.

Stephen Boyd: I do not think that the nature of free trade agreements is well understood in business or beyond. There is an assumption that free trade means free trade but, actually, the agreements are massively complex ones about managed trade, and the key issue is how we manage trade in our interests.

One of the most important free trade agreements will be that which the UK negotiates with the USA. You need to understand what motivates the USA and what it has its eyes on. The last time that we were before the committee, we were here to discuss our concerns around TTIP. US trade agreements are negotiated at the behest of well-organised and well-funded industrial lobbies, which have their eyes on things such as national health service procurement—access to that process has been a long-held aspiration for US pharmaceutical companies—and agriculture. In a scenario in which an extremely experienced, well-organised and well-funded US office for trade is negotiating with an extremely inexperienced and naive UK team that will probably be motivated by economic theory that does not bear much relation to the reality of the world that we live in, it is difficult to see how we will not get squeezed.

Kenny Richmond: On uncertainty across the economy as a whole, you must remember that only about 10 per cent of companies in Scotland export overseas so, for a lot of other companies, the uncertainty involves issues around consumer confidence and so on.

Rachael Hamilton (South Scotland) (Con): On the point that Kenny Richmond just made, businesses are going through a very uncertain period—it is almost as if they are in a holding pen. The situations that we are talking about are hypothetical, and there are no answers at the moment. We know that we would like access to the single market but how that issue progresses is, obviously, a matter of time.

This morning, there has been some positive news—from pharmaceutical companies about investment and from McDonald's about employment—and there has been a slight uplift in growth. How can we prepare businesses to look for opportunities? In its submission, Scottish Enterprise mentions that there could be opportunities through innovation and creativity. How can we prepare businesses to move forward in that regard, even as they are in this holding-pen situation?

Kenny Richmond: There are lots of enterprising businesses in Scotland and the evidence suggests that they are looking at opportunities, investing in innovation and investigating markets outside Scotland, including in the rest of the UK, which is potentially a huge market for businesses in Scotland.

I think that there is a role for us all—the public sector and business organisations—in thinking about how we can raise the ambition of Scotland's businesses and use businesses that are doing well as examples of good practice. Some businesses have told us that, with the change in the exchange rate, their exports are becoming more competitive, so perhaps there is an opportunity to increase exports. There is a lot that we can do to help businesses look at their growth characteristics and to support them.

Colin Borland: It is important to put things in context and I preface my remarks by saying that we are not starting off from a great place. Even before 23 June, the numbers were not looking good, particularly among smaller businesses. Confidence was falling, hiring intentions were weak, investment intentions were falling back, turnover was down, profits were being squeezed and overheads were going up—it was a difficult situation. We do not yet have enough data for this quarter to know exactly where we have been, but we are not starting from a particularly strong position.

Kenny Richmond is right that, in general, businesses are entrepreneurial and are out there identifying markets. Someone who is in high-end knitwear and has a lot of customers in the US told me that the value of the pound has been really good for sales. Other people may be thinking about pricing jobs in US dollars, for example, and thinking, "Well, I'm not going to go out of business, but that's my profit margin gone for this month." People are already spotting opportunities and adapting—that is certainly the anecdotal evidence.

We suggested that the Scottish Government could provide some sort of central advice function, which I think could help, and I was really pleased that the Scottish Government has agreed to take it forward. There is a lot of competing advice and forecasts out there, so it will be good for people to have somewhere to go to where they can ask, "Can you tell me what I should do with this particular issue?" If the answer is, "Do nothing, because nothing's going to change for five years", that is smashing. However, if I need to be thinking about an issue, I want advice now. I think that such an advice function would be really helpful—it would be a sort of early-warning or weather station that would test the temperature and pass on particular problems in particular industries, sectors or types of business that policy makers at the centre should be aware of or should be feeding back to the negotiating teams. A good early-warning system would be a good practical step that the Scottish Government could take—indeed, it is taking it.

I suppose the prescription for making the best of the situation is exactly what we would have prescribed if there had been a yes vote in 2014: we need to think about how we tax businesses and tax them fairly; we need to think about how we spend our money and spend it wisely by trying to spend as much as we can with smaller Scottish companies; and we need to regulate sensibly.

Dr Roy: I will widen out that point a bit. It is always difficult when economic forecasters come out with slightly gloomy news, but policy makers have an important role in restoring and boosting confidence as much as possible. There is a danger that we get into a cycle of saying that everything is gloomy. As Kenny Richmond said, people who do not export—and not everybody does—are more concerned about consumer confidence in the domestic economy. Government has a role in putting out strong messages about Scotland and the UK being open for business, and in working to grow the economy.

We also argue that there is probably a case now for some form of fiscal stimulus to the economy. We know that the Bank of England is looking quite hard at what it might do over the next month or so around interest rates or quantitative easing. Given where we are, we also see an opportunity for some form of infrastructure investment programme at the UK level, as well as for simple things. For example, how does policy encourage people to look at new opportunities and new markets? How does it support exporters to access new markets or finance? I think that that is quite important.

Although there are opportunities for business, there is a wider question for policy as a whole. We know that issues around productivity and regional and structural imbalances existed in the UK and Scottish economies before the decision to leave the European Union. Therefore, there is a potentially important role in thinking more broadly about the future of economic policy in this new world and how we boost productivity in an economy that is outside the European Union, as well as what we need to do around infrastructure and skills. The debate needs to go into that to restore confidence and to create the opportunities that will undoubtedly be there in the future.

10:15

The Convener: Does Stephen Boyd want to come in on that point?

Stephen Boyd: I want to come in on a couple of points, if you do not mind, convener.

We need to tread carefully. Any bit of good economic news that we hear at the moment is seen as a sign that the impact of Brexit has somehow been benign. During the campaign, the consensus among the economists was unprecedented and was motivated by the long-term impact, which Graeme Roy described very effectively at the start of the meeting. The short-term impact is much more uncertain. If today's forecast by the Fraser of Allander institute holds true, the impact will be significant. However, we certainly should not get hung up on whether we meet the conditions for technical recession over the next year, because the long-term issues are the really important ones.

On support for business, it is difficult to see any outcome that would not require greater investment in the enterprise networks. To return to the example of proof of origin, Scottish Development International does a very good job, but is it properly resourced to advise companies on such matters? I am not entirely sure that it is. Why would it be? It has never had to offer such advice before, so that is potentially an area for additional investment.

The point has been widely made that the pound's lower value is making exports more competitive. However, we should not get complacent about that, as recent experience has shown—during 2008 and 2009, when there was an even bigger devaluation, we got very little boost. Scottish exports are not particularly sensitive to pricing, as perhaps they once were. Some exports are the end product of quite lengthy and complex global supply chains, with the import component going up in price even as the final product price goes down.

Graeme Roy made a very good point about looking at long-standing issues. Implementing a national drive to improve productivity is an SNP manifesto commitment. We discussed that with Graeme when he was at the Scottish Government, and we have discussed it recently with Kenny Richmond, too. What has happened over the past few weeks should give that bit of work a whole new impetus.

The Convener: On that point, the previous European and External Relations Committee looked for clarity on how structural funds and the other support networks would come back to Scotland though the block grant if we were to leave the EU. We certainly did not get any clarity from the UK Government at the time. If we are going to invest extra in the enterprise network, for example, we will need absolute clarity on how the loss of European funds will be made up.

Dr Roy: Yes. A side issue that is part of this debate relates to the fiscal implications of the potential transfer of new powers to the Scottish Parliament. The new fiscal framework is quite clear: you either have Barnett or you have a tax-raising element. At the moment, there is no other mechanism through which funds could come.

I will give an example. Scotland has about 8 per cent of the UK population, but about 18 per cent of UK CAP payments come to Scotland. How will that funding reach the Scottish budget? It will not come through tax revenues. If comes through Barnett, you will get 8 per cent of the equivalent spending in England and Wales, which is certainly not 18 per cent. What is the mechanism by which those additional revenues will flow into the Scottish budget? There is uncertainty. That is an important point that was not thought about too much before the referendum. The funding implications of the potential transfer of powers to the Scottish Parliament and the obligations that would come on the back of that are significant matters that need to be resolved relatively quickly.

The Convener: We have invited UK ministers to come before the committee, and I am sure that members will press them on that issue when they appear.

Ross Greer will ask the next question.

Ross Greer (West Scotland) (Green): The Fraser of Allander paper mentions the immediate need for a fiscal stimulus from the UK Government. If we end up, on the other side of the negotiations, with a less-than-perfect solution—something short of access to the single market, a free trade agreement and so on—would you expect, in the immediate post-negotiation period, a renewed need for a fiscal stimulus at a UK level? I would be concerned about political willingness in that regard.

Dr Roy: There are two issues. Going back to the point about the short term and the longer term, we see the negotiation period taking the next three years of our forecast horizon. In that context, when we talk about fiscal stimulus, we really mean in the short term—almost to make up the potential aggregate demand that will be lost through further uncertainty and so on.

Let us look at the end of that negotiation period, three years hence. What are the potential long-term indications for the economy, and will we need a further fiscal stimulus or other measures? There comes a point at which we cannot keep having fiscal stimulus. That is just a fact. We are talking about having a fiscal stimulus in the short term to get through a period of uncertainty. In the longer term, the economy will return to growth; the question is whether, post-EU, it will be at the same level as previously. In the longer term, we are moving away from having a continued stimulus and towards looking at what policies are in place to help to promote growth across the economy in a world where we are no longer part of the European Union.

Ross Greer: My question was not so much about the long term as about the year, two years or three years immediately after the agreement. I absolutely recognise that we cannot have continued stimulus, but I wonder about the potential need for an urgent stimulus if we end up with an agreement that is not ideal or falls far short of what is required.

Dr Roy: I guess that you are talking about the three years after the three years.

Ross Greer: Yes.

Dr Roy: It depends on how the negotiations go and what the end point is. The economy will adjust well; the question is whether the ultimate negotiation is a shock or a surprise. As we say in our report, we are more likely to get a gradual transition as businesses adjust. If it looks unlikely that we will have access to the single market, businesses will adjust and change their investment plans. We will need to wait until closer to the time to see whether we need a stimulus at that point.

Colin Borland: If we are talking about the post-deal period, the other side of the argument is that, by that point, neither the Scottish Government nor the UK Government will be bound by EU procurement rules. Therefore, if the Scottish Government wanted to provide a fiscal stimulus, it could ensure that all of that money went to Scottish businesses—indeed, to Scottish small businesses. That might have a greater impact—we might want to wait until we have left so that we can capitalise on that.

Stephen Boyd: We need to be quite careful about that, because it assumes that we will break all ties with the EU. Under an EEA-type scenario, there will still be significant constraints. If we have an EEA scenario such as in Norway, under most of the examples that Colin Borland has in mind, EU procurement rules will still apply.

Mike Rumbles (North East Scotland) (LD): My question is about economic growth. I am a bit puzzled by some of the information in the Fraser of Allander institute's "Economic Commentary". Under the heading, "Outlook and Appraisal", it says:

"Growth over the past 12 months"—

in Scotland—

"was 0.6% compared to 2.0% ... in the UK as a whole."

Elsewhere, it says:

"Over the past year, Scotland's economic recovery has remained fragile."

It also talks about

"Last week's 0.0% growth figures"

for the first quarter of 2016.

If we have completely flatlined and there was no growth in Scotland in the quarter preceding the European vote, are we putting too much emphasis on forecasts about the impact of the European vote? The statistics that the institute has presented show that we were in trouble for a whole year before the European vote and, with no growth at all, are still in trouble this year.

Dr Roy: In the report, we make it quite clear that the Scottish economy has been fragile for the past 18 months, particularly because of the decline in the North Sea. As you will see, some of the charts are about particular sectors that are tied to the supply chain in the North Sea. Manufacturing, for example, reduced by 5 per cent over the year, and that was well before the EU referendum.

As you say, we had 0 per cent growth in Q1 of 2016, and we think that there will be challenges in Q2. Longannet power station comes out of the economic figures in Q2, so even if we matched UK growth, at 0.6 per cent, that one factor could take out anything up to 0.4 per cent from the Scottish figure, so we are likely to have pretty close to 0 per cent growth in the first six months of 2016.

My point is that that is before we add in the impact of the EU referendum. We are saying that the economy has already been fragile. Will the result of the EU referendum have a positive or negative impact on the economy? Our clear view is that once we add in the additional effects the impact will be negative.

Stephen Boyd: It is important to point out that the Scottish economy has been fragile over the past 18 months. The main explanatory factor is the fall in the oil price and the impact on the offshore and onshore parts of the oil industry, which was the result of global trends on which neither the Scottish Government nor the UK Government can apply much pressure.

On top of an already weak economy, we are potentially inflicting major and long-lasting economic damage. There is a contrast between a situation that we can do very little to influence at a Scottish or UK level and calling a referendum, the result of the vote on which is in danger of inflicting serious and long-lasting damage.

Lewis Macdonald: Graeme Roy will be aware that page 12 of the economic commentary that Fraser of Allander published this morning says that one of the reasons for revising downwards estimates of growth in the Scottish economy over the next two years is the expectation that the Brexit decision will reduce sales from Scottish companies to other parts of the UK. That was quite surprising. In his oral evidence a few minutes ago, Kenny Richmond talked about the potential for growing the UK market for Scottish products. Our focus has tended to be on relations with the rest of Europe, so those are interesting aspects. Would Graeme Roy or Kenny Richmond like to comment a little bit more on them?

Dr Roy: By far our largest export market is the rest of the UK, with £45 billion-worth of exports between Scotland and the rest of the UK, and this is a shock not just in Scotland but in the rest of the UK.

In our forecast, there is a positive shock to our rest-of-the-world exports in the immediate term, which is the boost from sterling's depreciation. However, we believe that the UK economy will slow over the next three years to the forecast horizon, which will reduce demand for Scottish products in the rest of the UK. That has a negative impact in our forecasts.

There is a balance between, on the one hand, rest-of-the-world exports being helped by depreciation and, on the other hand, the negative impact on the UK of the decision to leave the EU, which feeds through to Scottish exports to the rest of the UK.

Kenny Richmond: There is an opportunity to help companies to look for customers in other economies and to look at ways in which Scottish businesses can increase their competitiveness by being more efficient and offering better-quality services. Graeme Roy is right to say that we may see a slowdown in the rest of the UK economy, but there are still opportunities for Scottish companies to look beyond Scotland for customers.

Lewis Macdonald: The other point was a wider one about where we are now and where we will be over the next two and a half years. Everything that we have heard this morning confirms that the next stage of negotiation will be absolutely critical. When they draw up the UK negotiating position, what should be the priorities of the UK Government and the Scottish Government, as its partner?

Freedom of movement is closely tied to access to the single market. When we were in Brussels, I was struck by the fact that one or two of the people whom we met placed the emphasis not on the movement of people but on the movement of labour. First, is that a significant distinction? Secondly, does it offer opportunities for creative negotiation over the next two and a half years?

10:30

Dr Roy: The single market has four fundamental freedoms, of which freedom of movement is a key one. It is integral to the single market holding, because it is linked to the free movement of labour and the freedom of establishment. This is not usually picked up when we talk about the free movement of people, but the freedom of establishment is the freedom for someone to set up a business in another part of the European Union. In services, it is key that somebody from Germany can come to the UK—or vice versa—and set up a service. Freedom of movement is, therefore, integral to the successful operation of the single market.

One of the key questions is whether you could take that element out and still have the single market operating. I am quite sceptical about that, because of the link to the freedom of establishment and the free movement of labour—the situation would become quite difficult. Whether it could be negotiated and agreed is, ultimately, part of the process of negotiating with the EU and is a matter for the Scottish Government's and Scottish Parliament's input to the negotiations.

Colin Borland: From our point of view, what is important is the endpoint—the ability to hire the right people with the right skills when we need them and with the minimum bureaucracy, bearing in mind the particular issues that we have in the Scottish economy around seasonal labour, particularly in the tourism industry. I would be fairly relaxed about calling it something else or arriving at some other mechanism for doing it if that were possible, which is by no means a given. However, the bottom line must be that we cannot go through the sort of hassle that, for example, people who run a Bangladeshi or Indian restaurant have to go through to get chefs. We cannot start seeing that for things like hiring fruit pickers and housekeeping staff in hotels, because the system simply would not work.

Bruce Crawford: Let us turn to the negotiations. The Scottish Parliament information centre briefing that has been produced for the committee talks about international trade and says that

> "another reason for the declining reliance on the EU market may be the increase in bilateral free trade agreements being negotiated by the European Union."

In effect, because the European Union has been so effective in building new trade arrangements, our reliance on the European Union will be reduced. That seems counterintuitive.

It brings to mind something that Stephen Boyd said. Currently, there are 50 trade agreements and the European Union is now negotiating with the United States, Japan, India and China—the really big players in the world. Stephen Boyd said that there is a level of naivety about our ability to negotiate in the future. Will you expand on that? Does the fact that we have been so integrated in the European Union mean that all the UK experts who work in that area now operate in the European arena and we have nobody here who has the expertise to negotiate separate agreements on behalf of the UK in the future? Is that where you are coming from?

Stephen Boyd: That is precisely what I was saying. Much has been written—and our member unions with members in the civil service have confirmed this—about the fact that there is no capacity at Westminster to deal with these complex trade issues. It goes a wee bit wider than that. As I said earlier, I think that there is a lack of understanding about the nature of free trade agreements—their complexity, what they mean and the range of issues that they cover. There is also probably a lack of understanding of the importance of the scale of the EU in negotiations and its ability to introduce issues of global importance such as climate change, anti-trust—on which the EU has been very active although that has been poorly recognised—and tax avoidance. The EU can introduce such issues into its bilateral discussions in a way that the UK simply would not be able to do because it would be outgunned by partners that are more economically powerful and have much more experience in negotiating these complex agreements.

Bruce Crawford: Is that how the other panel members feel?

Dr Roy: I will broaden the point out. Aside from the expertise issue, we are in a unique situation—no country of the UK's size has ever come out of the single market. Even with the best experts in the world, how the process is done and its potential implications will be highly significant.

People have talked about immediately joining the EEA, as if that would be easy to do. However, one reason why the EEA has worked is that it involves a small number of countries that happen to be small. Throwing the UK into that mix would fundamentally change its make-up. Goodness knows whether it would want that to happen and whether the EU would want the UK to be in the EEA and still have access to the single market.

Stephen Boyd's point about expertise is right but, even with the best expertise in the world, the problem that we have to resolve is so complex that it is difficult to see how it could be done quickly without having big issues still to resolve.

Bruce Crawford: You made the point that the UK would be a big player entering the EEA arrangements. Are you suggesting that smaller players such as Iceland and Norway might think that a big player such as the UK entering the EEA would disturb their relationship and so might resist the UK joining?

Dr Roy: I am making a general point; I do not know how the other EEA countries would react, but they could react in that way. The general principle is that having a very large member—the UK—versus other, small members, such as Liechtenstein, would fundamentally alter the balance. I do not know how the other EEA countries would react to that, but it would be a fundamental change to how it operates. I am sure that those countries would want to think long and carefully about whether they were willing to go for such a model.

The Convener: Thank you—the panel's evidence has been absolutely fascinating. We have another panel coming, so we will—unfortunately—have to wind up. However, before we do that, I have a question. We heard yesterday that the European Commission has appointed Michel Barnier as its chief negotiator. With him in place, would panel members care to reflect on how likely it is that the UK will get its desire to have access to the single market but not free movement of people?

Kenny Richmond: It is too early to say; I cannot comment.

Stephen Boyd: The appointment reflects the fact that the EU is likely to play hardball, but anybody who has looked at the issue closely knew that that would be the case.

Dr Roy: I would not like to have Michel Barnier's job. The appointment sets the scene for how difficult the negotiations will be.

Colin Borland: The situation is one of a great many things that people who are running a business in Scotland during this uncertain period will have to reflect on.

The Convener: I thank all our witnesses.

10:38

Meeting suspended.

10:44

On resuming—

The Convener: In our second evidence-taking session, we will consider business and sectoral interests. I welcome our new panel of witnesses: Clare Slipper, the parliamentary officer for NFU Scotland; Bertie Armstrong, the chief executive of the Scottish Fishermen's Federation; David Frost, the chief executive of the Scotch Whisky Association; Alastair Sim, the director of Universities Scotland; Gordon Dewar, the director of Edinburgh Airports Ltd; Hugh Chater, the director of banking at Virgin Money; and James Withers, the chief executive of Scotland Food and Drink.

This is a larger panel than we would normally have but, given the wide range of sectoral issues that are affected by this decision, we felt that it was important to hear from as many people as possible. I urge committee members and witnesses to keep their questions and answers as succinct as possible.

What has come across strongly this morning is the continuing uncertainty for business resulting from a lack of clear direction from the UK Government since the vote. Would anyone care to comment on that and say whether they see an end to that uncertainty any time soon?

Alastair Sim (Universities Scotland): I will talk about universities in more detail later. The important thing is that we get the process right. It is vastly important that the relationship that we craft with the European Union is one that maintains the movement of talent and ideas across boundaries. A process needs to be set in train that will set out what our negotiating objectives are so that we can best maintain that movement. At the moment, we are reliant on the benefits of our continuing membership of the European Union, which are incredibly important for European students and researchers. However, we need to move into a phase in which we can start to understand whether the UK Government is setting priorities for a future relationship with the EU that will support our further success.

Gordon Dewar (Edinburgh Airport Ltd): My sector touches a lot of businesses because aviation is the route to markets and is the inbound route for tourism in particular. The current uncertainty is a huge barrier in that regard. By their nature, airlines are as transportable as it is possible for a business to be, as they can put their aircraft wherever they think they will get the best return. We hear that one of the largest airlines that we deal with, Ryanair, is going to move its future investment away from the UK at least until what is going to happen becomes clearer. EasyJet, a UK airline, is talking about having to set up a business and new licensing arrangements within the EU in order to preserve the benefits of open skies. In addition, Delta has cancelled 10 weeks of its winter schedule because of currency implications—the winter season is an outbound business for it, which means that it is a sterling-dominated one, and it does not think that that is going to work very well.

All of that is recoverable if we have clarity about what is going on because, fundamentally, our economy is strong and the market for aviation is very strong. However, we need access to the open skies agreement and continued support for an environment that encourages airlines to invest in Scotland and the UK when they have many other choices.

James Withers (Scotland Food and Drink): On Tuesday, we were involved in meetings with the UK Government in London, and—to answer your question succinctly—I do not see an end to uncertainty in the near future. From the food and drink industry's perspective, two things would be extremely valuable, one of which is broad and one of which is extremely specific.

One of the challenges in the discussion in London on Tuesday was the fact that we are still talking about extremely broad principles such as the benefits of being in the European economic area as opposed to being in a free trade agreement or being hostage to World Trade Organization rules. Some sense of what plan A or option 1 is would be helpful in narrowing down the discussions so that we can deal with the detail. I appreciate that we are engaged in negotiations and that there will be a limit to how much the UK Government will want to show its hand, but it would be helpful to have at least some sense of what an ideal option would be in terms of our future relationship with Europe. That would enable my industry to start dealing with more of the detail.

The specific concern involves the existing workforce. Around 30 per cent of the workforce in the food and drink industry is from eastern Europe. There is an urgent need to get an assurance that the workers who currently work in the food and drink industry—and in other sectors—in Scotland will have their rights maintained. That issue is causing a great deal of uncertainty for individual workers and for businesses.

The Convener: Were you unable to get those assurances about workers in your discussions with the UK Government?

James Withers: Those assurances have not been forthcoming. We said that it would be helpful to have a clear idea of the options for a future relationship with the EU, but we did not come away with that. The Government was very much in the mode of hearing what our negotiating priorities are, and we were able to share our position, but most food and drink companies would tell you that they have not had an assurance about their existing workforce.

Clare Slipper (NFU Scotland): I support what James Withers has just said. It is still early days and we are very much in business-as-usual mode, because you cannot turn farming on and off. The longer-term priorities are key, and those are what we are trying to voice at the moment.

It is important that lines of communication are kept open between the Parliaments in the UK and those in the wider European area. We are looking for a competent platform on which to make progress with regard to support. One of the first negotiations that we have will concern what we should do regarding the existing support funds that are received through the CAP. We are calling for an immediate commitment for that money to be devoted over the next four years.

Bertie Armstrong (Scottish Fishermen's Federation): The Scottish fishing industry has a very different take on the matter. We regard Brexit as a once-in-a-lifetime opportunity, as it involves a systemic change in the restoration of our exclusive economic zone with regard to fisheries, which amounts to half of the northern continental shelf—a really big patch of prime maritime real estate. Our challenge to the Governments north and south of the border is to have the backbone to enact that and not trade it away again. The best way to describe what happened 40 years ago is to say that those who perpetrated it probably did not know what was coming next. At the time, a small number of nations were given equal access to our seas when they were turned over to common grazing. Subsequently, however, 28 countries were involved—it will be 27 soon—and we now have an unacceptable situation in which more than half of the stuff from our exclusive economic zone, of which we should be the managing partner, is removed by other people.

In the previous evidence session, there was much talk about bureaucracy. There is a difference between complicated bureaucracy and a scheme that is completely unfit for purpose. The common fisheries policy is a completely unfit method of managing fisheries, particularly in our EEZ—you can Google 40 years' of invective on the matter. It involves 27 other nations—half of which do not fish—participating in the Council of Ministers and making a co-decision with 751 MEPs in the European Parliament, 22 of whom are on the Committee on Fisheries. If you put on top of that the European Commission's sole right of initiative for legislation and exclusive competence, you have a scheme that is completely unfit for purpose.

If people have the political backbone, we have an opportunity not to trade away what we have and to become the managing partner in the best piece of the north-east Atlantic for harvesting seafood. We could surpass Norway—which, on a thin majority in a referendum 40 years ago, did not join the EU—as one of the world leaders in harvesting seafood. There is a gigantic prize for Scotland's coastal communities, Scottish jobs and Scottish economic activity. We must not trade that away. There is lots of detail and there are lots of challenges, but that is the big message and the exhortation to this committee, the Scottish Government and the UK Government is not to sell us down the river as happened in 1973.

The Convener: I am sure that people will want to come back in with specific points on specific sectors, but I want to give everyone a chance to answer that general opening question from the point of view of their sector.

David Frost (Scotch Whisky Association): We export to nearly 200 markets globally, and we do so over long time horizons of a decade or more. In that context, we are already used to managing uncertainty.

To be honest, when we look at the situation now, we see a mix of certainty and uncertainty. I do not think that it is necessarily as unclear as everybody thinks. We can already see that, for us, quite a lot of things are going to remain unchanged. We know that we are going to have a zero tariff for exporting into the European Union and that a lot of external tariffs in third countries are going to remain as they are now: either zero, if it is the US, Canada or Mexico, or higher if it is one of the emerging markets. We are confident that we can continue to protect the geographical indication—GI—for Scotch whisky and so on.

There are, however, two areas of uncertainty and concern. The first is around EU free trade agreements that give us so-called tariff preference for perhaps 10 or 15 per cent of our exports to countries such as South Africa, Colombia and South Korea. Is there going to be continuity with those? Can they be grandfathered? Can we continue to benefit from that situation after Brexit? I do not know about that.

The other area of uncertainty and concern was touched on in the earlier evidence session—are we going to have an EEA or EFTA type of arrangement? Are we going to be part of the single market or are we talking about having access to it? That issue will hugely affect whether EU rules in the single market will continue to apply in the UK or whether we will have to redo all that. For us, that is a big uncertainty, because all of that is done largely at the European level at the moment. There are shapes in the mist, but there is still mist out there.

Hugh Chater (Virgin Money): Like probably the majority of UK banks, Virgin Money is much better prepared to deal with a period of economic uncertainty than we were in 2007 and 2008. Having said that, there are three key areas that will determine how the financial sector in particular manages through whatever period of economic downturn we are heading into. The first of the three areas that are particularly pertinent to our business is the future of the housing market in terms of both new build and existing stock, which is driven by consumer confidence as much as by any hard economic facts and indicators. The second area is what happens to the Bank of England's base rate. Although many banks have various business levers that we can move in response to a change in the base rate, that would put pressure on the economic performance of banks and other financial institutions. The third area is employment—more specifically, unemployment.

Those three areas are as much emotionally driven as driven by hard economic indicators because at their heart is how the individual consumer reacts to and anticipates what happens in the wider economy. To that end, there are certain things that central Government can do to encourage consumers to continue to be confident. The sooner that we start to see some of those levers and policy measures being invoked, the better.

The Convener: Your area of financial services is affected by a specific issue. We have heard how all services would not be covered by a free trade agreement and that access to the single market is therefore particularly important for services. We have heard that financial services organisations are already looking to locate in countries that have access to the single market. Are you concerned about that or picking up on it?

11:00

Hugh Chater: I share the concern about EU employees—of whom we have some—and their future, which is a key issue. Whether the passporting issue—which has been talked about quite a lot particularly in relation to financial institutions and which got a lot of publicity and column inches immediately following the vote—will turn out to be a key issue is unclear. In reality, it is questionable whether, if passporting were not available, financial institutions would choose to relocate to Europe or North America.

There may be an opportunity, but, as this is a political area, I will tread with care. In Scotland, particularly in Edinburgh, we have a thriving financial services sector that employs close to 100,000 people. Depending on where Scotland's relationships with the EU land, there may well be the opportunity to offer the country as a relocation safe harbour for institutions that are worried about the removal of passporting from the rest of the UK. As I said, however, that is a political area and I will not say any more on that.

The Convener: You are saying that, if Scotland were able to maintain its access to the single market, that would give us an advantage.

Hugh Chater: That is a credible view.

The Convener: Thank you very much.

Lewis Macdonald: The initial contributions were very interesting, and a couple of matters were raised that I want to come back to. On the one hand, David Frost said that he was confident that certain things will continue to apply—we will continue to have a zero tariff with the European Union and we will have similar certainty with some of our major export markets, such as the United States. He was also uncertain about some of the EU-negotiated free-trade agreements. On the other hand, Bertie Armstrong essentially said that, although there is a great opportunity here, there is also great uncertainty about how fisheries will fare in the negotiations that will ensue following the Brexit vote.

I am reflecting on the evidence that we heard towards the close of the previous evidence session about the lack of experience and expertise in the UK in trade negotiations. Clearly, the representatives of Scotch whisky and fisheries are involved in multilateral and bilateral commercial negotiations daily. Will you reflect on the position from your sectors' point of view, as well as on how you see the process of negotiation in which the UK and Scottish Governments will be involved in the period ahead?

David Frost: On the capacity question, I will answer with my personal hat on. Before I did this job, I was a diplomat, and my last job was as director for trade policy in the Department for Business, Innovation & Skills, where I had 140 people working for me. Therefore, it was news to me that the UK Government does not have capacity in that area. What it does not have are people who have spent a long time sitting in trade negotiations as opposed to supervising them; it also lacks some technical expertise in areas such as WTO rules and translating deals into text and so on. Therefore, capacity will definitely have to go up a bit, and the UK Government will definitely have to buy in some of that, but the idea that there is no capacity to do or think about trade negotiations is simply wrong. It exists; the negotiations can be kicked off straight away.

Bertie Armstrong: On capacity, we are involved in the coastal states negotiations not only as part of the EU delegation but as part of the delegation with other countries. One benefit is that—at last—we will be able to stop focusing on a bizarrely bureaucratic process and start focusing on the outcome, which, in our case, is fishing opportunity. That will be no small change and getting rid of that will be a great deal of help.

I re-emphasise the point that the one big issue for us is the systemic change. Most other industries will not come up against that but, in our case, we will be unleashed. Our fear is that, because the sector accounts for less than 0.5 per cent of gross domestic product, we will be an easy bargaining chip.

Over a period of 40 years, the Belgian fleet, the Netherlands fleet and the Danish fleet have got used to catching almost all of their fish in our EEZ. Of course they will use that in negotiations; it is a matter of observation. The bit that slightly frightens us is that we have got so used to the unusual, pressed, deprived position that we are now in—which we should not be in and would not be in if we had managing-partner status in our EEZ—that people will accept the continuation of that as the least-worst position instead of seeking the best position. I emphasise again that we are talking about Scottish jobs, increasing economic activity in areas that really need it and the potential for world leadership—I do not think that that is overemphasising the situation. There is a whacking great opportunity for Scottish fishing here.

We would not become the bully of the north-east continental shelf; we could not do that because we would have to negotiate not with a clean sheet of paper but from where we stand. However, being the managing partner in a beautiful piece of maritime estate would be very different from being one of 28 partners, only 14 of which fish and many of which have other things to do than take part in the negotiations. I am sad that Richard Lochhead is not here, because he is a veteran of the negotiations and would often ask why Austria, Luxembourg and the Czech Republic have a vote in the negotiations when they do not even have a coastline. Exactly.

Lewis Macdonald: In the north-east, many fishermen voted to leave the EU in the hope that the scenario that you have just described would come about. However, you recognise that whether it comes about will depend on the remit of the negotiations that are undertaken and their success.

Bertie Armstrong: Yes. That is exactly the case.

Lewis Macdonald: Let me come back to David Frost on the issue of whisky. David, you have enormous personal experience and the Scotch Whisky Association has enormous institutional experience of negotiating on a global stage. What is your sense of the challenges and opportunities that lie ahead for the wider Scottish economy and for your sector? Bertie Armstrong has talked about systemic change in his sector. I presume that it is much more "business as usual" for your sector, but what are the priorities and perspectives going forward?

David Frost: That is a big question. Our industry is unusual because we export well over 90 per cent of what we produce, so what happens in global markets makes a big difference to us. We also do not have a complex upstream supply chain. Basically, we take barley, water and yeast and turn them into money—that is how the system works. We do not have to worry about intermediate goods, complex movements across Europe and so on. In that sense, we are simple, and we can focus on export markets and doing stuff well in Scotland. What makes a difference to us globally is the ability to get Scotch whisky on to the market. It is the market-access barriers, tariffs and all the regulation that make a difference.

A third of our exports go to the EU and it makes things simple to be part of the EU single market; therefore, keeping access to that market is really important. However, that does not change the fact that two thirds of our exports go elsewhere, and keeping up the capacity to knock over market-access barriers and get Scotch into those markets is going to be just as important after Brexit as it is now.

Lewis Macdonald: Will it be harder to do that?

David Frost: It will be different because we will not be able to call into play the European Commission, as we quite often do now, in relation to specific market-access barriers. We will have to do more of the work ourselves—the UK Government is going to have to gear up for that. On the other hand, the UK Government's range of interests will be narrower and it will not be balancing lots of interests across the whole of Europe, which might create greater focus. That will probably be a bit challenging in the short run, but I can see how it could be done in the medium to longer term.

The Convener: I have a supplementary question on the whisky industry. When Oliver Letwin was before the Foreign Affairs Committee a couple of weeks ago, he specifically admitted that the UK Government's trade negotiators have moved to the EU and it does not have capacity. I do not know whether you heard his evidence to that committee.

David Frost: I saw what Oliver Letwin said, but we might be talking about slightly different things. As I said, it is true that we do not have people who have sat in negotiations on free-trade agreements. The UK supervises such people through the EU bureaucracy, so such work is done at the Commission. Do we have people who understand the issues? Certainly. Do we have lots of people in the UK who have done negotiations? Certainly. The intersection of those two things means that we have lots of capacity.

The Convener: Liam Fox was told yesterday in the United States that the US is not willing to negotiate a trade agreement in advance of the negotiations with the EU. Is that a concern for you? You suggested that you were confident about negotiating something with North America.

David Frost: I assume that the UK Government will have to get on to negotiating something with the US in due course. It is true that a country cannot sign any free-trade agreements while it is a member of the EU—that is certain. Can a country pick up the process and begin to establish the channels and the issues? Strictly speaking, it cannot but, in practice, the Commission will have to give some margin for manoeuvre for that to be done, to avoid a break afterwards.

One thing that is really important to us is what happens now and not just the big free-trade agreements. If there is a barrier in market X now, who talks to the Government there to get rid of that barrier? At the moment, we turn to the Commission and the UK Government, but it is realistic to think that the Commission might at some point show less enthusiasm for doing that on the UK's behalf than it does at the moment, so the UK Government will have to step up soon on that. That is the more immediate problem.

Bruce Crawford: I have a supplementary question for Mr Armstrong, because his approach is slightly different. He talked about a gigantic prize and a once-in-a-lifetime opportunity. It is obvious that the industry has thought a lot about the situation and that your perspective is different—I am glad that we are hearing it today. Given that, what trading arrangement would your organisation prefer the UK to have in the future?

Bertie Armstrong: For us, the most important issue is the status that the UK adopts. Under the Scotland Act 1998, there is an opportunity for Scotland, which has the bulk of the fishing, to show leadership as a coastal state that acts as the manager of exploitation in its own EEZ. I think that that would take care of it. Are you talking about a specific separate direction?

Bruce Crawford: The evidence that you have presented suggests that an arrangement such as that of Norway, which is part of the EEA, might be the best for the future. Is that actually what you suggest?

Bertie Armstrong: We stand with the rest, in that the choices—whether they involve the EEA or the WTO, at either end of the spectrum, or some hybrid in the middle—remain uncertain.

Bruce Crawford: I asked what your organisation's preference is.

Bertie Armstrong: We would prefer to have continued access to the market, of course. However, I note that the cod in people's fish and chips is likely to have been caught in northern Norway and that the prawns in people's prawn cocktails are likely to be from the mud of the Mekong delta. The European market already takes imports from elsewhere, so there is no reason for us to believe that we would not have access of some sort. Whether the model will involve free movement of people and therefore complete access to the single market is yet to be decided.

Bruce Crawford: What is your preference?

Bertie Armstrong: Like everybody else on the panel, we are waiting for an analysis of what the best model is and what is likely to emerge as plan A.

Bruce Crawford: We heard from earlier witnesses—I accept that their perspective is different from yours—that the least-bad option after coming out of the EU might be the EEA. Has your organisation looked at what costs the Scottish fishing fleet might bear from having proof-of-origin customs rules as part of the EEA?

11:15

Bertie Armstrong: That work—as you might reasonably expect—is on-going now. We were as surprised as anyone, to be honest, about the outcome of the referendum. There will be changes, but we cling to this thought: a market is an exchange of goods bought by people who want to buy them. I was told by a fisherman the other day that the Spanish buy his prawns not because the single market exists, but because they want his prawns. If there is an extra cost for the prawns—which may or may not be offset by a difference in the cost of currency exchange—the market is still highly likely to continue to exist. We should not regard that as an unjumpable hurdle.

Bruce Crawford: To get the free movement of people—which I recognise from your submission is quite an important issue for the fishing industry, in particular on the processing side—some sort of EEA arrangement, like Norway's, would probably be required. Given the fishing interests of the Dutch, Spanish and Norwegians, why would they welcome the United Kingdom into that arrangement with open arms?

Bertie Armstrong: The boot, if you like, would be on the other foot. As the managing partner in the sea space resource, we—if there were the political backbone to do it—would be able to apply pressure to the rest of the market, rather than find ourselves impossibly pressed by immoveable forces.

Bruce Crawford: Why, if it were against their interests, would the Dutch, Spanish, Norwegians or any country with fishing interests sign up to a deal for the United Kingdom to be in the EEA? You would not have the free access to people.

Bertie Armstrong: You are second guessing the outcome. If a crushing blow were dealt to the fishing industry in that way, it would be just that: a crushing blow. However, I really do not see that coming and we should not overemphasise the importance of the free movement of people. I did not hear anybody in the debate in the run-up to the referendum saying that we will ban everybody from everything. If it is in the country's best interests to import labour—for soft-fruit picking or for the fishing industry—I have no doubt that an arrangement could be reached to achieve that. We are continually fighting for more concessions to bring in labour from elsewhere—it is not immigration as the labour is used at sea—and getting nowhere. There are many aspects to consider, but I do not think that any of it is overwhelming.

Rachael Hamilton: It is no surprise that four out of our seven panellists today come from the food and drink industry, in which turnover has increased from £10 billion in 2007 to a predicted £16 billion in 2017. The industry is a very important part of the Scottish economy.

Are you working collaboratively, rather than on your own, on country of origin labelling and all the other requirements for the continued exports of food?

James Withers: I am happy to answer that. There has been a lot of work since 2007 in pioneering a world-leading level of collaboration among food and drink organisations. We developed a national identity around our products—the land of food and drink imagery and branding that is now used at any international show, whether in Tokyo or Hong Kong. We have a very consistent set of branding for seafood, salmon, spirits, beef, lamb, soft fruits and vegetables. There is a very high level of collaboration going on operationally among organisations. We have a strategic board—David Frost sits on it as does Clare Slipper's chief executive—and, around that table, chief executives of many of the trade associations have developed a single strategy and single branding approach.

Interestingly, one of the restrictions of being part of the single market is on the ability to promote regional foods. Within state-aid rules, we cannot promote Scottish foods, as that is seen as skewing one particular part of the single market. What we can do is promote geographical indications. There are about 70 products across the UK that have protected geographical indication status—the same thing that covers champagne and Parma ham—and we have 13 products in Scotland with that status.

Whisky has a fairly unique level of geographical indication protection through UK legislation, which provides greater certainty of the protection of that industry than is provided for Scottish salmon, which is Scotland's biggest export and the UK's number 2 export. As we go forward, it will be critical to understand the future protection of that status in Europe, in the UK and in third countries. On your initial question, about a base level of collaboration, we will be ahead of the rest of the UK and many countries around the world in working collaboratively to develop the brand. That gives us a good platform on which to negotiate in the next few years.

Ash Denham: I am interested in hearing about horizon 2020, which is the EU funding programme for research. To put it into context, by March this year Scotland had secured more than €200 million in funding from that programme. Edinburgh university was particularly successful in benefiting from that. Early analysis has shown that UK researchers are already not being included in planned bids. Is there any evidence that Scotland is already being affected? What are the future implications of that?

A wider issue is that research affects businesses and the economy and has implications for productivity and innovation. If anyone else would like to come in on that, that would be useful.

Alastair Sim: I will talk about horizon 2020 but, if it is all right, I would also like to touch on some of the student and staff issues that we face as a result of the vote. It all adds up to one picture of how we sustain a vibrant and internationally open university ecosystem—I do not like to look at these things separately.

To illustrate the scale of the European-ness, among other factors, of that ecosystem, 16 per cent of our academic staff are from the EU. In the past year, £75 million of research project funding came from EU sources, principally horizon 2020. We have 24,000 EU students in Scotland who contribute to the economy by spending about £156 million off campus, and about 1,700 students go out each year on Erasmus to European partners. It is an ecosystem that vitally crosses boundaries. That is intrinsic to the nature of universities.

Thinking about horizon 2020 and related issues, if we are going to sustain that research ecosystem, one of the crucial things is to be able to say to EU staff that they continue to be welcome and that the movement of talent will continue to be possible. At least we can say the first of those confidently; the second should be a prime negotiating objective for the university sector.

On horizon 2020, at the moment, while we remain a member of the European Union, there are problems of international partners' perception more than problems in reality. The perception is a problem in itself, if European partners are feeling more uncertain than they potentially need to be. It is important that there has been a range of statements from the Commission and others to say that, while we remain in the EU, business as usual pertains: get in there, do your research applications jointly with European partners and remain confident in horizon 2020. There have been messages on that from Commissioner Moedas, the League of European Research Universities, the European University Association and rectors from 24 European countries saying, "Yes. We still want you as a research partner because British and Scottish research is excellent. It's a necessary part of the European ecosystem."

Very helpfully, last week, we put out a joint statement with the Scottish Government emphasising that open for business message to try to restore the confidence that has been shaken a bit in the light of the Brexit vote.

Longer term, as we look towards negotiating priorities, a vital negotiating objective will be to sustain that European and international ecosystem, as well as the vital ecosystem across the internal boundaries in the UK. We need to put ourselves in as strong a position as we can be—as Norway is, for example—as a strong participant in European research networks and a voice in horizon 2020 and its successors.

There are other issues that we need to address quite urgently. The Scottish Government moved urgently to say that European students currently in the system or joining in 2016 would continue to benefit from Scottish Further and Higher Education Funding Council places. That was very helpful, but we need a similar assurance quickly on 2017 students because prospectuses are already out, having been published prior to the Brexit vote, that say that students can come here and benefit from Scottish funding council funding. We want to maintain that funding for 2017 entrants. There is a contractual element, in that the offer has already been made and applications will be arriving in the next few weeks. Further assurance in that regard is needed urgently.

There are a lot of issues for the longer term, such as what the status of EU students should be, how we remain open to cross-border movement, how we keep ourselves in European research networks and what happens to regulation—for example, the regulation of intellectual property. We need to look at the whole package of how, if we are not formally part of the European Union, we can maintain a close relationship with the EU that sustains a student, staff and research ecosystem.

Clare Slipper: For our sector, research and innovation are key and are really important in securing the on-going and future vibrancy of our industry and developing new techniques in our farming systems. We have fantastic capacity in agricultural research in Scotland, but obviously there are now concerns about future funding for that. The situation in the longer term will depend on the policy direction that the Scottish Government takes. If a new agricultural support system is being developed, there is a real prize to be had in putting more into supporting things such as practical research, meaningful knowledge transfer and advisory services, and building that into the support system. That could be a tangible goal for the future.

Bertie Armstrong: That was a good question about something that will be very important to us. We have a number of schemes that are indirectly funded by the European maritime and fisheries fund. We are still getting reasonably good news—yesterday, we heard about the continuation of the Government's gear innovation and technology advisory group, so the money is still coming and we have not seen it turned away. However, we also have seven observers who contribute to the science, with the oil industry, via the Fisheries Legacy Trust Company. We run a scheme whereby fishermen are told where the bottom equipment of the oil industry is, which is no small task. That will require alternative funding, so a big challenge is coming in a number of areas with the loss of indirect funding.

Mike Rumbles: I have a question about the huge issue of farm subsidies and the implications for the future. Hundreds of millions of pounds are involved, and I know that the NFU wants no change for four years. However, does the situation not give us huge opportunities, ranging from, for example, New Zealand's abolition of farm subsidies and making farms more efficient, to designing a system in which we can subsidise farming sectors that are not subsidised at the moment, such as the pig industry? At the moment, funding for farm subsidies is reserved to the UK, but when we leave the EU and the common agricultural policy is abolished, that money will come to the Scottish Government in the block grant. It will be entirely up to the Scottish Government what it does with that money. If the NFU does not get off the mark quickly, could not the Scottish Government do all sorts of things with that money? Would it not be a good idea to press the Scottish Government to come up with a home-grown solution for the hundreds of millions of pounds of farm subsidies, rather than just wait and see what happens?

Clare Slipper: You are absolutely right. There is a huge discussion to be had about that, including within our membership. However, it is only five weeks since we heard the result of the referendum so it is early days. It was not the result that we expected, but we will go out to our members in the latter half of the year to have a wide discussion about where they want the future system to go, because this is not a time for knee-jerk reactions. As was said previously, there could be a real prize here in that we could have a system that is much more suited to our needs and which genuinely supports sectors of the industry that need it and helps them to grow and be comfortable for the future.

One key thing is that the situation provides us with a great opportunity to look again at activity and genuinely reward farmers who are farming. We have tried to address that in round after round of CAP negotiations, but we have never quite had a robust enough arrangement. Now it is possible that we have an opportunity.

We have a dialogue open with the Scottish Government and we are making it aware of where our thinking is, but there needs to be a much more robust discussion within our membership.

11:30

Mike Rumbles: It is a tremendous opportunity, is it not? Bear in mind that, with Scottish budget issues regarding the health service and everything else, there will be a huge amount of pressure on that money and it will be entirely up to the Scottish Government how it spends it. It is an opportunity that should not be missed.

Clare Slipper: That is the concern. We do not know what the nuance will be. Will some agricultural funding come through the block grant? Will that even be spent? Will it be topped up by the Scottish Government? It is all to play for and it is hard to say at the moment exactly where things will lie.

The Convener: That touches on an important point that Dr Roy and the STUC made earlier. Under the new arrangements for Scotland's fiscal settlement, money can be allocated to Scotland only through income tax or the block grant, through the Barnett formula, which will remain in place—that is the vow. The point was made that some of the European payments are greater than what we would get through the Barnett formula, because Scotland gets well above our population share. There has been no discussion of how the UK Government will transfer that money back to Scotland—if it will at all—or whether it will transfer it according to the way that it is distributed in Europe, which gives Scotland a higher percentage than our population share. Have you had any assurances from the UK Government about how that money will come back?

Clare Slipper: Not as yet—nothing has been set in concrete—but that is exactly what we are pushing for. As I said in my opening statement, we are looking for the UK Government to commit the money that has already been dedicated for the next four years, but we need to address the longer-term situation. We are absolutely pushing for that in discussions with ministers, but we have not had anything set in stone yet.

The Convener: In your sector, for example, Scotland has 85 per cent of the less-favoured areas. That would need to be reflected in any new settlement.

Clare Slipper: Absolutely. When the time comes for us to have divergent support policies across the UK, we may see that they look wildly different in Scotland from how they look in England and the rest of the devolved nations. The point is that the policy direction will be for the Scottish Government. The massive question mark is over the amount of funding.

The Convener: I am sorry to press you on this, but in talking about the Scottish Government's policy direction we are way ahead of where we are now. We cannot have a policy direction if we are not given the money in the first place. Before the Brexit vote, the committee pressed UK Government ministers on how the block grant would be adjusted to make up for those moneys, but we were not able to get any reassurances. Have you been given any reassurances that we will get the money?

Clare Slipper: Nothing has been set in stone yet.

The Convener: You have not been given any reassurances.

Clare Slipper: We are absolutely pushing the new secretary of state for that.

The Convener: I am sure that we will push for that with the new secretary of state, when we see him.

Mr Withers might be particularly concerned about the issue. A lot of the pillar 2 funding for the Scotland rural development programme funds your sector. The Audit Scotland figures show that food processing, marketing and co-operation in Scotland get £70 million in this particular round. You must be very concerned that that money will not be transferred.

James Withers: It is a concern. I would also say that what happens with agricultural support is absolutely interlinked with food and drink more widely. The £3 billion Scottish agricultural industry is the bedrock of much of the £11 billion-worth of manufacturing that happens. David Frost talked about the raw materials for his industry: a huge amount of its malt and barley requirements are met in Scotland. Getting the agricultural piece right is absolutely central to Scotland's wider food and drink success, but sometimes we fall into the trap of putting agriculture in one place and food and drink in another. It is important that we do not do that.

Mr Rumbles mentioned New Zealand. We have a really good opportunity to look at other models, and New Zealand dramatically changed its support system. I am not sure that it is investing any less in the food and drink industry, but it moved where the funding went—from directly to farms to the processing and the export position as well. We can learn a lot from that model about how to do that.

The potential advantage of leaving a common agricultural policy that is not without its flaws is the real opportunity to create something innovative. It really is a once-in-a-lifetime opportunity. We need to do some work on that now, and there are lessons to be learned out there. New Zealand is a good comparator. David Frost said—I am paraphrasing—that the UK being out of the European negotiating block might allow us to be a bit more fleet of foot and prioritise where we go. The first country to negotiate a free trade agreement with China was New Zealand, whose population is smaller than that of Scotland. There are lessons for us to learn from that, and we have started some research work on what other models might exist in the current window. Such work will be really valuable and a sound investment.

The Convener: I suppose that the money has to come to the sector in the first place.

James Withers: It does.

The Convener: The promise on the bus was that the money would all go to the national health service.

Mike Rumbles: Can I continue?

The Convener: Sorry, but you have had your turn. I have to allow other members in.

Bruce Crawford: Convener, you have rightly picked up on the issue that I was going to raise. Can I ask a different question about aviation? Or do you want me to come back to that?

The Convener: Are there any more questions on the CAP?

Mike Rumbles: Can I pursue my point?

The Convener: I would like to bring in Lewis Macdonald, who has a supplementary question on the subject.

Lewis Macdonald: It certainly builds on it. The issue that has been highlighted in relation to the agricultural subsidy also applies to the higher education sector. Scottish universities punch above their weight in accessing European research funding. Is that on the table in discussions between Universities Scotland and equivalent bodies elsewhere in the UK and the UK and Scottish Governments? What would be the mechanics for sustaining that research in the event that we no longer have direct access to those European funds?

Alastair Sim: As we and our UK-wide partner Universities UK communicate our priorities, because our universities are part of vital cross-border ecosystems, one of the priorities that we are putting into the mix in discussions on the UK's overall negotiating priorities is the need for us to have as close a relationship as possible with Europe as members of the European research area. There are models and the EFTA countries are close in on that.

Lewis Macdonald: I am interested in hearing a little more about that. Does the European research area allow higher education institutions outwith the European Union member states to have access to European research funding?

Alastair Sim: That is correct. There are various degrees of association. There is associated country status, whereby a country is closely involved in the whole horizon 2020 programme and its successors—for instance, Norway and Iceland are closely involved in that programme and have accesses that are not so different from those that European Union members have. Because Switzerland stepped away from single market standards of freedom of movement of people, it ended up with a status that was one stage removed from that. Nevertheless, I understand that it is still quite close in, which gives it the capacity to bid for European Research Council funding on the basis of excellent research and Marie Curie mobility schemes for researchers.

We would encourage the negotiators to look at those models for building a relationship with the EU as part of the European research area in order to lever the maximum benefit from continuing to have a cross-border ecosystem.

Lewis Macdonald: In a sense, the options that you have outlined are parallel to the options that apply for trade. In other words, there is a degree of closeness and engagement with the countries that you have mentioned—Norway and Iceland—which have full access to the single market through the European Economic Area and have full access to the European research area on the same basis. Switzerland is one step further away from both those countries.

Alastair Sim: Yes.

The Convener: Rachael Hamilton wants to come in. Is it on the same point or a new one?

Rachael Hamilton: I just want to make a small point. We have talked a lot about the impact of rules and regulations and our leaving Europe. Hugh Chater mentioned three areas that very much depend on domestic policy: new-build and existing housing stock; the exchange rate; and unemployment and employment. Will you expand on how growth will be affected as we go forward?

Hugh Chater: Yes, certainly. Let us take the housing market first. Clearly, it is very much driven by supply and demand, but new build and Government-led new-build schemes support very large employers in the construction industry. The sector can be influenced—not entirely, but largely—by public monetary stimulus if necessary.

A lot of jobs are associated with construction. As members will recall, in the last recession, which started in 2007-08, the construction industry was very badly hit, and a lot of the skilled jobs were lost for ever—in inverted commas. I think that we will find that a similar thing will happen in the event that the UK Government decides, for example, to pull away from its target of 300,000 new-build homes. That makes up an important part of the sector, and a percentage will be earmarked—again, in inverted commas—for Scotland.

A very human dimension is associated with the housing market. The ambition to own your own home is still pervasive in the UK; a huge number of people living in Scotland and in the rest of the UK have that aspiration. I know that there have been particular Scottish flavours associated with the help to buy and help to save schemes, and a lot of the Government schemes that have been introduced recently need to be protected and, potentially, expanded, so that the people who live and work in Scotland and the rest of the UK feel that they can continue to have that aspiration and that houses are provided as part of the new-build approach that are suitable for starter homes and people can get themselves on to the housing ladder. Clearly, that all depends on people being in continued employment. I was simply trying to make the point that a degree of employment can, of course, be driven by fiscal and monetary policy. Good old Keynesian economics can potentially have a role to play.

In the recent past, we have seen a good degree of quantitative easing. Maybe in Scotland we need more direct investment in major infrastructure projects. We have a number on the go at the moment, including the second Forth crossing. In the rest of the UK, there is a lot of talk about the high speed 2 rail link, which clearly does not directly impact north of the border. We have to be very aware that, at the heart of the economy, we need consumers to be confident about having sustainable employment and a sustainable income to support local demand for the products and services that we have been talking about.

On exports, the opportunity to re-enter markets that we are part of now, including markets that we are part of because of our membership of the EU, is critical. However, at the end of the day, and as I have just said, we also need to pay a lot of attention to local employment, local consumer confidence and local demand.

11:45

Finally, on why the Bank of England base rate is important, there are two potential implications. Without going into too much detail, when interest rates reduce, the margin that financial institutions have between what they lend at and the savings that they pay interest on can get compressed, which can reduce their appetite for lending. As we have seen in previous recessions, if that happens, the economy grinds to a halt—to use an emotional phrase—extremely quickly. Whether we are talking about corporate banking, small business banking or retail banking—the kind of banking that Virgin Money is involved in—credit is the lubricant that keeps the system flowing. We need to pay particular attention to that and to ensuring that the messages that we have heard from the Bank of England and the chancellor about ensuring that that does not happen are heeded. We also need to ensure that the Scottish Government presses that home and ensures that lessons are learned from previous recessions, although they were caused by circumstances that were different from the circumstances that caused this one, which is very much the result of a political issue. The principle of ensuring that there is a ready supply of lending within the system for businesses and consumers is fundamental and vital and needs to be addressed in Scotland and the UK.

The Convener: Did that answer your question?

Rachael Hamilton: Very much so.

Ash Denham: I want to turn to aviation, so my question is for Mr Dewar.

Changes to how aviation operates could have a big impact on Scotland. They could affect tourism and the economy—we know that transport and air routes are quite important for foreign direct investment and so on. The International Air Transport Association has set out what it sees as the three available options for aviation co-operation: the first is continued access to the single aviation market; the second is a type of bilateral agreement; and the third is having no formal agreement. Which of those options do you favour, and why?

Gordon Dewar: It is critically important that we preserve our access to the open skies agreement. It would be deeply ironic if we lost it, given that the UK was behind the founding concept of that policy and pushed it for years. Further, we are an island nation on the north-west periphery of Europe, so air access is more important to us than it is to any other European country, as we simply do not have the land-based options.

The implications of not preserving that access are severe. We have already seen easyJet—the second-largest airline in Europe—thinking about relocating outside the UK and relicensing itself in Europe in order to preserve its access. That would inevitably mean that some of its focus on the UK market would be lost, which would have a severe impact.

Aviation is a good barometer. It touches every issue from access to markets to inbound tourism, which is our biggest employer, and we have real opportunities in those areas. It is also one of the most visible industries, as it touches individuals' lives as well as issues that Government is involved in.

The good news is that things that we do in aviation tend to have a fast return. This morning, we have talked a lot about negotiating over months and years to get to an outcome, but we can do one thing that is quick and demonstrably internationalist, which is just to follow the existing Government policy and halve air passenger duty. That would have a low cost but it would reverse what we are hearing about airlines moving investment away from the UK and would, almost overnight, result in significant growth that would benefit the economy and jobs in 2017, never mind the 2020s or 2040s. That is what we should do if we want to stand out as being internationalist, open for business and welcoming. It would benefit tourism as well as the education sector and others, as it would preserve and grow those links. Announcing such a move on APD and delivering on that announcement in early 2018 would have a profound effect in terms of the direct economic benefit and the signal that it would give not only airlines but every other business in Europe.

Lewis Macdonald: You mentioned open skies, for which the set-up has a parallel with the European research area. There is a European common aviation area, which extends beyond the EU member states. How does that operate for countries that are outwith the EU? How easy would it be to join or remain in that area as a non-EU member?

Gordon Dewar: The honest answer is that I do not know. The question will inevitably be part of the political bargaining that goes on. We have heard concerns about fisheries and I do not think that any industry is immune from being part of that political bargaining. We must put the priorities out there and say what is important.

If we look around the patch, I think that it is highly unlikely that we would lose significant access in Europe, although issues might arise about where the licence is held in terms of airport operation. I am not massively concerned about that.

However, we do not need to look too far to see that Norwegian air, which has full access to the European market, is not getting full access to the EU's open skies agreement with America. Such wrinkles round the edges and a lack of progress on future connectivity are conceivable.

China is an obvious area of huge growth in connectivity. The UK is doing well out of that connectivity but, if China decided for whatever reason that it would be more sensible to focus its bilateral activity with the remaining EU and not with the UK—even if that related to timing and not intent—that would raise significant issues.

Lewis Macdonald: There is a parallel with trade. I presume that Norway has to negotiate directly with the United States on future arrangements, so it is possible to be in the European common aviation area but still to have to engage in additional negotiations.

Gordon Dewar: Absolutely.

The Convener: We heard earlier that EFTA countries in the EEA are not part of the customs union. The SPICe briefing says that, without a formal agreement, there is the potential for more customs operations at airports. Would that have a big impact on your business and on tourism?

Gordon Dewar: It would be inevitable. If we had different tariff structures and different allowances, that would complicate things, if nothing else. However, it is not necessarily all bad news. Opportunities would arise from going back to true duty-free trading, which we have with non-EU countries. There are ups and downs, but the issue is the uncertainty. We are clear that we hope to have the widest possible access and continued growth.

I cannot emphasise enough how important aviation is to an island state. We must make coming here easy and understandable for tourists. A German tourist, for example, has choices about where to fly to—it is easy to go left instead of right. We need tourists to look at Scotland as somewhere that they want emotionally to come to, and we need to make coming here possible in practice.

The Convener: I think that Ross Greer has a supplementary question on aviation.

Ross Greer: My question is not on this topic.

The Convener: Does anyone else want to ask about aviation?

Bruce Crawford: I want a point clarified; I am trying to understand something. I recognise the challenge of the open skies agreement and the danger that, if the UK was no longer in the EU, it might have to do a separate negotiation with the USA. I assume that we would not automatically be part of the European common aviation area either. Does each country in that area require to agree to another country being part of that area?

Gordon Dewar: The position is negotiated at the European level, so there would be one negotiation, but all the countries would influence the decision and the outcome.

Bruce Crawford: If Iceland, Norway and Switzerland are part of the area, we must have agreement from them, too, so it would not be a straight matter of having an agreement with the EU. Am I right in saying that we would also have to have agreement from Iceland, Norway and Switzerland?

Gordon Dewar: You are going beyond my competence in asking about how the decision would be made. There would be one negotiation; anybody on the other side of the negotiation would have a say in some shape or form over the outcome.

Bruce Crawford: Wow.

Ross Greer: The Maastricht treaty and ensuing European citizenship conferred the benefits of freedom of movement on those who are not economically active. On the UK's negotiations with the EU on access to the single market and the implications for freedom of movement, do your sectors have particular opinions on the distinction between freedom of movement for all persons and freedom of labour movement for the economically active?

Alastair Sim: From the university perspective, it would be important that the dependants of EU staff are able to come here, as well as the staff themselves.

David Frost: I share the concerns about labour from other EU countries. It is probably not as big an issue for us as it is for others round the table but it is definitely an issue. Our membership is made up of large multinational companies that are concerned about the ability to move relatively highly paid staff around Europe easily—that is part of how such companies are run. That could come into question as part of this.

My only other remark is a bit wider. Sometimes these things are interpreted in too purist a way. Yes, it is true that there is full free movement of persons across the EU, but you still have to be qualified to do the job. You cannot move to some other European countries and expect to work as a plumber or an electrician, let alone a lawyer. The principle is one thing; the practice is much more complicated. That reality, as well as the principle, will have to be part of the UK-EU discussion.

The Convener: We are coming to the end—[*Interruption*.] Sorry—does Lewis Macdonald have a question on that topic?

Lewis Macdonald: It is on a broader topic that the witnesses might find it helpful to consider. The UK Government has invited the Scottish Government to be a participant in drawing up the terms of the exit negotiations. It would be useful to the committee to know whether conversations are going on between the different sectors around the table with the UK Government and the Scottish Government. Clare Slipper and one or two other people have referred to being asked what their priorities are in the negotiations. At this early stage, are there issues that it would be useful for the committee to be aware of in relation to the negotiating priorities that different sectors have and that both Governments are consulting them on? Are both Governments consulting? I suppose that that is the other important question.

David Frost: We have been quite quick off the mark in talking to both Governments and feeding into priorities. To be honest, we have probably been a bit quicker than the UK Government in getting ourselves in order and putting messages in. It is perhaps a bit different here in Scotland, where the First Minister got in on things quite quickly.

It is probably too early to say. The system is gearing up. There will be a committee structure and there are two new ministries to develop. We are just repeating some simple messages about our sector to as many people as we can. That will get into the processes as we go forward.

I am on the First Minister’s advisory council on a personal basis. That will be a forum where some of the issues can be thought about, but it is not at that point yet.

Bertie Armstrong: We immediately got involved in discussions with the Scottish Government. Fergus Ewing, as the fisheries minister, was straight out of the stall with us immediately after the vote. That was really useful. He is seeing every sub-association sequentially so that he understands the sectoral differences as well. In as much as that is information gathering, that is going very well.

I perceive that the UK Government is still setting up its infrastructure and therefore, whereas we have made requests and had a rather meaningless exchanges—“We’ll all do as best we can”—there has not been as much substance overall and we are very much looking forward to that. There may come a day when we ask the Scottish Government for assistance if we feel that things are not going well. However, it is very early days and the infrastructure simply is not there yet.

Alastair Sim: We have had good initial engagement with the Scottish Government, which, as I said earlier, moved quickly to give the necessary assurances to current and 2016 joiner EU students. We are working with the Government on what assurances can be given to people applying for 2017 entry. It was very useful to get a confidence-building statement out, jointly with Ms Somerville, on research.

In relation to the UK Government, we are working closely with our partner organisation Universities UK, which has had discussions with the relevant portfolio ministers. However, as others have said, the negotiating position of the UK Government is still very much being formed.

Bertie Armstrong: This will be my very last comment. One thing that slightly worries us is that the thrust of the terms of reference of the group that David Frost is part of is how we can best stay as close as possible to the EU. There is at least one sector that would wish, under whatever circumstances prevail, to look carefully at how we defend our position outside the EU. That is rather starkly stating it, but there is one area where it is in Scotland’s strongest interests to not have the closest relationship. That is just an area of worry that we wish to flag up, and course we will be talking to the committee about that.

The Convener: You have certainly been able to air that today.

We are out of time. I thank all our witnesses for coming along. I very much appreciate your time today.

12:01

Meeting continued in private until 12:36.

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