



**OFFICIAL REPORT**  
AITHISG OIFIGEIL

# Economy, Jobs and Fair Work Committee

**Tuesday 1 November 2016**

**Session 5**



The Scottish Parliament  
Pàrlamaid na h-Alba



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**Tuesday 1 November 2016**

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

**CONVENER**

\*Gordon Lindhurst (Lothian) (Con)

**DEPUTY CONVENER**

\*John Mason (Glasgow Shettleston) (SNP)

**COMMITTEE MEMBERS**

\*Jackie Baillie (Dumbarton) (Lab)  
\*Ash Denham (Edinburgh Eastern) (SNP)  
Liam Kerr (North East Scotland) (Con)  
\*Richard Leonard (Central Scotland) (Lab)  
\*Dean Lockhart (Mid Scotland and Fife) (Con)  
\*Gordon MacDonald (Edinburgh Pentlands) (SNP)  
\*Gillian Martin (Aberdeenshire East) (SNP)  
\*Gil Paterson (Clydebank and Milngavie) (SNP)  
\*Andy Wightman (Lothian) (Green)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

Stephen Boyle (Royal Bank of Scotland)  
Douglas Duff (Business Gateway)  
Jane Gotts (GenAnalytics Ltd)  
Linda Hanna (Scottish Enterprise)  
Dr John Kemp (Scottish Further and Higher Education Funding Council)  
Dr Matias Margulis (University of Stirling)  
Richard Marsh (4-Consulting)  
Gordon McGuinness (Skills Development Scotland)  
Professor Graeme Roy (Fraser of Allander Institute)  
Jenny Stewart (KPMG)  
Charlotte Wright (Highlands and Islands Enterprise)  
Dr Fabian Zuleeg (European Policy Centre)

**CLERK TO THE COMMITTEE**

Alison Walker

**LOCATION**

The David Livingstone Room (CR6)



## Scottish Parliament

### Economy, Jobs and Fair Work Committee

*Tuesday 1 November 2016*

*[The Convener opened the meeting at 09:32]*

### Decision on Taking Business in Private

**The Convener (Gordon Lindhurst):** Good morning everyone, and welcome to the ninth meeting of the Economy, Jobs and Fair Work Committee. I welcome our guests: Linda Hanna, managing director of strategy and sectors, Scottish Enterprise; Charlotte Wright, interim chief executive, Highlands and Islands Enterprise; Dr John Kemp, interim chief executive, Scottish Further and Higher Education Funding Council; and Douglas Duff, head of economic development and environmental services at Falkirk Council and chair of the business gateway management group.

Gordon McGuinness, who is director of industry and enterprise networks at Skills Development Scotland, is slightly delayed because of travel difficulties, as is one of our committee members. Liam Kerr has also sent his apologies. I remind everyone in the room to turn off electronic devices or switch them to silent so as not to interfere with the committee's work.

Agenda item 1 is a decision on taking in private items 4 and 5. Does the committee agree to take those items in private?

**Members** *indicated agreement.*

## Enterprise Agencies

09:33

**The Convener:** Having welcomed our witnesses, we will start our questions to them. I say to the witnesses that there is no need to switch microphones on, as the broadcasting staff will deal with that.

I have a question on regional economic strategy, but first, the deputy convener, John Mason, has a question about overall structures. Over to you, John.

**John Mason (Glasgow Shettleston) (SNP):** I am interested in where we are going with all this. I realise that none of you makes the decisions about that, but you are all part of the overall equation and I am interested in your views on where we might be going.

The word "simpler" appears at various points in "Enterprise and Skills Review: Report on Phase 1". Keith Brown notes in his opening comments that we want

"coherence and ... a simpler, more flexible and cost-effective system".

At the same time, I see the idea of a new statutory board and something for the south of Scotland. That does not seem simpler; it seems like more organisations. What are your thoughts on where we are going? Is being simpler important? Does the system need to be more joined up than it has been?

**Charlotte Wright (Highlands and Islands Enterprise):** I am happy to pick up the point, and I have no doubt that colleagues will want to come in as well.

Having seen feedback from users as part of the review process, we appreciate that there is a strong message that people want the process to be easier for users to navigate. A key point is how we deliver services more simply.

In relation to the strategic board, we welcome the opportunity to have strategic oversight across our agencies that are working together. You are right that the detail is not there yet. Our assumption at this stage is that there will be a strategic board, but we have yet to see exactly what that will mean for the boards of individual agencies.

Yesterday in Inverness, we had the convention of the Highlands and Islands, at which Mr Brown was present. He responded to questions from local authorities, which are—not surprisingly—keen to ensure that there continues to be a strong Highlands and Islands voice on the strategic board.

It is really important to us that we work together through the implementation of phase 2 of the enterprise and skills review to ensure that whatever the changes bring—we welcome the opportunities—the things that we can point to as having made the most difference to the success of HIE and the Highlands and Islands over the past 50 years continue into the new structures, so that the legacy continues.

**John Mason:** That is helpful. The radical option would be to have one organisation with five branches. I am not sure whether anyone is suggesting that or whether it would be a good idea. Does anyone else want to come in?

**Linda Hanna (Scottish Enterprise):** We were clear in our submission to the enterprise and skills review, which built on the Audit Scotland work, that although there is a clear economic strategy for the country, it is at a high level, so there is an opportunity to have a clear plan that binds everyone together and puts the outcomes that we want for the economy at the centre of what we all do.

Rather than having one organisation, we should be clear about how we all work together. That does not mean just agencies, because our economy's growth also depends on many other organisations and how they all work together. To support that, we need to be clear about putting the economy at the heart of what we do, about the things that make the difference and about ensuring that we are all going in the same direction.

**John Mason:** Do you feel that, in the past, the five organisations have not gone in the same direction as much as they could have?

**Charlotte Wright:** We continue to have separate agencies. In a number of areas, Scottish Enterprise and HIE are doing similar things to support businesses, but HIE exists for a particular set of reasons. We work with a different business community, we have a community development remit and we work within the geographic and social challenges of the Highlands and Islands. That means that we do different things in a different way. While at an overarching strategic level we are doing the same things and performing to Scotland's economic strategy, the delivery—how we do things—is different.

**Dr John Kemp (Scottish Further and Higher Education Funding Council):** I echo that. The five agencies do different things and sometimes do them in very different ways. There is a significant overlap and a synergy even when we do things that do not overlap.

The point is common to all the discussions that we have had as part of phase 1 of the review. Finding a way of linking the Government's

economic strategy to what we do through some board or other mechanism that brings the agencies together is something that we have seen as important. That could simplify things—that will depend on what happens with other levels of governance and so on—but we do not quite see the approach in the way that Mr Mason suggests, as one agency with five branches. The agencies are different from each other, but there is a synergy from which we must extract the maximum benefit.

**John Mason:** How does Mr Duff see things? From the local government point of view, should the system not be too centralised or would it be better if it was more centralised?

**Douglas Duff (Business Gateway):** The business gateway is part of local government services and we certainly welcome any opportunity to simplify and make more seamless the services that we offer. As part of the inputs from the Convention of Scottish Local Authorities and the Scottish local authorities economic development group, which is the national body for economic development officers, we have welcomed any moves that can be made to simplify the arrangements and make them more straightforward. Importantly, we have been blending services locally, but we try to maintain consistency across the country, and we work closely with the national agencies to achieve that. We see the review as part of a direction of travel to simplify arrangements, but it is important that we maintain scope for local flexibility as well as a nationally consistent picture.

**Gil Paterson (Clydebank and Milngavie) (SNP):** To follow on from that, I hear the message that you are all separate but together in some way. Do you see scope for collaboration on back-office services, which might allow you to save money to reinvest in what you do and in reaching out to small businesses?

**Charlotte Wright:** We have a live example of that, which is that our information technology support is shared across SDS, Scottish Enterprise and HIE through our enterprise information systems team. We can do that kind of thing, and I guess that we have the opportunity to see what more we could do.

**Dr Kemp:** Similarly, we share some human resources services with the Scottish Qualifications Authority. That kind of thing is going on in the agencies that are part of the review and more widely.

**Gil Paterson:** Does local government have the same mindset?

**Douglas Duff:** A common customer relationship management system has been developed jointly between Scottish Enterprise and the business

gateway. That is a means of maintaining a close understanding of the business growth pattern of companies and all the interventions that are made in relation to them. Strenuous effort has been put into building that system and making sure that it meets the needs of business.

**Linda Hanna:** We have those things in place and we already collaborate well on such issues, although there is an opportunity to go further. In our submission, we talked about the opportunity to share our approaches to continuing professional development with colleagues who have similar roles across the agencies that are involved in the review and more widely. For example, we could share our approaches on business advice and project management. We have done that for many years in relation to the business gateway and we work together with HIE on that, but we could go further to share best practice.

The review recommends looking at how we can share data and intelligence much more. We already do that a lot informally, but there is an opportunity to go further and ensure that that approach underpins the new strategic board and informs the services. As we move more to digital-enabled service delivery models in the public and private sectors, there will be even more enrichment of such insights. We are all keen on sharing that, to ensure that we continue to provide what customers are looking for and so that we get a sense that that is making a difference on the ground.

**Gil Paterson:** You have second-guessed my next question, which is probably my last one. It is common that small businesses do not know where to go or that they get confused. In some regards, that is because there are too many doors. I am thinking of one or two-person businesses that are interested only in running their business and perhaps do not have time to find help, whereas bigger companies have more staff to find their way to that door. Through the changes, can we make it much easier to provide signposts and make the position more distinct, so that the process is easier for the customer, who you have talked about?

09:45

**Charlotte Wright:** The review's recommendation of the no-wrong-door approach is really powerful, particularly as it provides the opportunity to have a simple and straightforward digital portal that all businesses can use to get through to the right part of the Government or the agency that can help them with their need. I am sure that we would all say that, over time, we have tried to make such access as simple as possible, but we recognise the feedback in the review report that we can do more.

As I have said, we all support the no-wrong-door principle, and we need to make all this as simple and transparent as possible for business. I absolutely agree with your point; given that businesses have no time to negotiate their way through something, we should make arrangements as simple and as straightforward as we can.

**The Convener:** I welcome Gordon McGuinness, who has now joined us.

**Gordon McGuinness (Skills Development Scotland):** My apologies, convener. Someone took ill on the train in front of us at Edinburgh Park.

**The Convener:** I am sorry to hear that. Thank you for coming today. We will let you get a bit settled before someone throws a question at you but, to fill you in, I should say that we have just been discussing the overall structure of the enterprise agencies.

I hand over to Jackie Baillie, who has another question on the subject.

**Jackie Baillie (Dumbarton) (Lab):** I, too, apologise for being late, which was for exactly the same reason that Gordon McGuinness mentioned.

The review recommends that a strategic board should be put in place, but I understand that there already is a strategic forum in which all of you sit around the table with Government officials and ministers. What difference will statutory underpinning make?

**Linda Hanna:** The difference is that the body needs to be much more than a board; it needs to genuinely consider and focus on what the plan will be, how all this will work together and what outcomes it is seeking to drive. The strategic forum has been much more of a collaborative forum; although it works well, the proposed board provides an opportunity to have a much clearer line of sight to links with outcomes in the national performance framework, with the key drivers of productivity in the economy, which are important, and with the different roles and responsibilities.

As we have said, we bring different forms of expertise to Scotland's economy and the current landscape. The board will be all about joining those things up and—increasingly—bringing the private sector to the table. The strategic forum very much involves the various partners, but the board will bring the private sector to the table as well. The proposal provides an opportunity to have an even stronger focus on the economy and the actions that need to be taken and then, over time, to be agile and flexible about the actions that need to be taken to ensure that all that flows through to what is happening with customers on the ground.

**The Convener:** I should say to Gordon McGuinness that, if he wishes to speak, he should

simply indicate that by raising his hand, and I will seek to bring him in at an appropriate point.

**Jackie Baillie:** I would like to hear other views on my question, and then I will come back.

**Charlotte Wright:** I caveat my remark by saying that it is just an assumption rather than based on knowledge, given that we have yet to see how things will be implemented, but I think that having a strategic board that is underpinned by statute will send an outward message, as well as the internal message about how we as agencies will work together differently across the strategic forum and the strategic board. Perhaps that comes back to the message that we have had from service users on the need to understand the position. Having one board that is giving overarching strategic direction, ensuring collaboration and providing challenge to agencies will send a powerful outward message.

**Dr Kemp:** I very much agree with what my colleagues have said. There was always more than one way of proceeding, but having a statutory board will shift the balance of responsibility in a different direction from that of the strategic forum, which is a collaboration between bodies whose boards are tasked with different things. A statutory board will bring things together in a way that a non-statutory board does not, but a lot of the detail—such as how the board will operate and interact with the five agencies—still has to be worked out in phase 2 of the review.

**Jackie Baillie:** I was not clear that there was any clamour for such a board from any of the agencies or a suggestion that you all thought that it would be a really good thing. I am genuinely surprised that a strategic forum with John Swinney, the Deputy First Minister, in charge does not seem to have achieved much, but you are saying that it is not fit for purpose and that you need something else. I am slightly confused about that.

**Dr Kemp:** I do not think that that is what we said.

**Charlotte Wright:** I do not think that we said that the forum was not fit for purpose. However, there is an opportunity for us to send a powerful message about how we are working together under a new strategic board.

**Jackie Baillie:** Is that not something that happened under the forum?

**Charlotte Wright:** I would not say that the forum had not been fit for purpose.

**The Convener:** Perhaps we could move on to something slightly different. We have looked at the overall structure so far, but I want to ask about the regional economic strategies.

The Scottish Enterprise submission to the Scottish Government's enterprise and skills review—it is on page 10 in the committee papers; it might have a different page number in the original submission—talks about the work that Scottish Enterprise is doing with the three Ayrshire councils to develop a shared regional economic strategy. I am interested in that, because we have agencies looking at the national Scottish picture, but Scotland is an economically diverse country and from region to region the workforces and local economies can have extremely varied focuses. The area that is covered by the three Ayrshire councils is an example of that. How can the agencies be best organised to localise their approaches and get away from the idea of simply having national strategies, which, although they might be necessary, can encounter difficulties in relation to the detail at the local level?

**Dr Kemp:** For some time, we have recognised that a one-size-fits-all approach does not suit the needs of all the colleges and universities that we fund. Therefore, for the past few years, we have been funding colleges through regional outcome agreements and funding universities through outcome agreements that are regional to various extents. That recognises that, as you say, some regions have different economic needs from others, and that the skills needs will vary from region to region. We fund a college or a university based on a document that we agree with the college or university based on a regional skills assessment from Gordon McGuinness's organisation, SDS, and discussions that our regional outcome managers have with the institution and other local stakeholders about what the needs are. We hope that, through that mechanism, we can recognise that there are different needs in different regions of Scotland. There are some things that are needed in most regions, but there are some things that are very specific.

**Charlotte Wright:** As a representative of a regional organisation, I come to this debate with a regional as well as a national perspective. After 50 years of the Highlands and Islands Development Board and Highlands and Islands Enterprise, we feel that there is a strong role for what we have done in terms of regional and community development, while working to ensure that what we do in the region contributes to the national picture. It is really important that we ensure that our strategy joins up. We work with SDS on a regional skills plan, which was discussed in some detail at the convention of the Highlands and Islands yesterday. There is a real opportunity to explore at a regional level how national partners and agencies can contribute to the on-going development of a region.



In the Highlands and Islands, we also have a number of area offices so that we can respond directly to the needs of rural and island communities and our small towns. There is even a level below that level, where we can see local economies operating. That is important because the needs of and opportunities for those local economies can be quite different.

**The Convener:** I wonder whether Gordon McGuinness wants to contribute at this point on that specific question.

**Gordon McGuinness:** In our work we have recognised the differences across regions in terms of economic performance, where some of the challenges are and where the opportunities lie.

We committed to developing regional skill assessments and we have done so, in conjunction with other agencies. We look at where the economic opportunities are, what the supply side is, what the colleges and universities are delivering, and the demographics within those areas.

We have also committed to working with local authority partners on things such as the Glasgow city deal. On that, we are working to produce a regional skills investment plan. We are also working with the college structures in Glasgow around curriculum planning and development, and in Aberdeen and the north-east on a regional skills investment plan there.

Charlotte Wright mentioned our work across the Highlands and Islands. We have an umbrella plan that was published in October 2014 and that identified the key issues around matters such as depopulation, the demographic profile of issues and some of the skill challenges that are being faced by particular sectors. Yesterday, we updated the Convention of the Highlands and Islands on progress against the plan.

There is a lot of joint development work there. In recent years, we have seen the emergence of city deals. You referred to Ayrshire: we have been working along with Scottish Enterprise and the three local authorities on matters around their growth deal and how that has developed in building on their strengths around manufacturing and particularly around aerospace.

There are ways in which we can develop the system. Sometimes, the funding sources need to be a bit more agile in order to meet local needs more effectively, but that is something that we hope we will be able to discuss through the review process.

**The Convener:** Structurally speaking, is there any need for enterprise agencies at a more local level, or can you work with local authorities? What is your view?

**Gordon McGuinness:** From a skills perspective, and speaking for a skills agency, I would say that we have a good blend of national approaches for the apprenticeship programme and also local responsiveness. In our work at local authority level we have, with every head teacher in our schools, service level agreements that define how we will deliver the service internally. We are also involved in community planning at a local level.

As I said, we have seen the emergence of work such as that done in Ayrshire on the growth deal. There, potentially different approaches are being offered and taken. That is something that we are open to working on.

Regarding the enterprise agencies, we have worked with SE for about 19 years, so when the local enterprise companies changed then perhaps the local authorities felt that they were missing something as regards that regional dimension. I do not think that either we or SE will be found lacking in terms of the work that we have done and how responsive we have been to that.

**Linda Hanna:** I would add that the work that we have been doing in Ayrshire has looked at what the region needs to do across the three different local authorities. I have worked in Ayrshire for many years—I was based in the local enterprise company in Ayrshire for a long time—and the three areas have quite different needs and geographies. They also have different assets that mean different things for the local economy and the contribution that it makes to Scotland.

We have a blend. We are able to look across the agencies and—working particularly with SDS around Ayrshire—really think about the national assets that are in the region. When we think of the life sciences opportunity that is based around Irvine, we can look at what Scotland can compete on globally, based around the work that we are doing with GlaxoSmithKline and others. As Gordon McGuinness said, we can also look at aerospace and the spaceport potential around Prestwick. On broader manufacturing, we have been taking the work that we are doing around the manufacturing action plan and supporting that plan around Ayrshire.

That work with local authorities is on the basis of what Ayrshire needs. The work that we have done has also been around together building a team approach—for example, team Ayrshire and team north Ayrshire. It is also about building the capability around the business advisers who are working with companies—whether that is through SE, the local authority or the business gateway. We have worked very actively on making that seamless. As a result of that, in North Ayrshire, we are working with more companies through the gateway growth pipeline, the services that we

deliver directly and the account managed portfolio. That work is beginning to bear fruit in terms of how we connect to some of the bigger opportunities at a national level and how that plays out on the international stage.

10:00

**The Convener:** Will the same considerations apply to a certain extent to the larger cities such as Glasgow and Edinburgh, or is that a different kettle of fish?

**Linda Hanna:** Absolutely. Our approach involves location directors who work across local authority areas, so there is a key member of staff working in each area. We also have a regional approach. For example, I work closely with partners on the Tay cities deal on what the deal will look like; what the best opportunities are for Tayside; and how ambitious we as partners are in that respect. That also applies in Glasgow, Edinburgh and Aberdeen.

**The Convener:** Gordon MacDonald wants to ask a question that might fit in at this point, unless Andy Wightman has a specific point to raise.

**Andy Wightman (Lothian) (Green):** Yes, I do—thank you, convener.

The report of the phase 1 review highlights the distinctiveness of the Highlands and Islands and the need for an agency that is

“locally based, managed and directed”.

It also refers to the creation of a new agency for the south of Scotland.

What about the rest of Scotland? It seems that the review does not recognise the distinctive challenges in Tayside or in the west or north-east of Scotland.

Is the review not an opportunity to embed the local approach more universally? Will Scottish Enterprise change its name to become central and north-east Scotland enterprise? How will that fit into a structure in which, as the review identifies, there are only two distinctive regional approaches?

**Linda Hanna:** Those are all matters to be looked at in phase 2 of the review. Scottish Enterprise believes that there is still a need to focus on the economy at a national level. Being able to look at the national, regional and local perspectives is important, and we believe that, in the other areas that you highlight, there are already mechanisms in place—such as the Tay cities deal, which I mentioned—to enable us to do that.

We are keen to focus on what needs to be done in the economy. We need to work with our

partners to ensure that we deliver on those priorities and that we deliver on the ground by working with our customers and partners. The Tay cities deal is the place for us to have those conversations in that particular area, and we need to ensure that we join that work up with the private sector.

**Douglas Duff:** Localisation has very much been the message since the business gateway service was transferred to local authorities, which was done with the intention of localising better. We have been able to achieve that by embedding business gateway services alongside the variety of services that councils offer, and attuning those services to local economic priorities so that they fit in with the direction of community planning and local economic strategies.

More recently, since 2008, those priorities have been aggregated up to a regional level, and we have seen a number of city deals, growth accelerators and so on. Throughout this round of the review, people have petitioned for a more seamless structure for setting regional and local priorities across the country so that there is a clearer pattern for dealing with them.

In working towards that, we must ensure that we achieve a proper blend of being attuned to local circumstances—there is already expertise at a local level in councils—and drawing in the national economic priorities, which focus on the significant areas for growth. Again, it is about marshalling the efforts of partners to achieve those things.

**Linda Hanna:** Douglas Duff must have read my mind with regard to aggregation and national priorities. It is important that we are able to respond regionally and locally, but Scotland is a small and open economy, and we are competing hard on the world stage for international inward investment and for the talent that we want to come to Scotland.

We have real capability, and there are opportunities to maintain that in some of our key sectors. However, there are also opportunities to build capability in emerging sectors such as data and subsea, and in the developments that are emerging in the oil and gas industry and other areas. We need a blend of being able to compete nationally in an ever-challenging world economy while ensuring that the opportunities in that regard are spread across the country and that we support local economies too.

It is important for our national perspective on the economy that we keep a focus on where our economy is going in future, how we will drive productivity and how we ensure that that flows through at a regional and local level to where companies and people are based and assets are being built. It is about both of those.

**Gordon MacDonald (Edinburgh Pentlands) (SNP):** My question relates to the local and national agencies working together. In some of the evidence that we have had from companies, there have been comments about a lack of clarity and a lack of partnership working. That is their perception, but I am interested in Scottish Enterprise's submission, which recommends

"a reduction in the number of economic development groups and forums across Scotland".

Will you expand on that? Why do you recommend that and who are you particularly aiming at?

**Linda Hanna:** One of the reasons that we shared that in our submission was that there is a need to think much more practically about action-oriented approaches. Over time, there has been a growth of lots of bodies and groups. We reflected on the challenge that the private sector has to support the number of bodies that exist—I hear about that because I sit on the Tayside regional advisory board—and made a recommendation to pull back on some of that and do some of it quite differently.

Rather than having fixed bodies or groups that are put in place and remain forever, we could do something more agile. We could have a focus on a particular issue, we could bring people together to address it and then that group could come apart. We wondered whether that would provide some different benefits. It was merely a recommendation. We see benefits in other things that happen like that and we wondered whether it might be of benefit.

Part of the clutter that businesses sometimes see concerns the fact that there are many groups. They grow from the bottom up locally for good reasons but that can cause the perception of clutter. We wondered whether there was a way to think through that and genuinely focus on the outcomes.

**Gordon MacDonald:** Do any countries of a similar size to Scotland—New Zealand and Ireland, for instance—provide support to businesses through a structure similar to ours? Is it less cluttered in other countries or do they have the same number of agencies across the piece?

**Charlotte Wright:** The Skilling report, which was produced as part of the enterprise review, undertook some of those international comparisons. It gives us a mixed picture in that we could probably learn from elements of some of those other countries but, in other cases, what we have in Scotland looks better. The international comparisons are helpful to enable us to benchmark ourselves and determine whether there are opportunities to improve how we do things but, in some cases, they give us the

opportunity to reflect that we start from quite a good structure in Scotland.

I hope that members have had a chance to look at that report, because it makes some useful comparisons.

**Dean Lockhart (Mid Scotland and Fife) (Con):** I thank our guests for coming along. My question relates to core elements of the Government's economic strategy: innovation and productivity. Based on international comparisons, the Scottish economy remains in the third quartile of productivity performance, behind the rest of the United Kingdom, Ireland and countries such as Denmark. The Scottish Enterprise submission indicates that that productivity mismatch comes at significant cost. It is estimated that if we reach the target of being in the first quartile, the Scottish economy would be boosted by £45 billion. What causes that productivity gap and what specific measures can we take to address it? It is a structural issue that has faced the Scottish economy for a long time.

A related question concerns innovation. We have world-class universities with world-class research and innovation, but commercialisation of that innovation is not coming through to the economy. Is there something wrong with the transition mechanism?

**Dr Kemp:** Linda Hanna will go first before I pick up on innovation.

**Linda Hanna:** Thank you very much.

Dean Lockhart is absolutely right. How to improve our productivity is at the heart of the matter, for our economy. We know that that is the puzzle to get right. Scotland is not alone; the same applies across the UK and in other parts of the world. The issue goes absolutely to the heart of how we drive our economy and how we drive benefit for all the communities, people and businesses that we have talked about.

On what is contributing to that, we know that our exporting performance is below what is needed for us to be in the top quartile for productivity. One estimate is that we—the UK would be the region, as opposed to the Organisation for Economic Co-operation and Development—would need another 5,000 or 6,000 exporting businesses for us to reach that. We know, in the context of innovation, that about another 1,500 businesses would be needed.

We are making progress on some of those things, but we know that the scale of that challenge is quite considerable in our economy. We also know that the challenge is quite considerable in terms of businesses per head of population: we would need another 120,000

registered businesses in Scotland. Therefore, we know that there are productivity challenges.

The structure and size of the business base in Scotland has been a persistent issue over a long period. Getting more businesses to start and getting them to grow and keep on growing has been a mantra for quite a long time in our work with business gateway colleagues—it certainly was when I was involved with the business gateway. That is challenging. There are more self-employment businesses, but they are not growing to a size to start to innovate, export and create contributions to productivity that SE would then want to look at.

It is about how we get more innovation and exporting and more companies to invest in research and development, and—overall—about how we get much more investment into the economy. We are working on those things, but we need to do much more.

Dean Lockhart is absolutely right: we have excellent academic expertise in our universities. The challenge is to get businesses to invest much more in R and D and take new products to market—especially export markets.

We need to concentrate on those things, and we would very much welcome their being at the heart of the actions that we need to take.

**The Convener:** I think that all our guests—or at least the majority of them—want to come in. We will start with Charlotte Wright.

**Charlotte Wright:** I want to add something about productivity before John Kemp talks about innovation.

I certainly endorse the remarks about the structural difficulty that we have in terms of the size of our business base. That is even more the case for the Highlands and Islands. The tourism and food and drink sectors dominate the sectoral mix and traditionally do not pay employees as much as other sectors do.

I also want to introduce to the discussion a point about the productivity of our human capital. Underemployment is an aspect of how we perform in the Highlands and Islands that we have looked at often. It is challenging to deal with and makes it more difficult for our population to be productive. Development of the University of the Highlands and Islands and delivery on being productive are therefore critical to us.

Maybe it would be helpful if the committee looked at productivity in the round. As well as the traditional way of looking at it in terms of outputs and inputs, there is the wider view of its impact on communities, people and populations. Underemployment is a key challenge.

**The Convener:** Before I bring in Douglas Duff, Gordon MacDonald wants to come back in to nuance his question slightly, or ask a follow-up question.

**Gordon MacDonald:** I want to ask about productivity. David Skilling's report says:

"The OECD note that productivity across the developed world has been in secular decline over the past 15-20 years."

With that background, I notice from HIE's submission that the Highlands and Islands ranked in 1997 32 out of 40 UK regions for productivity and that, by 2014, it had risen to 18th—the largest change in ranking of any region in the UK. Can the other agencies learn from HIE's remit what should be reflected by them in order to gain that level of increase in productivity?

10:15

**Charlotte Wright:** We welcome the opportunity to examine that as part of phase 2. One thing that has made a difference to the figures is that the starting place for the Highlands and Islands was a lot lower than that for the rest of Scotland. That increase is a fantastic achievement for the Highlands and Islands and, I hope, for the work of HIE. It reflects a growth in gross value added—although GVA still lags behind the rest of Scotland and the rest of the UK. Therefore, we still have a journey to go on, but we bring something to the debate, especially about what a south of Scotland agency might look like. We can offer support from our 50 years of knowledge and experience.

**Douglas Duff:** I have a brief point to add on the work of business gateway to boost innovation and productivity. Our growth pipeline is intended to help companies to move along a growth path by accessing specialist advice and support so that they can be more innovative and productive, access international markets and broaden their scope to employ. That is all designed to achieve growth. Work has been done recently to augment business gateway services with European funding to provide more dedicated support, to offer more expert help and assistance to companies in examining possibilities, and to lead them to the specialist support that Scottish Enterprise and others offer.

**Gillian Martin (Aberdeenshire East) (SNP):** Dean Lockhart asked about productivity; I will follow up on a couple of things that were mentioned. It was said that there is a deficit in respect of the number of businesses that are needed to be set up for us to reach our full potential. For the record, I am a convener of the women's enterprise cross-party group. We heard from Laura Galloway from Herriot-Watt University that she has seen a lot of female graduates in

science, technology, engineering and mathematics subjects end up in businesses that operate outwith their skill sets—for example, setting up a bed and breakfast or going into creative industries. There is a criticism that we are missing a trick with our graduates; we could be more involved in universities and colleges at the point at which people graduate in order to encourage them and give them support to consider enterprise as an option, rather than employment. Could I have some feedback on that?

**Dr Kemp:** We fund a variety of organisations that work with universities and colleges to support that kind of encouragement for graduates. The core organisation is the Scottish Institute for Enterprise, which works on exactly that with pretty much every university in Scotland and about 6,000 students a year, whom it encourages to see enterprise as a potential route after university. It runs competitions and boot camps and fits in with things such as the converge challenge, alongside the enterprise agencies. That is aimed at students across a range of disciplines.

Often what turns people on to business is not exactly what they are studying at university; it is not as simple as someone going to university, studying a course, then setting up a business. People who leave university might set up businesses very quickly or years later. Such people have studied a range of subjects; some competition winners lately have been medical students and so on—people whom we would not anticipate having an entrepreneurial bent. That is something that we need to support.

I come back to the point about innovation that I politely led Linda Hanna into and then moved on. There is a huge imbalance between the research that is done in universities in Scotland and how strong it is, compared with the amount that is done in businesses. There is an issue about how the research in universities translates into economic development in Scotland.

In the past few years, we have funded a set of innovation centres that sit between universities and business in order to bridge the gap. A recent evaluation of that programme was positive, but it is early days and we need to do more of that. In the enterprise review, the phrase “cluttered landscape” has occurred more than most because it can be confusing for businesses to know how to interact not just with universities but with the wide range of bodies including universities, enterprise agencies and other agencies. Therefore, better signposting and a degree of rationalisation might be the way forward in that policy area. It is a live issue that the innovation centres are trying to address.

**Charlotte Wright:** On Gillian Martin’s question, one of the most powerful things that we can do is

give strong role models and case studies of women in business and enterprise. We need to work with organisations such as Women’s Enterprise Scotland and the companies that we account manage to demonstrate that business and enterprise are a really good career track for women. We also need to find more role models, share case studies and do more to ensure that people can see them and see that there is an exciting career prospect in business for women.

**Gillian Martin:** Women are not the only demographic in which there is perhaps not so much a productivity gap but an enterprise gap. Are there other demographics in which you have identified such a gap? In which sections of society might there be wins from encouraging people into business?

**Dr Kemp:** The Scottish Institute for Enterprise, which I mentioned, deals not just with women—it covers men and women. We have also recently expanded its work to cover colleges as well as universities because people who study in colleges often leave to set up their own businesses. They are more likely to do that than university students are because of the kinds of subjects that they study. We consider that demographic—if we can call college students a demographic; they are a different group from university students—to be important.

We have also worked with HIE on some specific measures in the Highlands for supporting students into different types of enterprise as they leave university. We are open to doing more of that with other regions and demographics when need is identified.

**Gillian Martin:** You might know that I am a former college lecturer. At the point when students graduate, there is not much in the curriculum—I know that I am jumping into the Education and Culture Committee’s remit—to develop their awareness of how to set up a business. Is that an action point?

**Dr Kemp:** Yes. You were a lecturer, and I have not lectured for a long time. In speaking to colleges and universities, we have found that building support such as you mention into the mainstream curriculum of a subject does not work as well it being semi-extracurricular in, for example, the Scottish Institute for Enterprise because not everyone in a class might be turned on to setting up a business. Not everyone leaves college or university and immediately set up a business. Sometimes, we encourage it and it happens a few years later, so we need the full spectrum of support. Sometimes, the support is built into the curriculum, sometimes it sits alongside the curriculum of a course in which it might not appeal to most students, and sometimes it is for people once they have left education. The

last of those is probably less a matter for us, but we work with the enterprise agencies on it.

**Dean Lockhart:** On the full spectrum of support, I spent some time yesterday at Entrepreneurial Spark Ltd and spoke to a number of small companies that had benefited from the different stages of support and were complimentary about the support that was available. The one gap that they identified was in support for getting the first win—the first contract or external validation of their product or service—under their belt. I ask the witnesses to talk a bit about that because it has not been touched on in any of the papers that I have seen; there has not been anything about getting companies across the final hurdle to get their first win.

**Charlotte Wright:** We have a slightly different pilot model of E-Spark working in the Highlands and Islands to see how it works in a more rural region: it is a virtual accelerator. However, Dean Lockhart has raised a really important point. For businesses that are going through the experience, the issue is how they get the follow-on so that they can build on the experience and the passion and commitment that they have going through the accelerator process, which is usually a lot. It is about either business gateway or the enterprise agency plugging into the graduates of an accelerator process so that they can move on to the next stage. I agree that we need to make sure that accelerators have a clear place within a business growth strategy.

**Ash Denham (Edinburgh Eastern) (SNP):** You are probably aware that Audit Scotland gave evidence to us last week. I would like to pick up on a point that it raised. Its report “Supporting Scotland’s economic growth” said that the development agencies in general are performing very well against their own agreed performance measures, but that it is not possible to measure their specific contributions to the national performance framework. Is that a fair assessment?

**Charlotte Wright:** We got back to Audit Scotland on that particular point. We thought that its report was really excellent and we appreciate its recommendations, but we pointed out to Audit Scotland that in our operating plan we have mapped Highlands and Islands Enterprise’s performance measures to the NPF so that we can demonstrate exactly that contribution. We have a different set of measures that we have tracked over time. They are different because we do some things differently to our colleagues in Scottish Enterprise. We need to be able to demonstrate that those things are successful. The key point is that there is a mapping across of our outcome measures to the performance framework.

**Linda Hanna:** Like HIE, we have shared with Audit Scotland what we could call a line of sight between the NPF, our business plan, the published measures that we set out in that business plan and the broader measurement framework that we have in SE around what we track and monitor. We believe that that direct line of sight makes a contribution.

**Douglas Duff:** Through the work of SLAED—the Scottish local authorities economic development group—which is the national economic development body, we have been working with the Improvement Service to aggregate a set of performance indicators for economic development services at local level, which can be aggregated to national level.

Business gateway is an important component, but it respects the other economic development services that councils provide. We would certainly be happy to look at the relationship between our indicators and the national ones.

**Ash Denham:** The Audit Scotland report suggests that

“Northern Ireland’s approach to ... monitoring progress against its economic strategy”

is “good practice”.

The report mentions that the approach includes

“Publishing details of how its strategy was developed”,

annual action plans, regularly reviewing progress with annual monitoring, and so on. Would that be worth while? Would it add anything?

**Charlotte Wright:** We recognise, both from the Audit Scotland report and the first-phase recommendations from the enterprise and skills review, that a critical outcome is that we get a much better and clearer join-up between the national strategy and outcomes and the actions that we as an agency, or others, undertake to deliver on them. I absolutely think that that join-up needs to be made much more clearly.

**The Convener:** Would any other panel member like to comment on that?

**Dr Kemp:** The question was specifically about the enterprise agencies and the Audit Scotland report. However, on annual publishing of data and performance, we publish a summary of the outcome agreement data for the colleges and universities, which is a strong proxy for the performance of our organisation. We publish the data annually at aggregate level and at individual-college level. There are ways of doing it.

**Linda Hanna:** I will add to what Charlotte Wright said. Such measures will be looked at in phase 2. We must ensure that what that looks like in relation to the action plan and the measures is

thought through. There should be the simplicity that we talked about earlier and the direct line of sight nationally, regionally and locally. That is very important.

For me, the other thing in all this is always what we can learn. There was a question earlier about what works and how we learn from it. We were very pleased that the Audit Scotland report drew out the work that we and other agencies have done on our evaluation. The work to examine the plan and the measures is also helping us to understand where the investments that we make are making a difference. It is about knowing how we can do more of that and how we respond to how our economy is changing.

The work on the action plan and on the targets and measures helps us to hone what works for us. On productivity, we see that what is working for us is the join-up around leadership support, workplace innovation, internationalisation and innovation. It is not about doing those things separately, but about working with a business on its ambitions to do all those things. When we blend those, exciting things happen in companies—it is about how the elements work together. The more we can blend them, the more confidence we have about how we can progress aspects of the economy.

10:30

**The Convener:** Does Jackie Baillie have a follow-up question?

**Jackie Baillie:** My question is at a slight tangent, convener. The Government has made clear its commitment to encouraging women into business because of the increased economic contribution that that would make to GVA—the assessment was something like £13 billion. I am curious to pursue the second recommendation from the review, which was about the data gap, specifically in gender-disaggregated statistics. We have been told that there is a paucity of statistics overall. Within that, there is definitely a paucity of gender-disaggregated statistics.

I ask that in the light of Scottish Enterprise's contribution in its annual report, which said that, of the high-growth companies, 3 per cent were led by women. While I welcome the transparency, I am shocked at the small number. I do not know the number for HIE. Perhaps that is different. Would gender-disaggregated statistics help in addressing some of those problems?

**Linda Hanna:** I will take that question first. I agree that we need data that helps us to pinpoint what is happening, where it is working and what else we could be doing. I am not sure where the 3 per cent figure came from.

**Jackie Baillie:** It is in your annual report.

**Linda Hanna:** I will pick up that point when I go back to the office. The challenge of different ownership models means that it is sometimes quite hard to know the level of female ownership, what that looks like and how we gather the information. That is something that we will look at.

We have looked at equality monitoring for companies that approach us and access services for the first time, not just in account management but in everything that we do. We collect that data and, in cases where that answer is available, the proportion of companies that were female owned a couple of years ago was around 46 per cent, so we know that the figure is much higher.

We also know from the examples of companies that we are working with on the ground that we are working with companies that are female owned. I agree that being able to pull out those statistics would give a sense of the data to focus on.

**Jackie Baillie:** How many of the high-growth companies that HIE works with are led by women?

**Charlotte Wright:** I do not have that figure to hand, but I will certainly look it out for you.

We undertake equality monitoring of all the programmes that we run to ensure that there is nothing built into the way that we address a programme that could be a barrier to women or any other group. That is a key part of the way in which we would look at introducing any new programme of enterprise support. I will certainly look out the figure: I guess that it will not be as high as we would like it to be.

**Jackie Baillie:** What data collection is going on at business gateway? There are anecdotal stories that suggest that it is not consistent and that people are not necessarily looking at gender as an issue.

**Douglas Duff:** As with my colleagues, I am happy to get more statistics on that. We use a common CRM system, as I said. There is an initial data capture of the profile of participants in our programmes and we can gather that information and produce some analysis for you.

Certainly, the work of women into enterprise and programmes around that are vital in business gateway and our advisers support and promote those events. In recent years, I think that there has been significant growth in the number of women moving into business. They seem to be very keen networkers, and that is seen as an important part of building a business community locally. That adds to the scope for growth. We find that among women in business there is a huge appetite for working together to get the best quality service and for working closely with gateway advisers to

make progress and enable growth to take place. I am happy to get the stats.

**Jackie Baillie:** That is helpful. Do account managers and gateway advisers have specific training on gender? I see that two people are nodding.

**Douglas Duff:** Yes.

**Linda Hanna:** Yes. As part of the continuous professional development work that we do, we provide training for account managers, which includes gender issues. As Charlotte Wright said, we check that the issue is baked into all our services, so that nothing will get in the way. We also think about how training needs to change on the back of the feedback that we get from companies that are female led about what might have made a difference in that regard.

**Jackie Baillie:** Okay.

**John Mason:** We have talked a lot about women, which is great. I think that Gillian Martin mentioned other groups, such as disabled people and people from ethnic minorities. We have seen figures that suggest that although people from ethnic minorities are doing more higher education and coming out with better qualifications they are not doing so well with employment.

**The Convener:** Another group is unemployed Scottish white males from disadvantaged areas.

**Charlotte Wright:** I am not sure to whom the question was addressed, but if members are asking how many people are in account management or receive our products and services, we do not have such information to hand and some of it might be difficult to obtain. Some EU programmes require certain questions to be asked, but the information would be anonymised and would be at programme level.

**Gordon McGuinness:** From a skills perspective, we face slightly different challenges, particularly in relation to occupational segregation. We have spent a good amount of time working with partners from specialist groups to develop our modern apprenticeship action plan. In that context, we looked at gender; we also looked at black and ethnic minority participation, as well as participation among people with disabilities and care leavers, who are disadvantaged in the labour market. Our four-year plan has fixed milestones, and we are working hard with partners on its delivery.

**Linda Hanna:** A big part of our focus on inclusive growth is to do with workplaces and what happens in the companies that we work with. That involves thinking about how jobs are designed and organised and what that means in the context of different structures, and it involves encouraging employers to think about the workplace practices

that might enable them to access the mix of talent that will be best for their business. That might be about part-time working and disabled workers. It might be about using digital mechanisms or flexible working.

It might also involve busting myths. We have heard anecdotally that females, in particular, might think that they cannot do a job in a manufacturing environment because they will have to work full time, but that is not the case. We encourage employers to go to their communities and talk about such things. They can be engaged with schools and colleges in bringing forward the different models of work that I talked about, which I hope brings opportunities. When we have worked with employers in that way, they see a big difference—sometimes it is about youth, sometimes it is about disabled workers and sometimes it is about different parts of the community.

In talking to the Scottish Government we have increasingly been thinking about not just the asset dimension of regional economic development but the social inclusion dimension—the inclusive growth diagnostic. We are thinking about what might be stopping a talent pool coming through for employers and how we can match our work with companies with the work that is going on in colleges and elsewhere, to ensure that there is a skills flow that meets employers' demands.

There is a bigger piece of work to do in that regard. We have been doing a bit of work and we need to do much more, which I think will start to bring through some of the data and intelligence that will tell us where we need to focus.

**Dr Kemp:** We recently published our gender action plan. The plan was asked for in the report of the commission for developing Scotland's young workforce, and we expanded its scope to include universities. It seeks to address some of the issues that we have talked about today.

We recognise that there is quite a complex issue in the fact that, although about 50 per cent of students in colleges are from each gender, there is huge segregation in the courses that they study. Some courses are almost entirely male; some are almost entirely female. There is a separate issue in higher education, where, as well as there being gendered courses, the level of female participation is higher than the level of male participation. That is similar to the point that the convener made about young white males in some ways not doing as well out of the education system.

We are trying to work with employers and others, as well as through our outcome agreements, to achieve a gender balance. Gender is the issue that we have prioritised this year, but there are other groups and there has been quite a



lot of activity recently around care leavers. Over recent years, we have been building widening access for care leavers into our outcome agreements, which the commission on widening access work will address.

**The Convener:** Thank you. Richard Leonard has a question on budgeting and forward planning.

**Richard Leonard (Central Scotland) (Lab):** My question is principally for Charlotte Wright and Linda Hanna, but I would welcome comments and observations from the other witnesses.

In the weeks that lie ahead, one of the committee's tasks will be to consider the Scottish Government's budget, especially as it affects enterprise, skills and economic development. The Audit Scotland report on which we received evidence last week spoke about the 16 per cent real-terms cut in the Scottish Enterprise budget between 2008 and 2015 and the 22 per cent cut in the operational budget of Highlands and Islands Enterprise over the same period. In his foreword to the review that was published last week, the cabinet secretary used one of his favourite expressions in saying that any change would need to be cost effective.

In the light of that, will you help us to understand how we are resourcing the creation of the board of trade, the dispatching of trade envoys across Europe and the doubling—I think—of Scottish Development International staff? I would like Linda Hanna to reflect on the submission that we have received from Scottish Enterprise, which ambitiously recommends that the number of companies that Scottish Enterprise helps should grow from between 2,000 and 3,000 to between 10,000 and 15,000, which is a 500 per cent increase. Are you receiving additional resources for the work that you are now being asked to undertake on internationalisation in the face of Brexit, and do you expect to get a significantly enhanced budget in the round that is coming up?

**Charlotte Wright:** I will give some context to the Audit Scotland report and provide a bit more information. Audit Scotland focused on the grant-in-aid element of our budget, which is the bit that we get directly from the Government, but we augment that budget. Although our budget for 2015-16 was £66 million, we delivered a spend of £111 million because we brought in money from Europe and realised income from our own assets. We also got additional funds for specific programmes such as the community land fund, community broadband Scotland and wave energy Scotland, which added considerably to that total. That is the context to the figures in the report.

Having said that, I think that we are realistic about what the future will look like budget-wise, and part of the review is about ensuring that we

are all as efficient and effective as we can be. I would love to hope that more budget will come our way, but our expectation is that we will need to be as effective as we can be in our delivery. A great way into that is in looking at how we can use digital technology better to give our clients a better reach. We also need to be quicker in turning over our interaction with clients, and becoming sharper and more focused in those engagements so that we can reach a wider population of the business base.

10:45

**Linda Hanna:** As Charlotte Wright says, our team is focused on maximising our income beyond the grant in aid that we get from the Scottish Government. Some of that money comes from our property disposals, our investment income and our EU income. In any given year, we seek to do everything that we can to ensure that we make investments that match what the Scottish economy needs and that we focus our resources in the right places with regard to what needs to be done. Over the past number of years, that is exactly what we have done.

In the past couple of years, we have shifted resources around what has happened in the oil and gas industry in the north-east. Even within the model that we currently have, we have ensured that, where there are needs in the economy, we have responded to them, and we have also ensured that we are effective in relation to the other things that we have sought to do. We have made a lot of savings over the past number of years that have helped us to do that.

Like Charlotte Wright, I would love to think that we will get even more money, but I think that we are all realistic about where we are right now in relation to the public purse. Therefore, what is important is that we use the funding and resources that we have wisely and that we make the right investment decisions. We were pleased that the Audit Scotland report talked about the risks that we take and the fact that we are careful about the decisions that we make in an attempt to get the best return for the economy. That is exactly the approach that we need to continue to take.

Clearly, unless there are going to be lots more resources, there will need to be trade-offs. In phase 2, we need to think through how we make those decisions together. It will be increasingly important to work out the areas in which we can collaborate and work together in order to do even more, if we can, with the resources that we have. Certainly, with regard to what we have said about the need to work with many more companies, we are ambitious about using digital mechanisms to do that.

When I was involved in the business gateway 10 years ago, we really wanted to have a blend of digitally enabled services, but the market was not ready for that. However, the world has now moved on quite considerably, and I think that businesses are now much more ready for and interested in having services digitally delivered. We think that that gives us opportunities to provide many more businesses with services in a way that can be augmented in order to provide even more value for the public purse. We are investing heavily in that kind of digital. It involves not simply taking the existing services and putting them online but designing services for a digital world. We think that that will enable us to reach many more companies.

**The Convener:** Richard Leonard may ask a very brief follow-up question.

**Richard Leonard:** So the answer to the question about how you are going to reach five times as many companies is digitalisation. Is that right? Alternatively, do you envisage employing account managers?

On the doubling of SDI staff, does that involve new people coming into the organisation or is it a redeployment of existing staff members?

**Linda Hanna:** On your last question, we and our colleagues in SDI are still in discussion with the Scottish Government about what the four-point plan that was announced will look like, so I do not have an answer for you on that.

On the issue of reaching more customers, a portion of that will be around digital. We have still to work through what is needed in order to supplement that approach, particularly with regard to whether that will involve account management, specialist services or collaborative working across partners. We have set out our ambitions in our submission, but we still have to work through the detail of what that will look like.

**The Convener:** I am afraid that we have run out of time, so I thank all our guests for coming today and suspend the meeting for a comfort break. We will reconvene at 11 o'clock.

10:48

*Meeting suspended.*

11:02

*On resuming—*

## **Economic Impact of Leaving the European Union**

**The Convener:** Good morning. Agenda item 3 is our round-table discussion on the economic impact of leaving the European Union. I welcome the witnesses and point out that you do not have to press your request-to-speak buttons. If you indicate to me by raising your hand that you would like to come in on a question or to the discussion, I will bring you in and the broadcasting staff will deal with the microphones.

This is a sort of formal yet informal setting—an informal round-table set-up is meant to facilitate discussion between committee members and witnesses. Starting with Graeme Roy on my right, we will go around the table introducing ourselves and indicating the organisation from which we come. Jenny Stewart from KPMG can take the opportunity to explain a small bit about her role in that organisation, as she has been added to the list of witnesses slightly later than the others and has not had the opportunity to put in a written statement.

**Professor Graeme Roy (Fraser of Allander Institute):** Thank you very much for the invitation to come along this morning. I am the director of the Fraser of Allander institute at the University of Strathclyde.

**Richard Marsh (4-Consulting):** I am an economist with a small independent consultancy called 4-Consulting that is based in Kirkcaldy.

**Stephen Boyle (Royal Bank of Scotland):** I am the chief economist at the Royal Bank of Scotland.

**Dr Fabian Zuleeg (European Policy Centre):** I am chief executive and chief economist at the European Policy Centre, which is an independent Brussels-based think tank. I am also on the Scottish Government's standing council on Europe.

**Jane Gotts (GenAnalytics Ltd):** Good morning. I am the director of a business start-up called GenAnalytics, which focuses on equality and diversity in the workplace.

**Jenny Stewart (KPMG):** I am a partner at KPMG. I run our Government business in Scotland and I am part of a group that runs our UK public sector business. As you do not have a paper from me, I will do a quick one-minute introduction.

KPMG took the EU referendum vote very seriously, prepared for both eventualities and, within two days of the vote, appointed a head of

Brexit. We have been gathering intelligence from across our very diverse client base and we have been working with clients to help them respond to the Brexit vote. I will pick out some key points that people might want to pick up on later.

First, the immediate impact has not been as severe as was predicted, so I spend a bit of my time explaining to clients why that has not been the case. The quick one-second answer is that there are three bits to the economy: consumer spending, which accounts for 60 per cent; business investment; and whatever the Government and the Bank of England do. In effect, consumer spending has held up; on business investment, instead of thinking, “We will stop until we know more,” generally businesses are thinking, “It is so uncertain and we don’t know what is happening, so we will just carry on as usual”; and the intervention by Mark Carney and the Bank of England to reduce interest rates was pretty helpful.

On Brexit itself, every business will have a different exposure and, given the economic and political uncertainty at the moment, businesses are doing scenario planning—that is what we are doing with businesses. That involves saying, “We don’t know and we can’t possibly predict what it is going to be like, but what kind of broad scenarios are likely to emerge and how will we respond and deal with those?”

The key issues that businesses are picking up on at present include people—namely, businesses’ exposure to EU27 nationals. At KPMG, we knew before the vote exactly how many of our 700 staff are EU27 nationals. We ensured that we contacted those individuals after the vote and reassured them of their value to the company as individuals. We also set up arrangements to provide advice to them.

Another issue is strategy. With the significant drop in the value of the pound, there is a lot of foreign direct investment coming in and a number of companies have become acquisition targets. Equally, some businesses in the UK are revisiting their acquisition strategy in the light of the drop in the pound.

Also, given the issues around exchange rates, inflation and so on, businesses are reviewing their medium-term financial planning assumptions to see whether they breach their banking covenants in any of the potential scenarios.

The other issue is tariffs. If we end up in a World Trade Organization situation, how is that likely to impact on each particular business, and what are the costs?

Those are the key business issues. Clearly, individual sectors are affected differently and different countries in the EU are making it clear

that they have a competitive offer. For example, the automotive sector in Slovakia is stressing its competitiveness—Jaguar Land Rover has just made a big investment there—and Dublin, Frankfurt and Luxembourg are making a play for financial services institutions.

Regarding sectoral issues, specific sectors such as higher education, agriculture and financial services are affected, but for most businesses it is really about what will happen to the economy.

My last point is about what this all means for public policy. In Scotland, public spending accounts for about 40 per cent of GDP, the public sector directly employs about 20 per cent of the workforce and even more people are indirectly reliant on the sector. What happens on tax and spending will have a big impact on the economy, and the fiscal framework will need to be reopened in the light of changes to things such as the common agricultural policy.

Across our client base, questions are beginning to be asked about future policy in key areas such as agriculture, fishing, research and development, the social fund and regional policy, which are all policy areas that the Scottish Parliament and the Scottish Government will take over post Brexit. People are already starting to think about what the policy choices are and how their individual businesses will be affected if there is a significant policy shift.

I apologise if that was too long by way of introduction, but I hope that it was helpful.

**The Convener:** Thank you very much.

I welcome Dr Matias Margulis, who is a lecturer at the University of Stirling—thank you for joining us. We have a round-table format today. Members will ask questions and if you want to come in on a discussion topic, simply indicate by raising your hands—sorry, not both hands; one hand will do. Once that is noted, I will seek to bring you into the discussion.

**Dr Matias Margulis (University of Stirling):** Thank you. My apologies for being late.

**The Convener:** Not at all.

I will start with a question specifically for Richard Marsh, from 4-Consulting, who has submitted a paper to us on the contribution of EU citizens to Scotland’s economy and society. As the paper says, it gives a snapshot rather than setting out what may or will happen, because it does not address the way in which policy changes will affect what people do or do not do.

On page 2, you say:

“It is difficult to measure the number of EU citizens living in Scotland and their social and economic contribution.”

I have a few questions about the numbers. In paragraph 1.5 on page 2—that is by the numbering in our paper 5, although I am sure that you will be familiar with your own paragraphs—you say:

“There are around 209,000 people who were born in EU28 countries ... accounting for around 4% of Scotland’s total population.”

The First Minister has talked about 173,000 EU nationals living in Scotland. Can you clarify the difference between those two figures?

**Richard Marsh:** Absolutely. As you have kindly pointed out, it is actually quite difficult to measure even the number of such people. One of the big differences, which we set out in our submission, is between people who were born in other EU countries and people who are citizens of those countries. We refer to a paper from the Office for National Statistics that neatly summarises that. The ONS thinks that around 16 per cent of people across the UK who are from other EU countries have actually become UK citizens. That would account for some of the difference between the number that the First Minister cited and the number in our submission.

The other thing—

**The Convener:** Sorry to stop you, but 83 per cent of 209,000 is roughly 173,000.

**Richard Marsh:** I was trying to do the maths in my head, but that is roughly about right.

**The Convener:** Does that explain the discrepancy between the figure in your report of 209,000 and the First Minister’s figure?

**Richard Marsh:** It might. I am at pains to say that the figure that we have given is from a survey of a very small part of the overall population. All the figures in our report are estimates, and there is a margin of error in them of plus or minus a few thousand, or possibly tens of thousands.

**The Convener:** Am I correct in thinking that your purpose in the paper is to show the contribution that EU citizens make to the Scottish economy?

**Richard Marsh:** Yes. I originally submitted the paper to the then European and External Relations Committee and I was asked to pass on a slightly updated version to this committee. The paper’s aim was to answer the two specific questions in the call for evidence from the European and External Relations Committee, to show the economic and social contribution of EU workers.

11:15

**The Convener:** You will be aware that EU citizenship is not based on where a person is born.

A person does not necessarily possess the nationality of the country in which they were born, and the European Union framework is based on rights for European Union citizens. Therefore, a European Union citizen is such a citizen because they are a national of a member state of the European Union.

**Richard Marsh:** In our report, we have made it fairly clear that we are looking at people who were born in EU countries. We have not really gone into the issue of citizenship. The labour force survey includes some questions that allow us to interrogate whether people would classify themselves as a European citizen. However, it is a self-response survey, so we rely on people providing accurate information.

**The Convener:** It does not necessarily give us an indication of the number of people who have a right to be here on the basis of their European Union citizenship.

**Richard Marsh:** No, absolutely not. The survey looks purely at the number of people who were born in EU countries outside the UK.

**The Convener:** Under the common travel agreement, would some EU citizens who were not born in the United Kingdom, such as Irish citizens, have a right to live and work in the United Kingdom that was unrelated to their EU citizenship?

**Richard Marsh:** You are pressing me on an area in which I am not an expert.

**Jenny Stewart:** I talked about EU27 nationals because we recognise that the Irish would have a different status.

**The Convener:** The status of Irish citizens is unaffected by whether or not the United Kingdom is in the EU, because they have rights under the common travel agreement that pre-date European Union rights.

**Jenny Stewart:** That is our understanding.

**The Convener:** Did you look at the number of Irish citizens who are living and working in Scotland who, on that level, would be unaffected by the United Kingdom leaving the European Union?

**Richard Marsh:** We could do that. I had a quick look at the number of people who were born in Ireland who are living and working in Scotland. The problem is that the sample sizes get quite small when we begin to look at people from individual countries and ask what proportion of those populations are working and how much they get paid. The sample sizes would not allow us to produce credible results.

**The Convener:** But if we are talking about the number of European Union citizens who will be

affected, in the sense that there is a question about whether they will be allowed to remain here after the UK leaves the EU, you would have to take out the Irish citizens, because they will not be affected in that way.

**Richard Marsh:** If you wanted to look at that population, we could almost certainly take them out and the numbers presented in the report would be lower.

**The Convener:** EU citizens who have been in the UK for five years or more have a right to permanent residency in the United Kingdom. What percentage of the people in Scotland to whom you refer in your figures fall into the category of EU citizens who have been resident here for five years and who therefore face no question about whether they have a right to remain when the UK leaves the EU?

**Richard Marsh:** The labour force survey is a useful source of information that includes the year in which someone arrived in the UK. We could do analysis and filter out those who have arrived in the past five years. The problem is that that would require a more in-depth piece of research that might take a little longer. We could ask what country a person came from and whether they arrived here in the past five years—that would be entirely doable. If you wanted us to address a policy question instead of taking a snapshot, we could try to amend the data slightly to get closer to answering the question that you wanted to ask.

**The Convener:** If the Home Office has figures that suggest that more than 80 per cent of EU nationals living in the UK fall into that category, could that be extrapolated to Scotland in the same way that I think you have extrapolated the 16 per cent and 83 per cent figures from the ONS figures?

**Richard Marsh:** If we took the route of using the ONS figures, we would simply ask a slightly different question: “Are you a citizen of another EU country?” We could also take away certain countries, or we could try to cross-tab with the tables and add another dimension, by asking: “Have you arrived in the last five, 10, 20 years?”. All of that is doable.

**The Convener:** My understanding is that we have not done that for the purposes of this paper.

**Richard Marsh:** No.

**The Convener:** I take it, then, that you have not looked at the question of EU nationals who have been resident in the UK for fewer than five years but who have a right to remain because, for example, they have children who were born here and who are British citizens.

**Richard Marsh:** We could extend the analysis even further if we chose to do so and ask: “Do you have children who were born here in the UK?”

**The Convener:** Also, you have not looked at the question of dual nationality. Someone can be born in a European Union country and have British nationality or be born in Britain and have the nationality of a European Union country. They would be unaffected by the changes.

**Richard Marsh:** Yes. We have focused on those born in other countries and we have not touched on citizenship and nationality.

**The Convener:** Do I take it from what you are saying that you accept that the paper shows the contribution that people born outwith Scotland in EU countries and who are resident and working here make to the country, but it does not address the question of who would have a right to remain upon the UK leaving the EU?

**Richard Marsh:** Absolutely.

**The Convener:** Thank you. Let us move on.

**Gordon MacDonald:** I have a quick question that is relevant to your paper. Scotland, similar to western Europe, has an ageing population and we need young workers and people who want to come to this country and put down roots.

Yesterday, I visited a food manufacturing company, which highlighted that 41 per cent of its production staff and some of the office staff were eastern European people who had been there for up to 10 years.

The Home Office might put down an agreement that people have a right to remain, but what will happen in future years when we require a workforce and we still have an ageing population? How will we attract workers if we suddenly have a barrier in place?

**Richard Marsh:** Is that question for me?

**Gordon MacDonald:** Yes.

**Richard Marsh:** I point you towards the table that we produced that looked, as best we could, at some broad sectors of Scotland's economy. In manufacturing, the proportion of people employed from other EU countries was slightly higher and the wages paid to those workers was much higher—perhaps there are more full-time workers, or perhaps they are working slightly longer hours or are paid a higher wage rate; we could not go into that. Almost 12 per cent of the wage bill for employees in manufacturing in Scotland is paid to people who were born in other EU countries.

I recognise the situation that you describe; and in manufacturing, it is a particular concern. I do not want this response to sound flippant, but if it is more difficult to recruit people from other EU

countries that have traditionally been important sources of labour, it will become more difficult to find the workers that are needed.

**The Convener:** Gil Paterson wants to come in on this subject. I suggest that we open the discussion out; I do not want Richard to be put on the spot on his own.

**Gil Paterson:** My experience is in the automotive industry in Scotland, not the UK—I am not talking about big plants manufacturing cars in England. The number of EU nationals in that industry now in Scotland is quite substantial and they are very highly qualified.

My question also relates to the private and public parts of the health sector. What is the panel's view on the long-term future economic situation for Scotland if part of the workforce is removed? That is about the long-term issue, rather than the immediate issue of the five-year threshold, which might be removed at any time by the Government.

**Professor Roy:** You start to allude to one of the key issues and challenges in thinking about what the future might be in a world where Scotland and the UK are outside the European Union. The key thing is to hold everything else constant and assume that nothing else changes. We know that we have an ageing population in Scotland and that most academic studies show that attracting skilled migrants to the country is good for the long-term health of the economy. We then start to get into questions about what we do to respond to that. If everything else remains equal, Brexit gives us a headwind into the future. The institute encourages the committee and policy makers to start to think about what you might do in domestic policy and in the future negotiations on the terms of Brexit to tackle what we know is a genuine long-term challenge that Brexit will not help with.

**Stephen Boyle:** To pursue the point that Graeme Roy has just made, let us assume for a moment that, at some point, the existing arrangements that allow people to move freely come to an end and that migration falls very sharply from current and recent levels to much lower levels. We know that, as the Fraser of Allander institute's work points to, that will mean slower growth in the Scottish economy, other things being equal. That points us to a question about what other measures we have at our disposal and what other things we could do in a circumstance where the labour supply becomes constrained.

I would turn quickly to the fact that, in Scotland, a very large proportion of the working-age population is still outside the job market. By all means focus on the actions that you can take to try to secure a good deal on the free movement of

people, but it is at least as important to try to draw more people back into the job market, because that is in a sense a form of internal migration that you could think about drawing on.

**Gil Paterson:** I am looking at the long term, but there might be quite a sharp cut-off. How do we square that circle? How long does it take to train people in those highly skilled jobs and how will that impact on the economy?

**Stephen Boyle:** I will reach the limit of my knowledge on the issue quite quickly, but I think that the answer is that it depends hugely on what the occupations are. It will be much easier and quicker to do the training that is required for some jobs than it is for others. My guess—it is no more than that—is that, for some automotive trades, that might take a considerable period, whereas it could be done more quickly for other industries and occupations. If we have a cliff-edge reduction in labour supply, that would mean a wrenching adjustment for a lot of employers and it would push up labour costs sharply.

**Gil Paterson:** I do not know whether anyone else has an opinion. I referred to the automotive industry, but other people might be more familiar with the health service and the impact on it—it is just that I know all about the motor industry, I am sorry to say.

**The Convener:** Gillian Martin wants to come in with a question, and then I will come to Jenny Stewart.

**Gillian Martin:** We have heard reports of various dispensations or calls for dispensation in relation to the potential effects of Brexit. There has been an agreement with Nissan and calls for the City of London to be excluded from certain implications of Brexit. In particular, there has been a call for access to the European single market. I would be interested to hear people's views on whether certain sectors in Scotland should have a similar exemption from some of the implications of Brexit and what that might mean.

11:30

**The Convener:** We will start with Jenny Stewart because she wanted to come in on the previous point. She can answer Gillian Martin's question as well if she would like. We can then open things up to other guests.

**Jenny Stewart:** I will leave Gillian Martin's question to others—I have spoken quite a lot. On the point about the workforce, clearly, we do not know what the immigration policy might be or what constraints or what kind of visa system there might be. That is one issue that will impact on the future economy.

My other point is more of a short-term one about how attractive Britain will be to people thinking about moving here. The pound has dropped quite sharply—we may discuss that later. If people are being paid in pounds and they want to send money back home, it will become less attractive to come to the UK than to go to Germany or France, for example. Equally, it will be an issue for non-EU people coming here. One of our very bright economists was being paid in pounds but still has student loans in the US, so suddenly her costs spiralled. She was thinking about her career anyway and has moved to Australia.

One needs to think about how attractive we will be as a place to move to and the pound is a big issue in that context.

**Jane Gotts:** On Gillian Martin's point about internationalisation and the exporting agenda, as an overview it is probably important to look at the challenges that the Scottish economy faces in terms of our low levels of internationalisation. It would be quite useful for the committee to consider that, as Graeme Roy mentioned, in relation to what the forward projections and policy making should look like for the Scottish economy.

We know the statistics on Scotland's trade with the EU. How that trade will be impacted by Brexit we do not yet know. Jenny Stewart referred to the WTO and potential tariffs. If we are looking at the future success of Scotland's economy longer term, we need to be much more open to our businesses exporting beyond the EU. Our exports to Asia remain very low. Recent exports to China were £530 million. Recent exports to India were £228 million. China and India are two of the fastest-growing economies in the world and our export levels to them remain very low.

In our forward policy making, we need to look at Scotland's export strategy as a whole and ask why over 50 per cent of our exports are still being generated by 50 companies. It would be interesting if the committee could look at how many of those 50 companies are foreign owned and at the risks to the Scottish economy if those businesses decide to leave Scotland, whether or not that is due to Brexit.

That is not answering your specific question on trade agreements. However, it is important to have an overarching look at the current export situation for Scotland and ask why we still have very low levels of exporting among our business base, particularly among our small and medium-sized enterprises business base, which remains the key driver of Scotland's economy.

**Professor Roy:** To pick up on Gillian Martin's point about individual sectors, there are probably four ways to look at this. One is to start to think through the different trade-offs that might happen

from different trade agreements and the different outcomes from the UK's exit from the EU. The whole debate about the membership of the European economic area model, the WTO model and so on becomes quite important and the models will have quite unique implications for individual sectors. It is important to understand that. A model where the UK is in the EEA could be quite different for an individual sector from a model where the UK is in the WTO, and understanding the potential implications for individual sectors is quite crucial.

The second way is to broaden that out into asking how different sectors might be impacted by, for example, changes in migration rules. We know that certain sectors of the economy are more dependent on inward migration than other areas are: tourism, the automotive industry—which Gil Paterson mentioned—and the national health service. Therefore, it is important to understand the potential implications for those sectors.

The third way is to move into asking what policy opportunities open up from no longer being part of the European Union. That is much more controversial and takes us much more into the political sphere. However, we know that the Scottish Parliament will get further powers as a result of Brexit and that further elements might even come through the fiscal framework. In which of those areas could the Parliament use policy differently? That might have implications for different sectors as well.

The final way is to broaden that out to ask what policies and strategies the Scottish Government—also the UK Government, but let us focus on the Scottish Government at the moment—is implementing to deliver economic strategy. The delivery of the economic strategy cannot be exactly the same prior to Brexit as afterwards. There will be new challenges and opportunities, so it becomes crucial to reassess the economic strategy when we are no longer part of the European Union. What levers does the Scottish Government have at its disposal at the moment that it can use differently to have an impact on certain sectors?

To come back to Gillian Martin's general question, aside from considering the headline impact, our analysis and modelling for the Culture, Tourism, Europe and External Relations Committee started to consider what sectors are most exposed to the European Union and can be identified as ones about which we might need to be quite worried or on which we might have to think about our response. It also examined what other sectors might have further opportunities, such as greater scope to move into wider international markets. Our policy response for them might be quite different. It might be less

about protecting and more about nurturing and supporting a sector. How can we help such sectors to use the future growth in the global economy to tap into wider markets?

The situation is quite complex. There are quite a lot of factors but they all need to be examined if we are going to have a comprehensive response.

**Richard Marsh:** I will shamelessly borrow some research that I did with Fabian Zuleeg a long time ago. The point about what sectors might be involved is interesting. We have had some brilliant work from the Fraser of Allander institute on that.

The single market is much more than just workers and trade. If the committee looks at the *Financial Times* today, it will see that the biggest company in America is Apple. In the American top 20, there are six companies that were not there 10 or 20 years ago, including Google, Microsoft, Facebook and Amazon. However, there are no software companies in the top 20 for Europe. The single market is bringing together a series of disparate countries and trying to ask how we can have common rules for digital services and signatures; it is bringing all the difficult things together. In the United States, which has a fully integrated single market, that has produced world-beating global companies.

It is good and proper that we think carefully about the Scottish economy as it is and how we can protect the sectors that are thriving now but we must ask what we need to put in place to ensure that some of the smaller, creative, technology-based companies in Scotland that are doing well but which do not yet have the scale can still trade and integrate online with the rest of Europe and the rest of the world.

**Dr Margulis:** I will address the so-called special deal for Nissan that has been in the news a lot. We do not have a full picture of the assurances that the UK Government has made to Nissan but one of the suggestions that has been made in the news is that the Government would pursue zero-tariff entry for British automobiles into the EU market post-Brexit. That would make sense on paper, given that EU tariffs on automobiles can be as high as 22 per cent. However, special sectoral deals are not likely to be WTO compliant.

The only way to have that kind of arrangement is under a comprehensive free-trade agreement—in essence, the single market and customs union. Outside such an arrangement, duty-free entry cannot be provided for specific sectors and trade partners. The likelihood of such an option being WTO compliant is very low, so the idea that we can have special sectoral deals with the EU is not likely to fly with international trade.

**Jackie Baillie:** I want to pick up on Jane Gotts's point. There are undoubtedly challenges to do with

exports, but there are also opportunities. I am struck by an agenda that says, first, that we need to lift exports overall and, secondly, that we do badly in the rest of the world. Given that we know the hierarchy—we export more to the rest of the UK, then comes Europe and then comes the rest of the world—I am curious to know whether Jane Gotts thinks that it makes sense that the Government's strategy is to expand exports to Europe and not to take on the bigger issue of the rest of the world, where the opportunity lies. Should Europe be the priority or should the Government do something else?

**Jane Gotts:** The Scottish Government is to be commended, because its reach in international markets is very good. There is representation in all trading businesses through the UK, but Scotland itself has offices throughout Europe and in Asia and the USA. There was a recent announcement about increasing the Scottish presence in Berlin, which is a good thing, because the German market offers a lot of opportunities for Scotland, particularly given Germany's strong SME base. Trade between Scotland and Germany that focuses on SMEs is a positive.

The infrastructure is there, but Scottish businesses do not seem to be taking advantage of it to the extent that they should be doing if they are to grow exports. The challenges are to do with not the infrastructure but getting Scottish businesses to internationalise, for a host of reasons, whether we are talking about access to finance or awareness of opportunity. The Scottish Chambers of Commerce did a lot of research and found that some Scottish businesses do not think that their product can be sold overseas. However, businesses that are selling into England or Ireland are, in effect, exporting; it is just about getting a more international mentality.

I can understand that the pressures of day-to-day business are such that it can seem challenging and expensive to do business in overseas markets. However, the more that can be done to allay such concerns, the more positive the result for the economy.

**Jackie Baillie:** May I push you a little further? Should the priority be to expand in Germany, or should it be to expand in the rest of the world?

**Jane Gotts:** It is difficult to give a yes or no answer at this stage. The Scottish Government expanded its offices in India and China in recent years, so it obviously has priorities and plans in relation to the markets. I understand that the Government has expanded its approach into South America. I mentioned the recent announcement about Germany, which I think is a good thing, given the current German economy.



**The Convener:** Dr Margulis, do you want to come in on that point? You talked about the car industry and sectoral deals. As you rightly said, we do not know what assurances might have been given. The United Kingdom imports billions of pounds-worth of cars from Germany. If the Japanese continue to build cars in the United Kingdom after we leave the EU, those cars can be sold in the UK. The continued popularity of German cars in the UK might depend on the tariffs that are imposed, so the issue might be more to do with tariffs between the UK and Japan. I am speculating, but perhaps you will comment on that and respond to Jackie Baillie's question.

11:45

**Dr Margulis:** First, on the point that Jane Gotts made, we need to distinguish between trade promotion and market access. No matter what the scenario is, Brexit will reduce market access for British exports, so we have to look at whatever strategy is chosen in the context of reduced market access. The final option for the nature of Brexit will determine exactly how much market access will be lost. We are talking about the degree of disintegration. That needs to be part of the discussion rather than just trade promotion, which is about the promotion of products. If access to markets is more restrained, the incentives for exporters will change.

In response to the convener's question, I note that the Nissan cars are British made but are assembled with parts from all over the world. Several factors will influence the export of automobiles, and one will be the tariff rates that are set. Under the WTO option, we would go to most favoured nation tariff rates, which are significantly higher than those that the UK faces at present when it exports to the EU, but there are also rules of origin, so the content of the automobiles will determine the tariff rates.

When we talk about exports and production, we must remember that most things are globally assembled. They are not primarily built here; they are assembled here with parts from everywhere. Where this gets complicated is with the non-tariff barriers—such as rules of origin—that determine the tariffs that will be applied to the exported goods. It is not so much about the EU's tariff rates with Japan. It is about the terms of the British exit from the EU and its tariff agreements with the EU market, but also with the rest of the world, because those will affect all the inputs and outputs in relation to the automobiles.

**The Convener:** I take your point. My question might have been too simplistic. I was thinking more about which cars British people would be buying. If tariffs were introduced on German automobiles, there might be a growing appetite for

Japanese cars that are built in Britain, which might deal with the issue.

Perhaps we can move on. Gil Paterson wants to come in on some of the points that have been made. After him, Andy Wightman wants to come in, and I will then bring in some of our guests who have indicated that they would like to comment.

**Gil Paterson:** I hope that you will indulge me if I comment quickly on the previous subject, convener. I understand that the tariff for automobile parts is substantially lower than that for the finished articles. That is a worldwide phenomenon.

My main question is about the statistics on exports. There is a view that a substantial amount of Scottish exports are recorded as English exports because they leave from English ports. Is that the case or is it imaginary? As I said last week, one of the problems that the committee has is the lack of reliable statistics that are peculiar to Scotland. It seems that, often, such statistics do not exist and we rely on people such as those who are sitting round the table this morning to produce information. Businesses provide information to the Government, but information never comes back that is peculiar to Scotland.

**The Convener:** Dr Margulis, do you want to comment on that? I will then bring in Dr Zuleeg.

**Dr Margulis:** It is an astute observation. One of the problems is that British statistics are national and they are not broken down internally, which makes it difficult to know the extent of the Scottish economy. Most of the statistics that I see are based on surveys, so they are to some extent limited data.

The committee and the Government should be thinking about the fact that there are not great Scottish statistics. What kind of data do we require in order to make decisions? I know from my former experience as a trade negotiator that we cannot decide on appropriate strategies unless we have a hard picture of what our economy looks like, which is currently missing for Scotland. It is a significant information gap.

**Dr Zuleeg:** I will pick up on a couple of the points that have been made.

It is clear that there is still a significant amount of uncertainty about timing, transition and the final outcome. It is also clear that the harder and the quicker Brexit is, the higher the costs will be. The key question is whether the UK continues to be in the single market, which is qualitatively different from negotiated access to the single market. It is a binary choice. The single market is much more than a free-trade agreement.

If there is a free-trade agreement, rather than membership of the single market, it will depend on

when that is negotiated and it is likely to be way into the future. We are not talking about having a free-trade agreement on exit; we are talking about having one at some undefined point in the future.

There are a lot of questions, including what will happen with the UK and the WTO. The UK does not have a WTO schedule and it will have to negotiate one—again, there is the question of transition arrangements. All of that will impose costs: short-run costs, medium-run costs and long-term dynamic costs—which is where the really significant costs will come in.

There are some considerations about whether there can be special deals. If the UK leaves the single market, I think that it is highly unlikely that any part of the UK will get a special deal to remain in the single market. The big question with special deals is whose gift they are in. Who will be the one to decide on those special deals?

With international trade, there is a game of negotiation that involves give and take. The big question is always what the UK Government will give. What will be on the table to rescue some of the special provisions that there are? It should not be forgotten—it has already been mentioned—that that takes place within a framework that has already been set. WTO rules will prescribe certain things for the UK. For example, it is quite difficult to see how some agricultural subsidies or preferential trade deals will work under WTO rules.

It is not just the relationship between the EU and the UK that will change fundamentally, but the relationship between the UK and the rest of the world. Should Scotland aim for the rest of the world, rather than for the rest of the EU? It is about both, rather than either. It is about taking into account the uncertainty that will exist under WTO rules with the rest of the world. There is also an economic proximity factor: the closer a country is, the more you trade with it. Generally, that holds true regardless of the institutional arrangements. In the Nissan case, we do not know what has been promised, but the key thing is that we should not assume that UK car makers produce for the UK market. UK car makers produce for the European market, so it matters a lot whether there are tariffs for cars that are exported from the UK to the continent. That will also determine car makers' long-term decisions about whether to continue to invest here. There are possibilities for trying to mitigate some of that, but those possibilities are costly—state aid, for example—and again we come back to the question of what is WTO compatible and what is not.

**Andy Wightman:** Following on from discussions about special deals and so on, I note from 4-Consulting's paper that Edinburgh's economy is reliant on financial services to an even greater degree than London and, from a European

perspective, it is second only to Luxembourg in that regard. Given that financial services are a key UK export, what are the implications for the Scottish economy—and, in particular, the Edinburgh and Lothians economy—of whatever deal might be reached for financial services? Do financial services have a different profile in Scotland? Are they likely to be more or less impacted by exit from the European Union, or are they the kind of services that would benefit to the same degree as those in the city of London if it secures any special deals on the future of passporting?

**The Convener:** Does Stephen Boyle have any comment on that? I am happy for other guests to comment.

**Stephen Boyle:** I will do my best, convener. I do not carry precise numbers around in my head but, if I recall correctly, exports of Scottish financial services to the rest of the UK are between 10 and 20 times the value of Scottish financial services exports to outside the UK. The UK market matters to Scottish financial services to a considerably greater extent than the non-UK market does.

My expectation is that that is quite different from the position that applies in the City of London, for which the non-UK market is likely to be much more significant than it is for Scotland.

**Dr Zuleeg:** I would not necessarily assume that there will be a special deal for financial services in London. We have to look at what the EU 27 might want out of the negotiations, and there is relatively little incentive to give competitors good access to the market without any kind of give from the UK. If the UK wants to keep passporting for UK financial services, my question is: "What will the give be? What will the UK offer?" It will not be an easy ride.

**Professor Roy:** I want to reinforce Stephen Boyle's point about the make-up of the financial services sector in Scotland and its links into the UK, which are quite crucial. For example, RBS has largely been a domestic bank, for which service to the rest of the UK is crucial. That is the same with a number of other big financial players in Edinburgh, such as Standard Life, that are very much linked to the rest of the UK market.

I guess there is a second issue there about the companies that are much more open and trading internationally. They create large amounts of GVA and turnover, but in terms of employment the levels are slightly lower than they are in some of the companies that are more focused on the domestic side of things. There is a great distinction between the potential impacts on employment and other measures.

That starts to get into the point that Jackie Baillie was making on what markets we should go for. Fabian Zuleeg is entirely right: we should not

forget that, although trade deals and access to the single market are important, proximity is one of the most important things. One of the big focuses for the Scottish Government in future policy rounds should be integration into the rUK market and what it can do to support expansion into it. One of the reasons why Scotland has struggled with all this in the past is about growing small businesses into medium-sized businesses. Access to the local market is quite crucial there.

I return to my point that differences by sector will be crucial. Take a product such as whisky, for example. Yes, the whisky industry exports a lot of goods into the EU, but it exports a lot more globally. That is an example of where there are opportunities to focus on other markets. However, if we take a product such as fresh fish, we see that we cannot export that to Australia. A free-trade deal with Australia is all well and good, but we are not going to export our west coast fish or langoustines over there. That is an important point to think about. The actual results will be determined by individual sectors.

I will pick up on Gil Paterson's point about data. It is easy to knock the data, which is not perfect and is based on surveys, but the numbers that we have for Scotland are the best that we have. They are national statistics and they are based on questions to companies about where their end markets are and where they are exporting to. Ultimately, that relies on companies knowing where they are exporting to. For the most part, they are pretty accurate at finding out where the final export market is. Where it becomes much more interesting and difficult is where companies are part of a supply chain. They might be involved in an element that is going to the UK and then will be extended over into the EU. That is why our modelling was quite careful to look at the potential shock to not just Scotland but the rest of the UK. If I am a firm in Edinburgh that is producing a good that is part of a supply chain going to a company in Leicester and then into the EU, understanding the supply chain becomes crucial.

We need to think about the potential impacts of Brexit for not just exporters but people in the Scottish economy who are part of a much bigger supply chain into the European Union. That is also quite important.

12:00

**The Convener:** I am trying to make sure that everyone gets in. Gordon MacDonald has a quick question.

**Gordon MacDonald:** I will build on Andy Wightman's point about the importance of financial services to the Edinburgh economy. Anthony

Browne, the chief executive of the British Bankers Association, recently said:

"Many smaller banks plan to start relocations before Christmas; bigger banks are expected to start in the first quarter of next year."

When Mark Carney was asked about that last week in the House of Lords, he said:

"we are aware of the contingency plans that are in varying stages of readiness at those institutions."

What would be the impact in Scotland if some of the larger players started to relocate? Is there an opportunity for Scotland if we decide that EU membership should be retained?

**The Convener:** Jenny Stewart and Jane Gotts both want to respond; I do not know who is best placed to answer the question that Gordon MacDonald has put into the room. Stephen Boyle may also want to respond.

**Jenny Stewart:** As others have said, there is a big distinction to draw, because different parts of the financial services sector will be affected differently. Of the 90,000 jobs in Scotland that depend directly on financial services, a large number are probably in retail banking and there is, in effect, no single market in retail banking between us and the EU, so that sector will not be affected. A paper was produced recently at the University of Strathclyde by Owen Kelly, the ex-chief executive of Scottish Financial Enterprise, and by Jeremy Peat, which goes into quite a bit of detail about how the different elements on the investment side might be affected and who is more exposed to the EU or the UK. It might be worth reading that paper.

There are contingency plans for relocation for those that are based in the City of London. I will explain the passporting requirement. We have talked a lot about freedom of movement, but there is also the issue of freedom of capital and being able to invest in other countries. If we come out of the EU and do not get passporting, the financial services institutions will have to set up subsidiaries in the EU and capitalise those subsidiaries in order to continue to provide services. That is a significant issue for them to address, and it impacts on what their ownership structures and so on ought to be.

Potential relocation activities might involve headquarters but might also involve particular groups of staff. Investment banking will be more exposed, so activity might involve considering how many people an institution needs to put in Luxembourg by quarter 1 next year to be ready to deal with the relocation. The issue is slightly more complex than just the relocation of headquarters.

**Jane Gotts:** I agree with Graeme Roy that the statistics that the Scottish Government produces

on exports are the best that we can access from company information. It is interesting that Scotland's biggest export market is the USA, despite its distance—we export £4 billion of goods to the United States, which is over £2 billion more than we export to its nearest rival. According to the statistical information, our biggest market in the European Union is Holland, to which we export £1.9 billion of goods. However, we know that a lot of that trade goes through Holland and out through the ports. That goes back to Graeme Roy's comments about the final destination of our exports.

To look at the potential impact on the Scottish economy, we should if possible get more detail on which companies generate the bulk of those exports. Are exports to the USA primarily determined by USA-owned businesses in Scotland? That information is not necessarily available, but it would be welcome, as it would allow us to understand more the potential risks and opportunities for the Scottish economy.

The food and drink sector has experienced growth of more than 12 per cent in exports to China. Demand is growing for Scottish products that are at the high end of the market, which is another interesting area that should be explored in more detail. How do we take advantage of growing economies and growing wealth in markets throughout the world? We need to consider what niche Scottish products could go out to those markets.

**Stephen Boyle:** To return to Gordon MacDonald's point, my first observation is that it is exceptionally rare for headquarters to relocate. Other than in the event of takeovers, it is very rare for headquarters to change where they are. Therefore, I do not expect to see much by way of the movement of headquarters, either in or out.

**Gordon MacDonald:** To be fair, I did not refer to headquarters.

**Stephen Boyle:** Okay—thank you.

I will come on to the nature of the tussle or the trade-off. You referred to financial services. Depending on the terms of the agreements that are struck, I expect the costs of doing business from the UK to be higher than they are now and barriers to trade to be greater than they are now, which will cause some functions to leave the UK. However, at least two factors are pulling against that. One is that there are substantial agglomeration economies, particularly in London, from which businesses benefit. The fact that businesses are part of a richer labour market and an extensive supply chain means that the costs of going somewhere else are not negligible. That is the trade-off that businesses will be making.

On the point that Jenny Stewart made, if a business decided that it needed to be in a European Union member state to conduct its business, among the options that it would consider would be establishing an operation in that country specifically for that purpose, rather than taking its operation wholesale from London to that country.

**The Convener:** Dean Lockhart has a question. Is it on that financial point?

**Dean Lockhart:** It is on another point.

**The Convener:** I will call you in due course, then, because John Mason has been waiting to get in with a new point.

**John Mason:** My question is on a different point, although it has been touched on. We have talked about exports quite a lot, but I will go back to Jenny Stewart's point about the change in the exchange rate, because that has actually happened. It strikes me that a lot of people seem to be relaxed about that. If the exchange rate goes down, does that automatically mean that export levels go up? Can we just sit back and watch whisky exports go up and up?

What really is the impact? Jenny Stewart mentioned people who make remittances to other countries. What happens with foreign investment? Does the change make it more or less likely that people will invest in Britain? Has the pound stopped going down or will the fall continue?

When I was younger, we laughed at Italy and Greece because their currencies were worth thousands to the pound. It strikes me that the exchange rate is important because it reflects the strength of the economy and creates an image round the world. People seem to be surprised that the price of tea is going up, but I have not noticed any tea growing here, so of course the price of tea is going up—I presume that the price of quite a lot of things is going up. Where are we going with that? Is that a factor?

**Jenny Stewart:** It is clear that the change in the exchange rate and the fall in the pound have been significant. There have been a couple of direct implications of that. I think that people were surprised by the initial fall in the pound; then equities rose, and people did not really understand why the stock market was going up while the pound was falling. That reflected the fact that for a lot of companies—for example, a lot of the oil and gas industry—income is denominated in dollars. A fall in the pound was pretty helpful to them and, as a result, share prices went up.

**John Mason:** That meant that, if someone sold a barrel of oil for so many dollars, they automatically got more pounds. They had not actually sold anything more or done anything more.

**Jenny Stewart:** That is right.

**John Mason:** I am with you.

**Jenny Stewart:** Moreover, there is potentially a positive impact on exports, although we have not seen the data to find out whether that is feeding through significantly. However, it is important.

The other impact relates to inflation, which you touched on. Because we as an economy import an awful lot more than we export, the expectation is that the situation with the exchange rate will feed through to increased inflation. The Bank of England's inflation report is coming out on Thursday, but the bank has suggested—and others have said—that inflation, which is sitting at about 1 per cent, could go up to 2.5 or 2.6 per cent over 2017 and might even hit 3 per cent in 2018.

The inflationary effect of the drop in the pound might take a while to come through, but it all depends on what the Bank of England does. As its monetary policy remit is to target inflation, it is in a bind; it wants to keep interest rates low, but it also wants to control inflation. That is why the value of the pound is such a fundamental issue not only for the whole economy but for individual businesses.

**John Mason:** Do the timescales that you have suggested for the effects to feed through arise partly from the fact that energy companies, supermarkets and so on have bought ahead and can therefore fix the price for a period?

**Jenny Stewart:** That is partly the case but, for other goods, the effects will be almost instantaneous. We will have to see how all that feeds through.

**The Convener:** Stephen Boyle, Dr Zuleeg, Richard Marsh and Dr Margulis all want to come in, so I will take them in that order.

**Stephen Boyle:** To go back to John Mason's point about the impact of the exchange rate reduction, I believe that the pound has gone down by about 15 per cent since the referendum and by closer to 20 per cent over the year. There has already been a substantial adjustment in the exchange rate.

Let us assume for a moment that the adjustment is sustained and that there is no recovery. On the face of it, it might represent a substantial gain to exporters, because they could take higher revenue for the same volumes or adjust their prices and take higher profits. However, as Jenny Stewart explained, there is another dimension. Input costs are rising—we have already seen in the UK as a whole a sharp increase in input prices as a consequence of the really quick fall in the exchange rate.

Who wins and who loses in such a context depends on the balance between dependence on

export revenues and imported costs. Some sectors such as the drinks industry have limited imported costs but can gain substantial export revenues. More generally, it looks to me that the companies that will gain are those in the service sector, for which imports and inputs are not a big part of what they do but which have some export activity. Because of the nature of supply chains, the losers look predominantly to be those in the manufacturing sector who might be exporting but who also have a substantial amount of imported input content.

There are other winners and losers, too. Jenny Stewart talked about what the average increase in inflation might be. Different households are affected in different ways by the change in the exchange rate. So far, the input cost rises have been greatest in energy, food and clothing, which constitute a higher proportion of the spending of the country's older and poorer households. Such households are likely to be disproportionately adversely affected.

We might not see changes in, for example, import and export volumes manifest themselves quickly, because businesses hedge their currency risks so that they are protected against movement in the exchange rate for anything up to a year.

12:15

**Dr Zuleeg:** I will make a couple of points. Export performance depends on many factors. The exchange rate is one factor, but—depending on the sector—it is often not the most important factor. That is easily demonstrated by the experience in Europe. Before we had the euro, a number of countries periodically had competitive devaluations of their currencies, and that did not solve their export problems—certainly not in a sustainable way.

Another important factor is how responsive demand is to price, both abroad and in Britain. If the price changes, will there be a big effect? In general, at least for consumer prices, there tends to be quite inelastic demand, which means that the exchange rate loss will be passed on to consumers in a relatively short time.

It is important to note that volatility itself imposes a cost. The issue is not necessarily whether the pound is high or low; rather, it can be difficult, especially for SMEs, to deal with the costs of a fluctuating currency. Stability has a value in itself. There is still a threat in that regard, because the exchange rate still moves predominantly with events in the political sphere—whenever it is considered that Brexit might be harder, the pound deteriorates further, and whenever people think that there is a chance that the UK or parts of the

UK will remain in the single market, there is an improvement.

Much depends on the politics and on the final outcome. If we are truly moving towards a very hard Brexit, I expect the pound to fall even further.

**Richard Marsh:** We are in danger of finding that we have several economists in the room who agree with each other.

I will follow up Stephen Boyle's point. There is some data out there. The Scottish Government's input-output tables look at the balance between what we import and what we export, so we can look at the winners and losers. I quickly made a list and towards the top are—absolutely as Stephen Boyle said—food and drink sectors, with whisky at the top of the table, because it exports a great deal of its output and uses natural resources in Scotland. It is intuitive that whisky is potentially a big winner.

Towards the bottom of the list are sectors to do with energy, as Stephen Boyle said. In addition, sectors such as health and public administration make significant purchases of specialist equipment and plant from outside the UK, and such sectors export very little, because they are public services.

It is quite difficult to say whether Scotland is a winner or a loser, but I note from the stats that there are significant winners in specific sectors of Scotland's economy and that some sectors have to source things from outside the UK—they have little choice about that, as Fabian Zuleeg said, because adjusting the supply chains would require fairly significant changes in the economies of Scotland and the UK.

**Dr Margulis:** Much of what I wanted to say has been said. The issue reiterates the importance of having a better understanding of where Scotland fits in global supply chains. We cannot really understand how the change in the currency will affect exports until we know what the global supply chains look like and understand how those changes might play out within sectors.

**Richard Leonard:** Do any of our expert witnesses have examples of existing companies that are making contingency plans? Jenny Stewart has mentioned companies having to act as early as quarter 1 next year and Fabian Zuleeg talked about the potential for disinvestment over time. Jane Gotts spoke about the extent to which some of the commanding heights of the Scottish economy are now foreign owned, which one would expect potentially to lead to a branch plant approach and possible retrenchment.

Does that make it even more compelling that we have an industrial strategy that looks at how to plug the gap in medium-sized enterprises, develop

the indigenous industrial base and become less reliant on foreign direct investment as a way of transforming the economy?

**Dr Zuleeg:** It is very difficult to say when the disinvestment will happen. I would be astonished if, at least among larger companies, there is no contingency planning. It would be a failure towards their shareholders if they were not doing some contingency planning at the moment. Whether that means that they will plan to leave is a different question.

In the long run, we will see an effect on investment. There will be more reliance on indigenous growth. How that can best be promoted is a big question. Both technically and from an economic perspective, the kind of industrial strategies that we have seen in some countries have not worked particularly well in growing medium-sized companies. Also, it is generally the case that the international market is very important for medium-sized companies; they are not just oriented towards the national market. If one looks at successful countries such as Germany, their medium-sized businesses are very international. The question is how one can internationalise those kinds of company.

On top of that, a big question is what kind of industrial strategy will even be possible, within both the UK framework and the WTO framework. There are big questions about what kind of instruments could be used and what the response would then be from other countries, which will react to the kind of industrial strategy that Scotland or the UK puts into place.

**Jane Gotts:** The question is too difficult to answer, but it is important to have a blend. Scotland has been phenomenally successful in recent years in attracting foreign investment. Scotland has the best foreign investment in the UK outside London in terms of attracting overseas businesses. It should be a priority to maintain that.

At the same time, we need to look at where the potential gaps in our economy are and where there are opportunities for indigenous businesses. On John Kemp's point about where the opportunities are, we have not talked much about the tourism sector—we mentioned it briefly—but, with the drop in the pound, there is huge potential to grow our tourism sector. Of course, it is a double-edged sword, because we know that there are a lot of European citizens working in the sector in Scotland; therefore, how can we manage a potential boom in tourism, because of a falling pound, at the same time as making sure that we have enough people to service the industry? Those are not questions that we can answer now, but they all have to be on the table for consideration.

**Dean Lockhart:** Professor Roy, in your submission, you rightly challenged policy makers to examine the policy opportunities that may open up as a result of Brexit. I have two questions for you. First, am I right in thinking that the report that you prepared for the then European and External Relations Committee a couple of months ago looked at only three Brexit scenarios—the Norway model, the Swiss model and the World Trade Organization model—and that it did not take into account the potential upside of new trade deals with countries such as India, China and the US?

We have heard about the potential opportunities for exports that exist in different sectors across the Scottish economy. It is incumbent on policy makers to address not just the challenges but the opportunities that arise from Brexit. What steps do you recommend that the committee takes to explore those opportunities?

**Professor Roy:** Your first question was about the modelling. The modelling looks at the potential impacts of different trade models for Scotland and the UK in a post-Brexit world. It isolates the impact of Brexit—in other words, it considers the implications of having less trade integration with our largest international market.

You are entirely right. We then get into questions such as what the policy responses might be and what other things could flow from that. We do not model that because there is no clarity about what Brexit will be, let alone what policy opportunities might come from it.

In addition, we need to consider the issue in context. It is entirely possible that we could have trade deals with countries outside the European Union, but we must put those numbers into context. There are ways in which trade with those countries could be improved. Let us take the example of Australia, because there have been hints about potential trade deals with Australia. If we were to increase our exports to Australia by a third, those exports would equate to less than 2 per cent of our total exports to the EU. It is true that we could expand trade and get trade deals with other countries, but we must put that in context and take account of the relative size of that expansion.

As has been touched on, there is quite a difference between a single market and free-trade deals or arrangements with other countries. A single market provides a level playing field for trade. It means that there are rules to stop exploitation of workers and to harmonise product regulation and so on. It would be possible to enter into a trade deal with China, for example, but what would be the rights of the Chinese workers on the goods that were being exported to the UK? Would we want to enter into a trade deal with China? We have seen all the challenges around the

transatlantic trade and investment partnership and the concerns that people have had about American companies seeking to provide public services.

Dean Lockhart's point is entirely correct: we are encouraging people to start to consider the policy opportunities—because we know that Brexit will create headwinds to growth rather than be growth enhancing and consideration needs to be given to how to mitigate the worst of the effects and to the opportunities that exist to do things differently. We need to start to get creative and to think about what policy levers the Scottish Government has to do things differently and about the policy opportunities that might come from the greater devolution that might come down the line. For example, in the past we have been prevented from having powers over VAT and excise duties because of EU regulations, but what could happen if those powers were devolved to the Scottish Parliament? What might we do differently if we had a greater suite of fiscal powers? What might we do with the powers in agriculture and so on?

However, it is necessary to put the opportunities in context. Even with all those opportunities, Brexit will still be a headwind to growth, but if Brexit is happening, we must consider what we should do about changing policy in response.

**Dean Lockhart:** Earlier this week, in your blog, you mentioned that we should not let Brexit overcloud everything else and that some of the challenges that the Scottish economy faces have been there for years. I welcome that. Do you agree that, although Brexit is a possible headwind, there are structural issues with the Scottish economy that have been there for years and which we need to deal with?

**Professor Roy:** I agree with everything in that statement apart from the phrase “a possible headwind”—I would probably say that Brexit is a headwind.

You are entirely right to say that we have had structural challenges in the Scottish economy around internationalisation and the growth of small and medium-sized companies. Brexit will not help us to address those, but it is a potential opportunity to take a fresh look at, and to make a frank assessment of how we start to address, the structural challenges that we face.

12:30

**The Convener:** Before I bring in some of our guests, I will give Ash Denham an opportunity to ask a question about the short-term implications rather than the long-term implications, which the previous question addressed.

**Ash Denham:** My question may have been partially covered, but I want to highlight a couple of points. The Fraser of Allander institute has focused on short-term considerations, and we will all no doubt have seen newspaper headlines in the past few weeks crowing about the fact that the predictions of economic doom that were forecast have not quite come to pass. We have touched on the sharp fall in sterling, which would probably fit into that category.

The Fraser of Allander institute states:

“we should be wary of expecting to see any immediate changes.”

The full impact of Brexit has perhaps not yet come to pass, but that does not mean that it is not coming. When do you think that we might see some more impacts?

**Professor Roy:** The short-term challenges are really quite complex. If you speak to most economists, you will find that there is relative consensus about the impact of the long-term headwinds of Brexit in relation to the areas that we have discussed such as trade, investment, access to skilled migration and so on.

What happens in the short term is much more complex. As we have heard, businesses tend to wait to see what is happening. In the short run, they tend to be driven very much by issues around day-to-day supply and demand, such as what their orders are like and what is happening to interest rates and the exchange rate—those issues dominate in the short term. A lot of things are happening on the positive side that will help to boost the economy, and a lot of things are happening on the negative side that may turn out to present more difficulties.

If you look at the average forecast for the outlook over the next wee while, you will see that most people said that the economy would be slower in 2016 as a result of Brexit because of the uncertainty. The data that we have had so far has been surprisingly on the upside, although I caution that we have data for only the first three months after the referendum and a lot of the forecasting is based on model data.

However, most economists have predicted that the real challenges will come in 2017 and 2018, when the decisions on investment start to kick in. If a business made the decision to invest in 2016, it is unlikely to throw everything out immediately; it will wait for greater clarity. The issue is what happens with the next decision—for example, a business may cool its expansion plans slightly. One would expect that effects would begin to trickle through next year and the year after.

That is why we forecast that 2017 will be slightly more challenging than 2016 for Scotland. Most

independent forecasts, rather than the ones that the Treasury produces, are predicting that 2017 and 2018 will be slightly more challenging than 2016.

The key issue is what happens with inflation, which has already risen to 1 per cent. The Bank of England, in its report in August, referred to the possibility that inflation would rise to 2.4 per cent in 2018. That is when the effect on household consumption will really start to kick in as we move forward.

Stephen Boyle made the point really well about the impact on different types of households, but we have not spoken about the potential impact on the poorest households. We know that, typically, they face the highest increases in food and energy prices and so on, but we need to also think about what might happen in the autumn statement and about the outlook for welfare. We know that there are plans for a number of benefits to be frozen. If inflation rises, potentially that will make the challenges for people on welfare benefits all the more difficult.

A public sector pay award of 1 per cent is challenging, but it still represents a real-terms increase when inflation is 0.5 per cent. However, if inflation rises to 2.5 or 3 per cent, a pay award of 1 per cent suddenly starts to present many more difficulties. In 2017 and 2018, we will start to see the potential challenges coming through not only for investment but for consumption.

**Ash Denham:** Are there specific helpful measures that either the Scottish or UK Government could implement in the short term? For example, the Bank of England has cut interest rates and the Scottish Government has launched its £500 million growth scheme. Do our panellists have any other suggestions?

**The Convener:** Perhaps people could answer that question as part of their closing remarks.

**Jenny Stewart:** We have talked about the short-term impacts not being as significant for business investment as was thought, but there is so much that can still change. As Graeme Roy said, we are looking at reduced improvement next year, so things are changing. The forecasts for 2017 have gradually been shifting upwards a little, as more positive data have been coming through. In the weeks post-Brexit, the consensus was that the UK economy would grow by between 0.3 and 0.5 per cent next year, whereas now the consensus is hovering around 0.7 to 0.8 per cent. If the growth forecasts continue to be relatively positive, that is a good starting point for next year.

I want to go back to Richard Leonard's point about business investment. I would not want to give the impression that it is suddenly about to fall off a cliff. Businesses will be thinking things



through and making contingency plans, but we will need to see what happens, particularly the impact of the autumn statement.

There are some other points that I want to throw in that the committee might want to consider. We have not talked about skills yet. That has been a significant issue in the Scottish economy. We have some significant skills gaps, particularly around construction and technology—we touched on the digital agenda earlier—which may be made worse by Brexit.

The discussion has also not touched on the higher education sector, which will potentially be significantly affected by the freedom of movement issue. As I understand it, something like 16 per cent of staff and 25 per cent of researchers come from other EU countries. The higher education sector is worth considering, because it contributes significantly to the economy.

**Dr Zuleeg:** It is important to emphasise that Brexit has not happened yet and is not scheduled to happen for two and a half years, so the effects that we are seeing are based on what people are anticipating rather than Brexit itself. Its effect will be felt only after Brexit has happened, and then it is the long-term dynamic effect that will be much more important. The interplay between innovation, freedom of movement and foreign direct investment will have a significant, long-term, growth-reducing effect on the UK as a whole.

At the moment, there is still quite a bit of speculation that there will be, for example, parts of the UK that remain in the single market—there have been questions around passporting and so on. If the suggestions on those turn out not to be true, we will see a further effect. As the markets start to anticipate a harder and harder Brexit, the costs will be bigger. That is what we expect.

One of the issues that tends to be neglected in the discussion is the relationship between the UK and the rest of the world—not the UK-EU relationship, but what happens in foreign trade. There is very high uncertainty about what will happen after Brexit, so there is huge potential for damage to trade. Some people are assuming that there will be free-trade agreements with all those places around the world, but although that might be the case, it is quite a big ask to negotiate them, it will take a lot of time and the UK side will require to give up quite a lot in order to secure those trade deals.

If you look at the trade deal that the EU has just concluded with Canada, you see that it is a huge, 2,600-page book, because that is the big difference between being in a single market, where you have a level playing field, and having to negotiate access on every individual point. That is a huge issue on which the UK Government needs

to be pressed more. It must say what the contingency plans are for day X—the day after Brexit—because all of the current trade deals and the schedule of the EU will no longer apply.

**The Convener:** Dr Margulis, could you and Stephen Boyle address the question of what the Scottish Government can be doing at this stage?

**Dr Margulis:** I want to echo how much of a Herculean task it will be for the British Government to renegotiate its trade relationship with not only the EU but the other 50 countries with which the EU has preferential free-trade agreements that the UK currently enjoys. On a safe estimate, we are looking at it taking several decades just to renegotiate the access that the UK currently enjoys.

There is an idea of there being an upside to this, down the road, but that would be decades away, because the reality is that the UK has not negotiated a trade agreement since the late 1970s and has no capacity to negotiate such agreements. The UK has a much smaller economy than the EU and so does not have the same leverage, which means that when it strikes new deals, they are likely to be not as good as the deals that it currently has. Furthermore, nobody is getting in line to sign trade deals with the UK—globally, it is not such an important economy and the UK is not the country that most other countries are lining up to trade with. There must be some realism about where the UK sits in the global picture.

On what the Scottish Government can do, it is important to start a consultation process with stakeholders across sectors to get a better sense of their concerns and to identify the kind of measures that will need to be put in place in the interim to replace the supports and benefits that the UK currently enjoys as part of the EU and that might disappear when it leaves, such as agricultural subsidies and state aid. We cannot assume that we will be able to use the same things going forward. As an interim measure, it is important for the Scottish Government to figure out what kind of mitigation capacity it has.

**Stephen Boyle:** In a very narrow sense, one thing that we can do is to stop obsessing about Brexit. I say that because what the work of Graeme Roy and his colleagues shows is that, at its heart, Brexit presents a growth challenge: it makes the growth prospects of Scotland's economy poorer than they otherwise would have been. However, for a long time, we have been on a journey to try to improve Scotland's rate of growth, and Brexit provides a further, stronger justification for doing so. In practice, that means that when decisions are being made, the Government should continue, at the margin, to change the balance of spending towards

investment, which means away from consumption. That is difficult to do, but that investment will pay off in terms of longer-term growth.

On the narrower Brexit-related issues that arise, my judgment is that if we have a fixed pot of money for the purposes of promoting internationalisation, that money will likely be more productively spent on export promotion than on the attraction of foreign direct investment.

**The Convener:** Thank you, we will wind up there because we are at the end of the time available and we would not want to be accused of obsessing about Brexit. Thank you to all our guests.

12:44

*Meeting continued in private until 12:58.*

This is the final edition of the *Official Report* of this meeting. It is part of the Scottish Parliament *Official Report* archive and has been sent for legal deposit.

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