



OFFICIAL REPORT
AITHISG OIFIGEIL

Economy, Jobs and Fair Work Committee

Tuesday 19 December 2017

Session 5



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Tuesday 19 December 2017

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ECONOMY, JOBS AND FAIR WORK COMMITTEE

33rd Meeting 2017, Session 5

CONVENER

*Gordon Lindhurst (Lothian) (Con)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Tom Arthur (Renfrewshire South) (SNP)

*Jackie Baillie (Dumbarton) (Lab)

*Colin Beattie (Midlothian North and Musselburgh) (SNP)

*Jamie Halcro Johnston (Highlands and Islands) (Con)

*Daniel Johnson (Edinburgh Southern) (Lab)

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

Gordon MacDonald (Edinburgh Pentlands) (SNP)

Gillian Martin (Aberdeenshire East) (SNP)

*Andy Wightman (Lothian) (Green)

*attended

THE FOLLOWING ALSO PARTICIPATED:

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

Mary McAllan (Scottish Government)

Hugh McAloon (Scottish Government)

Chris Stark (Scottish Government)

CLERK TO THE COMMITTEE

Alison Walker

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Economy, Jobs and Fair Work Committee

Tuesday 19 December 2017

[The Convener opened the meeting at 09:30]

Decision on Taking Business in Private

The Convener (Gordon Lindhurst): Good morning and welcome to the 33rd meeting in 2017 of the Economy, Jobs and Fair Work Committee. I remind everyone in the public gallery to turn off any electrical devices that may make a noise or interfere with proceedings.

We have received apologies from committee members Gordon MacDonald and Gillian Martin.

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

Members *indicated agreement.*

Draft Budget Scrutiny 2018-19

09:30

The Convener: Today, the Cabinet Secretary for Economy, Jobs and Fair Work, Keith Brown, will give evidence to us on the Scottish Government's draft budget 2018-19. The Scottish Government officials with him are Chris Stark, director of energy and climate change; Mary McAllan, director for economic development; and Hugh McAloon, deputy director, fair work and skills. I welcome you all.

There are two matters to deal with before we commence the evidence session. First, the committee expresses its appreciation to the various chambers of commerce that have submitted evidence to it. Secondly, there may be a member who has an interest to declare.

Jackie Baillie (Dumbarton) (Lab): I declare an interest as the honorary vice-president of Energy Action Scotland.

The Convener: Thank you. As there are no further preliminary matters, I invite the cabinet secretary to make a brief opening statement.

The Cabinet Secretary for Economy, Jobs and Fair Work (Keith Brown): Thank you for the opportunity to give evidence on an exciting range of measures in my portfolio's budget. The measures are designed to help to address one of the most challenging economic scenarios in recent memory.

As Derek Mackay made clear last week, we believe that the fundamentals of the Scottish economy remain strong. In 2017, our economy continued to grow and, over the past year, the number of people in work has reached a record high. Derek Mackay also noted the conclusions of the first Scottish Fiscal Commission report, which predicted continued growth and rising employment. However, the Government also acknowledges the challenges—not least, of course, the consequences of the United Kingdom Government's austerity policies. In particular, I mention the refusal to lift the pay cap, which has knock-on consequences for the Scottish Government and its budget; the UK Government's failure to control inflation; and the damaging uncertainty caused by Brexit.

Taking action to counter those issues is at the heart of the Scottish Government's budget, which was announced on Thursday, and at the heart of the decisions that have been made in my portfolio. For that reason, I am delighted that the budget delivers an increase of £270 million, which is a 64 per cent increase, in the economy, jobs and fair work portfolio—the largest increase, I think, in any

portfolio. I acknowledge and apologise for the error in the chapter on the economy, jobs and fair work portfolio in the draft budget document: it mentions 39 per cent, but the figure is actually 64 per cent.

The additional funding contributes to investment of almost £2.4 billion in enterprise and skills through our enterprise agencies and our further and higher education bodies. The enterprise and skills strategic board is now fully established. That support will be vital to the realisation of the four strategic priorities identified in “Scotland’s Economic Strategy”, which are innovation, investment, internationalisation and inclusive growth. It will allow us to grow Scotland’s economy and ensure that it remains resilient.

I know that all members of the committee are aware of Scotland’s long history of innovation and invention. The Government is focused on maintaining that proud record of achievement. That is why the budget contains a 70 per cent uplift in our funding for business research and investment, taking our investment in that area in the coming year from £22 million to £37 million.

Last week, the First Minister announced a new centre of excellence in manufacturing—the national manufacturing institute for Scotland—which is to be based at Inchinnan. Construction will begin next year, supported by £18 million of funding from my portfolio in 2018-19.

In our programme for government, we acknowledged an ambition to maintain our competitive advantage in the low-carbon economy and announced a commitment to a £60 million low-carbon innovation fund. That commitment is supported by £10 million of Government capital funding in the budget.

A further measure set out in our programme for government was the creation of a Scottish national investment bank to provide patient capital to support innovation and drive productivity growth. That ambition is now supported by a commitment to an initial £340 million capitalisation between 2019 and 2021.

However, while the bank is being established, we will create a dedicated building Scotland fund, worth £150 million over the next three financial years. My portfolio will provide £70 million in 2018-19 with the purpose of supporting innovation and house building, helping to deliver modern low-carbon industrial and commercial facilities and providing further support for capital investment in research and development. Those measures will complement existing activity to unlock investment for ambitious small and medium-sized enterprises, including expanding the SME holding fund by £25 million.

I am also delighted that we will now more than double our commitment to drive regional economic growth through our city region deals to £122 million. Of course, that takes into account likely future city deals for Stirling and Clackmannanshire and for the Tay cities, as well as looking forward to the Ayrshire growth deal and the borderlands deal.

Our focus is not just on domestic opportunity. The budget retains funding to support the action that is set out in our trade and investment strategy. Our presence in Brussels is long established, plans for a new Paris hub are developing, a new Berlin hub will begin operating in early 2018, and the London and Dublin innovation and investment hubs are now up and running. With the process of doubling the number of people working for Scottish Development International in Europe well under way, and with five local export partnerships established, the Government is taking practical steps to maintain Scotland’s long-held position as a trading nation.

The budget maintains the seriousness with which the Government approaches the task of creating more inclusive growth and fairer employment, for example by supporting inclusion in the regions by meeting our commitment to the south of Scotland, with an initial £10 million to support the establishment of the new south of Scotland enterprise agency and interim measures.

The Government also supports inclusion through continuing the vital work on tackling barriers to work, supporting training and promoting fairer work—actions that are essential to improving Scotland’s economy and creating opportunities for all. Our devolved employment service, fair start Scotland, will be supported by £17.6 million. From April 2018, fair start Scotland will provide tailored, person-centred support to a minimum of 38,000 people who are furthest removed from the labour market and for whom work is a realistic prospect.

Our overriding aim is employment services that work differently and more effectively for people to help them find work and stay in work—services that treat people with respect and encourage people to take up the opportunity to find work voluntarily rather than being driven by the threat of benefit sanctions.

The 64 per cent increase in the portfolio’s 2018-19 budget reflects our determination to grow Scotland’s economy, seize the opportunities before us, build a fairer Scotland and put the progressive values of this Government into action.

I am happy to try to answer the committee’s questions.

The Convener: I will start by asking about the enterprise agencies. Scottish Enterprise’s resource budget is due to see a slight real-terms reduction over the coming year and Highlands and

Islands Enterprise's budget will see a slight increase. Would you enlighten us on the thinking behind that?

Keith Brown: In my statement, I mentioned the £10 million that will go to the south of Scotland economic partnership. That is capital, but, in addition, there is £3 million that essentially comes out of Scottish Enterprise's budget, because Scottish Enterprise has responsibility for that area. The £3 million should perhaps be added to the figure for Scottish Enterprise.

The total draft budget allocation, including non-cash—not just resource—for Scottish Enterprise is £256.15 million. That is up by 24.6 per cent. The total draft budget allocation for HIE is an increase of £4.6 million, or 7 per cent. There is a much larger increase in the total budget allocation for Scottish Enterprise than for HIE.

The goal that we are aiming for is that of withstanding the economic shocks and sustaining more employment. Scottish Enterprise has continued to bear down on operating costs and has offered to absorb some costs and live within a flat cash settlement in its resource budget. That does not include what is going into the south of Scotland and a substantial increase in both capital and financial transactions. That is why there is a difference between the two enterprise agencies.

John Mason (Glasgow Shettleston) (SNP): There is a bit of misunderstanding—or a lack of understanding—in the sector with regard to what the financial transactions that you have just mentioned are and what they can and cannot be used for. If I understand it correctly, they are linked to housing expenditure in England, but we are not required to use them for housing. Moreover, I believe that we cannot use them in the public sector—they have to be used outwith it. Can you explain the situation going forward and what we can do about it?

Keith Brown: You have given two of the defining characteristics of financial transactions. For example, the money that has been put aside for the building Scotland fund covers affordable and private housing. It is also important to remember that the money in those transactions has to be paid back, but we can apply it in those ways. I am happy to be corrected on this, but it can also be used for things that are very central to Scottish Enterprise's functions. For example, it can sometimes be used as loans to help companies get through particular circumstances or expand. The very substantial increases in FTs will help support Scottish Enterprise and the Scottish national investment bank.

With regard to the demand from SMEs for loans and equity, ensuring access to finance can be an important way of growing the economy and

protecting the jobs that are already there. I am sure that it will become evident that there are a number of ways in which the Scottish Government and different bodies can help in that respect, and financial transactions give us another weapon in that armoury. They can be used for a number of different functions, but they have to be paid back and, as you are right to point out, they cannot be used in the public sector.

John Mason: As you said, we are talking about quite a substantial increase. Is the demand there to ensure that the full amount is used?

Keith Brown: Yes, I think so. That will partly rest on our making sure that companies are aware of the option. The money can support other initiatives that we are already engaging in. For example, I am not sure whether you were at our recent Scottish microfinance event, but it featured a number of companies that were formed through the availability of such finance—it was largely European funding. Of course, we have more work to do on that, but the result of making companies aware of that possibility was that 128 new and existing businesses received £1.7 million, which helped create 200 jobs. It was a case of letting people know that a new fund was there. Although the sums involved were relatively small—up to £20,000—the money was for start-up companies that could not get access to finance elsewhere.

We need to make sure that people are aware of such options, and this evidence session will help in that respect. It is also true to say that the money will help with starting up the Scottish national investment bank, which I have mentioned, as well as the growth scheme and access to equity and loans for businesses. I think that the demand will be there, but it is up to us to ensure that the money is used properly and that people are aware of the facility.

John Mason: How do we handle the risk around that? I presume that we have to repay Westminster the full amount of the transactions, no matter what. What happens if we put money into a company that fails?

Keith Brown: There is risk attached. Like, I am sure, the committee, I have heard from number of individuals involved in the economic development sphere, and they say that if you are not willing to take a risk, there is not much point in your undertaking that activity. There is no question but that there is risk involved, but we do due diligence on these things before we make any commitment. We do not seek to make any losses, but we recognise that it is possible that such a loss could arise. There is not an economic development agency worth its name that has not made a loss on an investment or as a result of backing a particular company. There is risk involved, but we try to minimise it through due diligence.

John Mason: Thank you.

The Convener: Tom Arthur has a brief follow-up on that.

Tom Arthur (Renfrewshire South) (SNP): Good morning, cabinet secretary. I have been struck by the challenges with regard to the take-up of the money provided through FTs. Yesterday, the *Financial Times* reported that, as a result of the uncertainty surrounding Brexit, companies are holding off from making investments; indeed, it says that in the third quarter of this year there was a decrease of 11.8 per cent from the figure in the same period the previous year with regard to investment in vans and other transport equipment. Could the financial transactions money be marketed to businesses as a means of mitigating the effects of Brexit so that they are not put off investing? Could it be targeted to give them the confidence to invest?

09:45

Keith Brown: It would be difficult to do that. There is no question but that there has been deferred investment for a number of months, but the financial transactions that we are involved in will often be used to try to enter the market where nobody else is providing that finance, where finance is not provided at the same rate, or where there is no risk appetite in the financial sector to undertake the investment. The circumstances will usually be different. If a company thinks that it is not a safe bet to undertake investment just now because of the uncertainties of Brexit, it might be possible for it to work with us on financial transactions but, by and large, they are for the areas that I mentioned.

For example, I mentioned microfinance of up to £20,000 for companies that cannot otherwise access such finance. In fact, one of the qualifying points for that is that a company has to have been refused by a bank or financial institution for the borrowing that it then asks the microfinance fund for. At a higher level, we will tend to talk to companies that have tried to raise finance but have found the rates prohibitive or which cannot access the finance elsewhere. It is possible that we can help to finance something where a company has deferred investment because of the uncertainties of Brexit, or perhaps where the uncertainties of Brexit have made the finance too prohibitive for a company to take on.

We are also advertising the Scottish growth scheme, which is another means by which we can achieve such investment—around £19 million has already gone out the door through that scheme. That is for different purposes, but there might be some crossover.

Dean Lockhart (Mid Scotland and Fife) (Con):

Good morning, cabinet secretary. I have a couple of follow-up questions on the national investment bank. How much of the funding for the bank and for the building Scotland fund will come from financial transactions money?

Keith Brown: The vast bulk of it will come from that money. I mentioned the £150 million to help boost house building and commercial property investment and to support business research and development. In future years, we expect consequentials from financial transactions to be a large part of the money that we need for that.

Dean Lockhart: You mentioned the growth scheme and Scottish Enterprise. What role will the national investment bank have that is different from the existing enterprise support that is available through Scottish Enterprise, Highlands and Islands Enterprise and other agencies?

Keith Brown: The national investment bank's role is not finally defined as yet. Benny Higgins, whom I am meeting again tomorrow, should come back to us in January with his proposals, which will give us more of a definition of the nature of the bank. However, you will find that the difference is first of all in its scale—the £350 million that has been mentioned is initial capitalisation—and the range of its activities, which will potentially include long-term patient capital, which can help companies to scale up, or providing support to a particular sector within the strategies that we have for industry and enterprise. The difference is mainly in the purposes.

It is possible that we can work in other schemes. The growth scheme might become part of what the national development bank does, and one or two other schemes might possibly come into it. As I said, however, the role is not yet defined, but we should have more clarity on that in January. We expect to start up the bank, at least with the appointment of a chair and a shadow board, during 2018.

Dean Lockhart: You mentioned that money has started to be paid out of the growth scheme. Can you give us details of how much has been paid out and how many businesses have received financial assistance under the scheme?

Keith Brown: As I said, about £19 million has been disbursed so far, to 18 companies. Obviously, we cannot highlight them individually, for reasons of commercial confidentiality—these are agreements with investors. However, the figure is £19 million so far, and there are other agreements in the pipeline.

Dean Lockhart: I will move on to the economy and how the budget might address some of the challenges that you mentioned. Last week, the Scottish Fiscal Commission announced its five-

year forecast, which shows that growth over the next five years will be under 1 per cent and that the gap with the rest of the United Kingdom will continue. The Fraser of Allander institute has referred to that as “unprecedented”. Are we facing a growth crisis in Scotland?

Keith Brown: There is a challenging growth environment for the whole of the UK. In fact, there is evidence from various commentators out today to support the point that the UK is facing lower than trend growth in the coming years. The reasons that are cited for that are essentially the same. Of course, there is Brexit and the uncertainties that it has brought. There are also the continued austerity policies of the UK Government that I mentioned.

My view is that we do not discuss nearly enough the impact of the UK Government on the Scottish economy. A major clampdown on welfare benefits, which economists commonly refer to as transfer payments, has an effect in terms of the money in the economy. You will have seen reports from the Scottish Retail Consortium, whose big concern is always the amount of money in people’s pockets. If transfer payments are substantially cut back through universal credit, the amount of money in the economy will be impacted as well.

I am perfectly happy to concede the point that increasing tax can also have an effect on people’s disposable income. That is one reason why we have agreed to a 3 per cent public sector pay increase and to lifting the public sector pay cap—so that we are putting money into the economy.

I have also made the point to the Scottish Retail Consortium that all of its members paying the living wage—instead of just most of them—would put more money into the pockets of people, who will spend it on the items that supermarkets and others provide.

It is true to say that we have a challenging economic environment. The UK Government’s austerity policies contribute to that. Its failure to get a grip on inflation obviously contributes to that and is one of the reasons for upward pressure on pay, because inflation is now running at over 3 per cent.

If we say that we are lifting the pay cap, as we have done, and the UK Government says that it is not, we do not get the consequential that would flow from the UK Government’s decision to lift it. That also, of course, has an effect on the economy.

There is no question but that there are challenges in the economy—I do not deny that there are. The Scottish Fiscal Commission’s projections are perhaps the most pessimistic that I have seen, but they are not completely out of the

ballpark of those made by other commentators. Our challenge is to try to exceed those estimates.

Dean Lockhart: The Fiscal Commission identified lower productivity as one of the key issues driving lower growth. Given that Scottish Government targets for growth, innovation and productivity have not been met, and given the challenging forecasts, is the Government looking at a change of direction on economic policy?

Keith Brown: You are right to identify productivity. What constitutes a strategy to improve productivity is hotly debated among economists, but I think that factors central to it will be innovation, fair work—which is a precursor to productivity—good management practices and management capacity, and investment, and there are other factors as well. It is a challenge.

In Scotland we have seen an increase in productivity of, I think, about 6.6 per cent since 2007. In the UK it has been less than 1 per cent. However, our recent lower figures mean that we have more or less closed the gap with the UK, and that is not our target. Our target is to get into the top quartile of the Organisation for Economic Co-operation and Development’s table. To do that, we have to start to compete with the likes of France and Germany.

The things that we are doing in terms of the manufacturing centre, innovation funding and the funding of entrepreneurs are designed to increase that level of productivity. We realise that that is absolutely essential. The other factor is internationalisation; expanding the export base of businesses in Scotland is very important.

We recognise the problem. It is one not just for Scotland but for the UK, and the UK Government has tried to establish a number of interventions to increase productivity there as well. However, Tom Arthur’s earlier point is also relevant: if companies defer investment, that will have a knock-on effect on productivity. If it is investment that would have gone into new practices, innovation and new capital plant, that will have an impact on productivity.

These are not ideal circumstances—perhaps ideal circumstances never obtain—but we are very focused on increasing productivity.

Daniel Johnson (Edinburgh Southern) (Lab): I will start by looking at some of the recent evidence that we have had about the role of Scottish Enterprise and business gateway in providing business support. Specifically, the West Lothian Chamber of Commerce highlighted something of a gap, in that the perception is that Scottish Enterprise is really for large businesses and business gateway is for brand new businesses, and an awful lot of businesses fall between those stools. Is that a characterisation

that you recognise? If so, what steps need to be taken to address it?

Keith Brown: There is no question but that some people would have that perception, although many others would not. You are right that some people think that business gateway is for very small or start-up companies and Scottish Enterprise is for larger companies. That perception is not borne out by some of the companies that Scottish Enterprises engages with, as you also know very well.

You are right to say that we must have an ecosystem of business support that people understand. We have had the enterprise and skills review, and we are developing a whole-system approach. Business gateway is still, if you like, off to one side. We quite deliberately did not include business gateway in the review, because it delivers through local authorities; it is its own body with its own mandate. Towards the end of the enterprise and skills review, the Convention of Scottish Local Authorities representatives were willing to see how we can work together. In that regard, I cite the very good development of the three Ayrshire Councils coming together in one economic partnership. They are also tying in very closely to the rest of the ecosystem for which we are responsible.

We are moving more towards an ecosystem that is better understood by everybody. We are aiming to get to a situation in which it does not matter at which point a person accesses the system or what contact they make with it, because they will get the right response and the right person. At the moment, the situation is a little bit clunky, but we are trying to resolve it.

Daniel Johnson: Given that that is the case, what view will the new strategic board take in overseeing the integration and ensuring that there is better and more joined-up support between business gateway and Scottish Enterprise?

Keith Brown: It is for the board to decide the approach that it will take and it has only just been established. Among the board's number is Councillor Steven Heddle from COSLA. It will be a coalition of the willing. It is up to local authorities to choose whether to do what you suggest, or to find other ways. The strategic board can have oversight, but it does not have responsibility for business gateway in its remit. I think, however, that you will see a joint-working approach, not least because of Steven Heddle's inclusion, but also because that is what we are seeing happen in the example of the Ayrshire authorities that I have cited.

I want to encourage that joint-working approach, and I am saying to officials that, in relation to Skills Development Scotland and other agencies, we

want to bolster that as much as we can. Given the inclusion of somebody from COSLA on the strategic board, I think that you will see very effective joint working. "Integration" would perhaps be the wrong word to use in that regard. We are not forcing anything here; we will try to work with local authorities to achieve this.

Daniel Johnson: You very much focused on business gateway and the scope for change in your answer. How much scope is there for change in Scottish Enterprise? At this point, I declare an interest as a director of a business with retail interests. I know that practically no support is given to the retail industry from Scottish Enterprise. Does that indicate lack of engagement with more mature businesses? If we really want to boost productivity, surely we must focus on mature businesses just as much as we focus on high-growth and large businesses.

Keith Brown: If you were to look at the portfolio of companies for which Scottish Enterprise is responsible, you would see a very large number of mature businesses. I take your point about the retail sector, but Scottish Enterprise has many relationships with mature businesses that go back a long time—some of them almost go back to Scottish Enterprise's inception.

You are right to say that business gateway is a responsibility of local authorities. The enterprise and skills review may well start to challenge the point that you make about Scottish Enterprise's relationship with the retail sector, because we say that those agencies involved in the review should be much more aligned. The board's central purpose will be to make sure that they align with each other. Within that, I hope that we will also see joint working with business gateway.

It is not for me to lay down what the board will have in its strategic plan, but I would imagine that, if a sector is not getting the support that it requires, the board would want to address that. However, I do not think that it is the case that Scottish Enterprise does not properly link with mature businesses per se. Perhaps that happens across sectors, but it certainly manages businesses of that type.

Daniel Johnson: My final question will focus again on Scottish Enterprise. We have also heard evidence that some businesses find it difficult and frustrating to deal with how Scottish Enterprise's account management works. There are six-month lead times between requesting a decision and that decision being made. Businesses that are seeking to grow, such as start-ups, cannot work with that timeframe. I imagine that, even for large businesses, although they might be able to cope with that situation, they would not enjoy it. Is there a need to look at how account management works and at Scottish Enterprise's approach? Are those

six-month lead times for decisions acceptable to business?

10:00

Keith Brown: This is an interesting issue, and you and I and the convener had a discussion about it at the hustings before the election.

I am sure that there are ways in which Scottish Enterprise can improve areas of its work, and it would accept that, too. A six-month lead time seems long, although sometimes that will be to do with diligence having to be undertaken.

Perhaps one obvious improvement concerns the fact that Scottish Enterprise's account-managed companies do not cover a wide enough spectrum of the Scottish economy. I think that it is alive to that.

Since we had the debate at the hustings, I have had responsibility for Scottish Enterprise. Despite having previously been a board member of Scottish Enterprise Forth Valley, I am much more aware now of some of the excellent work that Scottish Enterprise does. Much of what it does is unreported, because of business confidentiality, but it regularly saves businesses and jobs. However, of course, like everyone else, it can improve and it might be that, in relation to the lack of coverage, it has to work intensely with very few people or perhaps do more work but less intensely. That is one of the areas that I am sure will be addressed by the strategic board upon which Bob Keiller, the chair of Scottish Enterprise, sits.

Daniel Johnson: I am glad that that hustings had such a positive impact.

The Convener: That might have been the hustings to be at, because most of the candidates who were at it were elected, and here we are, two years later, discussing those issues.

Colin Beattie (Midlothian North and Musselburgh) (SNP): A number of chambers of commerce have expressed concern about the level of business gateway support in their areas. Given that business gateway support is delivered through local authorities, how will the 2018-19 budget deliver better or good quality and consistent services across the board?

Keith Brown: That is a point for local authorities. Of course, the Government has a role to play in terms of the settlement that is reached with local authorities, but the delivery of those services is for local authorities. When I was a council leader, we were not too happy when the Government prescribed what we should or should not do.

It is also acknowledged among local authorities that, at the very least, the provision of business gateway services across the country is not consistent, and that some do exceptionally well while others have not put the same level of resource into business gateway.

It is right that those matters of local economic development are managed by the people who are closest to the local economy. Having said that, the enterprise and business support project, which came out of the enterprise and skills review, is also working to provide that ecosystem that I talked about in relation to the user. Business gateway is a core partner in that. That will allow, on an on-going basis, the improvement of products and services that will help to ensure good quality business gateway services.

Going back to the previous point, if business gateway can learn from elsewhere—whether it is to do with gaps in the provision that is delivered by other operators in that ecosystem, such as Scottish Enterprise, which business gateway used to be part of, or things that are done exceptionally well—that is a positive thing. The whole-system approach that we have undertaken will help to lead to an improvement in terms of all the elements of that system. I would have hoped that, although it is a matter for local authorities, business gateway would be part of that improvement, too.

Colin Beattie: My interpretation of the evidence that has been provided by local authorities and so on is that business gateway works better in urban environments than it does in rural environments. Do you agree?

Keith Brown: What Highlands and Islands Enterprise has done in relation to that issue has had an impact. It has been seen to be effective in our rural environments, and, of course, business gateway operates in those environments, too. Co-location is more frequent in an urban environment, of course.

I am not sure that I agree with your perception. I do not disagree that that is your perception, but I suggest that it might be easier to capture economies of scale in the delivery of a service in an urban environment—I accept that the issue that you raise might have something to do with that.

As I said in my previous answer, there is a perception of inconsistency across the country. Some areas work exceptionally well, and others do less well. It is important that we try to help those who do it less well—even those who acknowledge that they have done so. I do not want to criticise anybody in that. Perhaps our task should be to acknowledge that the Ayrshire partnership has developed to the extent that it could do things better by working in that way. We

want to try to make things as consistent as possible across the country, while observing local government's right to deliver such services.

Colin Beattie: Let us look at the specific examples of Caithness and the Borders. Both chambers of commerce indicated that there is a lack of business gateway resources there. That is critical. If a local authority does not have enough advisers or the resources to back them up, it will not be able to deliver. If we look at the evidence from just those two areas, that appears to be an issue.

Keith Brown: I do not accept that. Perhaps the resources are not the same in those areas, but that is a decision for local authorities. A settlement was made at the point at which local authorities took on responsibility for the business gateway, and they could then decide what resource they wanted to allocate to it. I do not say this specifically in relation to the two local authorities that you have referred to, but perhaps they have put less resource into the business gate, in which case that is their choice. Of course, I do not pretend that there are not constraints on resources. It might be worth hearing from Mary McAllan about the original dispensation when local authorities took on the function in the first place. I am not sure whether she was working in this area at the time.

Mary McAllan (Scottish Government): I was, and I am happy to go through that. However, the committee will have to excuse me because, as it is now a local government function, I am reaching back into the back of my mind for the history of this.

As the committee will know, we handed over responsibility for the business gateway to local government in 2008-09. I cannot be sure, but I think that the funding settlement at that stage was around £15 million or £16 million. It went into the local government settlement and the function became a local government one. The thought behind that was that in local economies it was helpful to have local control of the business gateway, so that it could be flexed to meet the needs of particular circumstances across the country.

As the cabinet secretary has said, the business gateway is arguably a variable service, but it can be variably very good. He has mentioned the Ayrshire example. If you were to speak to the Ayrshire authorities, they would say that the business gateway is not the only thing that they do in the local economic development space. They do a lot of activity of which the business gateway is the front end. They have chosen to integrate it very closely with what they do as councils—not just in North Ayrshire but across the three Ayrshire

authorities—and to work very closely with Scottish Enterprise.

Therefore the business gateway is fundamental. It is the public-facing bit of service to—mainly but not only—small business. It is about working very closely across the ecosystem that the cabinet secretary mentioned, because there is a linkage between the business gateway and Scottish Enterprise on growth companies. The business gateway identifies companies, helps them grow and then passes them on to Scottish Enterprise for more specialist support.

Keith Brown: Local authorities tend to deliver in different ways. Some have set up economic development trusts in their areas, while others have put out to tender. If we were to look at the spending per head across the different local authorities, we would find a remarkable range. However, it is the right of local authorities to decide how to do it. We want to be able to learn from the best ones and those that have done it most effectively and to get that practice across to other local authorities.

Colin Beattie: Given the importance of the business gateway working in conjunction with Scottish Enterprise, how do we monitor success or failure in each of the council areas?

Keith Brown: That is a matter for the various ways in which we monitor the performance of local authorities, for example through the Accounts Commission. It is not done directly, although this committee or the Local Government and Communities Committee could do it by having an evidence inquiry session. The business gateway is a local authority function, but it may be that research on the levels of spend and activity might be quite useful for the committee.

Jamie Halcro Johnston (Highlands and Islands) (Con): Good morning, cabinet secretary. In their evidence, all the chambers of commerce highlighted problems with skills and recruitment in their local areas. What does the budget do specifically to address that, particularly in relation to workforce planning and changes in technical, demographic and perhaps regional issues?

Keith Brown: That is a very good point. In the member's part of the country, there is extremely low unemployment and high employment, which produces its own pressures in terms of skills. We are doing several things and it might be worth hearing from Hugh McAloon on some of those. For example, we are further expanding the modern apprenticeship programme to 30,000 starts a year and SDS is working with partners to deliver foundation apprenticeships, which combine the benefits of school, college and work-based education. Some of that spills into education, which is John Swinney's area. He has announced

an ambition that up to 5,000 young people a year will start a foundation apprenticeship by the end of 2019—that is up from 351 starts this year.

Last year we introduced the flexible workforce development fund. That will be delivered by the college sector together with industry to better support in-work training to improve skills.

The new employment schemes for which we have responsibility are very important in getting those people who are furthest removed from the jobs market into productive work and staying in work. That helps to improve the general pool of skilled labour that is available.

Many different interventions are under way and much of that work is being undertaken by colleges and universities.

Hugh McAloon (Scottish Government): A key element of the enterprise and skills review is skills planning systems. We have two main bodies that are involved in skills planning and commissioning: Skills Development Scotland and the Scottish Further and Higher Education Funding Council. Through the enterprise and skills review, we have identified a need to bring their plans much closer together and to link what employers need in the short, medium and long term in planning across both organisations. We need to map out provision as best we can so that people coming through the system are better placed to go into jobs now and in the future.

That is a challenge. There are some clear differences in the system. For example, the apprenticeship system is tied to a job and an employer offers a job, but the college and university system is linked to learner choice and what learners want to do. Aligning two systems that are driven by different things is a challenge. However, the funding council and SDS are heavily committed to that work and are moving it forward.

We are also doing work to bring employers closer to the education and skills system. As part of developing the young workforce, we have 21 industry-led regional groups across the country, which seek to engage employers in the education of young people and help them to focus more on recruiting young people. In SDS we have the Scottish apprenticeship advisory board, which comprises employers who are interested and heavily involved in the development of apprenticeships. We are bringing employers much more closely into the running of the system as partners, rather than simply representative bodies, because they know their region and sector.

Keith Brown: During the enterprise and skills review, some work was done on the tension between investment in tertiary education and the production of graduates as opposed to apprenticeships and other skills training. The

question was asked whether a greater return on investment might come from skills training as opposed to graduates. We are at the top of the international league table when it comes to graduates, but the question is whether investment in skills at other levels would be more economically beneficial. Given that we have made that substantial investment in graduates, it is probably too early to say.

Many companies that I talk to, particularly the larger ones, are more inclined to have very strong apprenticeship programmes, sometimes in preference to graduate programmes, because they are more effective. They tell me that they feel that apprentices have greater loyalty and do not arrive expecting to be managing director within two years, as some graduates and post-graduates do. That is the tension.

We recognise the benefit of both approaches and we have brought both together through the graduate apprenticeship scheme.

Jamie Halcro Johnston: It is interesting to hear about greater employer involvement, which is very important. You mentioned foundation apprenticeships and it has been raised with me several times that there is a limited choice of such apprenticeships, particularly in rural areas. Is that scheme likely to expand and will there be greater choice in rural areas in the future?

10:15

Hugh McAloon: We are looking to expand foundation apprenticeship opportunities across the country to 5,000 a year by the end of 2019, and there will be some expansion towards that target in the year ahead. All local authorities will be involved, and SDS is looking at the range of frameworks available to ensure that the number of occupations involved grows.

There are challenges with anything that involves travel in our more rural communities, and there are extra costs to take into account, but no distinction is being made in what we are trying to do in different parts of the country. We are trying to introduce the programme first of all; to get young people, parents and schools more aware of and familiar with it; and then to grow it quite significantly as a new pathway coming out of the senior phase into post-16 education through work-based learning.

Jamie Halcro Johnston: And you hope to see a widening of subject choice in that respect.

Hugh McAloon: Yes. SDS is exploring routes into what are traditionally called the craft apprenticeships such as those in, for example, some of the construction sectors. I do not really like the term “craft apprenticeships”, because I

think that modern apprenticeships offer a range of opportunities right across the economy, and distinguishing between them does the sectors and those who work in them a bit of a disservice. However, that is how they are traditionally referred to.

Keith Brown: I would be interested in getting feedback on what you think are the particular demands in your area. We are talking about a very substantial, rapid and ambitious expansion from 351 last year up to 5,000 by the end of 2019, and it should take account of local needs. As I have said, that work is being led by the Deputy First Minister, but I am happy to pass to him any feedback that you might have on particular areas of demand.

Jamie Halcro Johnston: As I have said, the issue has been brought up a number of times by different organisations, particularly in my Highlands and Islands region. I am happy to write to you with more detail, because I think that that would be very useful.

Another issue that arose in the evidence from the chambers of commerce was the relatively low awareness and appetite among member businesses with regard to exploring export opportunities. What is the Government doing to boost internationalisation and, given what is happening everywhere else, to explore new markets?

Keith Brown: It is a huge area of concern. As the First Minister regularly highlights, 70 businesses in Scotland account for half of our exports. I am not sure whether it is still the case, but it was certainly the case up until recently that only about 7 per cent of our businesses exported. We have consistently said that internationalisation has to be part of building productivity and ensuring future growth; indeed, staying on the point about productivity, I think that exporting into more efficient and productive markets is a good way of making you more productive and efficient.

We have done a number of things. I have mentioned SDI's expansion into Europe, and there are also our local and regional export partnership pilots. Although we are undertaking those pilots, they build on what the industry is doing; I would highlight, for example, the Scotch Whisky Association's mentoring scheme, which takes smaller companies in the supply chain through the exporting side of things.

It is hard to know exactly what the inhibition is in this respect. Some companies simply do not want to export; they are happy with the domestic market and do not intend to go any further than that. However, given that the figure for exporting businesses is 7 per cent in Scotland and 70 per cent in Bavaria, the situation is one that we need

to address. Aside from the export partnerships, our expansion into Europe and the London and Dublin hubs that we have established, I would also mention an SDI event that we held in Abu Dhabi a number of months ago at which there were 80 Scottish small and medium-sized businesses. Many of them would not have gone to Abu Dhabi without that support; after all, once you get there, you have only six months before your visa expires, and therefore you have to make the best of that time.

Through SDI and others, therefore, we have provided support on what businesses have to do to establish themselves in other areas, and we have also appointed a number of trade envoys to help local companies become aware of market opportunities. Indeed, I had the first meeting with one of them last week. Internationalisation is a very big challenge for us, and the more we can do it, the more productive we will become.

Tom Arthur: I have a supplementary on skills. In its submission, the Edinburgh Chamber of Commerce stated:

"Since Brexit, our Universities and hoteliers have raised concerns about access to the migrant labour market, social cohesion and currency that makes working in UK/Scotland less attractive."

Today or yesterday, we learned that, in the second quarter of this year, net immigration to the UK from the European Union fell to its lowest level since records began. Has the UK Government indicated how it intends to attract skilled migrants to the UK and Scotland post-Brexit?

Keith Brown: No. I am sure that the member will be aware of the on-going debate about whether it would be useful for Scotland to have discretionary powers on immigration. I think that it would be. A previous Administration undertook the fresh talent initiative, which was very successful in its own right.

Immigration is a huge issue. When I was in Orkney a few months ago, I was told by the people at the hotel that I was staying in that, without EU nationals working there, we would not have had breakfast, been checked in or had rooms in a fit state for us to go to. Immigration from the EU is vital, especially in rural areas.

The issue affects the University of Stirling in my constituency and its ability to attract staff. Potential recruits have said that they will not come, and EU staff are leaving. In addition, of course, students from the EU are choosing not to come to Scottish universities because of Brexit, so it is having a huge impact already. We will probably know the full extent of it only in future months and years.

There is action that can be taken. If we had powers to attract people such as the powers that the provinces in Canada have, that would help.

Productivity has been mentioned. It is clear that net immigration has a huge impact on productivity. It is an extremely important issue, and I hope that, as we move forward with further Brexit discussions, the UK Government will show some willingness to move. The United States had an equivalent of the post-study work visa, which it stopped, but it restarted it almost immediately when it was realised what the impact on the economy would be.

Immigration is an area of huge concern for us but, as yet, there has been no movement on the part of the UK Government with regard to giving powers to Scotland or elsewhere, as far as I am aware—we will wait and see what happens with Northern Ireland—to allow the flow of people who can add so much to the economy to continue.

Dean Lockhart: I have a quick follow-up on the skills gap. Now that Scotland is the highest taxed part of the UK for skilled workers who earn more than £26,000, what analysis has the Scottish Government done of the impact that that will have and the potential for it to disincentivise skilled workers who might otherwise want to come to Scotland?

Keith Brown: I will get Hugh McAloon to talk about the analysis that we have done, including the work that we have done on the skills strategy, which we produced fairly recently.

I do not agree that it is the case that skilled workers are looking at tax rates in Scotland and saying, “I’m not going to go there.” If I have got my figures right, under the tax changes that were made last week, about 70 per cent of people will pay less tax. For many people—although not everybody—a 3 per cent pay increase more than overcomes the tax situation. I think that we have a very competitive tax regime.

On top of that, council tax in Scotland is, on average, about £400 a year less than it is in the UK, and people do not pay tuition fees or prescription charges. Over the weekend, Mr Lockhart mentioned that 393,000 police officers, train drivers and nurses face a tax rise—I do not know where he got that figure from; perhaps he can tell us. In Scotland, we pay nurses more in any event. I am confident that those workers are not about to leave Scotland, given that they have the benefits that I have just described, and I do not even believe that there are 393,000 police officers, train drivers and nurses in Scotland.

Dean Lockhart: I was referring to the Government’s tax paper, which shows a behavioural impact resulting from the increase in the additional rate and the higher rate. I do not want to go into the detail of that now, but the Scottish Government’s analysis shows that there will be a behavioural impact, through people either

not coming to Scotland or making different investment decisions, and that the impact will be on skilled workers. All the commentary on the budget highlights the fact that it will have an adverse impact on the skills gap.

Keith Brown: I do not accept that. Of course, one of the tax changes is a reduction in the basic rate of tax, so I presume that that will have a beneficial impact. There is some merit in what Dean Lockhart says in relation to the very top range. The change there involves a very fine judgment because, as was said last week, if we start to go beyond that, we can see behavioural changes. That has been factored in and analysis has been undertaken in the tax papers that have been put forward, although that really falls into the portfolio of my colleague Derek Mackay.

Analysis was done and consultation was undertaken in relation to the possible impact on different sections of the jobs market. However, I do not believe that there will be the impact that the member mentions. I question why somebody would want to continuously talk, for the best part of two years now, about Scotland being the highest-taxed part of the UK. I question what effect they think that that has on the Scottish economy and why they want to achieve that effect. It is wrong to say that, because of the effect that it could have and because it is not based in fact.

Dean Lockhart: I referred to the Scottish Fiscal Commission five-year forecast, which shows that existing policy clearly is not working. That is why I suggested earlier that it is time for the Government to look at a new economic strategy. If the Scottish Fiscal Commission forecasts turn out to be true, your Government will have £2 billion less to spend on public services.

The Convener: I want to follow up on the issues that Tom Arthur raised, cabinet secretary. You referred to immigration as being entirely positive, or that was the impression given, but what about the impact through lower wages as a result of there being lots of labour available? Secondly, what about the issue of the tens of thousands in Scotland who are unemployed and untrained? What steps is the Government taking to address those two issues and to take the opportunity that is presented by leaving the EU?

Keith Brown: I have already mentioned some of the employment schemes that we have responsibility for and those for which we are about to assume responsibility. Those are designed to try to ensure that the section of the workforce that is furthest removed from the jobs market, because of disability or other reasons, can access job opportunities.

The two points about a labour shortage and huge numbers of unemployed people cannot both

be true. Unemployment is at around 4 per cent just now, although I acknowledge the points that have been made that we also have some underemployment and insecure employment. Both things cannot be true. There is a labour shortage in certain areas. I am happy to have officials look at the issue and come back to you, but I think that most of the studies show that immigration has not driven down wages; in fact, the evidence is to the contrary.

I also point to the fact that, in Scotland, about five times as many companies per head of population have signed up to the living wage. We have the highest proportion of people paid the living wage—the figure is at 81.6 per cent, compared to around 78 per cent for the UK. I would not do as Dean Lockhart would and say that that is a crisis for the rest of the UK or that its higher unemployment level is a crisis for it, although it seems to be a crisis for Scotland if we have any indicators that are different from the UK ones. However, we have higher numbers of people who are paid the living wage and we have a higher level of employment. That is also true for female and youth employment.

There are still challenges. To go back to previous answers, one of the big ones is labour shortages. I have certainly had anecdotal evidence of people saying that they have advertised a number of times for staff and have found it increasingly difficult to get staff in recent months. That does not seem to fit with huge numbers of unskilled people coming to this country and having a distorting effect on the jobs market. It has been absolutely beneficial to Scotland to have the benefits of free movement within the EU.

10:30

The Convener: I accept that there is a fairly complex set of circumstances, but, with regard to forward planning and the issues in the country, there are areas in which there is unemployment and a lack of training that are not necessarily the same areas in which there is a need for workers. Other EU countries that equally have internal issues with the distribution of jobs and workers, for example, perhaps deal with those things more successfully. It would be welcome if you followed up on that.

Andy Wightman (Lothian) (Green): To return to the Scottish Fiscal Commission, it has noted:

“Apart from the change to public sector pay policy, the Commission’s judgement is that”

the policies announced in the budget

“are not of a large enough magnitude to have a significant aggregate impact on the Scottish economy, in particular with respect to our forecasts of earnings and employment.”

Do you agree with that?

Keith Brown: No. I think that the policies will have an impact. That is what they are designed to try to achieve. Obviously, the SFC has a view that is different from that of many other economic commentators. The national manufacturing centre of excellence, the lightweight manufacturing centre and the money that we are putting into the low-carbon economy and business research and development are designed to have an impact on growth.

I point out again that there are other major influences on the Scottish economy over which we have very little control, such as inflation, the UK’s national debt having gone to nearly £2 trillion in the past seven years, the UK’s credit rating having got substantially worse over the past few years, and our not controlling corporation tax and many other taxes or even tax allowances. I do not deny that that inhibits the extent to which we can effect change, but the measures that we are taking are designed to try to increase productivity, growth and, of course, well-paid and secure employment in Scotland.

Andy Wightman: The SFC accepts that changes to public sector pay policy

“could have some impact on the economy”,

but it notes that it did not receive details of that policy until

“towards the end of the economy forecasting process.”

As a result, it could not really factor that into its economic forecasts. Why was that policy decision given to the SFC so late?

Keith Brown: That is part of the budget consideration for which Derek Mackay is responsible, so that question is probably best asked of him.

Andy Wightman: I will do that.

On pay, the Scottish Trades Union Congress questions why the additional revenues that the budget raises primarily fund tax cuts for businesses. It has noted that £100 million of additional revenue raised has essentially been used to provide cuts to non-domestic rates. What economic assessment has been made of the economic impact of cuts to non-domestic rates?

Keith Brown: The Barclay review of non-domestic rates was substantial and has been very useful in a number of areas, and the output from that has led to Derek Mackay introducing a number of measures that will leave us with the most competitive local business taxation system in the UK. Its benefits include people no longer paying rates for up to a year when they have improved or expanded their premises. We also have the small business bonus scheme, of course, which I know that Andy Wightman has raised

previously. We have ample evidence that it had an impact right through the recession when many companies did not have enough money otherwise to keep somebody on or take somebody new on. The important thing was to retain employment. Maybe that is one of the reasons why we have better employment figures than the UK has.

The rigorous analysis of the Barclay review involved a huge consultation exercise, and it gave us a very good idea of the benefits of a competitive local taxation regime with non-domestic rates.

Andy Wightman: My question was about an economic assessment. Barclay did not do an economic assessment of his proposals. Has the Government done an economic assessment? What will the impact of those cuts be on the economy? Obviously, those businesses are paying less tax, which I presume is very welcome, but it appears to me that the economic impact has not been assessed.

Keith Brown: I am happy to come back to you on that, but I refer you to my previous point about the very important need to retain employment during the last recession, which had the economic impact of bolstering employment. Perhaps Mary McAllan has something to add to that.

Mary McAllan: We could write back to you with more information, Mr Wightman.

Andy Wightman: Thank you. That would be helpful.

With regard to the enterprise and skills review, a lot of hope is being invested in the new strategic board. What will be its role in assessing the amount of resources going into enterprise agencies and value for money in that respect?

Keith Brown: As I have said to Parliament, the decision on the budgets for each of the agencies will still be one for ministers. However, I think that a lot more collaboration will be undertaken. One of the enterprise and skills strategic board's main functions is to ensure alignment between different agencies and improve general economic performance, and that will necessarily mean looking at the effectiveness of the different things that the agencies do. It will have not only a strategic plan but an interface with ministers, and I think that there will be a collaborative effort with regard to ensuring that resources are used most effectively. However, ministers will still decide the individual allocations to each of the agencies.

Andy Wightman: Financial transactions account for a substantial part of the increase in this year's budgets, and that money can be used quite flexibly. After all, things can happen quite quickly; I am thinking, for example, of the situation with Ferguson's shipyard and the Rio Tinto Alcan

plant in Fort William. Will the strategic board play a role with regard to the flexibility in how that money is deployed? If in next year's budget you were to allocate half of the financial transactions resources to Highlands and Islands Enterprise and half to the south of Scotland enterprise agency—or a third to each of the bodies or whatever—would you be able to have any flexibility in funding if, for example, significant opportunities were to arise in the south of Scotland?

Keith Brown: Of course, HIE is involved in the south of Scotland, too. That issue would obviously be for the individual agencies, which are able to collaborate at the moment.

If a situation arose such as the one involving Burntisland Fabrications, for example, the strategic board would be much more interested in the extent to which the different agencies were working together. It might also have a view on providing that level of support to the renewables sector—which, of course, BiFab is involved in—and on which of the sectors it would be most effective to support to achieve the Government's ambition and the board's central aim of improving general economic performance.

The board will certainly want to take a view on whether the agencies have worked more effectively together. It will not be able to direct one agency to pass money to another for a particular priority; such a thing might be possible within agencies, and it might be possible for ministers to become involved in that discussion, but that will not be the strategic board's role. As we have discussed many times in the enterprise and skills review, the main function is to achieve alignment between agencies, and that will necessarily involve secondments and joint working to ensure that the agencies become much more aware of one another's activities. That might well lead to other collaborations of the type that you have described, but that will be for those agencies to take forward. It will not be directed by the strategic board.

Jackie Baillie: I want to return to the Scottish Fiscal Commission's growth forecast, given that the less than 1 per cent that it is forecasting is the lowest trend in growth that we have seen for 60 years. I do not want to talk about crisis, but the situation is serious enough to command our attention.

The cabinet secretary has suggested that the forecast is overly pessimistic. Is he working to a different target? Moreover, if he feels the forecast to be overly pessimistic, in what area does he feel that the Fiscal Commission might have got it slightly wrong?

Keith Brown: I did not say that; I said that the commission was more pessimistic than other

economic commentators, quite a few of which, including the Fraser of Allander institute, have published higher growth forecasts. Our aim is to be in the top quartile, which depends on the relative strength of the other economies.

It is important to lay out how we think we can achieve higher economic growth. Economic growth is important, but it is also important that we have the requisite level of employment in the country for reasons of equality and inclusion. Our other targets, such as driving down unemployment and driving up opportunities, especially for those who are furthest from the job market, are also important. Making sure that people are involved in a fair work environment and that they are being paid the living wage are other aspirations.

What we are doing in the manufacturing sector and in increasing business research and development is designed to improve the current levels of economic growth. I acknowledge the Fiscal Commission's projections, which are, by its own admission, more pessimistic than many others. It is our job to try to exceed them by the methods that I have outlined.

Jackie Baillie: You will be aware that the Scottish Fiscal Commission also considers that the problems are structural. If they are structural, they will take much longer to resolve. Indeed, one of the main methods of increasing productivity might be a problem. There has been strong growth in the labour market, and the Fiscal Commission thinks that we are at capacity—indeed, over capacity—which is hiding a weakness in productivity.

Do you recognise that productivity, as determined by output per hour, has declined in the past seven quarters?

Keith Brown: Yes. I have mentioned already the increase in productivity that we have seen over the past 10 years, but I have also acknowledged that it is not enough. It does not quite close the gap with the rest of the UK, and there is still a gap between productivity in the UK and productivity in France, Germany, the Netherlands and Norway. Every Government, including previous devolved Governments and previous Governments at Westminster, has struggled with that.

I understand the long-term nature of the issue. The fact that we have seen an improvement gives us some confidence about the measures that we might take to improve further. Those are about increasing skill levels, business R and D and manufacturing—which, for too long, Governments have written off, leaving us as a service economy. Those are the actions that we are taking, given that we acknowledge that there is a job to be done on productivity.

Jackie Baillie: Let us return to productivity. You said twice—it may have been once and I have misheard you—that productivity is improving. However, productivity has declined over the past seven quarters. The only reason that Scotland is going up the table is that UK productivity has got weaker. The source for that is the Scottish Government productivity series, November 2017—it is the current statistics. Productivity has got worse—is that correct?

Keith Brown: It depends on the timescale. I have said that it has increased by 6.6 per cent since 2007.

Jackie Baillie: I am referring to the past seven consecutive quarters.

Keith Brown: You are picking that timescale, and we must remember the big event that has happened within that timescale. We have discussed the number of people who are no longer coming to this country, whether for a university education or to work in other sectors. Most commentators acknowledge that Brexit has already had an impact on productivity.

One of the biggest generators of productivity in the rest of the UK and, to a lesser extent, in Scotland has been population growth, and we are seeing a major impact on population growth from Brexit. I acknowledge that there are challenges—I am not sure what else there is for us to debate around that—and I have laid out what we should do to address them.

You are correct in saying that, more recently—over the past seven quarters—productivity has not grown. However, since 2007 it has grown by 6.6 per cent. We must try to learn the lessons of what happened in both those timespans and improve upon it.

Jackie Baillie: I observe that the drop in productivity started before there was a referendum on leaving the European Union. I am concerned about a downward trend that started before that event. I will, however, move on.

Let us return to exploring the choices that we have, which is a huge issue. If we accept that there are structural problems and that the solutions to those problems, which will enable the economy to grow, will take a long time to come through, the choice that we are left with is to raise the tax take. Do you foresee that, over the next few years, income tax will have to rise in order for us to protect the block grant that we get from the UK Government?

10:45

Keith Brown: Decisions on tax are a matter for future finance secretaries and Governments. Governments raise tax only for a particular

purpose or to achieve something specific in the economy or society—tax itself is the hallmark of a civilised society—so they should not give general commitments to increase the tax take in the future.

Tax policy should respond to the environment that we find ourselves in, and the environment that we find ourselves in includes another year's cut in our resource budget and all the problems that Brexit has produced. Your point about the past seven quarters assumes that the decline in productivity has been continuous and that one issue has caused that, but I am not sure how that would explain how, in previous quarters over the past 10 years, there has been a dip and then an increase. It depends on what we see as being the cause of the decline.

We do not necessarily have to continue to increase our tax take year on year; it all depends on the particular circumstances of the economy and the demands of society.

Jackie Baillie: The point that we must all consider is that, if we cannot grow the economy as quickly as we would like because of structural problems, in order to protect our block grant we will need to increase our income tax take per capita. There are some stark choices ahead.

I will move on to infrastructure.

Keith Brown: Can I come back on that?

Jackie Baillie: Perhaps you could wrap up your comment in your response to my next question.

How will the Scottish Government use its borrowing powers for 2018-19? Am I correct in saying that £234 million has been allocated to make up the shortfall in the European system of national and regional accounts 2010 projects? You will recall that those ESA10 projects were reclassified. Is that money already accounted for in 2018-19 borrowing? In addition, are you using non-profit distribution as a financing model?

Keith Brown: Going back to your point about the pressure on budgets from economic growth, a big determinant of income tax receipts is the level of employment, as distinct from economic growth. I am not saying that the two things are unrelated, but we have very high employment just now. There are bound to be pressures on future budgets, but the two things are quite distinct.

On our borrowing powers and how we intend to use them, as Derek Mackay set out, we intend to borrow the maximum amount available to us under the devolved powers, which is around £450 million. Following agreement of the fiscal framework, we will be able to borrow up to £3 billion.

I am not sure how the Scottish Government could have foreseen the refinement and further

refinement of the rules around borrowing in respect of ESA10—the UK Government did not foresee it, nor did many other European Governments. However, we have a substantial NPD programme of work, which continues. You mentioned the fact that some projects—for example, the Aberdeen western peripheral route—have been reclassified, which means that there is more pressure on public sector borrowing. We are seeking to compensate for that by borrowing to the maximum in relation to that.

More worrying in relation to the Aberdeen western peripheral route and the M8 bundle—which was recently opened—is the fact that both projects were heavily invested in by the European Investment Bank, which has now said that it will do no more business in the UK in advance of Brexit. That is more of an issue for us.

We are examining the extent to which, through the Scottish Futures Trust, we can continue to use NPD and other methods that may be available to us. You will know about our use of things such as tax incremental financing and growth accelerator models to maximise our investment in infrastructure.

Mary McAllan might want to comment on the figure of £234 million that you mentioned. Despite all that has been said, we have one of the biggest infrastructure programmes across roads, rail and housing of any Government in the era of devolution.

Mary McAllan: I am sorry, but can you repeat what the issue is in relation to the £234 million?

Jackie Baillie: It was my understanding that, as a consequence of the reclassification of particular projects, including the Aberdeen western peripheral route, which the cabinet secretary mentioned, those projects are now on the public balance sheet for 2018-19 and £234 million of our borrowing—for which the ceiling is £450 million—will be used for them. Is that correct?

Mary McAllan: I am sorry, but I cannot answer that question. I will have to write to you.

Keith Brown: I am happy to get back to you in writing about that issue. We will check the position with Derek Mackay. However, it does not affect the infrastructure; it simply means that the projects will be paid for in a different way. They will not be paid for in the way that we would choose, because we would prefer to pay for them through NPD instead of the money coming straight out of public borrowing.

We will still undertake that activity—we will still have the Aberdeen western peripheral route.

Jackie Baillie: I understand that. I am just looking at the opportunity that will be lost because we will have to use £234 million out of our limited

borrowing for 2018-19. We will not be able to spend that money on other projects—that is the point that I want to establish.

Keith Brown: That was the point that I was making when I spoke about the other ways in which we can use finance for infrastructure projects to maintain our building programme.

Jackie Baillie: I want to ask about the national investment bank in the context of what I call the Swinney rule on borrowing, whereby 5 per cent of the discretionary budget for any borrowing items is the limit for any repayments. Will the national investment bank account against that borrowing rule?

Keith Brown: Mary McAllan is desperate to speak on that issue. It would depend on the nature of the financial transactions. As you say, the 5 per cent rule applies to the amount of borrowing that must be repaid in any given year. As I mentioned in my response to Dean Lockhart, at this stage, we do not know what the final constitution or definition of the activities of the national investment bank will be. We will know that shortly, and I am happy to come back to the committee when we know, which I expect to be in January or February next year.

Jackie Baillie: That would be very helpful.

I understand that, via the fuel poverty programme and predominantly through the home energy efficiency programmes for Scotland, or HEEPS—there are too many acronyms in the budget, cabinet secretary—budget line, the Scottish Government committed to spending £0.5 billion over four years when it refreshed its target for ending fuel poverty. The actual spend for 2017-18 is £114 million, and that amount will be the same as it moves forward. That is short of the £125 million that many of the organisations that are committed to tackling fuel poverty anticipated. Can we assume from that that we will see much higher levels of funding over the remaining years of this session of Parliament, or is there scope to increase funding now? That is the first part of my question.

Keith Brown: I will deal with one issue at a time, given that that area is largely looked after by Angela Constance and not by me.

I think that the total stipulated budget for this year was £141.9 million, which was made up of the £114 million that you mention, which was for fuel poverty and domestic energy efficiency, and £27.8 million for non-domestic energy efficiency. The draft budget that Derek Mackay has announced would make available a further £144.1 million, which, I think, would ensure that the target of £0.5 billion was met. Thankfully, Chris Stark is here, and he can you give you more detail about that.

Chris Stark (Scottish Government): That is entirely accurate. The commitment is for £0.5 billion for energy efficiency over four years, and we are well on track to meet that commitment.

At the moment, we have separate schemes that deal with various aspects of energy efficiency, of which HEEPS is one. I agree that there are a lot of acronyms; shortly, there will be fewer. A single integrated scheme will look at energy efficiency. The amount that we have allocated for 2018-19 towards the relevant schemes is £144.1 million, so we are on track.

Within that single scheme, there are a number of things, including the HEEPS scheme as it stands. We also look at various other ways of approaching energy efficiency. There are some non-domestic schemes and we look at how we might decarbonise the heat system. All those schemes are, in some way, focused on reducing energy use and fuel poverty.

Jackie Baillie: My understanding of the £0.5 billion commitment is that it is about residential rather than non-residential properties. Therefore, although you may be allocating £141 million, you will forgive me if I focus on the residential properties and ask how much you are allocating for those.

Chris Stark: I can confirm that the £0.5 billion is for energy efficiency in the round, but I am happy to answer that question. The allocation for domestic properties is £114 million. However, other schemes are relevant to the domestic setting, and we would have to disaggregate those headings underneath the overall budget line to identify the total allocation, which is higher than £114 million.

Jackie Baillie: Is it fair to say that the money for some of the schemes underneath it will be for loans and will be targeted at those who do not experience fuel poverty but have energy efficiency issues?

I am keen to separate the two areas and look at fuel poverty, for understandable reasons. Will you confirm how much within the £114 million budget will be allocated as grants and how much will be allocated as loans? Are the loans the other separate schemes that you describe?

Chris Stark: At this stage, we have notional allocations for how the £114 million will break down. Our plan is that £72 million would be capital, £12.3 million would be resource and £30 million would be financial transactions or loans.

Jackie Baillie: You will appreciate that the problem with loans is that they tend to be targeted at those who are not in fuel poverty and have a level of income that would make them eligible only for a loan. Restricting the budget in that way

means that it will take longer to deal with those who are the worst off in fuel poverty terms. If we are serious about tackling poverty, has any thought been given to removing the loans and allocating at least £114 million—if not £125 million—for grants rather than for loans?

Chris Stark: We have done a great deal of analysis of how the programme works, and the £30 million would be well targeted. I accept that capital grants are more suitable than financial transactions for some recipients, but the scheme is well targeted and will be even better targeted when we sweep it up into the new scheme.

Jackie Baillie: Was it not the case that you underspent your loans last year? I am trying to remember.

Chris Stark: Yes, I think that we did.

Jackie Baillie: Okay.

Chris Stark: I do not know by how much.

Jackie Baillie: I might go and find out.

The Convener: I thank the cabinet secretary and his team for coming in today to give evidence to the committee.

10:56

Meeting continued in private until 12:34.

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