

FINANCE COMMITTEE

Tuesday 21 May 2002
(*Morning*)

Session 1

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FINANCE COMMITTEE

10th Meeting 2002, Session 1

CONVENER

*Des McNulty (Clydebank and Milngavie) (Lab)

COMMITTEE MEMBERS

*Brian Adam (North-East Scotland) (SNP)

*Mr David Davidson (North-East Scotland) (Con)

Mr Tom McCabe (Hamilton South) (Lab)

*Alasdair Morgan (Galloway and Upper Nithsdale) (SNP)

*Mr Jamie Stone (Caithness, Sutherland and Easter Ross) (LD)

*Elaine Thomson (Aberdeen North) (Lab)

COMMITTEE SUBSTITUTES

Mr Keith Harding (Mid Scotland and Fife) (Con)

Mr Keith Raffan (Mid Scotland and Fife) (LD)

Andrew Wilson (Central Scotland) (SNP)

*attended

THE FOLLOWING ALSO ATTENDED:

Professor Peter Jackson (Adviser)

Murray McVicar (Scottish Parliament Information Centre)

Professor Arthur Midwinter (Adviser)

WITNESSES

Grant Baird

Campbell Christie (Scottish Civic Forum)

Stuart Duffin (Scottish Civic Forum)

Matthew Farrow (Confederation of British Industry Scotland)

Iain McMillan (Confederation of British Industry Scotland)

Peter Wood (DTZ Pieda Consulting)

ACTING CLERK TO THE COMMITTEE

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SENIOR ASSISTANT CLERK

Terry Shevlin

ASSISTANT CLERK

Gerald McNally

LOCATION

Committee Room 4

Scottish Parliament

Finance Committee

Tuesday 21 May 2002

(Morning)

[THE CONVENER *opened the meeting at 10:01*]

The Convener (Des McNulty): Welcome to the 10th meeting in 2002 of the Finance Committee. This is the committee's first meeting of the week—there will be another evidence-gathering meeting in Orkney on Thursday.

Mobile phones and pagers should be turned off. Jamie Stone has sent his apologies—he will be late—but there are no other apologies. Professor Arthur Midwinter and Professor Peter Jackson are in attendance.

Budget Process 2003-04

The Convener: Agenda item 1 is the 2003-04 budget process. As part of our review of financial scrutiny arrangements, we recently agreed that we should widen the consultation process on the budget and receive evidence on the proposals from organisations outwith the Executive. Therefore, we have invited a strong team of people to today's meeting. Campbell Christie is the convener of the Scottish Civic Forum and Stuart Duffin is its treasurer. Iain McMillan is director of the Confederation of British Industry Scotland, Grant Baird is a retired Royal Bank of Scotland chief economist—he has done many other things—and Peter Wood is head of public policy at DTZ Pidea Consulting.

The committee has received a paper from Peter Wood. I am grateful to him for supplying us with clear and in some ways provocative comments—they are welcome. Professor Arthur Midwinter has issued a short paper to members with questions that were issued to all witnesses. I propose that each witness should give a short opening statement, after which we will proceed to questioning. I ask the witnesses to keep their initial comments brief.

Campbell Christie (Scottish Civic Forum): I thank the committee for its invitation to give evidence. We welcome the opportunity to participate, although the notice that we were given was somewhat short, which meant that we could not produce a document as requested.

The Scottish Civic Forum is a relatively new organisation. As a result of the available time and resources, we did not feel able to engage in heavy number crunching on the budget—perhaps it is better to leave that to other heavyweight contributors today and to some of our heavyweight members from the Scottish Trades Union Congress, the Scottish Council for Development and Industry and the Federation of Small Businesses, for example.

At short notice, we called together some smaller organisations that might not normally be able to provide evidence to a committee such as the Finance Committee and that have worked with us in recent months in other policy consultations. We wanted to find out how far the budget process was transparent for them and whether the budget provision adequately meets new policy obligations on which we were consulted. Perhaps our contribution will relate more to the perceptions of people who beaver away day by day in the front line with the public—in that sense, I hope that it will be relevant. I will say something about that consultation and Stuart Duffin will say something about transparency.

In general, our members welcomed the budget process as a means of putting expenditure to policy provision. The general feeling of the people whom we called together was that the budget document was slightly more user friendly than previous documents, although its size means that it is difficult to regard it as entirely user friendly. I suppose that its size is inevitable, but there was a feeling that there had been an attempt to make the document more user friendly.

The document raised a number of questions about the adequacy of provision in areas in which there had been recent consultation and recent proposals for new legislation. I would like to speak about one or two of those areas before Stuart Duffin says something.

In November 2000, we were consulted on the strategic priorities for Scotland's passenger railways. We carried out a consultation exercise among our members and rushed to produce a response in early 2001. We addressed some interesting and important issues in that consultation. For instance, we were asked:

"How would you rank the ... operational priorities for developing Scotland's passenger rail services and why? ... What might be the most appropriate response to overcrowding on trains at the peak?"

From using ScotRail trains, we all feel pretty strongly about that issue. We were asked:

"How might communities be more effectively engaged in the 'management' and 'monitoring' of the safety and security of the railways that serve them?"

We were also asked:

"How would you rank the following service quality improvements and why?"

To answer those questions, we put a great deal of effort into our submission and identified a number of other areas in which we thought it was important for us to contribute. We identified six major schemes in the next 10 or so years that are essential if the passenger railway system is to meet Scotland's needs. Among those schemes were the Glasgow crossrail arrangement, the airport rail links, mainline electrification between Edinburgh, Glasgow and Aberdeen and the restoration of the Edinburgh-Galashiels-Hawick-Carlisle line. We made our submission in early 2001.

True to form, those who participated in the consultation turned up when we asked our organisations to come along and talk to us about the budget provision. There was considerable disappointment when we looked at page 200 of the budget document, where the budget allocation for the Scottish railway systems is given. There was no real feeling among rail users and people living on housing estates that sufficient provision had been made to enable us to move forward. The

feeling was that, on the big-ticket issues, we are not making the provision that we need to make now—in the 2003-04 budget—to ensure that within a reasonable time scale we have a modern railway passenger service in Scotland. That is a huge disappointment.

We also considered issues relating to the Land Reform (Scotland) Bill, as we participated in the consultation on that bill. We asked whether adequate provision is being made for the financial consequences of the bill. In our response to the consultation, we said that the Executive must ensure that there is sufficient funding to implement access legislation, that it must require transparent accountancy procedures to enable the public to understand where resources have been allocated and that it must ensure adequate revenue funding for path maintenance. We also said that it must ensure funding under policy areas other than the environment that will be supporting the implementation of the land reform legislation—in other words, the bill raises a range of issues other than environmental issues.

We were disappointed that the budget did not reassure us that that funding would be available, either through the environment and rural affairs department or through local authorities. There is an argument about the extent to which funding allocations to local authorities should be ring fenced. Ring fencing may ensure transparency, but it may not assist local authorities' operational arrangements.

We considered a number of other aspects of the budget, but because of time constraints I will not say much about those. We considered the arrangements for funding free personal care for the elderly, as we participated in the consultation on that measure. We do not feel that the provision that the budget makes for free personal care is transparently adequate. We also considered the joint future agenda—the work that local authorities and health boards are doing to integrate health provision. On that issue, too, we were disappointed. Similarly, we did not think that adequate provision had been made for funding nursery and pre-school education places for three-year-olds and four-year-olds.

Although the budget document represents a step forward, we still require more transparency on how policy provision is matched by budget provision. We do not feel that we have received satisfactory answers on that issue.

10:15

Stuart Duffin (Scottish Civic Forum): We asked members about how the £22 billion budget is spent and what impacts and priorities it has. The simple message that came back to us was that things should be made to happen more quickly

and that the Finance Committee should take a lead in showing how they should be done.

Participation is at the heart of the civic economy and relies on people's ability to do things. To achieve our joint aims of providing people with equal access, equal chances and an equal stake, we need to get away from reacting to funding initiatives.

The evidence and agenda of the Scottish Civic Forum is about melting the ice block—unleashing civic potential through innovation, creativity and enterprise. The civic economy's priorities in the 2003-04 budget are innovation and the delivery of an outcome-and-objective accounted budget similar to that which is provided under the Scottish Higher Education Funding Council allocations system and which facilitates a co-ordinated, integrated approach across all sectors and priorities.

For example, the targets and objectives of Arthritis Care cut across the boundaries of several ministerial portfolios—health, lifelong learning, enterprise and social justice. We therefore need to be able to proof outcomes and outputs, targets and priorities, and relationships and integration. That is dependent on our knowing what moneys are available to achieve outcomes. The Scottish Civic Forum recommends not only that the £22 billion budget should be presented on an outcome-oriented basis, but that it should assert what moneys are committed to delivering core services and what moneys are available for innovation.

Prescription stifles creativity. Large-scale national initiatives can be detrimental to facilitating local action and outcomes. The Scottish Civic Forum is keen that budgets should be proofed in their rationale, outcomes and performance. The current hierarchical budget process creates barriers to achievement, particularly in the civic economy. Many civic organisations rely on initiative funding to support core costs, so core funding is welcome.

There needs to be greater transparency at a local level when strategic choices are made among bundles of outcomes. That would enable the civic economy to be a true partner in finding the best way of achieving desired outcomes. To deliver outcomes, we need not only a public-private partnership, but a public-private-civic partnership.

Enterprise is generated by investment and underpinned by speed of action. In the private sector, especially where companies have external investors, results are assessed on the basis of outcomes. Decisions are made quickly and companies have to demonstrate results on a regular basis. Monitoring and evaluation of budgets must reflect that approach. Executive and Parliament action is often taken so late in the

economic cycle that it is counterproductive. The same considerations apply to the civic economy.

The Finance Committee could help to generate a higher rate of growth in both the civic and commercial sectors by fostering a culture of greater urgency. That would involve taking confident, enabling action quickly. Undue delays reduce confidence and, ultimately, discourage action, which contributes to stagnation, slow growth and non-participation. Until we have a higher rate of growth in all sectors, we will not be able to afford the civic and economic outcomes that we all aspire to deliver.

We need to know what funds are committed and what funds are available for innovation, creativity and enterprise. Civic participation adds value and helps to build connectivity in our relationships, allowing us to achieve mutual benefits. We look forward to being more involved in providing evidence on the rationale, outcomes and performance criteria of the three-year budgeting framework.

Mr David Davidson (North-East Scotland) (Con): One of the two gentlemen from whom we have just heard must have been present at a speech that I gave last week in Ballater about community empowerment. However, that is another story.

Campbell Christie talked about big-ticket provision. When identifying areas in the budget where it would like to see more action, did the Scottish Civic Forum try to prioritise? What do you propose should be put down the pecking order to fund, for example, the rail initiatives that you mentioned? Has your organisation considered any form of prioritisation in the budget?

Campbell Christie: That is a difficult question. I remember Michael Forsyth asking me to do that when I was general secretary of the STUC. He asked, "If you want us to spend more here, where do you want us to spend less?" That is a gun-to-the-head approach.

The Convener: That is the real world, I am afraid.

Campbell Christie: The issue is difficult and it leads to the question whether the tartan tax should be used. There might be areas for which the need is sufficient and for which there is sufficient cross-party support in Scotland to justify making special provision. Perhaps one of those areas might be investment in a decent railway system that covers most of Scotland. We do not want to say that whacks should be taken out of the education budget or the health budget and invested elsewhere. We must consider rationally whether we should use the legislative provisions to raise money in Scotland and to use it for Scottish issues.

Alasdair Morgan (Galloway and Upper Nithsdale) (SNP): I want to follow up on Stuart Duffin's comment about how much money is committed and how much is available. I understand the difficulties of taking money from other budgets, but before you decided that action on taxation might be required, did you assess whether money is being spent on areas that are not a priority in any view that might be formed? Such money could be put towards what you say are priorities. Is the information available to allow you to make that assessment?

Campbell Christie: That assessment requires a number-crunching exercise, which we have not tackled as yet. We are all adjusting to how the Scottish Parliament operates. In future we might want to give more detailed consideration to such an exercise. The information is now available and perhaps we should do more with it, but at this stage we have not carried out such an exercise.

Brian Adam (North-East Scotland) (SNP): Stuart Duffin's suggestion that we should separate the core budget from the budget that might be available for innovation or developments was interesting. I assume that when he read the budget he did not find that separation. Is he suggesting that we should put that point to the ministers?

Stuart Duffin: Yes.

Brian Adam: You envisage the process being speeded up, but you appear to be asking us for the greater involvement of civic society in monitoring and evaluation and in developing priorities at the consultation stage. How will that work in practice?

Stuart Duffin: If there is to be a thorough consultation exercise, we must be involved at an earlier stage in considering future budgets and provision. At the moment, we react to a budget that is almost set. The overriding view of our members is that there is no point in shaving off £200,000 here or there. There is little problem with the structure of the budget, but the roll-out of the budget concerns a number of organisations. Again, I will use the example of Arthritis Care, whose priorities cover several ministries and therefore several budgets. Trying to discover how those budgets can be integrated and co-ordinated is quite a piece of work. In that context, the budget is not transparent.

The Convener: The committee is concerned about some of the themes that the witnesses have highlighted. We are conducting cross-cutting reviews of particular areas precisely to address the issue that Stuart Duffin mentioned. The committee has sought to identify core services budgets and opportunities for innovation for more than a year, certainly since before I was a member

of the committee. Some of the witnesses' points about rail investment are probably more appropriate in the context of the spending review and what happens thereafter than in the context of this year's budget.

The process of budget consultation forces the committee to deal with difficult issues of allocation. The organisations with which we consult must also engage with those issues. If the witnesses want to argue for a civic development agenda, they must say how that can be achieved financially, not just that more money should be spent. They must identify those areas in which delivery is not adequate and in which, by transferring resources, we could achieve significant improvement. That is what any business, local authority or other organisation would have to do in the real world. I encourage the Scottish Civic Forum actively to engage in the debate along with the rest of us so that we can develop the agenda.

Brian Adam: We have only a limited amount of time. Campbell Christie listed a number of areas in which there appears to the Scottish Civic Forum to be a shortfall between policy development and resource allocation. It would be useful to have the forum's views on where that has happened. You said that you engaged in preliminary dialogue with your membership about how any shortfall in finance might be met. It would be useful to have written evidence on the forum's views about whether the tartan tax should be used and where the priorities should lie.

Campbell Christie: We are happy to undertake to do that.

Brian Adam: This is the first time that the forum has been given the opportunity to give evidence on the budget; it might be given the opportunity again. We are still learning about the process.

Campbell Christie: We welcome the opportunity to follow up our evidence in writing. I take the convener's point that we should engage in the wider exercise, although we have not had sufficient resources or time to do that.

Mr Davidson: Both the witnesses from the Scottish Civic Forum mentioned ring fencing. Stuart Duffin said that there should not be a prescriptive approach. However, ministers regularly tell us that, to enforce Government policy rather than local policy, some form of prescriptive approach is required, whether that is ring fencing or targeting. How can that issue be resolved?

Campbell Christie: I understand the argument made by local authorities and Scottish Enterprise that ring fencing creates problems and inhibits the ability to make judgments about local priorities. In my opinion, however, there is a good argument that ring fencing in the provision for those organisations gives transparency by allowing

people to discover how funds follow the legislative or policy requirement for which they are allocated. Stuart Duffin might have a different view.

10:30

Stuart Duffin: There is an issue to do with how ring fencing is done: ring fencing an outcome is different from ring fencing a pot of money. One can stimulate innovation, creativity and enterprise and develop the delivery of a target or the roll-out of an initiative. The general call that is being made by the organisations that are involved in the civic economy is that we should try to stimulate an entrepreneurial and innovative approach to the delivery of services.

The Convener: I thank Campbell Christie and Stuart Duffin for their responses and for their presentation. Although we are dealing with stage 1 of the budget process, we will consider not only this year's budget, but the spending review. We are happy to receive any further comments that you wish to feed in.

I invite Iain McMillan, who is accompanied by Matthew Farrow, to make a brief presentation.

Iain McMillan (Confederation of British Industry Scotland): Thank you for inviting Matthew Farrow and me to give evidence to the committee. The committee's work and our engagement with the committee are important to us.

Our wide interests in the Scottish economy, which are shared by many, influence our perspective on the budget and the budget process. Our principal interests are in the degree of competitiveness in the business environment in Scotland, how the Scottish Executive's budget contributes to that environment in general and how it contributes to the development of the supply side of the economy in particular.

One must test our priorities for Scotland's economy and business against the budget in order to get an idea of fit. I will address first those of our priorities that are already well financed. Their development will be able to carry on within existing expenditure frameworks, whereas other priorities, which I will come on to, will require new money.

The education and lifelong learning agenda is important for business, although I will not go into that issue exhaustively. The Minister for Education and Young People recently made an announcement to Parliament about the future of assessment in national qualifications, which is an important matter for business. Now that that decision has been taken, we would like the national qualification regime to settle down but, without disturbing the principles of the qualifications, we would also like the regime to be

made to work better than it does at present. The qualifications should move forward over time, so that they become even more relevant to the world of work. The qualifications could be aligned better with vocational education, perhaps through the Scottish group awards. The Executive should also ensure that there is a good dovetail between the existing regime and the outcome of the inquiry into education for work and enterprise, which is being led by Nicol Stephen, the Deputy Minister for Education and Young People.

Planning is another important issue for business in Scotland. The review of the national planning framework that was carried out over the past few years was good, but we believe that there is a dislocation between the planning framework's national and local levels. We recommended to ministers that they should undertake a review of local planning and the way in which it connects to the national planning framework.

We believe that, in recent years, there has been underinvestment in transport, which is very important for business in Scotland. Recently, we published our own transport delivery plan for Scotland, which set out our members' views on where transport investment should be applied over the next 10 years, although I accept that that takes us outwith the three-year framework that the committee is examining. The important point of principle is that we would like the Scottish Executive to give long-term commitments to the transport agenda and to some of the projects that should be developed and that cannot possibly come into a three-year expenditure framework. Our plan envisages that expenditure over the next 10 years—including expenditure that is attributed to the railway industry—would come in at more than £13 billion, or an overall annual increase of 26 per cent. That sounds like a lot of money, but the 10-year transport plan for England includes an annual increase in spending of 30 per cent above the base year, which acts as the comparable baseline.

We would like the uniform business rate poundage parity with England to be restored. I have no doubt that the committee will remember that such parity existed between 1995 and 2000. People with properties in Scotland that had an identical rateable value to that of properties south of the border therefore paid exactly the same in rates. After the 2000 revaluation, the Scottish Executive took a conscious decision not to maintain the guarantee to business that the previous Government had made. As a result, business in Scotland has a rates bill that is 9 per cent higher than it would have been if the guarantee had been kept. On business rates, Scotland's competitiveness has slipped quite sharply.

Before the meeting, we received a letter from the convener, who asked us to assess

“the adequacy of the planned expenditure total ... and to consider whether any use of the tax-varying power should be made”.

Our view on the ballpark figure of total expenditure is that it is probably about right. The total amount of money that is available is determined by the Treasury formula that ties expenditure in Scotland into a relationship with expenditure in the United Kingdom. However, given that, following the budget, tax is heading towards 42 per cent of gross domestic product, we would not want public expenditure to rise any higher.

The same rule applies to the use of the tax-varying power, about which we have concerns. We think that that would push up public expenditure and taxation levels, and proportionate to the amount that it could raise, it would be an expensive tax to implement. I could talk about that issue at length. The Scotland Act 1998 put in place the tax-varying power, but if the Executive were to exercise that power, Westminster would be required to introduce substantial secondary legislation to empower the Inland Revenue to take the necessary steps to assess and collect the tax. Employers and others who have an interface with the tax regime would also be required to be in a state of readiness to apply the legislation. The Treasury did not lay the statutory instruments before Parliament because it did not want businesses to have to deal with the undoubtedly high up-front costs that they would face if they were required to be ready to implement the tax. For example, for the financial services industry alone, the up-front costs of preparing for the implementation of the tax-varying power are estimated to be about £150 million. Such costs were never mentioned in the white paper. Other industries would be affected in different ways, including as a result of payroll changes. We are not in favour of the tax-varying power.

I will move on to address the question about the Executive's expenditure priorities. I have to give the committee the same answer as Campbell Christie gave to David Davidson's question about prioritisation. CBI Scotland exists to press for what we perceive to be our own priorities—many organisations also regard that as our role—while the role of the Government is to choose between priorities.

As far as the balance between capital and operational expenditure is concerned, we have no quarrel with the ratios that are in the budget document. Over time, much will depend on the level at which the Scottish Executive uses the private finance initiative or the public-private partnership regime in which the expenditure of

public capital becomes the expenditure of public revenue. That is a matter for the Executive to judge.

Our response to the question about the implications of the growth in funding in support of PPP projects is that PPP still represents only a small proportion of public expenditure. I think that the figure is under 2 per cent, but Matthew will confirm that.

Matthew Farrow (Confederation of British Industry Scotland): Yes, it is.

Iain McMillan: The proportion is insignificant. CBI Scotland's view on PPP is not doctrinal. We take the view that some, but not all, public sector projects lend themselves well to a PPP solution. It is important that those who evaluate and assess public sector projects take decisions that give the taxpayer the best value for money over time.

The convener also asked whether other issues are relevant to the committee's strategic role in the budget process. Our response is no. As I said, we regard the work of the Finance Committee as important. We support the Parliament's scrutiny of the Scottish Executive—that work is important.

The Convener: We will hear the other two witness statements before putting questions to Iain McMillan.

Grant Baird: I thank the convener for the invitation to give evidence—doing so is the first interesting thing that I have done in years.

Before I address the individual points that were raised in your letter, convener, I would like to address a general point, as that may go some way to addressing the point that was raised earlier by Campbell Christie about the need for transparency.

I agree entirely that the budget document is much more user-friendly. However, a low-cost improvement for all those—MSPs included—who are involved in scrutinising the budget would be to set beside the budget a context document as an aide-mémoire or a reminder of some of the big figures in the budget. Examples could include the most recent gross domestic product, balance of payment or inflation figures. That would provide a proper background to the budget document.

It would also be useful to have regular comparisons, where appropriate and possible, with England, independent countries elsewhere in Europe and other devolved areas in Europe such as Catalonia or Flanders. Without such context and comparisons, reading the budget is like reading a corporate report in which the reader searches in vain for the bottom line. I hope that that suggestion is helpful.

10:45

My response to the convener's question about the adequacy of the planned expenditure total for 2003-04 and the use of the tax-varying power is that, in the context of the existing framework, they are adequate. Given that we cannot borrow at present, we have to consider measures that will provide a degree of flexibility and elbow room. However, it is clear that the question is not merely technical but political.

My response to the question about the Executive's priorities is similar. Although a more viable economic case could be made for some of the suggestions that have been made, in common with Iain McMillan, I have focused on the growth of the economy. An explicit starting point is the fact that the growth in the Scottish economy has been rather poor and disappointing over a number of years. The Scottish economy is worse than that of the rest of the UK and it may be towards the bottom half of European economies. A top budget priority should be to put in place short and long-term measures to address the need to improve the growth rate in the Scottish economy.

I agree with Iain McMillan that the approach to the budget should include measures that are designed to improve the competitiveness of Scottish industry or to reduce the uncompetitive features that we all know about.

That point leads me to endorse the same general point about the uniform business rate that was made by Iain McMillan. Overall, however, I would put transport pretty much at the top of the list of priorities—not only road and rail but air and sea. It is good to see the commencement of the Rosyth ferry operation, as that should provide a direct contribution to the competitiveness of the Scottish economy. Like Iain McMillan, I consider the ratios in the balance between capital and operational expenditure to be reasonable. However, I am not an expert in that area.

I plead guilty to being the cheerleader in Scotland for PFI when Ken Clarke introduced it all those years ago. However, the concept has deviated in ways that could not have been imagined at the time. When PFI was introduced, I was the chief executive of Scottish Financial Enterprise, which is the promotional body for banks, insurers, fund managers and so on. At that time, I was moved by a desire to ensure the success of what was a new market for the financial services sector in the UK. I was keen to ensure benefits for the sector—for the banks that would lend, the insurers, the fund managers who would put packages together with lawyers, at great length and expense, and the accountants.

My desire was that all the profits—or fees—should not disappear in the direction of the city of London. Not only did I want that money to stay at

home where possible, I wanted it to provide an export base for our financial institutions to do the same in London and Europe. One could see a growing trend in that respect all over Europe. As a result, I was quite keen that we did what we could to get a slice of the business.

As far as PFI/PPP is concerned, we are faced in some cases with a set of impossible choices. If we want to provide a particular level of public expenditure, we can either borrow a lot more or tax a lot more, or we can simply do without the desired project. PFI was a way round that problem. I used to joke with my children that I rather liked the concept because it was like getting something on hire purchase: I would get something and they would have to pay for it. However, we should also recognise that HP is a dearer way of buying something than simply spending one's savings on it there and then. I should point out that both my sons disagreed with me at the time, and did not like the idea that I would get the hospital, for example, and that they would have to pay for it later. One of them has since changed his mind, but that is probably because he works for a merchant bank. The other is still agin the idea, but then he works for the *Daily Record*.

I will end by saying that I broadly agree with some of the specific priorities that Iain McMillan mentioned, and I am happy to take any questions that members might have.

The Convener: I ask Peter Wood to give us a brief presentation, after which I will seek questions for all three witnesses.

Peter Wood (DTZ Pidea Consulting): Good morning. It is a surprise and a pleasure to be asked to speak to the committee. Although I emphasise that I speak in a purely personal capacity, I am drawing on work that I have carried out with colleagues over the past 20 years on various aspects of public spending and the public sector in Scotland. I do not propose to address every issue raised in the questions that the committee clerk sent me, because they cover too much and ask about areas that I do not know anything about. This morning, I want to comment on certain key points such as the overall level of spending and the balance of growth within the programme, and will comment specifically on four areas that I have identified in my submission to the committee.

The question of what constitutes the appropriate level of public spending is a political matter, and there are different political views about the role of the state in that respect. As a result, I have tried not to get too immersed in that issue, but instead want to make some personal observations about the position of Scotland and the rest of the UK, and the implication of that for spending levels. It

has already been pointed out that the budget for the Scottish Parliament and the Scottish Executive is, unless we use the tax-raising power, controlled by decisions about the UK budget.

As everyone knows, identifiable public spending in Scotland is higher per capita than in any other part of the UK, except for Northern Ireland. It is interesting that that differential—which is found across almost all categories of spending from planning and economic development through to education—has fluctuated over the past 15 years between 18 and 20 per cent. At present, it is about 18 per cent higher per capita. That situation might be due partly to high levels of spending on social security and agriculture in Scotland. However, interestingly, if we strip out those aspects, the differential rises to 21 per cent. That means that, in reality, the higher spending levels are not accounted for by social security and agricultural expenditure.

It has been argued that the higher level of spending is justified or required in Scotland because of higher levels of need associated especially with deprivation and sparsity of population. As far as the deprivation argument is concerned, I should point out that social security spending—which is quite a good indicator of deprivation—is higher in Wales than it is in Scotland, but other forms of expenditure in Wales are lower. Furthermore, in its last proper needs study, which was carried out in 1979, HM Treasury concluded that, although Scotland required higher levels of spending in certain areas, the need was not enough to warrant all the differences in observed spending.

Although I do not want to descend too much into that controversy, I note that all the evidence taken together suggests that we have a relatively high level of public spending per capita in Scotland. As a result, it seems to me that arguing for a still higher level of spending, which would be supported by further taxation impositions, would need a qualitatively different view of the size of the state's share in Scotland compared with the rest of the UK. If people want to argue for a much bigger state share in Scotland, that is their right; it is part of political debate. However, that is what the evidence seems to imply. I think that the Scottish budget itself is adequate, even if we bear it in mind that there is an insatiable demand for many public services.

In that context, any move to implement the tartan tax—which is now an acceptable term—should be taken very carefully. Indeed, I would argue against it at this time. As one of the other witnesses has pointed out, it is not a very efficient way of raising tax. Furthermore, the tax product relative to the cost of collection is not good.

I also believe that such a step would be inimical

to economic development. For example, it would impose on employees a cost on working in Scotland that did not apply in other parts of the UK. Many of our most important industries such as finance, software engineering and so on have to compete for labour in a national labour market. As people can choose to work in London, Newcastle, Birmingham or Manchester as well as in Glasgow and Edinburgh, it would not be wise to impose an extra cost on their employment. It might also become a problem for employers, who would have to raise wages in order to compensate for the cost to employees. That would not help either.

I want to turn to the balance of spending. It was a shame that the convener called this issue provocative, because it raises some interesting questions. Although the spending plans imply that there will be growth in a number of areas, it seems that there will be particularly strong real growth in health spending. I well understand the political pressure for increased health spending; like most people, I have had reason to be grateful for the availability of high-tech medical services. However, the level of priority that has been afforded to health in the budget is open to challenge. As is well known, there is practically no evidence to support the claim that at the margin increased spending on health care exerts a dramatic or measurable effect on levels of health or well-being in the population. Countries with different levels of health spending in the developed world have similar levels of life expectancy, and there is no real relationship between health spending and life expectancy.

I note that the Health and Community Care Committee has walked up to—and perhaps stepped back a little bit from—that issue. However, in its recent report, the committee commented that the marginal productivity of additional spending on health care was hard to measure and was probably quite small. I should also point out that health spending levels in Scotland are already quite high. Indeed, it has been alleged that they are near the European level, although there is no doubt scope for debate on that issue.

I wonder about the benefits of turning on the financial taps into the health service, when the money needs to be spent mainly on medical personnel. As the numbers of doctors and specialists in training is pretty flat at the moment, it could be argued that spending should be built up gradually to ensure that the money is not entirely dissipated in higher costs. I am not calling for savage cuts in health spending, but there is a question as to whether the growth in spending should be slightly restrained. Someone asked what we should spend less on to spend more on; I suggest that we should spend more on education, particularly higher education.

11:00

The Executive's aim, and that of the Parliament, of creating a smart, successful Scotland depends upon us being able to operate at the highest levels of science and technology. Although we have some good universities, one of which I am a graduate of, they are in danger of falling behind. There is an argument, if we wanted to take a punt on something, for increasing our spending on education in particular.

Within the enterprise and lifelong learning budget, increases in spending in Scottish Enterprise and Highlands and Islands Enterprise are a little bit ahead of the increase in spending on higher education. The balance between those two is worth thinking about, although I note that, relatively speaking, training is taking a bigger share of the Scottish Enterprise budget.

As I said in my submission, at times it is hard to measure the returns on economic development work. The targets that appear in the budget for both Highlands and Islands Enterprise and Scottish Enterprise focus pretty much on process matters, such as how many firms they assist and how many grants they hand out, rather than how they are going to change the economy. However, perhaps the budget document is not the right place for that.

One of the striking things in the enterprise and lifelong learning budget is the projected cut in the money that goes to regional selective assistance or assistance to inward investment. I realise that behind that cut is a belief that, to an extent, we should be turning our attention away from inward investment to support indigenous development. I have a great deal of sympathy for that view and, like everyone else, I think that the labour market situation in Scotland no longer places us in the position of chasing after every screwdriver assembly plant that is going. We are not desperately short of jobs in the way that perhaps we were some time ago. However, inward investment has been an important factor in creating the modern Scottish economy. Companies such as IBM, for example, have made a massive contribution in transferring technology into Scotland. I would sound a note of caution that we should not go along too much with the fashion of denigrating inward investment. The world economy will continue to become more integrated and globalised, as they say, so it is important that we continue to attract international investment to Scotland.

I will make one or two small points about other parts of the budget. The social justice budget is directed mainly towards the provision of subsidised housing, one way or another. Great change has occurred in that sector over the past 20 to 30 years, including within recent years. More

change is likely to occur, with the diminishing direct role of municipalities and local government in the sector. Important questions must be asked about the long-term role of social housing in the housing system. Once upon a time, social housing provided for people of average, and above average, income. When I was a child, I lived in a council house in Stirling, where I had neighbours who were teachers, hospital administrators and white-collar workers; a broad spectrum of employed people was also represented. Today, the social housing sector accommodates mainly people who are dependent on state benefits or people who are vulnerable in some way. It is time to consider the matter afresh and ask how big the social rented sector, or social sector, should be and what scale of support we should give to different groups within the population. There may be a case for a fundamental examination of the role of the social housing sector.

Everyone acknowledges that transport is important to the economy, although everyone has different priorities. The evidence that marginal or additional investments in trunk road capacity have a big impact on the economy is pretty shaky. The Standing Advisory Committee on Trunk Road Assessment—SACTRA—did not produce a great deal of evidence that investment, at the margin, in the transport system improved the performance of the economy. Of course, that is not to say that some individual schemes are not of great importance, but we must consider carefully investment in the road system. On the other hand, it would be good if investment were to move ahead a bit quicker once decisions have been made—we seem to have been thinking about and conducting studies on the A8 and the A80 for an awful long time.

Based on work that we have done in rural Scotland, I will speak up briefly for the bus. The budget document refers to the importance of rail throughout Scotland, but buses are very flexible, it is easy to increase the number of buses, and buses can go to places where trains do not go. Supporting bus provision in Scotland, especially in rural Scotland, might have a bigger impact on rural areas than investment in rail. We should not denigrate the bus.

Rural Scotland, especially in more remote areas, faces difficult economic circumstances. The bulk of spending on rural matters is directed towards agricultural subsidies, which reflects national and European Union policy. By and large, that policy props up many areas of weak and perhaps unsustainable economic activity and does not promote restructuring of the rural economy. One would have hoped to see a shift in the rural development budget, away from direct support to agriculture towards measures that are designed to make rural locations, especially remoter ones,

more competitive.

The Convener: Thank you. I found your written and oral evidence very stimulating.

It is now open to members to ask questions of the three witnesses.

Alasdair Morgan: Both Iain McMillan and Grant Baird referred to the competitiveness of business. Grant Baird referred to GDP and to the rate of growth in Scotland being worse than the rest of the United Kingdom and most of Europe, yet the uniform business rate was the only measure to which both witnesses referred that seemed to have a direct link to competitiveness. I do not know whether putting that measure on a par with the level in England would necessarily have a huge impact on our business competitiveness. Do any other measures need to be taken to improve business competitiveness in Scotland, to bring us up to even the same GDP growth rate as the rest of the UK?

Grant Baird: I have in mind the other factor that both Iain McMillan and I mentioned, which is measures of transport improvement, for freight and the tourist trade—internally and in relation to aircraft. Those improvements would help. We can perhaps not do an awful lot, practically, in addition.

Iain McMillan: Alasdair Morgan is right. We concentrated on the supply side areas of the economy, such as transport and education. On fiscal measures, we deliberately restricted ourselves to the competence of the Scottish Parliament. Other taxation measures belong to a different jurisdiction in another place; I deliberately avoided discussing those here. However, no single factor is responsible for low productivity; it is a complex matrix of investment in the supply side of the economy and a competitive tax regime. Peter Wood went into more detail on the tax-varying power than I did. One point that neither he nor I made, which I make now, is that it would hit unincorporated businesses, which pay income tax not corporation tax.

The uniform business rate is an important tax. It is one of the three taxes that the Scottish Parliament has within its power; the other two are the council tax and the tax-varying power. We certainly hope that the Finance Committee recommends to the Scottish Executive that it at least make the uniform business rate as competitive as it is in other parts of the island of Great Britain. That would not cost a huge amount. The gap is £142 million at 2001-02 costs, or 0.7 per cent of the £22 billion that we are considering today.

The Convener: May I break in to supplement the question?

Has the CBI done any work that demonstrates

the impact that the reduction of the uniform business rate would have, as opposed to simply asserting that the tax costs business a lot of money?

You made a number of points about the additional costs of collecting the tartan tax, if you want to put it that way. Would those costs also apply in the event of a proposal to reduce the tartan tax? In other words, would there be a cost implication whether the tartan tax went up or down? Could you expand on the economic impacts?

Iain McMillan: Yes. There would be cost implications either way. The up-front costs that I referred to would have to be borne by business and others, whether the tax was varied up or down by half a penny, 3p or somewhere in between.

Let me give an example. The life assurance industry has never had to segregate its policyholders according to whether they pay tax in Scotland or in the rest of the United Kingdom. The industry would have to alter its systems to identify separately Scottish taxpayers, so that tax relief on certain pension contributions could be applied at the correct rate. The costs would be horrendous. Payroll systems would have to be amended and a suffix attached to the tax code of all those who were subject to the Scottish tax-varying power. Those are up-front costs that would have to be borne, whether the tax was raised or lowered.

Grant Baird: I can back up Iain McMillan's point from my experience in the Royal Bank of Scotland, where we contemplated the effect of the implementation of the tax-varying power. We thought hard about how much it would cost to create a superbranch at Berwick to deal with the number of people who might want to shift their finances down south. We also considered the administration costs of processing the accounts of people who lived in Scotland, who were liable to the tax and who might respond by moving their account residence. We were not certain of those costs, but they seemed to be quite large. This year, such costs would not be noted in the profits of the Royal Bank, but at the time that might have been a possibility.

Iain McMillan: You asked whether the CBI had done any work to show that businesses would invest less, employ fewer people or even put the key in the door and leave if business rate parity was not restored. The answer is no. Businesses operate on a complex mix of inputs and have to work the balance of advantage. For example, if an inward investor is considering coming to or leaving Scotland, it will consider various factors such as the ready supply of suitable labour; people's employability and ability to do the task required; the costs of water and power and the reliability of supply; distance and time to market; and the tax

base. The post-tax calculation is very important to business. Any capital investment appraisal will examine the post-tax returns, which include corporation tax, employer's national insurance contribution and rating costs.

Has any business shut its door because the uniform business rate has lost its parity? We will never know, because decisions are more complex than that. When an inward investor leaves Scotland, it thanks its hosts kindly for looking after it for 30 years and then leaves quietly.

Matthew Farrow: Perhaps I can add a couple of points. Although, as Iain McMillan says, we cannot prove such things according to a mathematical formula, the evidence suggests two things. First, the lack of parity of the business rate is part of a general pattern in which business costs tend to be higher in Scotland than in England. For example, the charges for water for businesses are higher under Scottish Water than they are in England. The charges that businesses in Scotland pay to the Scottish Environment Protection Agency for environmental regulation are also higher than those paid by businesses in England. Transport costs in Scotland are often higher because of distance to market and electricity costs are about 5 to 6 per cent higher. The business rate question is part of a pattern that shows that the core costs of businesses in Scotland tend to be higher—it will vary between businesses.

11:15

Our surveys of businesses across all sectors of the Scottish economy show consistently that margins have been squeezed tighter and tighter. That is due to several factors increasing competition. We believe—and our members tell us—that the creep of the business cost base is part of the squeeze. The surveys also show that as the margins get squeezed, investment intentions fall. So, our members tell us and our surveys show us that there is a steady link between a business cost base in Scotland that is less competitive, tighter squeezes on margins and diminishing investment intentions. Over time, that will contribute to a low growth rate and lack of competitiveness.

As Iain McMillan said, there is a range of other issues—skills are particularly important. However, we would put the business rates argument in the wider context. If the Executive has the opportunity to try to reverse the trend of rising and higher business costs in Scotland than elsewhere, it should take it.

The Convener: It might be interesting to consider that in the context of rateable value.

Peter Wood: I recently finished a review for the department of enterprise, trade and investment for

Northern Ireland on the future of industrial de-rating in the province. Currently, no rates apply to industrial or manufacturing premises in Northern Ireland and we concluded—the report will be made public in due course—that the removal of that arrangement and the creation of a rates system would not have a significantly adverse effect on the economy. The rates burden is a very small proportion of overall costs and there is good evidence that rents tend to adjust to rates burdens—where rates are high, rents are low. Finally, the rates cost was such a small element relative to other factors bearing on the businesses—that fact was borne out by the other speakers—we could not find a business in Northern Ireland that said that it would leave Northern Ireland if it had to pay rates. I hope that that is relevant to the discussion. I am not saying that costs do not matter. However, our work found that that particular cost item was not a powerful factor.

Mr Davidson: The last three witnesses have said that the tartan tax should be put away in a cupboard and left alone, whichever direction it might take, that the UBR is a direct contribution to post-tax business profitability and that a council tax increase would increase wage demand, which would be anti-competitive. If we take all those factors and consider what we must deal with in the budget, it becomes clear that if there is an improvement in competitiveness that merely produces more profit, which has an effect on investment, the tax base will go to the greater good of the UK and will not necessarily be put back into Scotland. That is not an argument for independence.

All the witnesses picked up on investment in infrastructure in different ways—investment not just in roads and communications, but in the labour force. Where do you think that we should be headed? That goes back to the question that I asked Campbell Christie about priorities. Given the current Scottish budget and the other things that you have mentioned, where should we focus if the major issue is to improve the economy, which will improve the social economy in turn? Wealth creation opens the door to most things because it creates employment. Will the three of you indicate briefly where you think that we should head? We are under great pressure to carry out the social spend, but, to date, we do not appear to have spent too much time on improving wealth creation in Scotland.

Grant Baird: I will select two areas from the whole lot. First, I strongly take the same view as Peter Wood—that buses are undervalued in some ways, especially in rural areas. Better bus services would mean improved access to transport and to the labour pool in a given area. Secondly, I would focus on almost anything that goes towards

making our international connections cheaper and quicker. I presume that aircraft would be the first area of concern to be tackled; ferries might be another such area. Members might have a different view, but I believe that Scottish exporters suffer from facing the cost of the extra 500 miles to Europe. I do not know how far that cost can be quantified. Obviously, I am thinking specifically of connections to Europe, not of connections with America, the far east or further afield.

The Convener: I invite the other two witnesses to make brief responses, as every member has indicated that they want to ask a question.

Peter Wood: The growth of the economy, in an economy in which most people are employed, depends on increasing output per head. There are two ways of doing that. In relation to the first way, investment by businesses, anything that encourages business investment should be welcomed. In relation to measures that the Executive could take, I return to the argument about investment in education. Investing in human capital by raising the skill and educational levels of the population to the highest possible level offers the best prospect of accelerated economic growth.

Alasdair Morgan: Could you put a time scale on that?

Peter Wood: It is a continuing process. We are talking about a rate of growth and we should seek to raise productive spending in education indefinitely into the future. Although, as in other areas, we could waste money, we could raise our rate of growth significantly within the next five to 10 years if we made more effective use of resources in promoting the skills and abilities of the Scottish work force.

Iain McMillan: I agree. At the beginning, I set out that education and lifelong learning were a priority. I repeat that assertion. Planning and transport are very important. Some studies have shown that there is a direct link between investment in transport infrastructure and growth in gross domestic product. Someone once challenged me on that and I replied, "Okay, let's pretend we don't have any roads and railways. Are you saying that we don't need them to grow an economy?" Of course we do. The question is how much investment is necessary and what the time scale should be.

I stress again the importance of the uniform business rate. Peter Wood's evidence from Northern Ireland is interesting and important, but every survey of businesses in Scotland has shown that business rates and their costs are at the top of their concerns. The Scottish Executive is introducing the small firms rates relief scheme from April next year because it regards the issue as important.

Brian Adam: I will pursue some of the remarks that Iain McMillan made about higher education. A range of organisations, including Scottish Enterprise, offers education in its broadest sense. Scottish Enterprise's training budget forms a significant part of its overall budget. Does that money represent the best way of delivering the upskilling of the work force, or would it be better spent in another way?

The Convener: Instead of seeking three responses, I will direct the questions a wee bit. Peter Wood talked about higher and further education. Do you want to answer that question?

Peter Wood: The question about what return the different schemes offer is big, but I will try to be brief. I have some concern that the money that is directed towards schemes that are aimed at the basic skill level does not produce a good return. I refer to some of the schemes that are about job creation and taking people off the unemployment register, rather than about greatly uprating their skills. A question mark exists about some of those schemes and the matter requires careful study and examination.

At the other end of the scale, I believe that raising the level and ability—or standing and capability—of our higher education institutions will produce a significant increase and pay-off. Finally, I note that the further education sector seems not to enjoy the largesse that is enjoyed by some other areas and I wonder about that. I am inclined towards forms of education that are relatively rigorous and formal as opposed to make-work schemes or things with low skill content.

The Convener: Jamie Stone has a question.

Mr Jamie Stone (Caithness, Sutherland and Easter Ross) (LD): I will keep it quite speedy.

Given the constituency that I represent, I rather sat up when Peter Wood mentioned rural areas. We talk about what we can do with the money that we may or may not control, but there is another income stream—European Community funds. Members will recall the debate that took place when the Highlands lost objective 1 status. Although areas such as north-west Sutherland or Ardnamurchan or Wick had lots of indicators to show that they were in need, the comparative strength of Inverness was a significant problem because it knocked out the application for objective 1. I am aware that parts of Wales went in for fine-tuning and targeting of funds. It strikes me that there is a pot of money out there.

In the Highlands and other areas of Scotland, there was a noticeable difference between when we had objective 1 funding and when we went through transitional funding. Yet, all of us who have constituencies in the remote areas—I am sure that this is also true of Alasdair Morgan—

have individual areas that could do with that sort of funding. Given his knowledge, does Peter Wood think that it might be worth considering a more focused and more cannily formed application for such funding in future? Wales did it. Could not Scotland?

Peter Wood: In brief, yes. I did some work with the Scottish Executive environment and rural affairs department on the competitiveness of rural areas, but the work was delayed because of foot-and-mouth. Without wishing to bore anyone, I must say that the fundamental thing that jumps out is the difference within the rural parts of Scotland. There is a huge difference between the position of the most remote rural areas and the other areas, which, although classified as rural on existing definitions, encompass the likes of Inverness. The situation of the remote rural areas such as north-west Sutherland and the Western Isles is much worse than other parts of rural Scotland.

In many ways, we need to look at our definition of rural and focus a bit on the more remote and sparsely populated areas, which are the most disadvantaged. To be candid, there are many areas that are classified as rural that are pretty prosperous because they are within commuting distance of the big towns. The most remote rural areas have problems that are of a qualitatively different sort.

The Convener: I very much agree with that.

Alasdair Morgan: I want to come back to my first question, which was on business competitiveness. Although we all agree that having higher business rates does not encourage business growth, we do not seem to have received many answers about how we can grow business competitiveness within what the Scottish Parliament can do.

I note that the aim behind the budget for the enterprise and lifelong learning department is

“To create a highly skilled, learning, earning, connected Scotland.”

Given the fact that the budget for the enterprise and lifelong learning department is going down in real terms, can that aim be achieved? That question is to everyone.

Iain McMillan: As the clerk may have explained, I must leave shortly to get a plane, so I will answer first. Any further questions can be directed to Matthew Farrow or we will be happy to supply a written response later.

In recent times, a lot has happened that will be good for the Scottish economy. In my introduction, I mentioned Cathy Jamieson's statement on national qualifications. Our members believe that the new national qualifications, which contain core skills that have a much better propensity to deliver

employable young people, should make a difference over time.

In addition, the new Careers Scotland has just been revved up after having been put in place in April by the former Minister for Enterprise, Transport and Lifelong Learning. Careers Scotland should do a much better job of identifying opportunities, and relaying where they are, as well as the right kind of education and training for young people. Those things are not a panacea, but it is important that the committee does not overlook the fact that some measures have been taken, which are at a formative stage of implementation but which could make a real difference over time.

I support what Peter Wood said about higher education, but with a caveat. The funding of higher education has increased greatly over the years along with the number of young people who are entering higher education, yet productivity has not increased. I do not know the answer. We may have to look carefully at how we can make the best use of our higher education institutions and connect them up to the productivity and growth agenda. We are probably not doing that at the moment, as there is too much dislocation.

11:30

The Convener: Do Grant Baird and Peter Wood want to add anything to that?

Grant Baird: Only to say, yet again, that I am in broad agreement with Iain McMillan. I wonder whether something could be done about the structure of higher and further education. The phrase “equality of esteem” was used years ago to talk about the product of Glasgow tech and the product of Glasgow University. Now, there is an undifferentiated bulge, as Glasgow tech has become the University of Strathclyde and the University of St Andrews—my old university—is apparently a refined finishing school. It may be only a change in names, but there is a perception that too many people have been trying to get professorships. I would like to see that reworked, if possible.

Peter Wood: I have two observations to make about higher education. First, although funding has increased, pushing increasing numbers of students through and giving them a relatively cheap education in a system in which many staff members are becoming demoralised is not necessarily guaranteed to produce a good outcome. Secondly, in talking about higher education funding we are talking not just about how many students we educate and in what subjects, but about investment in development and research in our higher education institutions. We should bear in mind the fact that there are many places in the world where the presence of

high-quality research and development activity in academic institutions has been an important motor and catalyst for economic growth.

Grant Baird: Yes. We perhaps underestimate the potential of one or two centres of excellence to be earners for the country as a whole.

The Convener: Stuart, do you have anything to add?

Stuart Duffin: I have a couple of comments to make on the lifelong learning debate, both from the Civic Forum's perspective and wearing my hat as the chief executive of West Lothian Chamber of Commerce.

First, we are looking at building capacity at the base level. In dealing with marginalised groups in civic society, the Civic Forum is trying to build their capacity to make decisions, to increase knowledge and to participate in the democratic process. One of the issues on budget consultation is the fear that exists among small organisations of being consulted on a large document. That is not a problem for people around the table, who are relatively confident in dealing with such issues.

Secondly, a key issue is the need for seamless links between further and higher education. Although we have a structure of integrated qualifications and an integrated approach, the links are still not seamless. In West Lothian, for example, people are studying for higher national diplomas and other qualifications at West Lothian College, and the articulation routes into universities are talked about but they are not practical. They are not rolled out in a substantial route.

Because people are penalised, they begin to ask about the value of going on to an education programme if they cannot achieve particular routes. That is also true of the business community. Although we have been considering articulated programmes for work-based learning in the business environment in West Lothian, we have been unable to achieve articulation, which means that we cannot roll out the programme. As I have said, although articulation routes are talked about, the problem is more how the programme is rolled out.

In regard to the Civic Forum's perspective on education and lifelong learning, we feel that the budget should be reshaped to bring together the budget issues involving further education, skills development and higher education to ensure that there are seamless routes.

Mr Davidson: Are people suggesting that we move away from the dumbing-down, everyone-does-everything approach in universities and return to the thinking that produced technical centres of excellence such as the Massachusetts

Institute of Technology? Perhaps that issue could be dealt with by combining the expertise of some universities.

Grant Baird: I suppose that I am suggesting that. It would be nice to be able to identify in Scotland such world-class single or joint institutions as MIT, Stanford University and Columbia University. Although the French do not seem to take this approach any more, l'Ecole nationale d'administration used to be given as an example of an institution that not only Frenchmen but Brits, and presumably Germans and others, aspired to attend. Such places were valuable assets for the nation that possessed them. I would like an organisation such as the Scottish Higher Education Funding Council to take some unpopular decisions about where resources are allocated. I include Strathclyde University in that statement, Arthur.

Professor Arthur Midwinter (Adviser): I was going to say that those decisions would be more unpopular, not just unpopular.

Matthew Farrow: Perhaps I can add to that without getting into such dangerous territory. As far as the research base is concerned, there is a case for specialisation and creating centres of excellence, but we certainly do not want to get into the question of where those centres should be, because there are powerful vested interests in those areas.

Business is increasingly concerned about the focus on getting particular proportions of youngsters to go straight to higher education. The current target is 50 per cent. Although we want a more highly qualified work force, surely the philosophy behind lifelong learning is that it is not important whether that 50 per cent enter higher education when they are 18 or 19. It is more important that a very high proportion of people undertake HE courses at some point in their working life. There is a concern that the pressure on youngsters to enter higher education is exacerbating the skill shortages in the Scottish economy. As Iain McMillan said earlier, a great onus should be placed on Careers Scotland to improve understanding of the labour market and get some of those things right.

Elaine Thomson (Aberdeen North) (Lab): Before I ask my questions, I suggest that Stuart Duffin look at the Enterprise and Lifelong Learning Committee's current inquiry. Articulation agreements are very much a part of its remit.

My questions centre on two issues. Although all the witnesses have discussed different aspects of the physical infrastructure, no one has actually mentioned electronic infrastructure. To what extent is that infrastructure important to Scotland's competitiveness, and is the budget as presented

adequately supporting it? Is the current roll-out of broadband adequate?

My second point is on skills and lifelong learning. I am pleased that moneys going into education, including higher education, are regarded as improving competitiveness. However, the demographic estimate is that, during the next few years, the population of young people will drop by about 25 per cent. Will that be a key issue for the continued competitiveness of the Scottish economy? What impact will that have? Where does that lie with other pressures that face the Scottish economy? Do the policies contained within the budget support dealing with that demographic issue?

Grant Baird: I will start by answering the first question on electronic communications. It would be a good idea if we revised what used to be the habit of talking about Scottish industry's communications, but specifically electronic communications, alongside road, rail and other communications. In promotional material, we used to tackle the perception that Scotland was remote by stressing the importance of electronic communications. That habit has faded somewhat, but I still think that it would be a good idea.

Peter Wood: The issue of the availability of broadband communications in particular is quite technical. However, there has been a bit of over-investment in that sector throughout Europe. A good deal of fibre is not lit, as they say on the technical side. Nobody is using that fibre and some businesses have lost their proverbial shirts on that investment. A fair amount of fibre in the Highlands is not being used, so laying down the cables is not always necessary. I urge great caution about boosting investment in that area without a proper technical review of current availability, although I am not conscious of that being a huge weakness as far as Scotland is concerned.

The labour side is interesting. With some others, I have been looking at long-term labour projections. Of course, if fewer people are available to work, our economy must grow more slowly, but that perhaps does not matter much as long as people's incomes per head grow. In fact, my reading is that Scotland is less squeezed by the demographic projection or outlook than, for example, the south-east of England—London and so forth. We have a bit more slack, as it were, in the system. Therefore, we may find ourselves in a more competitive position in terms of the availability of labour over the next decade or so. However, the position is relative.

Then we are into deep waters. Should we be promoting immigration in order to increase the labour supply? That is a controversial issue, no doubt.

Mr Stone: Given what you have said, as broadband rolls out, there is a danger for the remoter parts of Scotland that the more central parts will get ahead of the game. The one thing about broadband is that it could offer tremendous opportunities for north-west Sutherland or wherever in Scotland. We discussed that point earlier and you referred to it. What is your opinion? I think that there is a danger that, if sheer market forces prevail, we could lose out. What is your advice? Should we be getting the Executive to ensure that that does not happen and that places out there do not get left behind?

Peter Wood: My answer would be that, rather than plunge into spending commitments, the matter should be reviewed carefully. The reality is that e-commerce and the rest were oversold at first. We went from dotcom to dotbust. Now people are discovering the right thing to do. The situation is similar to others, for example, railways in the 19th century, when there was much unwise investment, but cooler heads made use later of what had been done.

Rather than plunge in with a sweeping view, I would say that there is a need for a careful look at the availability of telecoms infrastructure throughout Scotland. On the whole, I think that the infrastructure is quite good, but once one has put in the infrastructure, one must still encourage the businesses to make use of it. You can put in infrastructure that people will not make use of. I repeat that there is telecoms capacity that is not being used because people have not come up with the business opportunities to use it.

Mr Stone: I do not want an IT Dr Beeching in the Highlands.

Peter Wood: I do not think that anyone will haul the fibre out of the ground.

The Convener: I have a final question for Peter Wood. You have made a strong set of arguments, with a considerable degree of intellectual coherence, about increased health spending and the constraints in that respect. However, you then made an argument about increases in spending on education, particularly higher and further education. Surely one could make an equally rigorous argument to say that the constraints following a health increase would apply in the same way if there were an increase in education spend. Is that not a general argument that could be argued across a range of budgets? One could certainly argue that spending on education has increased substantially without the increase in productivity that people might expect that to deliver. The levels of spending on higher education in Scotland are already high when compared with the rest of the UK. Surely all those arguments translate across.

11:45

Peter Wood: Yes. However, there are some counter-arguments. I said nothing about school education—my observations were directed at the higher education sector. We need not worry too much about the capacity constraint issue. Higher education is a national-international market par excellence, more than almost anything else. If we make the resources available, we can attract scholars, scientists and researchers to work in Scotland.

The question of what students are being taught and how many are being taught is an issue, but I am more concerned about the need to establish true centres of excellence—Grant Baird touched on that. We must decide where to invest for the future. The coal mines are finished and we have moved beyond that. The resource in question is intellectual brain power, and I argue that if the Scottish Executive wants to do something distinctive, putting Scotland at the forefront of advanced and higher education will be a true priority. The evidence of development in institutions around Boston and certain parts of California shows that such centres can be powerful catalysts.

My argument is about a relative degree of investment and a shift of resources. In comparison with other areas, we do not face the same resource constraint in higher education. It is possible to make a move in that direction.

Matthew Farrow: I accept Peter Wood's arguments about higher education. However, on schools, the evidence of the last 10 years shows that churning out more qualifications does not increase productivity. If one considers Scotland occupation by occupation, the Scottish work force is more highly qualified than the rest of the United Kingdom, but labour productivity is no greater. Our analysis of that is that we need to think better about the sort of skills that young people are being equipped with, and we hope that the national debate will lead to a rethinking of the balance of skills and subjects in the school curriculum. That will have some spending implications for implementation, but it will not lead to a shift in resources.

I have a brief point on health. Business has a concern that the Scottish Executive has made no attempt to justify the level of health spending that it seeks. At least in England Gordon Brown has said that we are below the European Union level and need to get up to it using tax rises. Businesses are not knowledgeable enough to decide whether that is right or wrong. In Scotland, we are already at the EU level or thereabouts, yet the Executive still takes the approach that any money from Gordon Brown must go straight into health—it is unthinkable to do anything else. There is no

debate or discussion with the Parliament or stakeholders about whether that is right. There has been no analysis of the level of health spend or the particular level that the Executive is aiming at. Business is concerned that it does not know about the thinking behind the health budget.

Stuart Duffin: On the issue of skills and broadband, particularly for the civic economy, a core and cluster approach is needed. We must consider core activities and services and create service clusters around that. There is a similar issue around the skills debate and the centres of excellence. Where are the core centres of excellence and where are the clusters to support them?

The Convener: I thank all the witnesses for their evidence. It has been an interesting session. I suggest that we take a short break.

Mr Davidson: We should bear it in mind that some of us have a meeting at 1.30 with the clerks.

The Convener: Yes, I am anxious to press on.

11:49

Meeting suspended.

11:56

On resuming—

The Convener: We will reconvene. Agenda item 2 is the 2003-04 budget process. We have stage 1 reports from the subject committees, with the exception of the Education, Culture and Sport Committee's report, which will be signed off this afternoon. Arthur Midwinter has prepared a paper that summarises the main issues that arise from the reports, which has been circulated to members. I invite Arthur to comment briefly on his paper. If we want to go through the reports one by one, we can—I phrased that carefully.

Professor Midwinter: I will concentrate on the common themes in the committee reports, rather than go through them individually. I will concentrate on the overarching and co-ordinating role of the Finance Committee and on what is of relevance to the report that we must write over the next fortnight or so.

A number of issues that were raised in the reports are relevant to the budget exercise as a whole, in particular the issue that the Local Government Committee raised about national insurance costs. It would be useful to obtain a Scotland-wide figure for that from the Minister for Finance and Public Services, if we can press him on that later in the week. A question was also asked about the resources that will be released by HM Treasury's debt redemption, which is also a significant issue.

Brian Adam: The minister has already answered a question that I lodged on national insurance. A number of members have asked him about that. The answer should be published.

Professor Midwinter: Do you have a figure?

Brian Adam: He referred me to another answer that he had given.

Alasdair Morgan: I could not find the other answer.

Brian Adam: We should get hold of that answer today. All the answers are published. We get the individual answers, but it is the following day before they are widely available. The answer should be available now.

Professor Midwinter: The reports contain a number of positive comments. There is support for budget growth in almost every case, but there are reservations about the lack of growth in one or two budgets. In most cases, contentment was expressed with progress in the annual expenditure review. A desire to go further was expressed, as with some of the reports that I read last year at this stage, which were highly critical of the information that was provided.

I understand that the information that we asked for will be produced soon and that it will go beyond what we asked for, in an attempt to compensate for failing to deliver it on time. The AER is a better document. We still need to consider how we will rationalise it and the draft budget, but progress has been made.

A number of issues that were raised by the committees were similar to those that were raised by Campbell Christie and other witnesses, such as problems with transparency, in particular in relation to block allocations to health authorities and local government, or to cross-cutting issues across spending departments' budgets.

We have managed to generate 10 options for additional growth, in contrast with two in the past three years—or whatever the figure was. Committees that did not have an adviser suffered as a result. One or two committees made no recommendations, because they did not get advice that would have put them in a position to make sensible recommendations. However, the fact that we have 10 spending proposals in the event of new money becoming available, either through end-year flexibility later this year or through the spending review, is the beginning of real progress.

12:00

I have also raised—and kept separate in the appendices—a number of arguments about spending that are really beyond the scope of the

budget document, which is simply about increasing or decreasing spending on existing programmes. I have also grouped together for consideration the programmes that require new policy development before money can be spent, and a range of procedural issues that the committees have raised and that I will have to examine over the next fortnight in order to pick out common themes. We can raise those issues with the minister in the final report.

The most impressive feature of the reports is the high level of consultation that has gone on. Some committees have taken evidence from six, seven or eight witnesses, which is all to the good, given the Parliament's ambitions that the budget process should be more inclusive.

The Convener: The quality of the subject committees' budget reports is much higher than it was previously, and I want to thank Professor Midwinter and the various committee advisers for the amount of work that they have put in. We should send positive comments back to the conveners of the committees that have done particularly good work. Although it is probably invidious to pick out particular examples, I was absolutely delighted by the Rural Development Committee's report because of the issues that it highlighted and the quality of its contribution.

I am a member of the Transport and the Environment Committee which, after a thorough analysis of transport issues, has produced some fundamental thoughts that go beyond the scope of the budget process to address the problem of budget mechanisms. I will skate over the one or two disappointing returns, but members can draw their own conclusions from those.

As we have only a short time today, we should focus our attention on the particular issues that arise from the reports and that we need to raise with the minister. Although Professor Midwinter has highlighted some of those, I am happy for members to add to the list. We should put a longer-term analysis or sift of the issues back on the agenda for a future meeting; perhaps we might even have time to bounce that issue around in Orkney.

I think that that is how we should proceed; I now invite comments from members.

Brian Adam: This was my first experience of being sent by one committee to sit in on other committees, so I am interested in finding out what other members feel about our role in the process. I know that some members took a very active role when they attended other committees. However, I do not know whether we should do that. I am disappointed that I was not able to go to the Rural Development Committee, which obviously prospered without my involvement; it produced a

good report. I wonder whether it is worth while sending reporters to all committees, or whether we should concentrate only on the committees that did not do as we had hoped.

Mr Davidson: I will respond briefly to Brian Adam. I sat in on the Health and Community Care Committee's budget considerations and in previous years I have sat in on the considerations of the Transport and the Environment Committee and the Enterprise and Lifelong Learning Committee. I was disappointed by the approach that the Health and Community Care Committee took. It seemed to concentrate more on policy changes, rather than on an appraisal of budget priorities. However, I am impressed with the report that it has come up with, because it is different. I presume that the committee's adviser—who had played a quiet role—stepped in. That is how that committee seemed to operate.

There is a hint—through specific comments that were made in various reports—that there is a formulaic approach to budget allocation. Perhaps we could take that up with the minister. Two or three committees raised the issue: the Rural Development Committee questioned how European money is used and what it should be focused on; the Health and Community Care Committee said that the Arbuthnott formula needed to be revisited and gave specific reasons; the Local Government Committee—

The Convener: The Health and Community Care Committee did not give reasons for revisiting the Arbuthnott formula; rather, it commented on the application of Arbuthnott within health board areas. That was my interpretation.

Mr Davidson: That still represents a revisiting of Arbuthnott, its roll-out and what it will mean, so I disagree with you. Health is still split across several departments, because it involves not just the health boards, but the councils. If the Arbuthnott formula impinges on one part, the formula is not reacting as well as it should. I am not arguing that we need to examine how the formula is set up, but we need to consider whether it is working. That theme could be pursued. In evidence-taking sessions in other committees, there has been general discussion of that point; and we have heard evidence today about, for example, the strategic—or otherwise—role of ring fencing.

Last year I asked for the budget process to be scrapped halfway through and most members gave up on it. The budget process is growing up and we now have a much healthier approach in the committees. However, we must talk about where we go from here, bearing in mind the fact that the former Minister for Finance and Local Government gave us assurances that the current Minister for Finance and Public Services is not

prepared to live up to. It would be helpful if the clerks could track down all the times when the present minister said that he would come back to us after reviewing the promises that his predecessor made. We might want to consider such matters when we are in Orkney.

Alasdair Morgan: It is interesting that some committees have suggested changes to the budget. The justice committees in particular suggested quite a few changes. The suggestions did not include the phrase "if new moneys were available"; such a phrase was used only in reference to future years. The suggestions were for changes. Of course, the committees did not suggest where we would get the money for that—they drew the line at that, unfortunately. However, they might have given us an interesting conundrum.

Mr Stone: I thought that going to other committees was a positive exercise, and I was afforded great courtesy by the Local Government Committee. Arthur Midwinter has already alluded to points that have been made.

To answer Brian Adam's point, what we have been doing has been a good move in the right direction. If nothing else, it is ambassadorial—it is good to have a member of the committee present at other committees to be the embodiment of what the Finance Committee is trying to do. I am fairly new to the committee, but it has been a useful exercise.

Elaine Thomson: I am also a member of the Local Government Committee and I wanted to pick up on one aspect of its response. The Local Government Committee finds it difficult to make any real contribution to the budget process because the information that it needs is split across all the different policy areas—education, social justice or whatever. National insurance has been mentioned, but the Local Government Committee is concerned about ways in which it can make a more meaningful contribution to the budget process. What information would the committee need to do that?

Professor Midwinter: The Local Government Committee would probably have to have some sort of informal philosophical discussion about that with ministers. There is tension involved in the way in which people on the local government group manage the budget process. They see the budget as a regulatory framework for financial control; they do not see it as allowing questions to be addressed on what the budget means for schools. The subject committees are the locus for such discussions.

At the moment, there is no way of bringing together all the people who are involved. At least three committees raised issues relating to the sharing of local government allocations and their

unhappiness with that. Work is not joined up. If there is to be intensive scrutiny and the Parliament can say that it is content with what will happen to money, we must move on. That will require discussion of outputs that would be provided with additional funding.

There is a particular problem in local government because money is spread across other departments. The Convention of Scottish Local Authorities cannot even commit individual councils to what might be done about that. The issue in relation to local government is slightly more problematic than it is in respect of health, but there is still a problem in health because we cannot get information according to programmes. We can get the information from the boards, but we cannot see how much is being spent on different types of care or treatment, for example. That needs to be discussed at length with the Executive.

Alasdair Morgan: There are different philosophical arguments to be had in respect of health and local government. At least with local government, there is a democratic structure—allegedly—that should allow people to make different decisions in areas of their competence. It is obvious that that is—or should be—less the case in respect of health.

Professor Midwinter: There is tension. If the Parliament's view was that education, for example, should be a national priority, and it wanted to ensure that there was additional funding, there is no way of providing that through the block grant. There is ring fencing, but people will start to argue about ring fencing being wasteful and time consuming. We need a clear position on that tension.

Mr Davidson: Perhaps there has been some top-slicing again.

Professor Midwinter: There is top-slicing, ring fencing, earmarking—whatever you want to call it.

The Convener: I think that that issue also arose in the Social Justice Committee's response. Much of what the Executive is trying to do in respect of social justice is being delivered through local authorities, yet the relationship between how local authorities are funded and how the Executive operates is not particularly well geared towards delivering effective management of outcomes. There needs to be a wide-ranging debate that goes well beyond the debate that is taking place in local government on the issue. In due course, we should perhaps focus our attention on financial issues that are raised in that context.

I want to draw together matters. Are members content to identify a number of issues that we need to raise with the minister? Perhaps Professor Midwinter can systematise those.

Professor Midwinter: Will all members be accessible by e-mail tomorrow before we go to Orkney?

Mr Davidson: I will be available only until about half-past 11. I will be on a morning flight.

Professor Midwinter: I will bring a draft paper to Orkney, in that case; perhaps we can kick it around on Wednesday evening.

The Convener: That would be helpful. I suggest that we do not simply consider the recommendations for differential budgetary allocations. It would be tempting to pick out the 10 recommendations to the committee and ignore everything else that the committees have said. The committees have raised a number of interesting issues and have pointed us to particular areas for investigation. Perhaps we should begin to draw together matters for the committee's future work.

Mr Davidson: I do not argue that we are tidying up the structure, because the committees are obviously buying into the structural process, but the world outside does not want us merely to consider process. The committees have an appetite for considering privatisation and allocation and movement in the block grant—people are buying into that now. We must do both—we cannot just push that back. We want to encourage the committees to be more constructive.

The Convener: I agree and I am trying to push that forward.

Brian Adam: Has the Executive seen copies of the reports?

The Convener: No. They were published only today.

David McGill (Clerk): They are on the subject committees' websites, so they are available.

Brian Adam: I take it that we are going to be mean and rotten and simply ask the minister whether he is content with the committees' reports and what he plans to do with them, as well as raise individual issues.

Professor Midwinter: I would like to map out a number of issues for members to discuss with the minister and use those wider issues in the final report, if the committee agrees. Some wider issues about where we should go should be included in the report in a fortnight.

The Convener: Is that acceptable?

Members indicated agreement.

External Research

The Convener: Murray McVicar is in attendance for agenda item 3, which is consideration of a proposal for external research to gain an international perspective on financial scrutiny arrangements. A bid has been prepared.

Murray McVicar (Scottish Parliament Information Centre): In the past, the committee has expressed an interest in accessing the external research budget to consider financial scrutiny and budget processes in other countries. Perhaps we can put the proposal to the conveners liaison group, if the committee agrees. I suggest that, through desk-based research, researchers should consider systems of financial planning, control and scrutiny and about half a dozen other territories, after which they should come back with descriptions and concrete lessons that can be applied to the Scottish process.

The Convener: Do members agree?

Members *indicated agreement.*

Meeting (Orkney)

12:15

The Convener: Item 4 on our agenda relates to logistical issues connected with our meeting in Orkney later this week.

David McGill : At the previous meeting of the committee, we updated members on arrangements for the workshops and other sessions that will take place in Orkney. I can now inform members of the composition of the three workshops. I would also like to seek nominations for the workshops. Two members can attend each of two workshops and three can attend the third. I also need nominations for members who will report back to the committee when it meets formally at half-past 11. If members are interested in a particular workshop, they should say so now.

Mr Davidson: Why is Orkney Tourist Board grouped with rural affairs bodies, rather than with enterprise and business representatives?

David McGill: That is a good question. To begin with, the board was grouped with enterprise and business, but we had to decide how to separate workshops 1 and 2. We considered having only two workshops, but we thought that one workshop that included representatives of eight organisations and two or three committee members would be unwieldy. We had to draw the line somewhere. We thought that Orkney Tourist Board and Orkney Ferries formed one small group, and that the Orkney Fisheries Association and the National Farmers Union of Scotland formed another. There might be no automatic connection between those two groups, but we had to put together something.

Alasdair Morgan: There are significant links between the two groups.

Mr Davidson: Ferries are involved with the movement of animals.

Alasdair Morgan: Land access and foot-and-mouth are issues that link the NFUS and the tourist board.

Elaine Thomson: Orkney College features in workshop 3. Given that the college's brief is enterprise and lifelong learning, would not it be better to include it in workshop 1 with the business organisations?

David McGill: That is a good argument. However, Orkney College is one of the few colleges that are funded by a local authority rather than by the Scottish Further Education Funding Council. That is why it appears in the same workshop as Orkney Islands Council.

Mr Davidson: I will be generous and volunteer to participate in the workshop that includes the farming, fishing, tourism and ferries bodies.

The Convener: Are there any other bids?

Alasdair Morgan: I would like to take part in workshop 1.

Brian Adam: I will take part in workshop 3.

The Convener: Jamie Stone will not attend.

Mr Stone: There is no need to rub it in, convener.

The Convener: You will miss an interesting meeting.

Mr Stone: I know.

Professor Midwinter: In his absence, let us nominate Tom McCabe.

Elaine Thomson: I am interested in either workshop 1 or workshop 3.

The Convener: It appears as if Tom McCabe and I will take part in workshop 2.

Mr Davidson: I volunteered to take part in workshop 2.

Brian Adam: If you would prefer to take part in workshop 3, convener, I would be happy to attend workshop 2.

The Convener: I would be happy to take part in the workshop that deals with ferries, because I have done work on that issue.

Mr Davidson: I said that I would take part in workshop 2.

The Convener: Elaine, which workshop would you like to attend?

Elaine Thomson: Either workshop 1 or workshop 3—I do not mind which.

David McGill: There is space available on both.

Mr Davidson: Who will attend workshop 2?

Professor Midwinter: Brian Adam and Des McNulty.

Mr Davidson: Brian Adam and Des McNulty? I thought that I applied to attend workshop 2.

Professor Midwinter: I thought that you volunteered to attend workshop 1.

The Convener: David Davidson may replace me on workshop 2. I will attend workshop 1.

Brian Adam: I am glad that we have a difficult problem before us.

Professor Midwinter: It is a good job that you have no money to spend.

The Convener: David McGill will say where we are.

David McGill: By my reckoning, Alasdair Morgan and Tom McCabe will attend workshop 1, David Davidson and Des McNulty will attend workshop 2, and Brian Adam and Elaine Thomson will attend workshop 3.

The Convener: Is that agreed?

Alasdair Morgan: I did not realise that this shambles was being recorded for posterity.

The Convener: We now have some indication of which workshops members will attend.

Brian Adam: As we are dealing with arrangements for our meeting in Orkney, can you advise the committee of what may or may not happen tomorrow night?

The Convener: I will do that as a precursor to the next item on the agenda.

12:20

Meeting continued in private until 12:49.

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