FINANCE COMMITTEE

Tuesday 23 May 2000
(*Afternoon*)

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(*Morning)*

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FINANCE COMMITTEE
13th 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

WITNESSES

David Stewart (Scottish Executive Enterprise and Lifelong Learning Department)
Mr Allan Wilson (Scottish Executive Enterprise and Lifelong Learning Department)
Professor David Bell (University of Stirling)

CLERK TEAM LEADER

Callum Thomson

SENIOR ASSISTANT CLERK

Anne Peat

ASSISTANT CLERK

Sean Wixted

LOCATION

Committee Room 1

Scottish Parliament

Finance Committee

Tuesday 23 May 2000

(*Afternoon*)

[THE CONVENER *opened the meeting at 13:11*]

The Convener (Mike Watson): Welcome. These are busy days, with committee meetings back to back.

First of all, are we agreed that we will take agenda item 3, considering how we will handle David Bell's evidence, in private?

Members *indicated agreement.*

Education and Training (Scotland) Bill: Stage 1

The Convener: Members will recall that last week we wanted clarification on some areas of the bill. We have a memorandum from the Scottish Executive in response, which some members received only this morning. I welcome David Stewart, head of the opportunities for learning division, Scottish Executive, and Allan Wilson, Education and Training (Scotland) Bill team leader, Scottish Executive. Since we have not had much time to digest the memorandum, would you say a few words on it? We will then move on to questioning.

David Stewart (Scottish Executive): We have provided a note expanding on the financial memorandum, which we hope will address the committee's concerns. As with any new programme, at this stage all the figures are estimates. On administration costs, the contract with the customer services provider will be for a set period of time so that costs can be reviewed in the light of experience. We envisage the unit cost of administering a learning account reducing as the number of accounts increases.

On marketing, it would perhaps have been more helpful to have used the word "outreach" in the memorandum because the policy intention is to change attitudes to lifelong learning, for example by encouraging small businesses to undertake more training and by raising awareness of learning accounts among the socially excluded. Outreach of that sort is time consuming and requires staff and training materials. Marketing will be an important part of the learning accounts initiative. Once the initiative is well established, we hope that the ratio of administrative and other costs to expenditure on financial assistance to account holders will improve.

The Convener: Thank you. I should have said at the start that that Kenneth Macintosh has sent his apologies and that Richard Simpson, who raised a number of points last week, is unable to be here at the beginning of the meeting although he will join us later.

Are there questions?

Mr David Davidson (North-East Scotland) (Con): Last week we were aghast at the on-cost percentages. I have not had a chance to read the note fully but one question we asked was whether that was usual.

David Stewart: In developing the programme we began from scratch with a zero budget, if you like, based on what would be needed to make the initiative a success. There is no obvious comparator in lifelong learning. For example, while the further and higher education funding councils give grants, they give large amounts to a small number of institutions. In other training programmes, the whole provision is bought as part of the contract. The costs that are given are what we think will be needed to deliver the programme that ministers wish to achieve; they are not derived from any other programme.

13:15

Mr Davidson: I asked that question because when I was a councillor I sat on the board of an arm's-length training company in the Stirling area. It provided training services, shorter courses and tailored packages for young people. We did not have the sort of mark-up envisaged in the form of, if you like, retained gross margin before operating costs. It was a small operation and there were many like it elsewhere in Scotland. I presume that part of this programme is to move that agenda on. The operating costs in that company were much lower. It is obvious that a much larger marketing exercise is envisaged in this case; you are proposing a maximum sum budget as opposed to a predictive sum.

David Stewart: Yes—I hope we will see a change in that ratio as the programme is established, as the idea takes hold and as economies of scale in administering the accounts kick in.

Andrew Wilson (Central Scotland) (SNP): The question put by Dr Simpson last week expressed our concern about what appears to be around 20 per cent of the overall budget going on administration. That struck us as very high. From what you said, no attempt was made to see whether that was high compared with other programmes. We wanted to hear your explanation of why administration is such a high proportion and whether that will be reflected in other similar programmes.

Mr Allan Wilson (Scottish Executive): Those figures are unlikely to be reflected over time. We are faced with a number of one-off costs. We have had to set up the process from scratch. That has meant a quite expensive procurement exercise. We have also been establishing contingency arrangements, to ensure the system will work. Once those costs are taken out of the process you will find that the overall costs will reduce remarkably.

It is also worth remembering that in the negotiations with the commercial supplier—the person who will provide the customer services interface—it is clear that the initial cost of setting up an account for an individual will be higher than the on-going costs. Running an account year by year will cost considerably less than opening it. Also, because this is a new initiative, we have to invest quite heavily in evaluation. We must ensure that it is effective and getting through to the intended people. We need to undertake research on that. That adds to the overall administrative costs.

Andrew Wilson: That is reasonable.

What proportion of the overall administrative cost is a one-off cost?

Mr Allan Wilson: We have estimated that the overall administrative cost will be about £2.5 million over two years. In the first year, the cost is likely to be about £1.5 million, of which £500,000 is the roll-out and contingency costs, which are one-off costs, and about £300,000 is for procurement and development. In the second year, we expect that the cost will reduce to about £1 million, of which £500,000 will be for marketing. About the same sum will be for research and evaluation and administration.

It is very difficult to estimate the cost of the contract that we will have with the customer service provider because it will be demand led and depend on how many accounts are opened. All we can say at this stage is that it will cost about £2 million a year. Although we expect the sum to be fairly constant, the breakdown will change. There will be a higher cost initially for setting up accounts, but later we will be able to run more accounts with the same amount of money.

Mr Keith Raffan (Mid Scotland and Fife) (LD): What is the cost of each of the three pilot projects, in Fife, Grampian and Lochaber? Is that contained in the £2.5 million?

Mr Allan Wilson: The costs for the Grampian and Lochaber projects are contained in the £2.5 million. At the moment, I do not have a breakdown of those costs. As the Fife project was not a formal pilot and was funded by European structural funds, the costs for it are separate.

Mr Raffan: Were roughly the same number of people involved in each project?

David Stewart: I will add to what Allan Wilson said. The Grampian pilot cost £100,000 to administer and £250,000 has been paid in incentives so far.

Mr Raffan: That administrative cost is very high.

David Stewart: Yes. The key point is that we are starting up a new idea.

As of the middle of this month, 2,800 accounts have been opened under the various pilot projects in Scotland.

Mr Raffan: Is one of the main aims of the pilot projects to streamline the administration and find ways of reducing the on-going costs? You mentioned that procurement is one cost; can you define what you mean by that?

Mr Allan Wilson: I will answer those points in reverse order. We are involved in a UK-wide procurement exercise, although each country will sign separate contracts because our needs are slightly different from those down south. The costs that are involved are for professional legal and procurement advice and for working out much of the detail of how the system will work. The procurement requires a very detailed specification of the system. In producing that specification, we have leaned heavily on the experience that we have gained from the pilots in Scotland and elsewhere in the UK. We have tried to produce a system that will work effectively. In doing that, we have sought opportunities to streamline the system to establish whether particular steps need to be taken or whether there is another way of doing it.

Mr Raffan: Did you deal with my first point? What was my first point? You said you would answer in reverse order and you have told me about procurement.

Mr Allan Wilson: Your first question was about the lessons that we have learned from the pilot.

Mr Raffan: The main point was my concern that the pilots should be used to find ways of cutting the administrative cost.

Mr Allan Wilson: The pilots have been used in a variety of ways, certainly including that.

Mr Raffan: You say that the procurement is being done on a UK basis. Are the one-off set-up costs here comparable to the costs in England? Carrying out the procurement on a UK basis should reduce costs.

Mr Allan Wilson: I think that we will find that some of the one-off costs down south are higher than the costs here—certainly our costs are not higher than those down south. In England, there is a greater variety of types of pilot, which are being run by different organisations, whereas we have been centralising the process.

The Convener: In paragraph 4 of the note that you supplied for the meeting, you cover the types of people you are trying to encourage back, such as adults who have not been in learning since school, the socially excluded, and people in employment, especially in small or medium enterprises. You say that they are notoriously difficult groups to reach. You have based the cost of £16.5 million on an uptake of 100,000 in the first two years. How did you reach that nice round figure? If those groups are notoriously difficult to reach, how confident can you be that you can reach them in two years? If you do not succeed, what will happen to the £16.5 million? Presumably, it will simply be reduced.

David Stewart: The target arises from the commitment in the programme for government that 100,000 individual learning accounts would be opened in Scotland. At the general election, there was a target of 1 million accounts across the UK, of which 100,000 was the pre-devolution Scottish share. The amount that is spent on incentives will be determined by the take-up, which could be higher or lower than 100,000, depending on how quickly the initiative takes hold of the imagination and is developed.

Mr Davidson: Paragraph 4 of your statement refers to

"co-operation with the Scottish university for industry".

Can you explain the financial connections and whether money flows to or from the university or whether it is completely separate?

David Stewart: Individual learning accounts and the Scottish university for industry are primarily separate. Scottish UFI will have an important role in promoting not just the opportunities for learning and the courses that are available, which is its prime function, but in giving the added message that people may be able to get financial support for learning through ILAs. The Scottish UFI budget will be provided through a contract from the Scottish Executive. It will be a separate contract for all its functions. The budget for ILAs is separate from that. SUFI is very comfortable with the idea that it can promote ILAs at the same time as it puts out the wider message about lifelong learning. Those two messages together make a much stronger point.

Mr Davidson: I do not argue about the marketing. I am seeking clarity only about the cash flow. A budget goes to the Scottish university for industry and it is paid to carry out marketing on your behalf, on a directional basis.

David Stewart: Yes.

Elaine Thomson (Aberdeen North) (Lab): I want to return to the matter of the £2.5 million for marketing, research and evaluation. Given that certain groups are extremely hard to get hold of—that was reflected in the pilot studies, for example the Grampian pilot—will any of that money be ring-fenced and targeted at those groups or used to develop the linkages that were found to be necessary to get hold of people who are not accustomed to learning?

David Stewart: Your colleagues on the Enterprise and Lifelong Learning Committee have been particularly concerned about how the initiative will be marketed and how marketing can be targeted at particular groups. The prime intention is that Scottish UFI will do the national awareness-raising marketing and local enterprise companies will focus marketing locally on particular groups and needs. Using their local contacts, they will develop a local marketing plan as part of the learning accounts initiative to focus on the groups that need to be reached in their areas. Each LEC will receive a sum of money through Scottish Enterprise or Highlands and Islands Enterprise for that.

Elaine Thomson: So some of that £2.5 million will be divided among local enterprise companies, which can decide how they want to spend that money. If they want they can target certain groups.

The Convener: If there are no further questions, I thank Mr Stewart and Mr Wilson for being with us today. The committee will now move to agree—I think—that the Parliament should pass a financial resolution in regard to the Education and Training (Scotland) Bill. Is that agreed?

Members: Yes.

13:30

Meeting continued in private.

13:53

Meeting resumed in public.

Convener's Report

The Convener: We are now back in public session, and we will go on to agenda item 4. Subsequent to last week's evidence-taking sessions by this committee and by the European Committee, Callum Thomson and I met Stephen Imrie, clerk to the European Committee, and Hugh Henry, the convener of the European Committee. Elaine Thomson was there as deputy convener of this committee.

We made the point that we were concerned that there seemed to be a move away from the arrangement that we understood to have been quite clear, with regard to the remits of the two committees in this inquiry. We reached agreement that there was no question of the European Committee going into the Barnett formula, or into areas that were exclusively the remit of the Finance Committee. That is the basis on which we will move forward from here. I hope that I have members' agreement on that. To make this absolutely clear, it will be key that the reports that both committees eventually produce do not duplicate, and do not stray into areas outwith, the remit.

European Structural Funds

The Convener: We now move on to agenda item 5. I am pleased to welcome Professor David Bell from the University of Stirling. Thank you for being with us today, and for the paper which you have submitted in advance. I am sure that you have had an opportunity to hear about, if not read, some of the evidence that we have taken already, and you will know all about the inquiry that we are involved in. It would be helpful if you could make some opening remarks, further to your paper.

Professor David Bell (University of Stirling): I wish to start by thanking members of this committee for the opportunity to address them on this issue. The work that we have done forms part of a larger project which the University of Stirling is carrying out with the Leverhulme Trust. Alex Christie, who is with me today, has been instrumental in gathering a lot of the information that we have brought today.

The substance of my presentation will focus on the interaction between the Barnett formula and European funding. The committee specifically asked whether the Barnett formula is the most appropriate way to allocate structural funds in the United Kingdom. I will give you an economist's answer: in a sense, it is no, but a qualified no, and I will try to explain why.

Structural funds are allocated by a mechanism that seeks to identify need by various different measures. For example, there is a requirement that objective 1 status is determined by whether the average level of per capita income in an area is below 75 per cent of the EU average. In contrast, the Barnett formula is a purely mechanistic allocation mechanism, which takes no account of relative need. Instead, changes in allocations to Wales, Scotland and Northern Ireland are determined in fixed proportion to changes in allocations made in England.

As long as it is the case that the increase in European funding in areas receiving funding is greater than the increase in comparable programmes in England, the use of the Barnett formula will disadvantage that area relative to its previous position. That is quite a technical argument, and perhaps the best way to make it clear is to give an example.

Suppose, for the sake of argument, that England initially receives £100 million in EU funding, and that another region—let us invent a region and call it the Celtic fringe—receives £10 million. Let us assume that, in this state, both England and the Celtic fringe are able to meet the requirements laid down by Brussels in terms of additionality and match funding. Suppose further that the Barnett formula works in the following way: across the range of relevant public expenditure, there will be an increase of 10 per cent on any increase that happens in England. That 10 per cent will be applied to increases for the Celtic fringe.

Now suppose that we go on to a new round of EU funding. Brussels decides that an extra £10 million should be spent in England, and an extra £2 million should be spent in the Celtic fringe. Although the increase in the Celtic fringe is smaller in absolute terms, it is bigger proportionally. At that point, the Barnett formula kicks in. The Celtic fringe will get a provision—not actual money—to spend. That provision is 10 per cent of whatever is allocated to England. If it gets 10 per cent of the £10 that has been allocated to England, that is £1 million. However, the EU said that it should receive £2 million, so there is a shortfall. It has no option but to find that extra money from somewhere else in its budget. That is the essence of the argument that occurred in Wales.

The short answer to the question as to whether the Barnett formula is an appropriate mechanism is that it is not, if, by appropriate, we mean that it should not create financial hardship within the component parts of the United Kingdom. That is different from saying that the Scottish Parliament ought to press for different arrangements. I will qualify what I said in my paper somewhat. Scotland is not quite in the same position as the Celtic fringe region that I have invented as things are not getting relatively worse, at least in Europe's eyes, compared to the rest of the United Kingdom.

14:00

The paper that I submitted to the committee contained a graph, which was the response to the question that John Swinney had asked in Parliament. The graph shows that expenditure in structural funds on Scotland has declined as a share of total UK spending during the past 20 to 25 years. As a result of that, the amount that Scotland gets in each successive programme is getting smaller. Therefore, the problem of finding match funding and getting appropriate provision from the Treasury is lessening.

The outcome of that is that, as far as Scotland is concerned, the problems of finding match funding and having provision via the Barnett formula are significantly less than they are in Wales. David Heald argues in his paper, which I received a copy of yesterday, that given that Scotland has been able to deal with those problems in the past, it may be dangerous for it to argue that one part of the Barnett formula is causing a problem, as examination of that might lead to a review of the whole Barnett formula.

Given that in the past the Scottish Office seemed to be able to deal with the problems of match funding and provisions in the budget, as Scotland's share of EU funding is declining and as the UK share of EU funding is likely to continue to decline as the EC expands, I am coming round to the conclusion, in relation to the current arrangement, that if it ain't broke, don't fix it. If I were in Wales, I might say something different—but I am not in Wales, so there we are.

The Convener: Thank you. There are a number of interesting points in your written submission and in what you have said. You acknowledged David Heald's paper. Members might ask you about your opinion on aspects of what he said. I hope that is all right.

You mention in your paper that in 1992-93 European regional development fund provision was included in Scotland's block grant for the first time. You say that that was principally to persuade the EU that those funds were additional to UK Government regional assistance. Is that your impression, has that been stated, or is it just accepted?

Professor Bell: It was stated. We have discussed this at some length and we cannot quite understand why it is the case, but it has been stated.

The Convener: By the Scottish Office or the Treasury?

Professor Bell: The Treasury.

The Convener: Did the inclusion of ERDF increase the additionality of funding?

Professor Bell: I am at a loss to explain why that might have been the case. Additionality is a difficult concept to identify. It is a classic what if problem. The best that the UK Government has come up with is that there is a lack of subtractionality; in other words, at least you keep programmes where they were and do not bring them down. It seems that that is acceptable as a means of identifying additionality.

The Convener: You state in your paper that that is what the EU takes as evidence of additionality—that there is no evidence of subtractionality.

Professor Bell: Yes.

The Convener: What happened prior to 1992-93? Was the change presentational, moving the beans about on the board?

Professor Bell: As I understand it, there were disputes about British programmes. Specifically, in one coalmining case in Wales, it was deemed that there was a clear substitution of European funding for UK funding. As a result of that there was constant negotiation between Europe and the Treasury. This outcome was seen as a way of making what happened in the UK acceptable to the EU as far as additionality was concerned.

Previous to 1992-93 there were a lot of disputes.

The Convener: I will ask other questions, but I will bring some other members in first.

Andrew Wilson: I thank Professor Bell for a very illuminating paper. There is little in it that many of us would contest. I will explore some of his conclusions.

First, in relation to the graph from John Swinney's question at Westminster, you came to the conclusion in your opening remarks that the structure is essentially the same as in Wales, but the scale is different so the problem is less. I do not think anyone would dispute that. My point is that, from 1975 to 1999, on that graph there are only two years in which Scotland's allocation of the UK pot is less than its population share and therefore less than Barnett. Is it logical to suggest that, from your conclusion, there will be a shortfall in funding in every year except those two?

Professor Bell: That is correct, but it depends where you start from. If you assume that Barnett was originally a reasonably generous provision due to the fact—and I noticed this when I drew up this graph—that the trend line, or indeed the figures, stays above roughly 8.5 per cent, then that means that Scotland has always received more than its share of UK European funding. Remember that not all of that goes through the Barnett formula. The ERDF does, but structural funds do not. There are various other smaller schemes.

Andrew Wilson: But when you said that Scotland receives more than its share—

Professor Bell: Population share. In EU terms it receives the share that it deserves, based on relative need.

Andrew Wilson: Would it be more accurate to say that Scotland is being allocated the share that it deserves? We are trying to explore whether it receives that.

Professor Bell: Yes. The allocation within the United Kingdom is a question of how the Department of Trade and Industry allocates the single programming documents that it puts together and makes requests for the various component parts of the United Kingdom.

Andrew Wilson: If we draw the trend line from 1994-95 and carry it on, it moves markedly upward. That suggests that if we were to start now or, indeed, in the previous Parliament, your conclusion would be reversed.

Professor Bell: That is true. The reason that I feel that the trend line that I have drawn is more accurate is that there may have been backloading of the 1994 to 1999 programme in Scotland. It does not seem to me that a sudden reversal of the trend that I have set out is likely, given the prosperity of Scotland relative to that of the rest of the United Kingdom. It may level out.

Andrew Wilson: There is only one outlier during that period—1998-99. Both trends are accurate; it is a question of which one is useful.

The Convener: Can you explain what backloading is?

Professor Bell: Under the single programming documents, a sum is agreed for a programming period of five years. When the money is drawn down depends on how particular projects come forward and how approvals for spending on those projects are made. It may well happen at the end of the period—that is what I refer to as backloading.

Andrew Wilson: So we should look at the whole programme period rather than one year. That seems reasonable. On the basis of the information that you have or may be able to get, can you say in which years there has been a shortfall in the allocation of funding?

Professor Bell: I was not examining the data at that time, but there is most likely to have been a shortfall in a year such as 1981, when we were getting more than 35 per cent of the EU funding. However, it should be remembered that that was prior to ERDF coming through the Barnett formula. If no specific allocation had been made at that time, the Scottish Office budget would clearly have been subject to severe constraints.

Andrew Wilson: So there must be a threshold that determines whether we are in shortfall or getting too much. It would be very rare for us to get exactly the correct amount.

Professor Bell: As Alex Christie underlined to me while we were sitting outside, we do not get too much, because what happens under the Barnett formula is that we get a provision to spend. We get an allowance that enables us to spend a certain amount in a specific period. Wales is worried that it is not getting sufficient provision to spend, given what it has been allocated. It is likely that, given the way that the Barnett formula works, we will have sufficient provision to spend to meet the requirements that the European Commission is laying on us. We do not get extra money. We get only what Europe has allocated to us. This is a fairly abstruse point, but the Barnett formula is not overgenerous. It is undergenerous to those areas where insufficient provision has been made.

Andrew Wilson: So, leaving the scale to one side, under the current structure we will never get more than we need, but there could be a shortfall.

Professor Bell: Yes.

Andrew Wilson: This is something that we tried to explore with your academic colleagues from Wales. However, we lacked the information from the Treasury that would have enabled us to put a precise number on it. What information do you think we require a Treasury witness to provide us with, perhaps in advance of their coming here, for us to be able to get a detailed picture of the situation between 1975 and 1999 and of the forthcoming programme?

14:15

Professor Bell: As far as the Barnett formula is concerned, a document—to which David Heald refers—was published by the Treasury earlier this year. The document lays out precisely which programmes are included in the Barnett formula and which proportions of those programmes are included. Some of the programmes cover areas that are relevant to European funding. It might, therefore, be worth finding out from the Treasury how that provision has worked in practice during the period in which you are interested.

The committee should also ask for detail about provision for spending in Scotland on an annual basis, given that there is a five-year programming period for which we know the global amount that Europe has promised to Scotland. What is the mechanism whereby the Treasury has allocated provision throughout that five-year period?

Mr Adam Ingram (South of Scotland) (SNP): On the Barnett formula, you used the argument, "If it ain't broke, don't fix it." What has been teased out in the meeting is that the Barnett formula has not operated entirely fairly in terms of allocations throughout the period. Is it not the case that we are holding on to nurse for fear of something worse?

Professor Bell: There is an element of that. One might say that we have done worse in certain areas of spending, but in health or education, for example, we get roughly 20 per cent more per head than the rest of the UK. That is based on the Barnett formula.

David Heald's point—with which I have some sympathy—is that the broad view is that the Barnett formula has been reasonably generous to Scotland, and if we start trying to unpick a part of the allocation that is not so generous, we might undermine the whole structure.

Mr Raffan: I would like to follow on from Adam Ingram's point. My question might, in a sense, be inappropriate because it is more political than economic. Might we be forced into a debate on the Barnett formula as a result of pressures from the mayor of London or from the north-east of England? I accept the points that you and Professor Heald have made, but we might be forced into an examination of those issues because of a national UK debate.

Professor Bell: Of course—that might happen. As I said in my introductory remarks, the operational bases of EU structural funds and of the Barnett formula are quite different. EU structural funding and the local authority spending assessments in England are based on need. A variety of indicators are examined for whatever programme is relevant and allocations to areas are based on perceived need.

The Barnett formula works in a quite different way. If we accept the principle of change, we will be into a completely new ball game and will have to start considering whether, because heart disease, for example, is much worse in Scotland than in the rest of the UK, we could justify spending 20 per cent more on health per head. However, that would have to be argued case by case. That is what happens in English local authorities—I have been party to the debates that they have and it is an extremely tedious process—whereas the Barnett formula is fairly clear cut.

Mr Raffan: It has the virtue of simplicity.

Professor Bell: Exactly.

Rhoda Grant (Highlands and Islands) (Lab): You said that Scotland receives no more because of the Barnett formula, but that it can receive less. Why is that? Is it because Europe says that we can receive X, but no more that that?

Professor Bell: It is to do with the European regional development fund, which is the one that goes through the Barnett formula. A provision is made that England can spend, for example, £100 million. Scotland would receive provision to spend £8.8 million. If Europe has promised only £4 million, Scotland will not get the £8.8 million—it will get only the £4 million that Europe has promised. So, although there is provision to spend a further £4.8 million, it cannot be spent.

If the reverse were the case and Scotland had been promised £10 million by Europe, but the provision from the Treasury was only £8.8 million and there was a shortfall of £1.2 million, the Treasury would not step in and say, "Here is the £1.2 million." Scotland would have to deal with the shortfall from existing resources, by deferring the programmes or in some other way.

Rhoda Grant: Is the money just lost?

Professor Bell: It is not real money. It is a provision to spend, not cash.

Rhoda Grant: Yes, but the Government cannot reclaim it.

Professor Bell: No, it cannot be reclaimed.

Rhoda Grant: It is money in Europe that has not been drawn down.

Mr Davidson: I want to clarify some things that you said in your introduction, which seem pertinent at this point in the debate. Early on, you made it clear that the money was an allocation or a provision to spend—whatever phrase we use. You then made a comment, which I took to mean that with a lower structural fund allocation, it is easier to get the matched funding. Does that mean that drawdown and completion of programmes are more likely to happen with a lower structural fund allocation than if you get a high structural fund permission figure, which you cannot use because you have nothing to draw in matched funding? Are you saying that over time Scotland has spent quite realistically on programmes?

Professor Bell: Scotland has been able to do that because of the way in which the public expenditure system in the UK has worked. If there is a problem with getting sufficient provision for the programme, there will be an added problem with matched funding, because one has to dig into other spending programmes to get the provision—the money—that one needs to pay the contractors. Additional matched funding has to be found, the vast proportion of which comes from the public purse—enterprise companies, local authorities and so on—so ultimately, it all works its way back to the Barnett formula. If there is a shortage of funds to meet the allocation from Europe, there will almost inevitably be similar problems meeting the matched funding requirements.

Mr Davidson: Therefore, is it a three-stranded argument, rather than the simplistic Barnett formula and structural funds argument? Matched funding has to be thrown into the equation as well, with the complications across programmes.

Professor Bell: Absolutely.

Mr Davidson: I asked for the purposes of clarification only. I thought that that was where you were leading us, but the point did not quite come out.

Mr Raffan: You made the point about the difference in interpretation of matched funding between the Government and Brussels. Brussels is quite clear that matched funding is public funding, whereas the UK Government does not care where that funding comes from. However, I presume that matched funding is still predominantly public funding, therefore the difference in interpretation is not a reason for great tension between the two. Do they accept each other's positions?

Professor Bell: Yes, I think so. It would be possible for the Scottish Executive to set aside a fund for matched funding. That would save a lot of effort for a lot of people who have to try to cobble together all the bits and pieces to make up matched funding, because, ultimately, that funding comes from the same sources. Perhaps that would make the Executive think a little harder about the value of its projects and investigate them more thoroughly, as matched funding from whatever source will have to be scrutinised by the body that makes up that matched funding.

Mr Raffan: I should like to raise a technical point. I am not sure where it comes in, but I would like to explore it briefly.

Your paper says that

"the managing authority draws money from a suspense account at the Bank of England where the European Commission deposits the funds."

I presume that the funds are deposited in euros and withdrawn in sterling.

Professor Bell: I guess that that is true.

Mr Raffan: It is important, in terms of the exchange rate, to find out at what point the funds are exchanged into sterling. Does that happen when they are withdrawn or when they are deposited?

Professor Bell: The single programming documents are written in euros but recompense is made if there is a swing either way, relative to the only other currency in Europe.

Mr Davidson: In your paper, you talked about, ideally, excluding structural funding from the departmental expenditure limits and ring-fencing them under annually managed expenditure. That suggests that you want to break down the Barnett formula, taking bits of it and tinkering with them.

Professor Bell: Actually, I am retreating a little from that position. I know that the witnesses from Wales who previously came to the committee took that position. That would be a clean position—everything would be very transparent, and that might be the best course of action, if transparency were the ultimate goal. However, I suspect that if one is in a reasonably favourable position, it is not necessarily good tactics always to make everything completely transparent.

Mr Davidson: If I read you correctly, you were saying theoretically that, when setting up the system from a cold start, you would have preferred more transparency. However, you have considered the practicality of the delivery of funding, in relative terms to Scotland's needs, and concluded that the Barnett formula has not damaged that situation too badly—I think that someone else used that word. You are saying that, in realistic, pragmatic terms, that is why you think the formula should roll on as it is, without major change, although that is not to say that there might not be change or that change might not be suggested.

Professor Bell: Yes.

Mr Davidson: If there were to be changes, what changes would you like?

Professor Bell: Do you mean changes between London and Scotland, or—

Mr Davidson: Changes between any of them. You said that you have stepped back from your initial position in the paper, which was a statement of theory. If we said, "Right—that's not going to happen, but here we are in a new discussion, and you are our adviser," what options would you advise us to consider?

Professor Bell: There might be an argument for discussions with the Treasury about the way in which the provisions are put together—about whether the way in which the provisions are sequenced meets clearly the sequencing that the Scottish Executive might desire. I am thinking of the five-year periods over which the projects are run. The Scottish Executive might decide that it did not want to back-load all the projects but would rather get things off the ground more quickly. At that point, one might discuss with the Treasury the sequencing of the provision to spend public money, to allow for a slight variation from the precise answer that the Barnett formula would give. It would involve only a slight alteration from the current position, but would allow a more even flow of project money rather than having great leaps from year to year.

14:30

Mr Davidson: You are suggesting that the Barnett principle is fine, but that having it annualised means that it gets out of step with the European programmes. You want it to be stretched, much in the way that the Executive is considering having a three-year rolling budget with spending carried over and so on.

Professor Bell: I am sure that the Welsh would welcome that, too.

Mr Davidson: Would that be of benefit to Scotland?

Professor Bell: I think so. It would not be hugely beneficial, but it would help to smooth out the variations in the programmes.

Andrew Wilson: As I have followed your working statements on these matters with great interest, I can follow the logic of your paper perfectly, but I cannot follow the logic of what you have just said. Your stance seems to have altered.

How can you square the statement that we can only lose from the current situation with the statement that we are in a beneficial position and should not change that?

Professor Bell: We cannot gain in the sense that we can never spend more EU funding than Europe allocates to us. I would not describe that as losing. The slight change in my position towards the current situation is based on the view that, realistically, Scotland cannot expect suddenly to increase its share of resources from the structural funds. As a result, it seems that the problems of making the provision and of matched funding will not be that great. You point out that our European funding level is above our population share—although we are approaching a point where that will equalise. The general argument is about whether one wants to open up the Barnett issue because of a smaller issue. That is a political decision rather than an economic one.

Andrew Wilson: Would it be feasible for us to do what you suggest in the paper and allocate the European funding external to Barnett, which would leave Barnett untouched? Why would the issue of the structure of Barnett automatically be opened up? There are consistent precedents for things being added into the Barnett formula, so why should there be a problem in taking things out?

Professor Bell: That would require the agreement of the Treasury. It would have to go back to the EC and ask to take the European regional development fund out of the Barnett formula.

Andrew Wilson: With respect, the European documents seem to be relatively clear that that is an internal matter. The statement from Commissioner Barnier suggests that the way in which the UK deals with that is a matter for the UK.

Professor Bell: Obviously, this is a matter on which I am not clear. Perhaps you could explore the issue with the Treasury. The ERDF went through the Barnett formula because the European Commission insisted that that was a way in which additionality could be established.

George Lyon (Argyll and Bute) (LD): I want to turn to some of the European issues that you mentioned at the end of your paper, because they may be more important than the minuet about how the Barnett formula affects us. Can you tell us about how the rebate system that was agreed at Fontainebleau acts as a disincentive to the UK accessing additional funds in Europe? There is great reluctance to access anything more than the dedicated spend, particularly in agriculture.

Professor Bell: For the Treasury, transactions with Europe are just part of the gamut of public spending. In a sense we are making our contributions to Europe in the form of VAT, customs duties and so on; that is one side of the account. On the other side of the account there are our receipts from Europe; the common agricultural policy and the structural funds make up the vast bulk of that. There is a gap between those two—our net contribution to Europe. We also receive a rebate, which is related to the size of that gap. For every £1 reduction in the size of the gap, the rebate will fall by 60p. If we increase funding on cattle schemes or on building fishing boats and so on, effectively, that extra pound is being funded 40p by Europe and 60p by the Treasury. Therefore there is a disincentive for increased overall spending. Effectively there is a 60 per cent tax rate on such extra spending. It is difficult, because there is no direct experience of that apart from people's experience with the agricultural funds.

George Lyon: You are saying that the make-up of the extra spend on each pound is 60:40. That ratio has been quoted to us, by the Treasury, as 79:21. In my experience, in agrimonetary compensation, the argument has always been that UK taxpayers contribute 79 per cent of every extra pound because of the Fontainebleau agreement. Is that right?

Professor Bell: The issue is complicated by the fact that we always make a contribution to our own spending. We are the third or fourth largest economy, so we contribute about 10 to 12 per cent of any spending. It is a question of whether we add in that 10 to 12 per cent. The figures tend to hover, depending on whether we take into account our contribution to overall European spending. I am sure we can be bump the contribution above 60 or 70 per cent.

George Lyon: Is it true that most other countries operate on a 50:50 basis on any additional spending?

Professor Bell: Other countries do not have the rebate.

George Lyon: So the effect of the rebate is that we operate at a disadvantage.

Professor Bell: Yes.

George Lyon: You suggested that there was a compensation mechanism to cover any programme funds that were eroded because of the exchange rate over the period.

Professor Bell: I understand that to be the case.

George Lyon: How does that work? Does the Treasury top it up to the original expectation?

Professor Bell: No, the European Union. My understanding is that the UK taxpayer does not contribute to that.

George Lyon: So the number of euros is increased?

Professor Bell: Exactly. I suspect that they have increased somewhat more than was expected at the beginning of last year.

George Lyon: In your last paragraph, there is a throwaway line about the effects of enlargement. We are in transition with objective 1 and structural funds. Ireland will go from being a net gainer to being a net contributor to the European Community at the end of the six-year period. Is enlargement—allied with the threat to the CAP budget when the eight or nine countries that are joining the EU lobby for an allocation of that budget—one of the biggest threats to European funding for Scotland?

Professor Bell: Imagine the position: we bring in a number of countries from eastern Europe while in Brussels the commissioners decide how much to spend on structural funds. There has been pressure to spend less on those funds, particularly from the UK. The pressure to spend less on agricultural funds has been even greater. Generally, however, one expects the sums that the current members would like to contribute to be tightened up.

Think about the civil servants in Brussels considering and treating equally each component of the new, enlarged Europe and establishing a criterion, such as 75 per cent of average gross domestic product. All the eastern European countries will qualify. The structural funds will be sucked to the east and with an at best constant overall budget being spent, the share for Scotland, Ireland, Wales and England is likely to decline.

George Lyon: Will that apply to the CAP funds?

Professor Bell: I suspect so.

The Convener: That is rather wider than our role in this inquiry, but it is an interesting answer none the less.

I wish to ask a question about additionality and how it is calculated, which I asked a witness last week. In your submission you use the term subtractionality, which I had not heard used in relation to our inquiry. I can understand how additionality is measured in years two, three, four and five of a six-year programme. How do you measure it in the first year if there has not been that sort of application of funds to that part of the country before?

Professor Bell: All one can do is a kind of thought experiment in which we ask, "Would the UK Government have spent money on this anyway?" Let us suppose that Europe was possibly going to fund a replacement bridge over the river Ness. Brussels would ask whether UK public spending would have built that bridge anyway. That is a question to which there would seem to be no obvious answer: it is hypothetical. Subtractionality is a little more concrete, as the figure that was spent previously on bridge projects can be cited. Additionality is not judged case by case, but at a UK level. If the amount of public funds that are allocated to construction projects have not been reduced, we can say that the funds that Europe provides are additional funds.

The Convener: Surely that could be said only if the projected spend was on a downward curve and European funding maintained it at the same level. It would not have to be a forward projection of thought, but could be based on fact if there had been a proposal to reduce that funding internally within a state.

14:45

Professor Bell: Yes. There are always public expenditure plans that one can go and look at, which might show what the chancellor thought ought to have been spent on the various components of public spending. There is a danger, though, that it may have been in the chancellor's mind that he could spend a little less on certain projects because Europe might intervene.

If one takes the chancellor at his word in saying that the amount of spending that the UK Government is prepared to commit to various projects is x, and if that level of spending is maintained, Europe is quite happy to allocate funds. As long as the amount of spending in the UK does not fall below x, Europe will be satisfied that any funds that it provides are additional. I realise that the issue is complex.

The Convener: Thank you. I may have to read that over again in the *Official Report*.

I have one last question, which relates to Professor Heald's letter. He says that

"the present devolution finance settlement hinges on the ambiguous status of the undertakings in the July 1997 Devolution White Papers that the Barnett formula would be maintained after devolution."

Do you agree that that status is ambiguous?

Professor Bell: It is a fine point that Professor Heald is making about a white paper and the weight that a white paper might carry. At the moment—this is a political view—the Barnett formula does not seem to be under serious threat. I am not sure what constellation of political events would need to occur for it to become more seriously threatened. I would take a more robust view than that of Professor Heald. He seems to be qualifying his view about the Barnett formula's longevity.

The Convener: Thank you. Are there any further questions?

Mr Raffan: We have covered the Welsh situation and the questions of scale and the extension of objective 1 funding that it raises. The problem is more serious there; it is not every day a First Secretary loses their job over this issue. Wales benefits less from the Barnett formula than we do. Can you describe how that affects its position in respect of structural funds and having to negotiate even harder with the Treasury between now and July?

Professor Bell: What you must remember about Barnett is that there are two bits to it. First there is the starting position and secondly there is the year-on-year change. We hear about the year-on-year change. If spending in England increases by £100 million, spending in Scotland will automatically increase by £8.8 million. I have forgotten what the precise proportion is for Wales.

Less attention is focused on the starting position. If, way back in the mists of time, there was a reasonably generous starting position, relatively small changes to that position will still allow the country to maintain a relatively strong position. Wales is getting its population share of any change in comparable programmes in England, just as Scotland is.

The best way to explain why Wales appears to be doing relatively badly compared with us is that it had a weaker starting position. In addition, the Barnett formula was for a long time not adjusted to reflect the fact that Scotland's population was declining. The formula now takes account of that on a yearly basis, but it was not adjusted between 1979 and 1992, when the population of England and Wales grew substantially and Scotland still got a share of any changes that was well in excess of its population share. Wales has suffered from having a bad starting position; we did well because adjustments to reflect our declining relative population were not made, which made our position even better.

Mr Raffan: That is another part of the country that might have a vested interest in reopening the Barnett formula, particularly given what it has gone through, but you still do not think that the formula is under threat. You take a more robust position. We have had the mayoral election in London and we have seen the Welsh situation over the past six or seven months. The north-east of England is beginning to debate devolution and there is a general election coming up, at which those issues may be debated. Do you still not think that it is under threat?

Professor Bell: I acknowledge what you say. I am making a judgment based solely on the inertia of the formula system over the past 100 years, starting with Goschen. It has been going for a long time. It is clear cut and does not reflect need, but I suspect that many politicians would find it easier to make small adjustments than throw out the whole mechanism, which would get us into annual debates about whether lung cancer is worse than another health priority, for example. You can see where that might lead.

The Convener: Professor Bell, thank you for your assistance. We appreciate your evidence, which will form an important part of our report.

Meeting closed at 14:53.

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Tuesday 30 May 2000

FINANCE COMMITTEE
14th 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

CLERK TEAM LEADER

Callum Thomson

SENIOR ASSISTANT CLERK

Anne Peat

ASSISTANT CLERK

Sean Wixted

LOCATION

Committee Room 1

Scottish Parliament

Finance Committee

Tuesday 30 May 2000

(*Morning*)

[THE DEPUTY CONVENER *opened the meeting at 10:06*]

The Deputy Convener (Elaine Thomson): Welcome to this morning's meeting of the Finance Committee.

As you can see, Mike Watson, our convener, is missing as the result of a slight accident involving his back. I have received apologies from Kenneth Macintosh and Adam Ingram will, I believe, turn up later.

Items in Private

The Deputy Convener: There are three items on our agenda, the first of which is to ask whether the committee agrees to take the second and third items in private. Do I have the committee's agreement to that?

Members: Yes.

The Deputy Convener: The meeting will now move into private session.

Meeting continued in private until 11:55.

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