EUROPEAN AND EXTERNAL RELATIONS COMMITTEE

Tuesday 3 March 2009

Session 3

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EUROPEAN AND EXTERNAL RELATIONS COMMITTEE
4th Meeting 2009, Session 3

CONVENER

*Irene Oldfather (Cunninghame South) (Lab)

DEPUTY CONVENER

*Michael Matheson (Falkirk West) (SNP)

COMMITTEE MEMBERS

*Ted Brocklebank (Mid Scotland and Fife) (Con)
*Patricia Ferguson (Glasgow Maryhill) (Lab)
*Charlie Gordon (Glasgow Cathcart) (Lab)
*Jamie Hepburn (Central Scotland) (SNP)
*Jim Hume (South of Scotland) (LD)
*Sandra White (Glasgow) (SNP)

COMMITTEE SUBSTITUTES

Jackson Carlaw (West of Scotland) (Con)
Ken Macintosh (Eastwood) (Lab)
Gil Paterson (West of Scotland) (SNP)
Iain Smith (North East Fife) (LD)

*attended

THE FOLLOWING GAVE EVIDENCE:

Gordon McLaren (ESEP Ltd)

CLERKS TO THE COMMITTEE

Lynn Tullis
Simon Watkins

ASSISTANT CLERK

Lucy Scharbert

LOCATION

Committee Room 2

Scottish Parliament

European and External Relations Committee

Tuesday 3 March 2009

[THE CONVENER *opened the meeting at 10:32*]

Interests

The Convener (Irene Oldfather): Welcome to the fourth meeting this year of the European and External Relations Committee.

I welcome our new members, Sandra White and Michael Matheson, and invite them to declare any relevant interests.

Sandra White (Glasgow) (SNP): I look forward to working on and with the committee. I have no interests to declare.

Michael Matheson (Falkirk West) (SNP): I am delighted to join the committee. I refer members to my declaration of interests, and I should point out that I am co-chair of the cross-party group on Malawi, and sit on the Scottish Government's international development advisory group.

The Convener: I am sure that the committee would like me to place on record our thanks to Keith Brown and Alex Neil for the work that they did and the commitment that they showed to the committee's work during their time with us.

Deputy Convener

10:33

The Convener: The Parliament has agreed that only members of the Scottish National Party are eligible for nomination as deputy convener, therefore I ask for nominations of members from that party.

Jamie Hepburn (Central Scotland) (SNP): I nominate Michael Matheson as deputy convener.

Michael Matheson was chosen as deputy convener.

The Convener: Congratulations, Michael.

Decision on Taking Business in Private

10:34

The Convener: I ask the committee to agree to take in private at the end of our meeting our consideration of the key themes that arise from today's oral evidence session. That is what we have done following other oral evidence sessions. Do we agree so to do?

Members *indicated agreement.*

Financial Crisis (European Union Response)

10:34

The Convener: We will now take evidence from Gordon McLaren, the chief executive of ESEP, on the European Union's response to the financial crisis and what is happening on the ground in Scotland. ESEP is the body that administers the EU's structural funds programme in lowland Scotland. At our next meeting, we intend to take evidence from other bodies that are involved in the structural funds programme.

It is a pleasure to welcome you back to the committee, Gordon. It has been too long since we have seen you here, and I know that things have changed considerably in that period. We look forward to hearing your views this morning. I invite you to make a short opening statement.

Gordon McLaren (ESEP Ltd): Thanks for inviting me here today. I look forward to the question-and-answer session, but I thought that it would be helpful if I made a few opening remarks to set the scene.

We are living in fairly unprecedented times, given the financial crisis and its impact on the real economy. The way that we do business in relation to structural funds has gone through fairly radical changes. ESEP manages the European regional development fund and the European social fund in lowland and upland Scotland for the current programming period from 2007 to 2013, under contract to the Scottish Government. Our three-year contract will come to an end this year. Subject to satisfactory performance and external independent review, we hope to continue that contract, at least on an annual basis.

The programmes have changed in a number of respects, largely because the level of European funding for this programming period has reduced dramatically—it is down 50 per cent on the receipts of all of the programmes in the period from 2000 to 2006—which has created certain pressures, demands and challenges. When the new programmes were drawn up in 2006, a level of restriction was built into them to try to manage the flow of applications. That was necessary because, although the funds were reducing, it was envisaged that the level of interest in them would not.

With regard to how the structural funds programmes are positioned to deal with the current economic crisis, I will say a number of positive things before talking about some matters of concern that have arisen.

In any difficult situation there are challenges, but, equally, there are opportunities if you can seize them. One of the positive things to have come out of the current situation is that there have been significant exchange rate gains. The value of the pound compared with the euro has been a particular feature of the current crisis—it is almost approaching parity. However, because the structural funds are allocated in euros, that means that their value in sterling has increased. We have probably gained more than £100 million since the programmes were approved. That is a temporary situation—it is important to understand that what goes up can go down—and it could change in the next year or so. The trick is to capitalise on that situation by spending through the programme and declaring it to the European Commission so that we gain from the beneficial exchange rate. There is, therefore, pressure on us to get projects spending.

Another positive aspect is that—whether as the result of a happy coincidence or foresight based on our experience of managing and closing programmes in Scotland and elsewhere—we argued, at the beginning of the programming period, that we should front load the programme in order to achieve high commitment and drive spend early on. Inevitably—as we are finding in closing the 2000 to 2006 programming period—we often find that a lot of decommitment underspends are declared too late, and therefore we cannot recycle them or redistribute them within the programme, and we have to hand back tens of millions of pounds to the Commission, even though it does not want it. In March 2008, the monitoring committee therefore agreed that in order to manage better the commitment and spend process, we should achieve high levels of commitment early on, rather than just disburse the moneys on an equitable basis annually.

We know from past experience that revenue and capital projects tend to be delayed, for example as a result of hitting technical problems, so there is underspending and decommitment. Sometimes projects' targets are overly ambitious or people are overly ambitious in assessing the market, so money comes back in. If it comes in early enough, we can redistribute it and achieve higher spend levels than we previously achieved. The system has operated in our favour in the current crisis, because under certain programme priorities there have been high levels of commitment, which has meant that we are banking commitments and, I hope, spend at the high exchange rate. I will touch on a few other practical issues to do with delivering the programmes in a moment.

We are coming to the end of the second round of the programme. When the monitoring committee meets on 18 March, it will consider recommendations from the advisory groups. Obviously, I cannot pre-empt the monitoring committee's decision, but if we factor in the level of bids in the second round, we see that there is potentially full commitment on ERDF priority 1, on research and innovation. Priority 2, on enterprise growth, could be almost fully committed by the second or third round. There is less commitment on priority 3, on urban regeneration, and priority 4, on rural development. I will touch on aspects of that. In addition, there is very high commitment on the ESF priority on progressing into employment, which prioritises hardest-to-reach groups and people who are furthest from the labour market, and is positive and good. However, there is less commitment on people progressing through employment—employees in workforces—and improving access to lifelong learning. We are considering aspects of that.

The Commission is showing willingness and flexibility in dealing with the current crisis, particularly on structural funds. It is introducing flexible arrangements. It is not necessarily simplifying procedures, but it is being more flexible and considering issues to do with state aids and co-funding levels. Its response has probably been slightly overcautious; perhaps it could go further in some areas. Inevitably, the changes that we are looking for require regulation changes and revised Commission decisions, but unfortunately such things take time—it is difficult for such changes to be fast tracked. We may wish to push the Commission to go further in some areas than it is willing to go at the moment. People are really beginning to appreciate the depth of the recession and the crisis that we are in. Reports from insurance giants and the banking sector yesterday showed serious and deteriorating positions. We will not be out of the current situation for at least a couple of years. However, it is fair and important to give the Commission credit. It is not sitting on its haunches; rather, it is considering the issues and trying to bring forward proposals that can be introduced fairly quickly. That said, some things cannot be introduced fairly quickly; they take time.

10:45

We are considering a number of mechanisms and ways to fast track decisions, particularly through the monitoring committee. We have an annual round and an exceptional project procedure for fast tracking, which—again perhaps as a result of foresight—was agreed last year before the credit crunch started to kick in. That procedure gives us the opportunity to fast track through the committee key strategic projects in response to the current crisis rather than go through the full, drawn-out process. However, it is important to understand in considering flexibility of response that we must be careful to have procedures that are agreed by the monitoring committee and then by the Commission. We must ensure that flexible responses are audit proof, because we have had some fairly difficult experiences. We were creative, cleared our responses through the Commission and proceeded on that basis, only to find years later that auditors came on the scene and challenged and overturned the decisions. They said, “I’m sorry, but our interpretation is that you’ve breached the regulations.” We must therefore be careful about how we introduce flexible arrangements. They must be audit proof, because they will almost certainly be challenged.

Huge structural fund investment has been made in a number of key strategic sectors in the Scottish economy, such as the life sciences sector. However, key economic sectors such as the construction industry are not necessarily target sectors for growing small to medium enterprises, although they are fundamental to growing the economy, jobs growth and supporting major infrastructure. Many of the activities to do with the key infrastructure for research and development and innovation that we have supported and are looking to support—such support is all about the Lisbon goals—depend on a dynamic and vibrant construction sector, but that sector is currently in serious straits. It is important to consider how we respond to that and bring forward key developments that will keep that sector going. The response will clearly impact on skills in the construction sector, for example. It is important that we do not consider a short-term response; rather, we must look ahead to position the economy. People must have the key skills to take us out of the current situation. The Scottish Government has made a number of key strategic responses to skills needs, which will come forward at a special monitoring committee meeting on the fast-track procedure in May.

Partnership working has been and continues to be one of the fundamental principles in structural funds work. It is essential that collaboration continues. That approach has always been promoted in structural funds work, and it will continue to be important in the programmes. For example, with respect to ERDF priority 3, on urban regeneration, there has been significant investment in community planning partnerships to deal with urban regeneration issues, particularly employability issues and supporting complementary infrastructure developments such as incubator space and job brokerage schemes. Some £54 million has already been invested in the 13 CPP areas, to which we look to deliver.

There are also significant collaborations in life sciences work, which is key. There are key life sciences centres in Glasgow, Dundee and Edinburgh, but we have a Scottish life sciences centre, as opposed to a Dundee, Edinburgh or Glasgow centre. That centre must function as a Scottish centre to be an international centre of excellence. Encouraging developments are taking place involving collaboration between the medical schools and research institutes.

As I have said, the programmes were designed to be fairly restrictive for good reasons. However, it is important to say that we are seeking to make several changes to at least two of the ERDF programme priorities—those on urban regeneration and rural development, which are particularly restrictive. The level of interest in and activity on those priorities has been less than we anticipated, and there is now an opportunity, if not a need, to increase flexibility and relax some of the tight constrictions that have applied. The Commission has been helpful and accommodating in making progress on that. Proposals have gone before the monitoring committee and I believe that significant developments will take place.

Another reason for changing the scope of eligible activity under priority 3, which is urban regeneration, is to position that priority for the possible development of a JESSICA—joint European support for sustainable investment in city areas—fund. Sorry, that is a rather long acronym. The Scottish Government and the monitoring committee consider that that is a particularly important new mechanism, as it is a revolving fund, rather than one that simply gives grant aid to urban regeneration. JESSICA can invest in large-scale infrastructure in urban regeneration areas in a way that is not possible under the priority as it is currently drawn, and it also brings with it key investment expertise from the European Investment Bank. We could put together a significant fund value and consider investing in significant development opportunities in regeneration areas such as the Clyde gateway, Ravenscraig and Dundee waterfront. That is being progressed rapidly. This afternoon, we will interview consultants to carry out a major feasibility study, the findings of which will go before a special meeting of the monitoring committee in May.

We are fast tracking developments that will address key issues. Significant regeneration projects that have been in the pipeline for some time will be key and will have a significant impact on the construction industry. The JEREMIE—joint European resources for micro to medium enterprises—programme is also being considered in Scotland. It is a risk capital holding fund arrangement that could bring in significant funds from the EIB. The ERDF would go into that, as it would go into JESSICA. The notional figures for a JESSICA fund would be an initial £25 million from the ERDF, which would be matched plus, so the figure would be about £50 million to £60 million. If there was real interest and potential, that could be increased slightly.

I am sure that some members will remember N+2, which is the financial discipline principle that the programme allocation for 2007 must be spent and declared to the Commission by the end of 2009. N+2 has always been a significant challenge, particularly in Scotland, because we have an open competition and challenge fund approach. At any one time, we do not always know the level of interest and number of projects that are emerging. N+2 has always been pretty challenging, but this time round it will be even more challenging. Although we have forecast spend for the commitment that we have achieved, it is always difficult to drive the spend, and many projects have been delayed for a variety of reasons. It is a mountain to climb to comply with N+2 at the end of this year. The United Kingdom and Scottish Governments have approached the Commission on extending N+2 to N+3. The new member states enjoy N+3, but the Commission is standing firm on N+2 for the EU 15 member states. The Commission may relax that view if all the EU 15 states begin to say that they cannot achieve N+2 this year. The committee should be aware that that will be a fairly difficult challenge for us this year.

There are issues to do with programme closure, as that has not been finalised. Until the end of last year, we were moving towards an early closure timetable, but then the credit crunch started to kick in. The Commission’s response has been helpful. It has taken the view that, in the circumstances, it might be sensible to postpone for a limited period the closure of old programmes to allow any unspent resources to be spent fully, so that money can go into the economy rather than back to the Commission. Obviously, a range of conditions still apply. The extension is up to the end of June this year.

The Commission has produced that proposal and the Scottish Government has notified its interest in it, but the issue is reserved to the UK Government, so the Treasury will take a view. The Treasury has been approached, but we have not yet had a decision. We seek to use unspent resources, but the exercise will have to be targeted—we cannot open it up to hundreds of projects, because the task would not justify the returns. Millions of pounds could be involved, divided largely between the west of Scotland and east of Scotland programmes. We are primed to go with that and we have been speaking to sponsors of key strategic projects for which the resources would have an impact. That is a helpful proposal from the Commission and there have been one or two others.

I have probably spoken for long enough.

The Convener: Thank you for that extremely comprehensive and helpful overview. I had a list of questions, but you have answered many of them.

In meetings that I have been involved with in Brussels, I have heard what other regions have said to the Commission about their concerns and the challenges that they face. They want the Commission to be more flexible, they have asked for simplification of the procedures, and they have certainly raised the N+2 issue. Those of us who have been involved in structural funds for a long time have seen a shift from an emphasis on big infrastructure projects to an emphasis on skills and training in small and medium-sized enterprises and tourism, which is a slightly different agenda. Colleagues in Europe are calling for another look at funding for big infrastructure projects, which would allow spend in local communities to assist local regeneration. I appreciate that your discussions with the Commission have been positive and helpful, but if you had to tell us about three things that projects on the ground have asked for to assist them, what would they be?

Gordon McLaren: There are probably more than three things—sorry, I should not be facetious.

Projects on the ground are raising several issues and that number will grow. You may have seen the response from the West of Scotland Colleges Partnership to the Government consultation on structural funds, which was thoughtful and raised several issues.

Your point about large infrastructure must be put in the context that the Commission, in the three most recent programming periods—1994 to 1999, 2000 to 2006 and the current one—has constantly put pressure on the UK and other states to move from capital infrastructure spend to revenue-type activity. In the early days, structural funds were all about infrastructure such as water, sewerage and roads, but the Commission now feels that we need to move further up the value chain and consider more investment in SMEs, revenue support, research and development, innovation, commercialisation and skills. We have always accepted that argument, but in the global economy, and in trying to build a knowledge economy in the post-industrial period, we argue that we also need essential infrastructure. In the life sciences, for example, you need high-cost components such as research facilities, research equipment and the key skills base. They do not come about by themselves. It is important to get everything in place. To compete internationally, you need to provide research facilities of a quality that will attract and retain key research scientists.

11:00

We have always argued along those lines, but the Commission has always pushed and pushed for limits on capital infrastructure expenditure. That view has been built into programmes, but we argue that it must be relaxed. Work still needs to be done. For example, Scottish Enterprise and the university sector are still suggesting high-quality projects. There was an article in *The Herald* recently on the proposed new Scottish centre for regenerative medicine, which is a major project—£50 million-plus—that is going through the Commission and the monitoring committee. Investment in stem cell research has led to a significant breakthrough this week that might allow a move away from the use of embryonic cells and towards reprogramming basic skin tissue to become stem cells. If we do not invest in infrastructure, we will not get such breakthroughs, from which can come significant commercial applications. We continue to push on that door.

The West of Scotland Colleges Partnership stresses the importance of continued investment in key learning infrastructure. From my many years of experience in working in further education, I feel that it is legitimate to make that case. We have more than 40 colleges around the country, most of which have had major refurbishment. Such refurbishment is much needed, as committee members will know if they have been in any colleges recently. We are in the 21st century and we are trying to develop a knowledge-based economy, so we have to create a learning environment that attracts people of all ages and encourages them to take part in lifelong learning. Further education colleges are fundamental to that.

Some of our college estate is not fit for purpose and needs major refurbishment. The argument is made that we do not have enough structural funds to invest in that refurbishment. We have had the money in previous programmes, and we will probably have limited money in this programme. ERDF priority 3, on urban regeneration, allows for a level of investment in the refurbishment and adaptation of learning facilities, as long as it is part of integrated urban development plans. There has to be a focus on what the college facilities will do for urban regeneration in the community. That is not to say that investment in learning infrastructure is not a good thing, but such investment has to be targeted, because we simply do not have the funds. The colleges make a legitimate claim that increased investment will be required.

The Commission makes particular points about flexibility, and it has increased the thresholds for state aids. The de minimis limit of €200,000 has gone up to €500,000, since the view is that that level of aid to SMEs will not distort competition, which is true. In the current crisis, I wonder whether even €500,000 should be the limit. I am not sure that we should be setting limits for SMEs. We need to set limits for large companies, because we can see distortion there. Issues related to protectionism are developing throughout the EU in key sectors such as the automobile sector, which must not be allowed to happen. However, SMEs are a substantial part of the Scottish economy—more than 96 per cent of our businesses are SMEs—so if we cannot invest in export aid, which is prohibited, we need to maintain the current SME base and ensure that SMEs are primed to come out of the crisis. They will need support.

Many of our SMEs are in distress. In a normal economic situation they would be viable businesses, but in the current situation they are struggling because of a lack of working capital. It is critical that we intervene. A number of measures are being taken. As I have said, we are considering JEREMIE funding. We have already committed more than £46 million for two Scottish Enterprise proposals for the Scottish co-investment fund and the Scottish venture fund. I see scope for using other funds. In fact, we are speaking to a number of people about private sector venture capital funds investing in key sectors in Scotland and supporting the SME base.

It is easy to criticise the Commission, but the current circumstances are unprecedented. We cannot make that point often enough. I wonder whether the relaxations that it has introduced are enough to deal with the current crisis.

The Convener: I will open up the meeting to colleagues in just a minute.

You mentioned legislative initiatives that the Commission might undertake. By their nature, such responses are slow. Are you thinking about things such as the proposed small business act, or are there other legislative initiatives in the pipeline that will assist us in Scotland?

Gordon McLaren: I do not know the details, but the Commission is responding. It is easy to criticise the Commission, because it is pretty remote and does not have much of a profile. However, it is working hard to introduce measures. Inevitably, some of those measures will require legislative change, which means that a process has to be gone through that is not of the Commission's making. Approval is required from member states, and that takes time. However, the Commission is being helpful by saying, "Look, this has to go through a set procedure, but you can go forward on the basis that the legislation will be put in place and the necessary directives will be implemented." The Commission is being encouraging. I am not saying that there are risks attached to that; it is just that things are being backfilled, and that takes time. It is difficult to imagine a fast-track legislative procedure.

The Convener: In our previous evidence session, we took evidence from Stephen Quest from the cabinet of the European Commissioner for Financial Programming and Budget. He mentioned a figure of, I think, £5 billion in unspent funds from the agriculture sector, which was going to be reprioritised into energy and infrastructure projects throughout Europe. Have you seen any sign of that money coming through to you?

Gordon McLaren: Not so far. I have seen the announcements of the details, and they are positive in that they begin to tackle issues such as climate change. It is ironic, in a way, that we are only now beginning to tackle these fundamental issues because of the impetus of the credit crunch and the financial crisis. However, through the challenges that we face will come significant opportunities that we will need to consider, such as new energy grids, especially for renewable energy. That is the kind of major infrastructure in which we should be investing.

Those unspent resources from the previous budget period are significant. However, they are only a small proportion of potential unspent resources from the 2000 to 2006 programming period. That is very positive. The funds must be matched and member states really need to come together on these proposals, but I am not sure that all member states are signed up to them. I have read some fairly negative responses to the proposals. However, at least there is a debate about how we should deal with the credit crunch and the problems in key economic sectors by investing in major infrastructure while, at the same time, tackling key policy priorities such as climate change. These things are to be welcomed. Inevitably, because of the scale, they will take time, but at least they are being kick-started.

Ted Brocklebank (Mid Scotland and Fife) (Con): As you have said, all the structural funds projects will have to be co-financed. In the present credit crunch conditions, will that capital be available, and will there be the confidence in either the private sector or the public sector to push ahead with those projects?

Gordon McLaren: That is a good question. The simple answer is that that is going to become an issue. It is not an issue at the moment partly because we are coming to the end of the second round that was launched last August, before the problems really kicked in. It is possible that, this year, project applicants will come forward who expected the co-finance to be available only to find that it is being redirected to other, more critical areas. We may see projects withdrawing, which is a worry because they are a critical component of N+2. If we start to see a number of major decommitments and projects withdrawing from the current list of approved projects, we will have problems in achieving N+2.

We do not have any immediate indications of what you suggest, but it would be prudent to expect it to happen. I cannot quantify it just now, but there may be a loss of public sector co-finance and, probably more critical, private sector finance. At the moment, the programmes do not factor in private sector finance. It can be involved in the financing of a project, but it is not counted. We are seeking to change that under certain priorities, particularly when risk capital is involved. We foresee some difficulties there, for sure.

Ted Brocklebank: I am thinking of three projects that you say would be of potential benefit to Scotland. The first is the £150 million project to develop the North Sea grid, which would benefit other projects in the UK, the Netherlands, Germany, Ireland and Denmark. The second is the £40 million development of the Aberdeen offshore wind farm, and the third is the carbon capture and storage project for Longannet. Those projects are aspirational and are what we are looking for. Where do you see the finance coming from on our side to match whatever funds might be available through European funding?

Gordon McLaren: Those projects have not come to us and I do not imagine that they will, simply because of their scale. They will obviously require significant private sector investment. That will come from Scottish Power for the Longannet project, and I know that Scottish and Southern Energy has a significant interest in carbon capture. Nevertheless, the projects will look for a level of Government funding. The other key player will be the European Investment Bank, which has been given significant additional sums of money to invest. At a European level, the Commission will seek to invest in such projects, which are key to tackling climate change and to positioning the economy going forward as we come out of the crunch.

Although the projects are notional, they are on the table and have been talked about for some time, so I would like to think that they will go forward. They may be delayed slightly, and the big utilities that are involved in them may have to scale back their investment. Nevertheless, although I am not an expert in the field, I understand that utilities companies such as Scottish Power and SSE are still doing okay despite the current economic circumstances—they are still in reasonable health and have reasonable capital levels.

11:15

Ted Brocklebank: The Commission's proposals were considered by European energy ministers on 20 February 2009 and the projects received a fairly acrimonious response. Germany's economy minister expressed his "scepticism" after the talks. He said:

"I wasn't the only one to voice criticism".

He also suggested that the proposals were just

"a jumble of national wish lists"

and that they were not real "European projects".

The Convener: It is a bit unfair to ask Gordon McLaren to comment on that.

Ted Brocklebank: It is in the committee's briefing.

The Convener: We have a very helpful and thorough briefing from the Scottish Parliament information centre.

On Ted Brocklebank's first point about co-financing, you are saying that using N+3, as opposed to N+2, would make a difference. It would give you more time, but would you still have the same co-financing problem? Would that give you more time to look for other projects? Would it make a difference? It is quite important to know that.

Gordon McLaren: Yes, that approach would give us some breathing space this year. The Commission's response has been to say no at the moment, because it would only store up problems further down the line, which is true. However, we do not want to face almost certain failure this year for reasons that are totally outwith our control. That would not be good. At the same time, the Commission does not want unspent resources to go back—money that would be lost to the programme. The Commission wants that money to be invested.

The Commission may shift its position if we say absolutely seriously that, on the basis of all our projections, N+2 is not achievable. At the moment, we cannot say that because, in terms of forecast spend, we should achieve N+2 this year. However, the co-finance is not kicking in just yet, although it must. We cannot quantify the issue at the moment but we will probably do so in the next few months. At that point, we must raise the matter again with the Commission.

Jim Hume (South of Scotland) (LD): I am interested in the JEREMIE side of EU funding, which is for micro to medium enterprises. You have said that more than 96 per cent of businesses in Scotland are SMEs. A pot of money of £25 million is not huge, albeit that it would be match funded. Would funding be given through soft loans or grants? I am also interested in how it would be managed. Obviously, everybody down the chain has to win. Would it be administered through banks or through Scottish Enterprise?

You also mentioned that Scottish Enterprise has a venture capital programme of £46 million. Is that separate from the £25 million? What criteria would micro to medium enterprises have to satisfy to gain access to that finance? I know, from talking to business, that the main problem that small businesses face at the moment is access to finance.

Gordon McLaren: I have mentioned the two Commission-EIB initiatives—JESSICA and JEREMIE. JESSICA is being fast-tracked for investment in urban regeneration activities. As you say, JEREMIE is support for small and medium-sized enterprises. It would involve a level of ERDF going in, but we do not yet have figures for that. That is being progressed by Scottish Enterprise.

Scottish Enterprise already has two significant venture capital funds in the system: the Scottish co-investment fund and the Scottish venture fund, which are targeted at SMEs. They provide some loans, but mostly equity finance—investing in share ownership of SMEs.

Jim Hume is dead right that if the current situation did not exist we would still need the co-investment fund and the venture fund, because in the early 2000s a lot of venture capital funds left Scotland and headed south. Quite a few funds that were headquartered in Scotland left, which left a bit of a vacuum. The vacuum was filled in part by angel investors—angel syndicates—which have been hugely effective and have done a great service to the small business community; they continue to exist, but there are still gaps in the market.

JEREMIE is an EIB initiative. My personal view is that I see real merit and value for urban regeneration in the JESSICA fund and what it can do in bringing in the EIB. However, I am not convinced that JEREMIE is entirely appropriate for the Scottish situation and circumstance, because we have a fairly dynamic investment community in Scotland—despite what I said about VC funds moving out, they are now coming back in. We have already had approaches from two VC funds looking to base themselves in Scotland. They see opportunities, in particular in relation to technology sectors such as information technology, media, telecoms, biotechnology and optoelectronics.

JEREMIE would just bring in infrastructure, in the shape of a holding fund. The idea is that it would probably manage the process and that there would be a number of derivatives, such as the Scottish co-investment fund and other VC funds. I am not sure that we need that institutional arrangement, but I stress that that is very much a personal view. I have been involved for a number of years in risk capital, which is important, particularly when it comes to dealing with businesses. We need to move away from a grant culture for financing investment. People who invest through a fund have a totally different relationship with a business from the relationship that exists when a public sector body gives a grant. The business almost takes the grant as if it is theirs by right, whereas when the investment is through a fund all sorts of conditions go with the funding, and the fund manager will probably put a non-executive director on the board, because the fund manager wants to know exactly what is happening with the money and tracks it. That relationship is much more mature, positive and constructive. When the public sector has a stake in the funds, we get a return on the investment. It is not the case that the grant goes out and the money disappears—we get money back in, which can be reinvested. Why should that not happen?

The role of venture capital funds or risk capital funds has achieved a profile that it is important to maintain as we move forward. I am positive about and supportive of that development, but I have a slight concern. We have a number of very good financial instruments that do an important job, such as the Scottish co-investment fund and the west of Scotland loan fund, which is run by local authorities but independently fund managed and which gives loans to SMEs. We probably need to expand the number of such financial instruments, but we can do that—we perhaps need to add a few smaller funds in specialised areas, such as very early stage technology businesses. Given that we have models for those already, I am not sure that we need a big new institutional arrangement. However, such a new arrangement is being considered and may well go forward.

Charlie Gordon (Glasgow Cathcart) (Lab): On current priorities, you said that you have decided to loosen up the criteria for urban regeneration and that there are good potential partners waiting in the wings. The reason that you give for that decision is that there has not been so much front loading of the spend in urban regeneration. Do you put that down simply to the perceived restrictiveness of the criteria before you proposed to change them, or are other factors at work, such as a lack of co-financing?

Gordon McLaren: It is probably a bit of both. The provisions in the programme were very restrictive. For example, any infrastructure projects had to be small scale and had to involve refurbishment of existing facilities, so there could be no new build. There was a rationale for that, but it limited local authorities' ability to come forward with any significant proposals. It meant that significant-scale developments, such as the development of the Clyde waterfront, would not feature in the new programme. The Commission has agreed in principle that we can remove the small-scale qualification, and we have removed the qualification that the facilities must already exist, so that allows for new build.

The other rationale is to allow proposals to be brought forward, which brings us on to the JESSICA fund. We have still to test it—that is what the consultants have been asked to do. A JESSICA fund will work like a venture capital fund. It is a revolving fund; it needs to invest money. As with a VC fund, money is invested only if there is a return on that investment. The level of investment return for a JESSICA fund in relation to urban regeneration obviously has to be scaled back from a VC fund. VC funds look for, on average, 13, 14 or 15 per cent—and sometimes higher if they can get it—overall. They can also suffer losses, as some businesses do not survive. Those figures are not realistic for a JESSICA fund that is funding urban regeneration. I do not know what the figure would be—it might be 5 or 7 per cent. Investment in regeneration will involve mixed development, so there will be elements that generate value. For example, if someone develops a piece of derelict land and puts in site servicing, they increase the value of the land and uplift its asset value. That is the kind of development that we are looking at. It has never been possible for so-called competitive funds to invest in housing, because we do not have the required scale of funding, but JESSICA would allow investment in affordable housing through the installation of strong energy efficiency measures. It opens up a spectrum of opportunities.

You referred to the level of co-financing. After the first round, we asked a number of the key local authorities, including Glasgow City Council, whether they had any projects in the pipeline. To be fair, at the time their focus was on community planning partnerships. All credit to the local authorities, because although we had an idea—I use "we" in a collective sense; I refer to the partnership—of how the CPPs would work, we were, to an extent, making it up as we went along. We challenged the CPPs to deliver on those integrated programmes—they are almost mini ESF and ERDF programmes—and the local authorities turned them round in six months. That was a huge piece of work, so all credit to them for that. Although CPPs were their focus at the time, we were looking to ask what else would come forward under that priority. They said that although the restrictions were posing difficulties, there were projects that they would like to do, but they could not deliver the matched funding.

Charlie Gordon: That is what I am driving at. Are you worried that the fact that money is currently tight in local government may mean that, even with the changed criteria and the new

JESSICA funding arrangements, there might not be enough leverage in the eyes of local government to justify allocating scarce cash resources to such projects?

11:30

Gordon McLaren: Yes, that is a worry. I go back to the conversation about N+2. The concept of the JESSICA fund has been around for about two years, and we have been looking at it. Glasgow, in particular, has invested a lot of time in JESSICA.

One of the problems with JESSICA was finding the co-finance. We could lever in funding from the EIB and the ERDF, but where would we get the additional public and private sector capital? Even looking forward, we could see that there would be problems, particularly from the public sector.

Various parties lobbied the Commission, and the breakthrough came in around November last year, when it accepted the arguments and agreed that, although the co-finance would ideally be cash, we could include asset values—for example, land—instead of cash. The various city authorities, such as Glasgow City Council and Dundee City Council, hold land, some of which is zoned for development—and has been for years and years—but is in difficult areas with poor access. However, it still has value and, if we can invest in that land value, there will be an uplift and, therefore, a return on the investment. That was the breakthrough that allowed us to think that we could make JESSICA work. That is the approach that we are now taking through the independent study, which will be extremely fast, because we want it to report at the end of May.

The Convener: That is interesting.

Sandra White: I have a short question that follows on from Charlie Gordon's comments about land banking. The price of land has gone down, so I imagine that that will have a knock-on effect on match funding. Will you clarify whether we are talking about euros or pounds and millions or billions?

The EU's recovery plan is worth billions of euros. In your opening remarks, you mentioned recycling the underspend and a mechanism for taking advantage of the current favourable exchange rate, but legislation has to be changed to bring those mechanisms to fruition. Do we have a timescale for that? N+2 will give some of the projects in which we are all involved more of an opportunity to get funding, and I hope that N+3 will do the same. Would recycling the underspend and taking advantage of the current favourable exchange rate have a knock-on effect on the audits that you talked about? You suggested that you could say that you were accessing the funds without the funds being there, but would that have a knock-on effect on audits three or four years down the line?

Gordon McLaren: The point that I was making was that we need to be careful and prudent. We have been burnt before on audit. When we faced other challenges—not necessarily as difficult as the current one—we invoked certain creative measures, which we discussed thoroughly and cleared with the Commission only to find that, three or four years down the line, Commission auditors came along and said, "We're not happy about that. You shouldn't have done that and the Commission shouldn't have agreed it in the first place." That creates a difficult situation.

Having learned that lesson, we need to be careful that we document everything and, as far as we can, observe due process. We have done that and will do it. We will take a precautionary approach to the measures that we take. We will not delay anything, but we will build up the documentation that justifies the measures so that, if they are challenged in an audit, we can show the auditors the decisions that were taken, when they were taken, why they were taken and what reporting and monitoring arrangements were put in place.

Doing that in parallel takes a bit of time, but that is our approach. For example, we agreed an exceptional project procedure to fast track time-critical projects. We built that into the programme because we thought that something may happen that would cause us to need to invoke such a procedure, although we did not envisage the credit crunch and its effect. That procedure has been agreed by the programme monitoring committee and is in place.

We have set up a special meeting of the PMC in May to consider a number of key strategic projects that are being designed to respond to the redundancies that are kicking in and the need for credit in SMEs. However, we will observe due process and set up special advisory groups to appraise the proposals and document everything.

We will rely on PMC members to find the time to come to an extra meeting and read the papers. We will have also have to ask people to find the time to come to an extra meeting of the advisory groups and read about and discuss the projects. The current situation calls for such contributions, but we must ensure that due process is observed and that the procedure is, as far as we can make it, fundamentally audit proof, although we can never guarantee that.

Sandra White: It looks like the recovery projects will go ahead because of the fast tracking of time-critical projects. Is there a timescale for making changes, such as projects being allowed three years rather than two, recycling the underspend or introducing mechanisms to take advantage of the favourable exchange rate? European legislation must be amended in order to make such changes. Is there a timescale for doing that? If it takes two to three years, will that have an adverse effect on projects?

Gordon McLaren: Many of the flexible provisions do not require legislation, although some will. That legislation is being progressed and we will see it come through, but it will not take two to three years.

Sandra White: Do you have a date?

Gordon McLaren: No. However, such legislation normally takes many months, with different reading stages. As with similar parliamentary processes, the legislation goes through the committee stage before going to the European Parliament, the Council of Ministers and so on. For us, the key flexible arrangements that can be brought in do not require significant legislative change. We must ensure that we respond in the same spirit in which the arrangements are offered and get all the agreements in place so that the Scottish Government can agree the changes, because ministers must inevitably sign them off. Obviously, the PMC and the wider partnership must agree them before that. We are doing that as quickly as we can in the circumstances.

The Convener: Does the change from N+2 to N+3 require a change in guidance or in legislation?

Gordon McLaren: The simple answer is that I do not know. N+2 and N+3 are enshrined in financial regulation, so that would require to be changed. If the European Commission thinks that it is important to legislate in that regard, it could quickly introduce a proposal. I am not familiar with the different stages that would have to be gone through, although the European Parliament would obviously be involved. Again, the European Parliament is on the case and looking for ways to simplify matters and put pressure on the Commission.

We would have to be able justify the case for legislation and provide evidence. I suspect—indeed, I hear—that other member states are saying that that will be a big challenge. The Commission's view is that it is too early to relax the financial discipline rule. However, if we feel by May or June that that approach is not achieving what we want, we need to make that clear.

The Convener: The final question is from Jamie Hepburn.

Jamie Hepburn: I have a fairly straightforward question. You have talked a lot about your enthusiasm for the JESSICA scheme. You spoke about urban regeneration, but the scheme refers not to urban areas but to city areas. There are urban areas in Scotland outwith what we might term city areas. Can you clarify what is meant by a city area in the context of the scheme? Some of the places that we represent, such as Falkirk, Dumfries and Glenrothes, are quite large urban areas that do not fall within city areas. Would they qualify for the scheme?

Gordon McLaren: That is a good question. The issue that you raise is akin to the debate about how we define and where we draw the boundaries for city regions and metropolitan regions; sometimes that becomes an academic, sterile debate. Forgive me for being facetious, but I wonder to what extent the word "city" was included in order to produce the acronym JESSICA.

The matter has been debated. Some of the 13 local authority areas that are targeted under priority 3—urban regeneration—are not city areas, so they would not be included in the programme. The Scottish Government has argued that we need to take a more flexible view and to use a wider definition. Ravenscraig, for example, is not a city area, although it is part of a wider conurbation and there are significant opportunities for urban regeneration on the site. It would be crazy to exclude Ravenscraig from the scheme.

JESSICA will be operated and managed as a fund. Proposals will be submitted and may be declined, if they do not meet the investment criteria. The fund will be set up and proposals will be allowed to come forward from 13 target local authority areas. Falkirk is not one of those areas, which were identified using the Scottish index of multiple deprivation. The Scottish Government says that the selection will be reviewed annually; that has happened, and the 13 areas that were identified at the beginning remain. One area will not be removed from the list of those eligible for funding from JESSICA if another is added—the 13 areas that have been identified so far are fairly fixed. However, if another area meets the qualifying criteria, it will be included. If Falkirk were suddenly to qualify, it would be in the club, although I make that point for argument's sake only.

Currently, 13 areas can submit legitimate proposals to the JESSICA fund. At the end of the day, the success of the fund is dependent on the quality of the proposals and the extent to which they can generate a return on investment. If they cannot, they will not be funded.

Jamie Hepburn: Basically, proposals must come from the areas that have been identified, based on the Scottish index of multiple deprivation.

The Convener: I must conclude our evidence-taking session; that is all that we have time for. We are grateful to Gordon McLaren for taking the time to come here today to share with the committee his wide experience in this matter.

European Union Budget Review Inquiry

11:44

The Convener: The next item is our EU budget review inquiry. We will consider a paper from the clerks on the key themes arising from the evidence that we have taken. Colleagues will recall that, at our last meeting, we decided to pause the inquiry for a while, as we were content with the evidence that we had taken to date. Phase 2 of the inquiry will take place after the new European Parliament and European Commission are in place.

On the basis of the *Official Report* and the evidence that we have taken, the clerks have produced a summary of the information that we have received so far, so that we do not forget it. I am sure that none of us would, but we want to ensure we have a clear recollection of the evidence that has been given to us. I invite comments from members.

Ted Brocklebank: I do not want to pre-empt our report on our trip to the Czech Republic over the weekend but, in relation to juste retour—for the benefit of the newcomers to the committee, whose French might not be up to it, that means the business of how much countries get out of the budget in comparison with how much they put in—it is interesting that the Czech Republic is moving just about now from being a net recipient to being a net contributor. It is clear that that is taxing people there, who are examining carefully aspects of their position, while trying to be good Europeans.

Jim Hume was even more flabbergasted than I was to learn that people in the Czech Republic have big ambitions in relation to the common agricultural policy. Scotland has heard about fairly minor reductions in funds of about 5 per cent, but people in the Czech Republic talked about a 30 per cent reduction by 2013.

Jim Hume: The deputy minister of agriculture's personal view was that that would be the minimum reduction.

Ted Brocklebank: Those were interesting little points from the Czech Republic.

The Convener: At our next meeting, we will have a full report on your visit to Prague, which Lucy Scharbert is preparing. That will help.

I think that Dr Zuleeg said that one of the key priorities was demographic change, but I am not sure whether we have taken that into account. I ask the clerks to check that in the *Official Report* and, if that is what he said, to insert such comments in our paper. Perhaps Lucy Scharbert is going to correct me on that.

When we took evidence from Stephen Quest, he mentioned the globalisation adjustment fund and the solidarity fund, although he did not give examples. It might be useful to have information about those funds when we return to the inquiry.

Lucy Scharbert has pointed out that the paper mentions demographics, but we will check out whether those points are covered. With that, are members happy to agree the note of the evidence that we took?

Members *indicated agreement*.

Scottish Government Transposition Update

11:47

The Convener: Item 6 is the Scottish Government's transposition update. Established committee members will recall that the update is a fairly regular item. I am happy to take comments on the report. Jamie Hepburn usually wants to make lots of points.

I note in the report that the transposition deadline for the first directive that is mentioned—directive 2003/105 amending Council directive 96/82/EC on the control of major accident hazards involving dangerous substances—was four years ago and that

"An infractions letter has been received from the Commission and the Scottish Government and other administrations aim to have necessary legislation in place during early 2009."

If the committee agrees, we will write to the Scottish Government to ask whether that comment continues to be accurate and up to date. Four years is rather a long time. If infraction proceedings—which involve money—are about to start, it is all the more important for us to query the situation. Are members happy with that?

Members *indicated agreement*.

Patricia Ferguson (Glasgow Maryhill) (Lab): Could we have more detail on what the directive is about?

The Convener: Yes—absolutely. We will have a briefing paper at the next meeting to update us on the position. I noted that directive 2004/41/EC, on food hygiene, is also significantly past its transposition deadline—transposition is three years overdue. We might want to query that.

On directive 2004/35/EC, on environmental liability with regard to the prevention and remedying of environmental damage, I note that the Government said:

"We are currently working to implement this Directive as a matter of urgency, and aim to have this completed by February 2009."

As part of our role of scrutinising the Executive, we should ask for more up-to-date information about those directives. Are members content to do that?

Members *indicated agreement*.

The Convener: We note the information that has been provided.

The committee agreed to monitor the transposition of directive 2006/123/EC, on services in the internal market. The clerks have suggested that it might be useful to ask the

Scottish Government for an update on the position. The committee has kept a watching brief on the services directive for some time, so the suggestion is helpful. Do members agree?

Members *indicated agreement*.

"Brussels Bulletin"

11:51

The Convener: I invite comments on the bulletin.

Jim Hume: On page 3, it says:

"The Czech Prime Minister … in his capacity as President of the European Council, has called for an extraordinary meeting of Heads of Government to address issues surrounding the economic crisis".

Ted Brocklebank and I were aware of that, as a result of our visit to the Czech Republic. Members might be interested to know that until around Christmas and the new year the Czechs were still forecasting growth in their economy, whereas now they hope that the economy will at best remain at a standstill, with zero growth. The crisis has perhaps hurt eastern—or middle—Europe slightly later than it has hurt us.

The development of national biomass action plans is mentioned on page 6. I will be interested to know how the Government's approach compares with that of the rest of Europe.

The Convener: Ian Duncan, our European officer, has started to use a page in the bulletin to respond to members' queries. Perhaps your point will be covered in the next edition.

Ted Brocklebank: It would be remiss of me not to draw attention to Commissioner Borg's forthcoming green paper on the common fisheries policy, which will be launched on 29 April. The commissioner is quoted on page 6 as saying:

"there must be no such thing as a no-go area in the debate on the future of the CFP".

However, the commissioner has

"specifically ruled out the re-nationalisation of fisheries policy",

so there are no-go areas, after all.

The Convener: You are our rapporteur on the CFP, so we can leave the matter in your competent hands.

Charlie Gordon: I noted that during a speech in the European Parliament, at the start of the Czech presidency of the Council of the European Union, the Czech President compared the experience of further European integration with life in Czechoslovakia during the Soviet era. It says—somewhat delicately—on page 8:

"His speech was not warmly received by the chamber."

Should we write off the six months of the Czech presidency? I do not see what influence the Czech Republic can have, given that not-very-diplomatic start—I know that that is a bit rich, coming from me.

Jamie Hepburn: I hope that the European officer will apprise us of developments in the efforts to catch the person who robbed a bank inside the European Parliament in Brussels. I hope that the robber will have been caught before the next "Brussels Bulletin" is published.

The Convener: Yes. I noticed that item, under the heading "Stand & Deliver".

On page 7, we are told that the Irish referendum is likely to coincide with the European elections in June 2009. That is interesting, because it affects a number of items that relate to our work programme. We had put on hold until October our work on the Lisbon treaty, because we thought that the vote would take place then. It is good that Ian Duncan is keeping us up to date.

Sandra White: It says on page 7 that a paper on the EU health gap was to be published on 16 February. Will the committee get a copy of the paper? It would be interesting to see the figures for the different countries of the EU.

The Convener: We can certainly ask for that information.

We note the contents of the "Brussels Bulletin". That concludes the public part of the meeting. I thank members of the public for attending.

11:55

Meeting continued in private until 12:15.

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