FINANCE COMMITTEE

Tuesday 16 May 2000
(*Morning*)

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FINANCE COMMITTEE
12th Meeting 2000, Session 1

CONVENER

*Mike Watson (Glasgow Cathcart) (Lab)

DEPUTY CONVENER

Elaine Thomson (Aberdeen North) (Lab)

COMMITTEE MEMBERS

*Mr David Davidson (North-East Scotland) (Con)
Rhoda Grant (Highlands and Islands) (Lab)
Mr Adam Ingram (South of Scotland) (SNP)
George Lyon (Argyll and Bute) (LD)
*Mr Kenneth Macintosh (Eastwood) (Lab)
*Mr Keith Raffan (Mid Scotland and Fife) (LD)
*Dr Richard Simpson (Ochil) (Lab)
Mr John Swinney (North Tayside) (SNP)
*Andrew Wilson (Central Scotland) (SNP)

*attended

THE FOLLOWING MEMBER ALSO ATTENDED:

Bruce Crawford (Mid Scotland and Fife) (SNP)

WITNESSES

Angus Macmillan Douglas (Scottish National Blood Transfusion Service)
Dr Aileen Keel (Scottish Executive)
Alasdair McLeod (Scottish Executive)
Dr Gillian Bristow (University of Cardiff)
Dr Nigel Blewitt (Institute of Welsh Affairs)

CLERK TEAM LEADER

Callum Thomson

SENIOR ASSISTANT CLERK

Anne Peat

ASSISTANT CLERK

Sean Wixted

LOCATION

Committee Room 1

Scottish Parliament

Finance Committee

Tuesday 16 May 2000

(*Morning*)

[THE CONVENER *opened the meeting at 09:49*]

The Convener (Mike Watson): Colleagues, I bring this meeting of the Finance Committee to order. First, I want to welcome, on record, Callum Thomson, who is now clerk team leader to the Finance Committee. His replacement as senior assistant clerk is Anne Peat. Sean Wixted remains as assistant clerk. I want also to pay a warm tribute to Sarah Davidson for her work over the first year of the committee. She has been a tremendous help to me, a very wise counsel and I am sorry to see her go. She goes on to other things, which I hope, from her point of view, will be greater. In the meantime, the work of the committee carries on. On behalf of the committee as a whole, I record our thanks to Sarah Davidson for her efforts.

We have a full agenda today and we are a little more time constrained than usual because we are in a three-committee cycle. We have received apologies from some members, largely due to the fact that the Enterprise and Lifelong Learning Committee is meeting at the same time as us and is dealing with stage 1 consideration of legislation. John Swinney, who is convener of that committee, Elaine Thomson and Adam Ingram are therefore unable to be with us.

Before we move to item 1 on the agenda, I seek the committee's formal agreement to hold item 4 on the agenda—the preparation for taking evidence at item 5—in private. Is that agreed?

Members *indicated agreement.*

Contingent Liability

The Convener: Under item 1 on the agenda, we return to a matter that we considered last week—contingent liability, specifically in relation to the Scottish National Blood Transfusion Service. Members will recall that we asked for clarification of a number of matters. As a result, we have received an Executive note, which was circulated with members' papers. Alasdair McLeod, assistant director of finance at the Scottish Executive, Dr Aileen Keel, deputy chief medical officer, and Angus Macmillan Douglas, national director of the Scottish National Blood Transfusion Service, are here this morning to give evidence and assistance to the committee. I thank them for coming.

I understand that Mr Douglas will make an opening statement, following which I will open up the floor for questions.

Angus Macmillan Douglas (Scottish National Blood Transfusion Service): Dr Keel and I will make a short opening statement to give some background to, and try to put in perspective, the papers that members have received.

We want to show that we have defined the risk and potential liability, put a probability on the liability occurring and the costs involved, tried to define a worst case and matched our insurance cover to that. We want also to show that our insurance cover has been benchmarked against best practice in the pharmaceutical industry and that we have a degree of extra cover which, I hope, will give assurance.

We also hope to convince the committee that we have not only a reasonable amount of cover, but that we have taken a professional management approach to assessing the cover, by using our lawyers, Dickson Minto, as advisers on entering into the contract, taking advice from Aon Risk Management Limited, our insurance brokers, on the amount of cover that we should have and having good internal procedures to examine all such contracts, which are subject to internal audit by Ernst & Young. I want to assure the committee that we have been through those management processes.

What activities are we talking about? Why is the Scottish National Blood Transfusion Service involved in this sort of thing at all? We try to make full use of public assets, in effect by entering into public-private partnerships. The potential contract with BIEM ilac in Turkey is an example of that.

Members will see in the papers reference to clinical trials, which is a different issue. I suggest that we come to that second.

What are the public-private partnerships? SNBTS has carried out a major modernisation over the past few years, which, I am glad to say, has been completed on time and on budget. One of the outcomes of the review was recognition of the need to make full use of all our assets, including intellectual property. We are very proud in Scotland to have very good intellectual property on blood issues. There are a number of examples of contracts into which we have entered which, we believe, make full use of our public assets.

We have a contract with DiaMed, a Swiss reagent company, which gives real benefits to patients in Scotland by providing products at cheaper prices. The paper refers to the Taiwanese contract that can bring £14 million into the health service in Scotland over the next 10 years. The BIEM ilac contract—the contingency liability of which we are considering today—is part of those contracts. The advantages of such contracts are: they provide assistance to the country with the developing blood transfusion service; they bring money back into the health service in Scotland; they help SNBTS become an integral part of the biotechnology industry; they promote the Scottish biotechnology industry and improve the morale of our staff, who see themselves as part of international development.

If we did not use such contracts, we would have a £3.5 million per year hole in our budget that would have to be met from elsewhere. The type of contract that we are considering is not new to SNBTS and we are not unique in using such contracts. Our sister organisation in England carries out similar development work, but on a larger scale. I hope that that puts the contract in context.

I will try to define the contingent liability. The risk to SNBTS and the contingent liability for the Exchequer is limited by the draft contract that we have entered into with BIEM ilac. The risk for SNBTS and the Exchequer is restricted to the manufacturing risk. The plasma from which the products are made is purchased from Germany and the United States, which have their own liability, should the plasma not be of the correct quality. Using our intellectual property, we manufacture products that are licensed by the Medicines Control Agency, which is world-renowned for its strictness. The products are also licensed by the Turkish licensing authority. When the product is passed to the Turkish distributor, it is liable for any problems that arise from storage there. The potential risk that we have is the manufacturing risk.

Two issues arise from the manufacturing risk. We could make a mistake in manufacturing or we could be sued for professional negligence in manufacturing. However, we are not aware of having been sued for any mistake or for professional negligence over the past 20 years. We can go into more detail on that if the committee so wishes. The contract has restricted the liability considerably and we are confident that we are competent to manage the exposure that we have.

My colleague, Dr Keel, will now say a few words on the probability of the risk occurring and the worst case scenario.

Dr Aileen Keel (Scottish Executive): The simplest way of setting the context is to explain the current legal actions against SNBTS. Colleagues have examined the records back to 1995. In that time, 23 legal actions have been raised, all of which have been sisted—they are not currently proceeding. All the cases relate to hepatitis C transmission and many date back to the 1970s and 1980s—they are not recent incidents.

10:00

Whether any case goes ahead is a matter for the courts and the lawyers involved to decide. The amount of money attached to cases varies between £30,000 and £130,000. For its purposes, the central legal office has attached a putative figure of £50,000 to each case. Supposing that all cases sued successfully, we would be looking at a total of about £1.15 million for the hepatitis C-related cases dating back to the 1970s. When compared with the £20 million ceiling on the insurance that SNBTS is taking out to cover the Turkish contract, that is quite small.

The other thing that it might be helpful to mention is the worst-case scenario that we might be looking at. In the early 1990s, there was a bad scenario of HIV transmissions in blood products particularly to the haemophilia community. As a result of that, a compensation scheme was set up and £12 million was allocated on a UK basis—approximately £1.2 million to Scotland—which, at today's prices, would be somewhere around £1.5 million. Each of those cases received approximately £40,000 in compensation. That should be set against the £20 million insurance cover that SNBTS intends to take out. It is a reasonable sum to allocate against the contract.

The Convener: Mr McLeod, would you like to add anything?

Alasdair McLeod (Scottish Executive): No, I do not want to say anything.

The Convener: Thank you very much. I would like some clarification in relation to the Executive note that has been supplied for today's meeting. The third paragraph begins:

> "SNBTS believe that, taking into account . . . an estimated turnover of £2.6m on non-NHS activities . . . this cover is adequate."

I take it that that refers to the £20 million cover. How are your NHS activities affected?

Angus Macmillan Douglas: Our NHS activities are covered by the Exchequer. We do not take out separate insurance for that.

The Convener: So the only cover you need is in relation to your non-NHS activities.

Angus Macmillan Douglas: Yes. Except for the issue that is number 2 on the agenda: the clinical trials.

The Convener: Could you expand on that point? Are those regarded as a non-NHS activity?

Dr Keel: No. They are an NHS activity, but cover is required for the people who are conducting the trials, who may be exposing themselves to risk if something goes wrong.

The Convener: But the trials have been carried out since 1993 and there have been no claims.

Dr Keel: Yes.

The Convener: Those opening remarks have been very helpful in dealing with some of the matters that were raised, as is the Executive note—particularly on the point of what is defined as an incident, which is clear. I have no further questions. Do other committee members have questions?

Mr David Davidson (North-East Scotland) (Con): Good morning. I have a background in pharmacy and the pharmaceutical industry, so I have some understanding of the matter of litigation, particularly in respect of an exported product. Politics get involved, which tends to inflate the lawyers' fees, and the costs get bigger and bigger. A point was made in the papers about the gross income from this contract. What is its net value?

Angus Macmillan Douglas: The net value of this particular contract is £400,000. The net value of all our contracts of this type is £3.5 million.

Mr Davidson: Sorry, I have obviously misunderstood what was in the paper. Do you have sales of £400,000 or is the income £400,000?

Angus Macmillan Douglas: The income is £400,000.

Mr Davidson: Before costs?

Angus Macmillan Douglas: I am so sorry—you are right. The turnover is £400,000, and the profit, if you like, will be about £250,000.

Mr Davidson: I welcome that, as it obviously helps the organisation's progress.

You said that formerly there was a centrally based indemnity with the Treasury. Has that always been a separate exercise or has the Scottish Office budget always provided cover?

Angus Macmillan Douglas: I can go back only three years. We have always taken commercial insurance for activities outside the NHS. For our activities in the NHS over the past three years, we have received our cover from the Scottish Office and the Scottish Executive. I am afraid that I cannot go back much before that.

Mr Davidson: Fine.

My concern is that as our only support is the Scottish block grant, we must ensure that any arrangements cover the Scottish block grant, which includes the health service budget and so on. We are seeking an assurance that, in modern international commercial trading terms, you have adequate cover and protection that does not expose the Scottish block grant and budget to damage.

Although I have been very pleased with some of the comments that have been made, I am always concerned that any non-trading, non-commercially based organisation that gets into the trading world should have not just internal expertise but access to support and professional advice to ensure that it does not get into any difficulty. I think that some of us were concerned about that last week when we received a bald statement. I would be grateful for any information about how you intend to approach SNBTS' new commercial role in future.

Angus Macmillan Douglas: I can certainly answer that question. I and my colleagues in the SNBTS are very concerned that we do not run before we walk. The organisation has acquired some expertise on international relations and business. We also get tremendous support from Scottish Enterprise, the Foreign Office and trade organisations. We use the best professional advisers to ensure that we do not run into difficulties. We have particularly relied on Aon Risk Management, which has one of the best reputations for risk management in the pharmaceutical business. Before we entered into the amount of insurance involved, Aon carried out a benchmarking exercise across the pharmaceutical sector to find out what a commercial company would take as insurance cover for various turnovers of similar types of pharmaceutical business. For a turnover of £5 million, a sample of seven of the major international pharmaceutical companies had insurance limited to £5 million. Companies do not go up to £20 million until their turnover is more than £20 million.

We then considered factors such as comparability of product and safeguarding the block grant. As we do not have a balance sheet or limited liability, we finally come back to the taxpayer, whom we are trying to assist—not the reverse. As a result, we secured roughly four times more cover than a pharmaceutical company would normally seek; however, we reach a point where we start to waste public money by paying out too much in premiums. That is how we struck the balance.

Mr Keith Raffan (Mid Scotland and Fife) (LD): Excuse my ignorance, but can you explain, in layman's terms, what is meant by surplus by-products of the protein fractionation process? My line of questioning will be clear in a moment.

Angus Macmillan Douglas: Absolutely. Plasma is spun off from any blood that is donated. We are referring to products that are derived from plasma—that is a manufacturing process. We have a factory, built with public money, which tries to match the demand for plasma products in Scotland with our capacity to make them. Of course, demand changes through the years, so it can never be matched exactly. Therefore, potentially, we always have some surplus capacity. There will always be surplus parts of the product, because the demand will never meet exactly the way the product is split up through fractionation. We therefore use our surplus capacity and our by-products for those processes; we do not buy especially for those processes.

Mr Raffan: How far back do the surplus by-products go? How old are the products we are talking about?

Angus Macmillan Douglas: The plasma and the intermediate products will not be old at all—it will be a matter of months. It was a real concern to us that if we could not enter into a contract such as this one, with the Turkish company, we would have to destroy the product, which would mean destroying a gift.

Mr Raffan: I do not know about such matters, but I am asking how far back it goes because I am concerned about hepatitis C, in particular, having anything to do with the product.

Dr Keel: You are absolutely right: transmission of hepatitis C by blood and blood products has been a real issue in the recent past. The plasma we are talking about, from which these products are manufactured, is tested by state-of-the-art technology—something called polymerase chain reaction, which is a very sensitive test. We no longer rely on antibody tests to the virus, which can take a few weeks or months to develop. Plasma from Bavaria or the US is tested there using PCR, which shows up any positive donations.

Mr Raffan: You say it is state-of-the-art technology. So it is foolproof?

Dr Keel: I would not say that any technology is foolproof, but it is as foolproof as it can be today, given our knowledge.

Mr Raffan: But you are aware of the wide incidence of hepatitis C in Scotland now? Hepatitis C is a time bomb under health boards throughout Scotland—for example Fife Health Board. The Scottish Centre for Infection and Environmental Health estimates the figure to be 7,000 or 8,000; the footnote says that that could be an underestimate and that the figure could be several times higher. That is my concern.

Dr Keel: The hepatitis C epidemic that we think is under way in Scotland is mainly due to drug abuse and needle sharing. We are talking about non-UK plasma, so that is—

Mr Raffan: But it is mixed with surplus by-products from here, is it not?

Dr Keel: No. We no longer use UK plasma to manufacture blood products because of the theoretical risk of new-variant CJD.

Mr Raffan: The imported plasma is from countries—I think you mentioned the United States and Germany—where the prevalence of hepatitis C is similar.

Dr Keel: There are not vast differences. The centres from which the Scottish National Blood Transfusion Service purchases plasma are accredited. They were inspected by the Medicines Control Agency in the UK before the blood transfusion services were allowed to import. However, the prevalence of hepatitis C is not markedly different from what it is in this country.

Dr Richard Simpson (Ochil) (Lab): I apologise for my late arrival.

We are not trying to make matters difficult—members welcome the fact that the blood transfusion service is trying to maximise income from its products.

I—like Keith Raffan—am concerned that in the early and mid-1980s modelling of the risks from hepatitis C was not being done. There is, possibly, more than a theoretical risk that there is infectivity that is not recognised or tested for in the imported plasma. We are effectively dealing with unlimited liability. I give the example of the trouble into which the French Government got in respect of AIDS. That Government chose, for various reasons, not to test blood appropriately for AIDS and was, in the end, judged by the courts to have been negligent. Ministers in France have had to pay a heavy price for that.

I appreciate that you are insured to deal with theoretical risks, but I am concerned about the limitation on such insurance. If the risk is theoretical, the company should be able to offer the transfusion service unlimited liability. I am concerned that the Scottish block grant might be jeopardised if another virus was discovered that might cause a risk of infection in another country, which could then sue.

Can you reassure me that those fears are unfounded? If you can, I will be happy.

Dr Keel: Prior to Dr Simpson's arrival, I tried to set the context by referring to legal actions that are pending in Scotland regarding the hepatitis C virus and to what one might call the HIV worst-case scenario of the early 1990s. The sums that would attach to both those scenarios would amount to much less than £20 million. If all the hepatitis C cases were successful, the total amount payable would be between £1 million and £1.5 million.

The French Government was criticised for the problems that it ran into because it did not deploy state-of-the-art technology. It did not test plasma to the requisite level, which it could have done. As long as SNBTS can assure those with whom it contracts that it is testing plasma using whatever methods are considered by manufacturers around the world to be the state of the art, I cannot see how any criticism could be levelled if another virus emerged tomorrow that we do not know about and cannot test for today.

10:15

Dr Simpson: So if it were proved to the courts that all reasonable precautions had been taken, SNBTS would not be liable.

Angus Macmillan Douglas: That is right. It is not clear how consumer legislation covers blood products, but even if it covers them fully, the point that you have just made is correct. There is a clause in the Consumer Protection Act 1987 that says that one cannot be held responsible for something that typical professional producers of a product could not know about.

I hope that that has dealt with unknown viruses, but I would like to mention hepatitis C. We purchase the plasma from organisations that take it from volunteer donors in Germany and the United States. Any liability would be at least partly shared with that supplier—we would, in fact, argue that that supplier should be wholly responsible for such liability.

SNBTS is in the vanguard of introducing the polymerase chain reaction test in Europe, thanks to support from the management executive, and we believe that our testing is very good. Not only the testing but the manufacturing process is designed to kill the viruses. There is extra cover there. On hepatitis C, we believe that we have taken all the necessary steps. Unknown viruses are a real issue, but I hope that my answer has given some comfort.

Dr Simpson: That is very helpful.

Andrew Wilson (Central Scotland) (SNP): I think that your last point was pretty important. It would have been helpful if it had found its way into the briefing paper. What was the logic for increasing the indemnity limit per incident from £15 million to £20 million?

Angus Macmillan Douglas: One might argue that it was unnecessary. We did it because, after working through the sort of arguments that we have just rehearsed, taking advice from Aon Risk Management Limited, our insurance brokers, and examining the pharmaceutical company comparators, we found that the pharmaceutical companies would have insured for £5 million. Our indemnity was at £15 million, and we thought that we would give ourselves some more headroom. We like to think that this is good for Scotland's reputation: it is about using our public assets more effectively. The last thing that we want to do is to produce a liability for the taxpayer. That is why we increased our insurance.

Andrew Wilson: Those points are well taken. However, I do not understand how the risk per incident could have risen by £5 million because of your involvement in the Turkish market. Where is the logic in that?

Angus Macmillan Douglas: You are quite right. There is no empirical link between the contract in Turkey and £5 million. We examined the insurance that we had before, saw the Turkish contract coming along, hoped to have other contracts similar to the Turkish contract and, as we were doing an annual review of our insurance, raised the indemnity limit to £20 million.

Andrew Wilson: So this is part of a general review.

Angus Macmillan Douglas: Exactly.

Andrew Wilson: By how much does it increase your premiums?

Angus Macmillan Douglas: I cannot answer that. I know that if we were to increase our indemnity limit by another £5 million our premium would increase by about £15,000 a year.

Andrew Wilson: So there is an incentive for your insurers to advise you to do this. How much of the income that you receive does the SNBTS get to retain internally? How much is passed on to the NHS as a whole?

Angus Macmillan Douglas: I would like to return to the point about Aon Risk Management. Of course the insurance brokers have an incentive to sell us more, and I appreciate that what they recommend must be only one consideration. However, in fairness, the insurance company recommended a lower liability. It was we who chose to increase the premium. It was a difficult judgment to make, but we were trying to err on the side of safety.

SNBTS retains £2.5 million out of our total commercial income of £3.5 million—that is because, in restructuring our organisation as part of modernisation, we took out a loan from the management executive and we are now repaying that loan. As I understand it, all that money goes into the NHS in Scotland.

Mr Kenneth Macintosh (Eastwood) (Lab): Is it possible to buy unlimited protection?

Angus Macmillan Douglas: No, it is not, as all insurance companies are limited liability companies. However, it is true that for comparatively modest increases in premium we could increase our cover substantially. We have to judge whether that is a good use of public money.

Mr Macintosh: People can grasp a figure of £20 million. If you were to increase the cover to £100 million or £1 billion, which is a more theoretical figure, what increase in your premiums would that entail?

Angus Macmillan Douglas: I cannot give you a precise figure, but I think that, to take the cover to £100 million, we would be talking in terms of about a £50,000 or £60,000 per annum increase in premium. I must admit that I have never tried to find out what the premium increase would be for £1 billion.

Mr Macintosh: It is a theoretical concept; you would have to deal with a company that would be able to pay out. I am just trying to get an idea of where you draw the line. Obviously, that must be a difficult decision for you, when the whole country is drawing the line for you above that. I wanted to know what offers you had had from insurance companies and how much more increased cover would cost, given that it would be extra money for the Exchequer if you decided not to take it.

Angus Macmillan Douglas: If we went to £100 million, we would be talking about a premium of around £60,000 more than we pay at present. That is a jump of five times and is 20 times what the industry would insure for, which shows what a low risk the insurance industry puts on this.

Mr Davidson: My little knowledge of the background may assist my colleagues. You are basing your risk on the advice that you are given and you are sharing risk at different stages of the processing, handling and distribution. The question that arises from that is whether you have had sufficient assurance from the other people in the chain of supply that their insurance is in place and that you are not having to take their risk as well.

Angus Macmillan Douglas: That is something that we specifically require of our suppliers in the United States and in Germany—we required it before this contract. We require that assurance for the protection of patients treated in Scotland. You make an extremely fair point. I am told by my adviser that we have checked with our Turkish suppliers. We insist on that insurance and on being able to review it and get proof that they have it.

The Convener: I have a question for Mr McLeod about the contingent liability of the Scottish Executive. What effect will that additional liability have on the total spend of the Scottish Executive in insuring the various risks across all the departments for which it has responsibility? I imagine that it will have a fairly small effect, but can you tell me what impact it will have?

Alasdair McLeod: The effect will be very little in some ways and very big in others. In general, we do not insure against risks of any kind. This case is exceptional, as the risk is one that arises because of the use of a foreign supplier and foreign patients. We would not consider it right for the Scottish taxpayer to run that risk, but as a general policy we do not insure, simply because the cost of insurance would outweigh the benefits over the Executive as a whole.

The Convener: I know that when a department of the Executive proposes to undertake a contingent liability for which there is no specific statutory authority, it is appropriate to report the circumstances to the Parliament. How many incidents are there of departments undertaking contingent liability without specific statutory authority? This is the first one that this committee has received. Does that mean that it is the only one so far?

10:30

Alasdair McLeod: It rarely happens. I can think of one case in my time in finance—12 or 13 years—that we had to take to the Westminster Parliament. That had to do with an indemnity that we gave to Lord Cullen in relation to the Dunblane inquiry. We make an annual report to Parliament, which we could let you have.

The Convener: I think that the information that you have given has answered my question.

Alasdair McLeod: I should stress that I was talking about the unusual liabilities. All sorts of contingent liabilities are taken on in the action of carrying out the work that Parliament has authorised us to do. We would not expect to go to Parliament with each of those.

The Convener: I appreciate that.

It goes without saying that we hope that neither the public liability insurance of SNBTS or indeed the Executive's contingent liability will ever be called upon. I ask you to remain a few minutes longer as the committee must now decide whether to accept the minute from the Scottish Executive or to amend it in some way. Does the committee approve the contents of the minute that was submitted to us last week?

Members *indicated agreement.*

Angus Macmillan Douglas: There is also a minute about clinical trials. I do not know whether your comment took account of that as well or whether you wish to leave that for another occasion.

The Convener: We have been asked only to endorse the minute that was sent to us last week.

Point 2 in the note that was sent to us for today's meeting states that no action by the committee is required in relation to the minute that you mention. We might be asked to make a decision on the matter at a later point, but we are not in a position to do so today.

National Parks (Scotland) Bill

The Convener: We will now consider two bills that have begun their progress through Parliament. Members will be aware that the committee has suggested that this function should pass to the Procedures Committee. That suggestion has yet to be considered, so we still have to examine the financial memorandums.

On the National Parks (Scotland) Bill, the financial memorandum is set out on page 21 of the explanatory notes. A number of costs will have to be borne by the Scottish Administration and by Scottish Natural Heritage.

As ever, we are shooting in the dark, as is, it is fair to say, the Executive. The last time that we went through this process, we said that the Executive should be obliged to state where the proposed expenditure would come from. I think that Callum can confirm that we wrote to the Executive on the matter.

Callum Thomson (Clerk Team Leader): This financial memorandum was published before we lodged our request. We are still waiting for a response from the minister in relation to the education bill.

The Convener: Does anyone have any points to raise on the projected expenditure, particularly in relation to the Loch Lomond park or the likely second park in the Cairngorms?

Mr Macintosh: This is an example of costs on which we could have been given more information about how the Executive did its calculations. There are no national parks in Scotland, but there are elsewhere in this country; those parks have running costs, which could be used as a model.

In particular, the figures in paragraphs 144 and 145 of the explanatory note are fairly defined. From the memorandum, we do not know the basis on which the estimates are given, but that would be the kind of information that we would need to be able to come to an informed decision.

We have discussed the limitations before but, in this case, I think that the Executive would have been in a position to answer a few questions and to give us more information. I do not want to push this matter today, but I think that, in future, someone should be present to explain the estimates or the matter should be referred to the lead committee on the bill, so that that committee could explore the costs.

The Convener: The clerk has just informed me that the Rural Affairs Committee, in considering this bill, asked for such additional information and received it. I have not seen the *Official Report* for the relevant meeting of that committee, but that is the information that I have received.

Mr Davidson: I have two issues on which to comment, apart from those that Ken Macintosh has raised. In the explanatory notes to the bill, paragraph 148 reads:

"The Bill will impose no major additional cost on local authorities."

Having been a member of Stirling Council when the development of the park arose, I know that there were tremendous costs on local authorities. There is concern among the three authorities in the Loch Lomond park area about the on-going costs, despite the fact that a central body is taking the park proposal forward. The statement in the explanatory notes is not terribly clear. Similarly, the comment in paragraph 150 that

"the creation of National Parks should not create any compliance costs for business"

is not the interpretation that I get, still having a business in the area, nor is it that of colleagues who operate in the area. The notes make sweeping statements; they require more definition in future. On this occasion, as you said, convener, the Rural Affairs Committee is trying to tease out these matters.

The Finance Committee needs to be aware of the costs on such bodies as local authorities, whose funding partly comes through the Scottish Parliament. We should ensure a clear definition of what costs they might have to face, particularly as there may be different models in different parts of the country. The local authorities in the north-east of Scotland and the Highlands are concerned about the likely implications and about what budget support they may get. This is all a bit unknown. Some of them want an indemnity, which is difficult to achieve in a piece of legislation. We should send a clear message that this matter has not been handled with the greatest of clarity.

The Convener: Can you clarify that yourself, David? Are you saying that the information that we have here is not as clear as it might be?

Mr Davidson: I think that we have to challenge whether the simple statement that the bill

"will impose no major additional cost on local authorities"

is justifiable. It is not what local authorities are telling us.

The Convener: The costs to which you referred, in relation to Stirling, have presumably been incurred now. This refers to the period after the bill gains royal assent and becomes an act—it does not refer to retrospective spending.

Mr Davidson: It has nothing to do with retrospective grant.

The Convener: You are saying that there are forward projections by Stirling Council. That suggests that it will have to bear some costs.

Mr Davidson: If there are changes in the planning set-up, whereby the park becomes a planning authority in certain respects, that will require additional effort from the three councils that feed into the national park body. There will be an overlap on local plans and on structural plans, and a lot of work will have to be done jointly between up to four sets of public officials. That is not without cost.

Mr Raffan: I do not want to labour David Davidson's point, but I would like to back him up on it. Having been involved on the margins of the consultation process on the Cairngorms park, I know how costly such consultation exercises can be.

Stirling Council is somewhat well known for being in the vanguard of local authority consultation, both with the Stirling assembly and its local forums. I support the parks, but controversies have arisen surrounding them, and the council will want to consult local people extensively.

The Loch Lomond and the Trossachs national park lies in the region for which I am one of the representatives. I am concerned about the operating costs. The estimates for operating costs are detailed and specific for both the Loch Lomond and the Trossachs national park and the Cairngorms national park. On the other hand, the estimates for programme costs fall within a much wider band. I am concerned about that; it might be helpful to have the relevant papers from the Rural Affairs Committee. I am also concerned that—although the information given on the operating costs is much more detailed than that for the programme costs—the operating costs estimates seem rather low.

The Convener: We are required only to note that there will be an expenditure requirement from the Scottish consolidated fund as a result of the bill's being passed. However, both David and Keith have raised important points about that expenditure; the committee can ask for clarification on those points. What we say could be specifically related to the concerns of the three local authorities involved, which David spoke about. I imagine that they must have raised their concerns with the Rural Affairs Committee as the bill has progressed, so those concerns will already be on the record. However, this committee should also register the points that have been raised—although, as I said, all that we are required to do is to note that there will be a requirement for expenditure from the Scottish consolidated fund. Is that agreed?

Members *indicated agreement.*

Education and Training (Scotland) Bill

The Convener: The second bill before us today is the Education and Training (Scotland) Bill; there is a financial memorandum on page 4 of the explanatory notes. Some considerable costs are outlined for the Scottish Administration—£16.5 million in the first two years of the operation. Paragraph 17 states that the total cost of paying grants in the first two years would be in the region of £23 million. I do not think that the figures seem out of line with reasonable expectations.

Dr Simpson: If I have understood paragraph 15 correctly, the cost of running the service is £4 million.

The Convener: Yes, the running costs of the customer services provider could be £4 million over the first two years of the operation.

Dr Simpson: All the figures relate to the first two years. So, out of a total spend of £23 million, the administrative costs will be around 18 per cent or 20 per cent. On top of that, advertising costs will amount to £2.5 million. Therefore, the amount of money that will go to the consumer will be £16.5 million, and the costs of administering, advertising and promoting will be £6.5 million.

How much of that will be start-up costs and how much will be permanent administration costs? In the long term, if the administrative system—without the marketing and promotion—continues to cost 25 per cent of the value of the service, I would have some serious questions to ask.

Andrew Wilson: What Richard has said strikes me as perfectly sensible and germane. We should find out more before we proceed with this, because the figures suggest that there is a problem with this policy area. There is a reason for not accepting the memorandum at this stage.

The Convener: We can defer consideration until our next meeting and ask for someone from the enterprise and lifelong learning department to give evidence and to answer specific points.

Mr Raffan: The only point about which I am concerned is paragraph 16. It seems fair enough that

"Costs related to marketing will be dependent on levels of take-up".

However, in view of the level of Government expenditure on marketing and advertising, I would like some more detail on those costs. I have no concern about research and evaluation as that seems sensible. I would like to know how long the Executive waits before it undertakes an extra marketing programme, what happens if the money is not used, and so on. It is sensible for the Executive to say that those costs will be dependent on take-up, but how long does it wait? I would like to have a background note on that because such a large amount of money is involved.

The Convener: Would we be content to receive a background note on the points that Keith Raffan and Richard Simpson have raised, rather than asking for an official to appear before us?

10:45

Mr Davidson: I support Richard Simpson's position on this. It would be helpful if the Executive gave us comparators with other schemes and administrative exercises that are conducted on behalf of the Executive to find out whether the figures in the memorandum are the norm. If they are, that may lead us to other questions. If they are not, why not? The amount seems tremendously high. Presumably an unknown risk factor must be built in, about which we ought to know.

The Convener: I am not sure that there are any obvious comparators. The question is whether we want to speak to an official next week—we have other business next week—or whether we want something in writing, which we can consider before we return to the matter.

Mr Raffan: I suggest that we seek background notes initially.

The Convener: Callum Thomson is reminding me that the stage 1 debate is on 25 May, so we will have to take a decision next week.

Andrew Wilson: We cannot be bounced by the Executive's timetable. If the Executive fails to give us information in advance of sufficient depth and quality, it is not our problem. That has happened time and again. My concern about next week is that we have an inquiry under way and we do not want to take away too much time away from it, as we have done today.

The Convener: That is also my concern.

Andrew Wilson: We have timetabling problems, as every committee seems to have. However, the issues that have been raised, especially on comparators, seem to be wider and more significant. It might be useful to schedule a guillotine session with an official on this—we should try to restrict the item on the agenda to five or 10 minutes.

The Convener: The points that have been raised will be in the *Official Report* and anyone appearing before us will know exactly what we want to ask. We would have to exercise discipline and not go into other areas relating to the bill. If we restrict ourselves to the points that have been raised, we can ask officials to attend for a 15-minute slot next week. Do not forget that this is a responsibility that we are trying to offload, so we should not make too much of it at this stage.

Dr Simpson: Perhaps we could start 15 minutes earlier next week.

The Convener: That gives Elaine Thomson difficulties, as she travels down from Aberdeen in the morning. However, I have just been reminded that next week is not a normal week, as we are meeting at 1 o'clock. We will meet at 12.45 pm, subject to the availability of the room—there are three sets of committee meetings next Tuesday. We will leave that in the hands of the clerks; members will be advised in due course. We will defer our decision on the financial memorandum of the Education and Training (Scotland) Bill.

As we agreed at the start of the meeting, item 4 will be taken in private.

10.48

Meeting continued in private.

European Structural Funds

11:02

Meeting resumed in public.

The Convener: We now move back into public session. I am pleased to welcome, as part of our inquiry into European structural funding, Dr Gillian Bristow, from University of Cardiff business school, and Dr Nigel Blewitt, from the Institute of Welsh Affairs. Thank you for sparing the time to assist us in our inquiry. Dr Bristow will read an opening statement. We have received the papers that you circulated, which are very helpful, and we welcome your statement.

Dr Gillian Bristow (University of Cardiff): Dr Blewitt and I will speak jointly on the paper that has been circulated.

The Convener: That is fine.

Dr Bristow: Dr Blewitt will begin.

Dr Nigel Blewitt (Institute of Welsh Affairs): We are delighted to have been invited here today, to assist you in your inquiry into structural funds. That issue has exercised our minds for some time, over the past year or so.

The "Unravelling the Knot" report, which has been circulated among committee members, was written in the context of Wales having been granted objective 1 status for the 2000-06 period, for west Wales and the valleys. There was much talk about the significance of the scale of the funding and the step change that was likely, following the award of that status. We wanted to consider what was happening between the block grant structural funds and the Barnett formula, as they are intermingled and it is difficult to grasp the scale of the resources that Wales will receive as a consequence of being awarded that status by the EC.

Our paper this morning is a brief summary of that report, which has been circulated, and we shall talk about the interactions between the various parts of the funding set-up.

Dr Bristow: A main objective of the paper is to explain how European structural funds are administered through the centralised public expenditure system in the UK. We felt that such an explanation was necessary to enable people to understand how the funds interact with that system. In giving a context and an introduction, we believe that it is important to define clearly the different elements of European funding as they are considered in the public expenditure system.

There are three elements to European funding. The first is the grant from the European Commission for each programme or initiative. The second element is public expenditure, which is defined by the UK Government as provision within the block grants to Scotland and Wales to spend the grant commitments from the European Commission. The third element is match funding, or the non-EU grant element of project costs, which consists of both private and public sector components. It is important that those definitions are understood, in order to understand the interactions that Nigel Blewitt will now go into.

Dr Blewitt: We all know that, for the foreseeable future, the annual changes in the block grants to Wales and Scotland will continue to be determined by the Barnett formula. The important point for the committee is the fact that many elements of European funding are treated as comparable programmes within the assigned budget. Therefore, if there is a spending increase on a programme in England, or an increase in cover in England of, for example, European regional development funding, there will be knock-on effects in Wales and Scotland through the Barnett formula. The key point is tying the matter down and considering comparability between what is in Scotland, what is in Wales and what is England, in terms of public expenditure cover on programmes.

ERDF is not a ring-fenced item within the budget—it is part of the assigned budget, so Scotland and Wales are free to allocate provision for ERDF as they see fit. Therefore, one might get a mismatch between what the European Commission says that Wales or Scotland is entitled to in ERDF expenditure, which has been agreed and negotiated through single programme documents, and the level of provision that is made available to Scotland or Wales through the Barnett formula by the Treasury. The key issues that the committee should consider are the extent of the provision that the Treasury has made available and comparing that with the contents of documents that have been sent to—and accepted by—Europe, because those documents have been agreed by both parties.

The problem in Wales is the expenditure cover required for objective 1 over the next nine years of the programme—there are seven years plus two years run-on of costs that are being paid for. That provision has a baseline of about £20 million. However, it is expected that about £90 million will be required to cover European Community receipts in grants alone. Therefore, members will see that there is a big build-up of tension within the Welsh block. Of course, the Assembly is free to allocate extra provision for ERDF within its own block grant, but that would run the risk of taking funds away from other elements in the block. With such tight restrictions on finance, and with many services requiring funding, if one were to start reallocating funds from other areas of the budget, an obvious tension would be created.

Another element is match funding. The allocation of objective 1 status to west Wales and the valleys probably received most attention in Wales. That was going to mean a huge increase in the demands on the budgets of public sector agencies and quangos, which would have had to find finance for the match funding. Most funding for public sector institutions, such as the further education sector, local enterprise companies, training and enterprise companies and the Welsh Development Agency—the Welsh equivalent of Scottish Enterprise—comes from the block. Therefore, there are restrictions on the Assembly in allocating expenditure. It will have to decide between spending on EU programmes and diverting resources away from other expenditure in the non-objective 1 area, and spending in areas that are ineligible for structural funds. That is the second tension within the block.

Total match funding for the next nine years for objective 1 alone is expected to be about £888 million. That is roughly £90 million a year from the public sector alone. There is also funding from the private sector—an attempt is being made to lever in as much as possible from the private sector, to relieve the burden on the public sector.

Dr Bristow: The different elements of European funding and the way in which they interact with the public expenditure allocations to Wales and Scotland through the block grant raise significant questions about whether structural funds are additional to existing expenditure in the block grant.

The extent to which the block grant has to rise with any structural fund programme to satisfy EU requirements for additionality has been an important issue in Wales. According to the European regulations on additionality, the UK Government is required to demonstrate only that public expenditure in eligible regions benefiting from structural fund programmes is at least equal to the level in the previous programming period. One of the difficulties with measuring additionality is determining what is included in the baseline level of public expenditure. Does it include, for example, previous elements of provision, which then make it difficult to come to a definitive assessment of additionality?

The other important point on additionality is that there is no requirement on the UK Government to demonstrate additionality at the Welsh or Scottish levels. The existing rules and regulations require only that additionality be demonstrated at the level of, for example, all the objective 1 regions in the UK as a whole. Additionality is therefore measured at the level of the member state.

It is important to note that there is no compulsion on the UK Treasury or Government to provide extra resources in line with increased match funding commitments. The rules apply only to the public expenditure provision. There is nothing that says that the Government has to ensure that there is a direct increase in the block grant equivalent to the extra demands for public sector match funding, although as the debate has developed in Wales, it has become increasingly important that, in principle at least, the block should be allowed to rise in line with the perceived extra demand for public sector match funding.

In the briefing paper, we consider the importance of the UK's rebate for its contribution to the EU budget and the role that that might play in influencing the Government's propensity to draw down and spend European moneys. As it stands, the rebate ensures that any increase in EU structural funds for any part of the UK is largely balanced by a reduction in the rebate. In other words, the rebate provides in effect an incentive for the Government to exercise restraint in its spending of European moneys. It would seem that the Government prefers the freedom to benefit from the rebate, which can be spent on whichever programme the Government sees fit, to drawing down and spending structural funds.

One of the main conclusions that we reached in the "Unravelling the Knot" report was that the Barnett formula appears not to be the most appropriate way in which to allocate European structural funds. We therefore recommend that European money be ring-fenced and separated from the operation of the Barnett formula. As Nigel Blewitt said, it is important that questions are raised during this inquiry about how the volume of provision to spend European moneys in the block grants to Scotland and Wales—as determined by the Barnett formula—relates to the agreed grant allocations contained in single programming documents. That information is vital in beginning to determine the additionality of structural fund resources.

The Convener: Thank you very much. We are well aware of the work that you have both done on those matters, and of the political hot potato that the issue has become in Wales. It might or might not become such a hot potato in Scotland—time will tell.

I thank you for making clear the difference between additionality and match funding, which I have always had difficulty getting my head round, but it is much easier as a result of your briefing.

Dr Blewitt quoted the figure of about £880 million for match funding and said that about £90 million a year had to be found from the public sector. He speculated about the extent to which that might be found in the private sector. I had not appreciated that the match funding could come from the private sector. Is there no restriction? Does not it have to be public finance, or is there a minimum of match funding that must be public finance?

11:15

Dr Blewitt: The UK Government treats the two as interchangeable. The more that can be raised from the private sector, the better.

The view of the Commission is slightly different, in that there was talk earlier in the year that it would prefer to see a pound-for-pound match of public funding with the grant; funding from the private sector would be a bonus on top. In Wales, we are trying to treat the funding as being able to be substituted between the two. There is certainly no restriction on the amount of private sector finance that one can use, as far as we are aware. The private sector match is anticipated to be about £310 million over the next nine years—about £30 million a year.

The Convener: In Wales, roughly what percentage is the £30 million per annum of the match funding?

Dr Blewitt: About a quarter.

The Convener: In the second paragraph on additionality in your brief, you set out what European regulations require:

> "the UK Government is required only to demonstrate that public expenditure in eligible regions benefiting from Structural Fund programmes is at least equal to the level achieved in the previous programming period."

I am not clear about this: if additionality is measured year on year within a project's development, how is it measured in the first year of a project? What is it measured against if there are no previous examples against which to do so?

Dr Bristow: I am not sure that I can answer that question. I think that additionality is measured based upon the whole programming period. I do not think that that assessment is made.

The Convener: Therefore, it is not done on a project basis.

Dr Bristow: The measurement refers to the complete programme.

The Convener: Even if it is taken over the previous programming period. What if an area has just gained objective 1 status and there is nothing to look back on for the purposes of measurement? For example, parts of Wales that have just qualified have not previously had objective 1 status. How would you measure that?

Dr Blewitt: The Government would have to compare expenditure with programmes that were previously in that area—for example, economic and industrial development, or employment and training programmes. It would examine the average expenditure over the previous six or seven years, in real terms. It would compare that with the figure that is being made available from 2000 onwards. If that figure is higher, it seems that there is additionality. While one cannot compare an objective 1 programme exactly with what has gone before, one has to check that expenditure in similar areas has not fallen. One cannot compare the two periods directly.

The Convener: That is my point. There seems to be potential for the Government to choose comparators that suit it.

Dr Blewitt: Of course.

The Convener: No one from the European Commission could say, "No, that is not an appropriate comparison." The Government has the discretion to make those choices, so it sets the baseline on which it is judged thereafter.

Dr Blewitt: Negotiations must take place as to the suitability of the baseline that the Government has chosen. The emphasis is on the UK Government coming up with that baseline.

The Convener: I see. I have other points to make, but do any other members want to ask about additionality or match funding?

Andrew Wilson: Thank you for the reasonably comprehensive briefing paper.

On additionality, there is a problem for us all, in that the same word is applied to many different matters at a regional, national and project level.

The issue that exercises our minds most, and I am sure yours in the Welsh context, is the extent to which European funding is made additional to the budget of the National Assembly for Wales or, in our case, the Scottish Parliament. Your paper seems unequivocal in the conclusion that that is very much open to question.

On 10 March, in a press release from the European Commission, Michel Barnier makes it reasonably clear why people such as Dafydd Wigley and myself are arguing for a national assessment of additionality to be applied to Wales and Scotland. He notes that that is an internal UK matter, in which the European Commission cannot intervene. That suggests that our concerns should be focused on the internal UK system. To what extent can we unravel the knot from a Scottish perspective? Given that it is not a step change—we have had European funds under the scheme since 1975 and objective 1 funding began in the mid-1980s—we would have to go quite far back. Do you think that we could get that information from the Treasury, and what should we be asking for?

Dr Bristow: The need to examine volumes of provision within the block over the previous programming period up to the current period and to compare that with the allocations contained in the agreed single programme document is critical. One would need to compare the Scottish entitlement with what the Treasury had allocated through the public expenditure block grant system—the Barnett formula.

Andrew Wilson: That suggests that we should request a note from the Treasury on how the European element of the Barnett formula has been calculated and allocated. I cannot find that information at present. Convener, can we take advice on how best to obtain that information? It strikes me that it would be useful to know the Treasury version of that calculation before we hear evidence from the Treasury.

The Convener: We can write to the Treasury to ask for information on that.

I welcome Bruce Crawford to the committee. As our guests will know, we are carrying out a joint inquiry with the European Committee and we are keen to ensure that there is no overlap in our work.

Bruce Crawford (Mid Scotland and Fife) (SNP): Thank you for allowing me to take part in this morning's proceedings. I hope that the questions that I ask you will not be repeated at the European Committee this afternoon, although I suspect that we will have to cover some of the same ground.

We are primarily interested in additionality. We are not so concerned with match funding, although we understand its significance in Wales. In Scotland, match funding is perhaps a local issue, about whether local enterprise companies have the resources to match European funds.

The primary statement from article 11 of the rules on additionality says:

> "In order to achieve a genuine economic impact, the appropriations of the Funds may not replace public or other equivalent structural expenditure by the Member State."

That is the prerequisite that sets all the rules on additionality. Dr Bristow, could you tell me whether you used that definition as the anchor for the understanding of additionality as described in your written evidence?

Dr Bristow: Yes. The debate in Wales has focused on the issue of how to define additionality and how that criterion can be satisfied; the point that you make about the need to demonstrate that there is a net economic benefit or impact is critical. That is uppermost in the European Commission's mind and is something that the Welsh Assembly sees as critical in ensuring that the objective 1 programme makes a difference in Wales.

Bruce Crawford: We have also received a note from the Minister for Finance in Scotland about the way in which structural funds are treated within the block. It is a short paragraph, which I will read for you:

"If payments of Structural Fund grant increases or decreases from one year to the next, the resources available for other purposes change correspondingly,"

subject of course to any changes to the assigned budget as a whole—thus the Executive will adjust its other programmes, up or down, to reflect the expected call on the assigned budget from structural fund payments in any year. In view of the additionality definition and the Executive's description—which is primarily that of the Minister for Finance—do you think that the bottom-line position of European structural funds has no effect on the net budget of Scotland?

Dr Bristow: The statement that you quoted suggests that there is switching within the block to make room for the structural funds. This relates to Nigel Blewitt's point about how the budget has to be altered. Money has to be put into or taken out of provision within the assigned budget to make room for structural fund payments. It is difficult to say definitively whether that constitutes non-additionality. As I said, it is necessary to have a bit more information about precisely how much provision is being made available.

Bruce Crawford: That is an important point, which could be raised when the Minister for Finance appears before the committee or before the European Committee.

The Convener: In your opening statement, you referred—understandably—to the Barnett formula. Obviously, we will also want to address the conclusions that you reached on that. I was concerned about the comparability percentage that is used for ERDF. The comparability percentage is 6 per cent in Wales and 10.34 per cent in Scotland. How is that applied in relation to ERDF? Is there any negotiation with the Treasury on that point, or is it set hard and fast that that is the figure and there is no room for movement?

Dr Blewitt: The degree of comparability is 100 per cent. The population ratios are applied. ERDF is one of the programmes that are applied by the Department of Trade and Industry or the Department of the Environment, Transport and the Regions, and Scotland and Wales have comparable allocations. The programme passes through the Barnett formula and the outcome is known—the money is added to the assigned budget.

We passed our document to the Assembly officials for their views and they agreed that that is what happened and that there were no other negotiations. At the moment, we are entering the comprehensive spending review. Officials at the Assembly are negotiating strongly with the Treasury to try to get an allocation that is in excess of that which would come through the Barnett formula. There is obviously an issue because strict population ratios are being applied to the figures.

The Convener: What you describe in Wales clearly follows on from the Welsh select committee report, which recommended separation.

Dr Bristow, at the end of your introduction, you said that, given that the Barnett formula is not the most appropriate way of operating European funding, such funding should somehow be ring-fenced or separated from the Barnett formula. How simply could that be achieved? Would another mechanism have to be introduced or would simple ring fencing mean that, in effect, the percentage of European funds to Wales and Scotland would increase?

Dr Bristow: I think that it should be reasonably straightforward. Other elements of European funding are ring-fenced—some aspects of common agricultural policy funding, such as certain livestock subsidy schemes, are ring-fenced.

The Convener: Is some of the social fund not ring-fenced?

Dr Bristow: Yes. Those elements are included in the assigned budget but are not subject to the Barnett formula. I have found no reason why ERDF should be subject to the Barnett formula. All the logic suggests that it should not be and that it should be ring-fenced. It is clear that the amounts are directly comparable with the allocation that is contained in agreed programming documents.

Dr Simpson: Does that apply only to objective 1 programmes?

Dr Bristow: It applies to all the programmes.

Dr Blewitt: Our rationale is that the European structural funds are allocated on the basis of need, according to the relative prosperity and development of the regions, but if money is being passed through the Barnett formula, the allocation is based purely on population. There is a contradiction in the allocation of moneys.

Mr Raffan: That was useful as it leads to the point that I was about to make. Perhaps I am wrong, but I detect a slight difference between what you say in "Unravelling the Knot"—the Gordian knot—and your opening statement. "Unravelling the Knot" begins by saying that the funding mechanism should be based on a needs assessment; you mention the Australian model. You go on to say that the argument has been raised in the Welsh Assembly that funds should be ring-fenced and excluded from the operation of the Barnett formula. What is the point of making a recommendation about the Barnett formula if you are taking the Barnett formula out of European expenditure? You seem to be having it both ways. It is as if the idea of ring fencing came out of the Assembly and the Welsh select committee report, but you had gone partly down the route of changing the Barnett formula to make it more sensitive and responsive, through needs assessment.

Dr Bristow: The report covers other issues and debates about the Barnett formula, which we have not raised today because we did not regard them as being directly relevant. One might argue that there are certain tensions between reviewing the Barnett formula and changing the way in which European funds are allocated.

11:30

Mr Raffan: You are saying that, if you cannot win the ring-fencing argument, you will fall back on the position of calling for the Barnett formula to be based on needs assessment.

Dr Blewitt: We think that the structural funds should be treated separately, whatever else is decided. It is a completely separate issue and should be treated as such. An examination of the Barnett formula and any possible needs assessment review would be much longer-term actions, which would require co-operation between all the devolved Governments and the UK Treasury. It would probably take several years to carry out the needs assessment, put in place formulae and set up an independent commission. The structural funds are such a pressing issue that they need to be considered now. I do not want to speak for the Assembly, but I think that it is quite keen to consider structural funds outside the Barnett formula arrangements.

Mr Davidson: I will pick up on something that you said about the CAP—I declare an interest as a farmer. The CAP does not work quite as you describe. It works on a population basis. It works on the headage rates of animals in the different sectors—where one is in Scotland, for example, is almost irrelevant to that. There is a difference between less favoured areas and others, but it is very much based on headage.

On the application of funds, I can think of calls for the renewal of the Scottish fishing fleet, which happens to be based mostly in the north-east of Scotland. There was a difficulty as the Government said that it could not afford to carry out the whole programme because of the displacement of cash to match the funding. Although an element of private funding was available for the programme, there was great difficulty as central funds would have been displaced from other Government projects.

Are we not heading into a discussion of how the UK nation state runs its affairs and is open to bidding from the devolved areas and parts of England? Will the UK be questioned by the EU on how it delivers the UK budget? There seems to be a hint of that in some of the things that you have written and said. If that is your recommendation, how do you think that it will develop, given that under the current system the application of funds in a nation is run by the home Government? You are now hinting that that will not be the case in future.

We all know the different political arguments. I am not arguing for or against anything; I have campaigned for European funds for different parts of the country. However, the matter is difficult to deal with if it is not linked to the Barnett formula and I cannot understand how Keith Raffan can separate the two issues. One pot of European money might require the addition of funds that would deplete the Government's ability to serve all the state's needs, despite the Barnett formula having a baseline that is supposed to deal with those needs. Are you recommending that we feed that money straight into the Barnett baseline?

The Convener: That might be a bit difficult to answer—I think Mr Davidson asked three questions there.

Dr Bristow: As we have said, if the European Commission has agreed particular objectives or programmes with the UK Government and any undevolved bodies, each region should be assured that it will get its entitlement to European money to maximise regional development benefits. Does that answer your question?

Mr Davidson: I was just trying to tease out your position on the matter. Like Keith, I think that you are coming at the argument from two sides. We are trying to find out how we can apply certain financial mechanisms in a more understandable way, because one of the big issues surrounding European funding programmes is that people on the street do not understand them. They do not seem to realise that the Government needs to match European funding and that tension will exist when a Government of any persuasion attempts to match funding for all agreed programmes at the same time as it tries to fulfil other commitments in its country. One of the reasons why you are here is to suggest ways of examining that issue.

We have discussed whether the rebate acted as a disincentive for drawing down funds. Can you give examples of that, or are we getting back into who directs how national spend is conducted?

Dr Bristow: It is very difficult to get evidence that proves the impact of the rebate, other than to illustrate that the mechanism is a disincentive to drawing European moneys down. The logic is that the greater the allocation of structural funds in the

UK, the smaller the rebate will be. However, the rebate can be distributed as the UK Government sees fit, rather than being allocated to specific programmes. Perhaps that reflects the tension that you mentioned in striking a balance between giving money to allocated structural fund programmes and benefiting from a rebate that can be distributed as the Government sees fit.

Mr Davidson: Is there evidence of how other countries deal with that tension?

The Convener: Other countries do not receive rebates.

Mr Raffan: You said that no work had been done on the rebate. Governments prefer to allocate money in their own way, because they operate in a Machiavellian way. However, is there any evidence to show that—during, for example, recessions in public spending—the Government has drawn down less European funding so that it can use the rebate to cushion any possible reduction in public spending?

Dr Bristow: We cannot provide any direct evidence—we have not examined that matter.

Mr Raffan: It seems logical, however.

Dr Bristow: It might seem logical, but we should emphasise the importance the Government attaches to the rebate. The fact that both the previous Conservative Administration and the new Labour Administration have defended the UK rebate suggests that Governments believe that it has an important role to play. In the paper, we also point out that, after discussing the rebate, the Treasury's public expenditure statement says that the Treasury will

"press for restraint in the level of Community spending."

The UK Government is certainly committed to restraining European spending in the UK as part of its overall containment of public expenditure.

Bruce Crawford: I want to tease out a small issue regarding whether, because of the Barnett formula, Wales or Scotland will get the maximum impact from European structural funds. David Davidson was right to say that the Barnett formula is not completely centred on population, but it is driven primarily by population and Scotland's share works out at 10 per cent of expenditure in the UK.

However, the figures for UK structural funds allocation to Scotland in 1997, 1998, and 1999 make interesting reading. In 1997, the allocation was 13.4 per cent; in 1998, it was 23.3 per cent; and in 1999, it was 15.2 per cent. Given the new 10 per cent figure, the amount of European funds coming into Scottish assigned budgets is necessarily depressed by the Barnett formula. Is not that at least an argument for a review of the Barnett formula, if not for ring-fencing of European funds?

Dr Blewitt: Yes.

The Convener: You have suggested some alternatives. Can we learn any lessons from structural funds allocations to areas in other major European member states, such as the autonomous regions in Spain, the German Länder and the French or Italian regions?

Dr Blewitt: I must admit that we have not examined the ways in which other European states draw down funds and allocate them to their regions. The model that we have suggested in the paper is based on Australia, which is, obviously, outside the European Union. Such an examination would be an important piece of work; there must be experts from other countries in Scotland who would be able to answer questions on how funds were allocated in their countries. We are a little bit ignorant about that issue. Our case was based purely on the mechanisms and formulae in the UK.

The Convener: In a sense, your study has been ring-fenced in the UK.

Dr Blewitt: Yes.

The Convener: Do you know whether there is evidence that the regions—if we can use the term loosely—and countries of the UK are less favourably treated than the regions of Spain or Germany?

Dr Blewitt: No.

The Convener: Do you have any anecdotal evidence on whether that is the case?

Dr Blewitt: No.

The Convener: Such comparisons will be important to us, but I take it that that is not your field.

Dr Blewitt: No.

The Convener: Fair enough.

Andrew Wilson: It is probably worth mentioning that there is no European formula that compares with the Barnett formula—that is unique to this country.

The Convener: With respect, that was not my question, which was about what other countries do.

Andrew Wilson: By definition, no other region will allocate funds through the Barnett formula—no other region has such a funding mechanism.

The Convener: I am not sure—I think that the Spanish system has similarities. However, we will have to consider that matter at another session.

Mr Raffan: I want to ask about the contrasts between the Welsh and Scottish positions. In a former life, I was a Welsh MP—not that that means that I know anything about the situation now.

I interviewed Monika Wolf-Mathies—the former European regional commissioner—in the Welsh valleys when objective 1 status in Wales was relatively small. Can you indicate the extent of its expansion? That is at the root of the controversy in Wales.

Dr Blewitt: We have never had objective 1 status in Wales and objective 2 and objective 5b status are just coming to an end. Objective 1 will cover 65 per cent of the population.

Mr Raffan: What happened previously?

Dr Blewitt: Previously, objective 2 and objective 5b covered industrial south Wales—which includes the valleys communities—and some of the rural parts of west Wales. Considerably less of the area was covered by European structural funds.

Mr Raffan: When I interviewed Monika Wolf-Mathies, the whole Irish Republic had objective 1 status and, with its ferry connections, the Welsh always looked enviously at the Irish Republic. For every punt that the Irish put into Brussels, they got four punts back, which might have had something to do with their 10.5 per cent annual growth rate. How did a country that was relatively poorer operate the system of match funding and additionality?

Dr Blewitt: My knowledge of Ireland is not detailed, but I think that the Irish were very up-front about match funding. Because the money was ready to spend as the programme got under way, there was no worry whether there was enough money in other budgets to finance match funding year on year.

Mr Raffan: Perhaps I did not make myself clear. Where did the Irish Republic get the money? Given that the whole country had objective 1 status, I would have thought that they would have had a considerable struggle finding that money.

11:45

Dr Blewitt: One would think so. That is a question for the Irish officials. Perhaps we could do some work on that and drop the committee a note.

Mr Raffan: I would like to make a final point. I do not want to go back, but my question is on the Scottish-Welsh contrast. You talked about the difficulty of estimating additionality. The areas covered by the Development Board for Rural Wales and the Mid-Wales Development Board—or whatever it is called—covers quite a bit of the objective 1 area. Presumably there was considerable extra spending on projects there, some of which would have gone into the objective 1 area and some which would not. It must be difficult to get a detailed estimate for additionality purposes, considering that a lot of the expenditure was cross-boundary.

Dr Blewitt: That is one of the principal problems of additionality. There is not only a problem in defining comparable programmes—which could be compared before and after—there is an issue about the population that is covered and where the geographical boundary is drawn with regard to the provision of public expenditure. That was picked up by the European Court of Auditors in its review of additionality, which was published recently throughout the member states.

Dr Bristow: Boundaries are now different—the objective 1 boundary is unique and data will not, therefore, necessarily fit it.

Mr Macintosh: I will continue the comparison between Wales and Scotland. Scotland does not now qualify for objective 1 funding. Under the current system, do you think that Scotland will miss out on European funding? Will we have full additionality?

Dr Bristow: That question is difficult to answer. We made it clear in our briefing paper that we have not looked at the detailed figures relating to Scotland, so we do not know, for example, how much money Scotland will be eligible for in the current programming period. We understand that there is, in principle, transition funding for, for example, the Highlands and Islands. That funding is almost equivalent to the amount of money that was available under objective 1. We can comment only on the principles and the funding mechanisms that apply. Following the logic of those mechanisms, we suggest that there is a significant question mark over whether the full benefit of structural funds is being captured in Scotland. As you say, there are certain key pieces of information that it is necessary to have in order to make a fuller assessment.

Mr Macintosh: You pointed out that the Highlands and Islands is enjoying transitional funding arrangements at the moment. Are any areas likely to miss out? If there are problems, they seem to be specifically focused on objective 1 funding, rather than on other regional funds. Is that interpretation wrong?

Dr Bristow: Problems seem to focus on objective 1 programmes simply because of the scale of funding, which draws attention to the issue. It is not clear how the money is being treated, or whether it is additional funding. As I said, however, if one followed the principles and the logic—given that European money seems to be included in existing public expenditure allocations—one could argue that the problem applied to all Europe-funded programmes throughout Scotland.

Mr Davidson: Are there types of projects within the structural funds areas that seem to win, and others that do not? Are there any comparisons in your research between types of projects that clearly get support and others that you would raise questions about?

Dr Blewitt: That would also be beyond the scope of our examination. That is very much a macro-perspective issue and such issues would be for the monitoring committees and the evaluation committees. If the projects tied in with the strategy in the single programme document, it would be more of an issue. Funding for types of projects is obviously a significant issue when projects cannot get match funding to take a project forward. The question then would be: where are the funds for match funding? Perhaps the issue drives the amount that is spent under different priorities. Perhaps business development can get more money than environmental projects can. I do not know—I am hazarding a guess.

Dr Bristow: This issue was important in Wales in the previous programming period when—for example, under the objective 5b programme for rural Wales—there was a significant problem in getting public sector match funding. Perhaps the problem relates specifically to match funding. You might be able to demonstrate that certain projects are able to get match funding more easily than others.

The Convener: I would like to ask a question about the mechanism. You say in your briefing:

> "Grant money from the European Commission does not become public expenditure until it is drawn from the suspense accounts . . . and paid over to project sponsors."

The briefing talks later about the fact that ERDF provision can be carried forward if it is not all spent in one year. Who controls when that money is drawn down, and is there even a possibility that that draw-down could be delayed with a view to influencing public expenditure in a particular financial year?

Dr Blewitt: The paying authority, which will be the Welsh Assembly or the Scottish Parliament, will accumulate receipts for the costs that are incurred by the programmes. It will then charge those against the accounts. Once the money is passed down, it becomes public expenditure. As far as we are aware, there is no delay in getting that money to the Assembly or the Parliament when the money is needed to pay out to project sponsors. That is not the issue; the issue is the cover within the block grant itself. Money will be drawn down, but, effectively, the Assembly or the Parliament will have to pay for that grant out of their budgets, because they will have gone over the baseline provision.

The Convener: So there is no evidence of delay with either the Welsh Assembly or the Scottish Parliament. For how long has this carry-over procedure operated?

Dr Blewitt: It is the same with any spending programme. There is end-year flexibility to carry over.

The Convener: End-year flexibility is a relatively new phenomenon in UK public finance. Has it always applied to European funds?

Dr Blewitt: I think so, yes.

Andrew Wilson: I will be brief, because we are coming close to the cut-off guillotine. To summarise your position again—because it is an area of significant complexity for everyone here—could you focus specifically on the question of additionality to the Scottish block, and compare the position with Wales? That is what the committee is keen to do. The general principle is that it is irrelevant whether funding is objective 1 or not. What is important is whether it is structural funding.

The second issue is that funding that is allocated through Barnett takes account only of population—it does not take account of the initial European allocation. That allocation is—as you say—based on a need or requirement to fit the European regulation. That suggests that if our allocation from Europe were in excess of our population share of the UK allocation, we would lose out. If our allocation from Europe were less, we would gain. That is, however, unfair—somebody else in the UK would lose out. Either way, your point is that the principle is that funding should be allocated externally to the Barnett formula. That seems to me to be a straightforward and self-evident argument.

The next issue—which is more confusing for Scotland because we have been applying for structural funds for a quarter of a century—is match funding. That is a live issue in Wales because of the step change.

What would you say to the committee about match funding, given that Scotland has consistently been allocated more than our population's share of European structural funds to the UK? Is that something that we should just deal with, as it has gone on for a long time, or can we learn lessons from the debate in Wales?

Dr Blewitt: That is a tricky one. It would probably be too much to ask the Treasury to give any region full match funding for its projects. There needs to be some kind of financial commitment from the people who are involved, so that they will take charge of the project. If they simply get extra money from the Treasury, they might not be so keen to follow the programme through. If they know that some of the money will come from their budgets, they will ensure that that money is spent properly. In our paper, we did not argue for full match funding for every programme that comes within the Parliament's remit, but that there should be sufficient match funding to prevent the creation of too many tensions within the budgets. That is the key point about match funding.

Mr Macintosh: I want to return to the issue of additionality, which is a difficult concept to grasp. You say that the Barnett formula does not work when it is applied to regional funding. If Scotland or Wales does proportionately better out of Europe than England or Ireland, the Barnett formula does not reflect that difference. Is that correct?

Dr Blewitt: Absolutely.

Dr Bristow: Yes.

Mr Macintosh: That is particularly well illustrated when one sees that 65 per cent of a country such as Wales qualifies for objective 1 funding. Scotland has never been in that position, unfortunately—or fortunately. Have you calculated the proportions? Have you worked out whether Scotland does proportionately better out of Europe than England or Wales? Have you worked out the difference, now that the Highlands qualify for transitional relief? I do not know the difference between the funding that Scotland receives from Europe and that which the rest of the United Kingdom receives. Is there a huge difference? Are we losing out because of the Barnett formula?

Dr Blewitt: We are trying to get hold of further information on the way in which the allocations to the English regions are made, the level of those funds and whether they reflect what is in England's single programme documents. We know that the baseline provision for Wales—the amount that is allocated every year—is £20 million, but that £90 million of objective 1 funding is needed. We know the situation in Wales because of the step change, but we need to consider the way in which the funds are being allocated to the English regions. We could then undertake a like-with-like comparison.

Mr Macintosh: In theory, although Scotland might be losing out—and we do not know that at the moment—the UK as a whole is not. The money is probably being allocated elsewhere and England is benefiting. The areas that should not qualify as well as Scotland or Wales are gaining. Is that correct?

Dr Blewitt: It would seem that the money simply stays in the Treasury and is not passed on. I do not think that England does better out of it than Scotland.

The Convener: The English regions could be benefiting. I take your point about the money remaining in the Treasury, but it could be allocated disproportionately to the English regions.

Dr Bristow: We do not know that.

Mr Macintosh: The Treasury is demonstrating additionality to Europe. Additionality is taking place.

Dr Blewitt: It is certainly happening at a UK level, but additionality is a UK concept at the moment.

Mr Raffan: You made the point earlier—in reference to something that Andrew Wilson said, although it was not a direct response to what he said—that objective 1 status is irrelevant and that European structural funds are important. However, contrasting the Welsh and Scottish situations in respect of objective 1 funding is not irrelevant, because of the scale of the problem in Wales and Scotland. The issue has become controversial in Wales and, perhaps, some people in this room want to import that controversy and its electoral possibilities into the Scottish scene. Could you address that issue again? You mentioned earlier that objective 1 status is not irrelevant.

Dr Bristow: Objective 1 covers two thirds of the population and two thirds of the area of Wales and there is a significant interaction between European moneys and the block grant. Annually, the figure for objective 1 money is about twice the amount of European money that Wales is eligible to receive each year: it is double the interaction between European money and the block grant.

Mr Raffan: Is that the reason for the huge controversy?

Dr Bristow: Yes.

Dr Blewitt: You must remember that the Welsh block is smaller than the Scottish block, so there is a much bigger impact.

The Convener: Thank you. Your evidence has been very helpful, although it is slightly unnerving to be faced with two respected academics whose combined ages are, apparently, the same as mine. [*Laughter.*] The information that you have provided, both written and oral, has been very helpful and we thank you very much.

That completes our business for this morning.

Meeting closed at 12:00.

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