FINANCE COMMITTEE

Tuesday 5 May 2009

Session 3

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FINANCE COMMITTEE
11th Meeting 2009, Session 3

CONVENER

*Andrew Welsh (Angus) (SNP)

DEPUTY CONVENER

*Jackie Baillie (Dumbarton) (Lab)

COMMITTEE MEMBERS

*Derek Brownlee (South of Scotland) (Con)
*Linda Fabiani (Central Scotland) (SNP)
*Joe FitzPatrick (Dundee West) (SNP)
*James Kelly (Glasgow Rutherglen) (Lab)
*Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD)
*David Whitton (Strathkelvin and Bearsden) (Lab)

COMMITTEE SUBSTITUTES

Murdo Fraser (Mid Scotland and Fife) (Con)
Kenneth Gibson (Cunninghame North) (SNP)
Lewis Macdonald (Aberdeen Central) (Lab)
Liam McArthur (Orkney) (LD)

*attended

THE FOLLOWING GAVE EVIDENCE:

Colin Borland (Federation of Small Businesses)
Stephen Boyd (Scottish Trades Union Congress)
Sandy Brady (Highlands and Islands Enterprise)
Garry Clark (Scottish Chambers of Commerce)
Sandy Cumming (Highlands and Islands Enterprise)
Nick Fletcher (Chartered Institute of Housing in Scotland)
Stephen Gallagher (Scottish Enterprise)
David Lonsdale (Confederation of British Industry Scotland)
Jeremy Peat (David Hume Institute)
Jack Perry (Scottish Enterprise)
Alf Young

CLERK TO THE COMMITTEE

James Johnston

SENIOR ASSISTANT CLERK

Mark Brough

ASSISTANT CLERK

Allan Campbell

LOCATION

Committee Room 6

Scottish Parliament

Finance Committee

Tuesday 5 May 2009

[THE DEPUTY CONVENER *opened the meeting at 14:02*]

Strategic Budget Scrutiny Inquiry

The Deputy Convener (Jackie Baillie): Good afternoon, everyone. Welcome to the 11th meeting of the Finance Committee in 2009. I ask members to turn off pagers and mobile phones. We have received apologies from the convener, Andrew Welsh, who is ill, and from Derek Brownlee. I welcome to the meeting Kenny Gibson, who is substituting for the convener.

Item 1 on the agenda is further evidence on the committee's strategic scrutiny of the budget. We will focus principally on three elements: the effect of the recession on public sector budgets in Scotland, the immediate pressures facing the 2010-11 budget, and likely future trends. Our first panel is most welcome. It consists of Colin Borland from the Federation of Small Businesses; Stephen Boyd from the Scottish Trades Union Congress; Garry Clark from the Scottish Chambers of Commerce; Nick Fletcher from the Chartered Institute of Housing in Scotland; and David Lonsdale from the Confederation of British Industry Scotland. Thank you for your written submissions. Would any of you like to make a short—I stress "short"—opening statement?

Witnesses No

The Deputy Convener: That is excellent—I hope that the other panels will take note of such exemplary behaviour. I invite questions from members.

James Kelly (Glasgow Rutherglen) (Lab): Among the central issues in the inquiry are economic growth and anticipating when we will come out of the current downturn. This morning's press refers to a couple of reports on the subject that have appeared, including a report on trends by the Confederation of British Industry. The reports acknowledge that the most recent quarter has been difficult, but there are indications that we are beginning to move towards a period in which the rate of decline will slow down. One report says that business optimism has increased since January. Do you think that the rate of decline is beginning to slow down?

David Lonsdale (Confederation of British Industry Scotland): The survey—[*Interruption.*]

The Deputy Convener: I am sorry, but I understand that there are technical problems with the sound that mean that your every word is not being captured.

14:05

Meeting suspended.

14:15

On resuming—

The Deputy Convener: I understand that we did not capture Mr Lonsdale's interesting words, so I invite him to repeat his response.

David Lonsdale: I take it that the question was recorded. Mr Kelly's analysis is right: the CBI's small and medium-sized enterprise trends survey, which was published this morning, captures a continuing decline in order books and optimism among our SME members, but the decline is less than it was previously. That message permeates most of the CBI's surveys in the United Kingdom and in Scotland. It is fair to say that although there is the odd green shoot, few have roots. Our economic forecast continues to be for an up-tick in the economy and for growth to resume next year, not this year, which is at odds with the Chancellor of the Exchequer's position. In the second quarter next year, positive growth in the economy will resume.

Garry Clark (Scottish Chambers of Commerce): The Scottish Chambers of Commerce published its quarterly business survey a couple of weeks ago. Much like other recent surveys, including the CBI's, we have detected potential growth in the future and we see the decline in growth becoming shallower at present. Some parts of the manufacturing sector suggest that growth might be restored by next spring. Optimism in the tourism sector is still depressed, but it is much higher than it has been for some time—whether events of the past couple of weeks will have a negative impact on that remains to be seen. Our surveying suggests that it will be at least next spring before the overall economy grows.

Stephen Boyd (Scottish Trades Union Congress): The STUC annual congress a couple of weeks ago afforded us an excellent opportunity to meet workplace representatives from throughout the economy. The discussions in Perth did not point towards there being too many green shoots in the economy. I agree with colleagues' analysis of the budget, which is that growth in the economy will be more aligned with the figures from the Organisation for Economic Co-operation and Development and the European Union in the past week than with the chancellor's rather optimistic forecast.

We can argue about whether the measures that have been introduced at UK level are sufficient, but the important point is that global uncertainty is not diminishing. There are a few major imponderables on which any growth forecasts are highly contingent. A major stimulus package has been implemented in the United States of America, which will inject a phenomenal amount of money into the economy, but economists across the spectrum—from Paul Krugman to Martin Feldstein—argue that it is insufficient. The rate of decline in the US economy and the rate of job losses are pretty frightening and will have major impacts on the global economy. This week, the Federal Reserve will publish the results of its stress test on the US banks. If they point to more uncertainty in the US banking sector, that will ripple throughout the global economy extremely quickly, so we would be highly nervous about identifying too many green shoots at this moment.

James Kelly: There has been a lot of discussion about the various measures that the UK Government has introduced over the past eight months to try to stimulate the economy and protect us against decline. One of those was the VAT cut. The Centre for Economics and Business Research recently produced a report that indicated that the cut had had a positive effect on the economy and estimated potential sales growth of between £8 billion and £9 billion. Do the witnesses have any views on the impact of the VAT cut?

Colin Borland (Federation of Small Businesses): The VAT cut did not have the impact that was envisaged when it was introduced. The timing was unfortunate because the Government was giving taxpayers 2.5 per cent off VAT, but they were walking down the high street and seeing 20 per cent, 30 per cent or 40 per cent off in various retailers. The feedback from our members is that the cut had an administrative cost to them but they have not seen a consequent increase in footfall. However, some of the other measures that were announced as part of the pre-budget report have proved helpful. HM Revenue and Customs's flexibility on tax payment for small businesses and some of the measures to improve cash flow through loan guarantee schemes have been good—their effects now seem to be coming through.

Stephen Boyd: When the pre-budget report was announced last November, we were disappointed that the main stimulus measure was the cut in VAT. Unlike many people, we never argued that it would have no effect on the economy; rather, we argued that the Government could have introduced other measures that would have been far more efficient. We are lucky that a lot of first-class work has been done on fiscal stimulus over the past couple of years, such as a particularly helpful paper that the Brookings Institution in America published last year, which said that a fiscal stimulus should be timely, targeted and temporary. It argued—we agree—that a stimulus is best focused on targeted tax cuts for low-paid workers or benefits increases for the newly unemployed. Those measures have the dual benefit of helping to make the economy fairer and ensuring that the money goes to people who will spend it. We argue that that should have been the main focus of the PBR.

We welcome many of the individual measures that were introduced in the PBR and the budget report and there is little that we would criticise, but the totality of the measures that have been introduced to date is insufficient to address the challenges that face the economy. We, along with others such as the National Institute of Economic and Social Research, argue that there should have been a stimulus package of about 2 per cent of gross domestic product in the budget last week. That would have helped to safeguard many jobs in the economy and, importantly, would have created new jobs in emerging sectors such as renewables and environmental technologies.

The Deputy Convener: What would the consequence and impact of a stimulus of 2 per cent of GDP be on the Scottish budget, never mind the UK budget?

Stephen Boyd: If you are looking for a number, I cannot give you one because we have not done that detailed work. The Trades Union Congress has done more detailed work than we have because of its resources. It has argued that such a stimulus would pay for itself many times over. Spending that money now would help to preserve jobs and cut back on benefit payments. If young people in particular lose their jobs as part of the recession and cannot find new ones, long-term problems that are really detrimental to the economy quickly become embedded in it. I do not have figures on me today, but I would be more than happy to provide them to the committee, if you are interested.

The Deputy Convener: I certainly would be interested. If the fiscal stimulus is to be increased, its relationship to growth and its impact on the Scottish budget would be of particular interest.

Nick Fletcher (Chartered Institute of Housing in Scotland): On VAT, the CIH and many others in the housing sector would have liked the United Kingdom Government to reduce significantly the VAT that is paid on housing refurbishment and improvement. New build housing does not attract VAT, but refurbishment and improvement work on housing attracts VAT at 15 per cent. Ideally, we would have liked that to have been reduced to zero, but that cannot be done within European rules. However, we believe that a reduction to 5 per cent would have built a nice stimulus into the building industry. At a time when builders are still going to build new housing, a reduction in VAT would have encouraged housing associations and local authorities to do more refurbishment and improvement work on their houses, which would have helped to sustain the building industry and some allied trades. We would therefore like pressure to be put on the UK Government to try to deliver on that 5 per cent VAT rate, because we think that it would not only improve houses for the folk who live in them, but would help to sustain the building industry at the current time.

Garry Clark: I echo those sentiments. I go round speaking to businesses in all parts of the country, and I have yet to meet someone who thinks that the VAT cut has made a positive difference to their business. I have seen the survey that has been referred to, but my experience on the ground across Scotland is at odds with it.

The Scottish Chambers of Commerce argued, in advance of this year's budget, for a VAT cut for home improvements and repairs. We are sorry that the Government did not take up that suggestion, because we think that it could have delivered a substantial directed stimulus into construction and related industries in Scotland, which have had a fair amount of damage done to them over the past couple of years.

Linda Fabiani (Central Scotland) (SNP): I have for Mr Lonsdale three questions of clarification on his submission. Paragraph 6 refers to further use

"of the private and other sectors in the delivery of public services".

What do you mean by "other sectors"? Is it, for example, the voluntary sector? You also say in paragraph 6 that there should be a

"focus on outcomes rather than inputs".

Can you explain what those inputs are?

Furthermore, paragraph 12 states:

"The size and scope of its public sector provides Scotland with an opportunity to be world class in this area of public service reform".

In my career over many years, I have found that there is sometimes an assumption that the private sector will be better and more efficient, and have better outcomes. However, that is not always the case. Can you say some more about that and about whom Scotland could lead against, because other economies do fairly well with quite a large public sector?

My final question for Mr Lonsdale is on paragraphs 15 and 17. Paragraph 15 states:

"Private sector bidders should not be discriminated against simply because of their ownership model",

and that there should be

"a level playing field for providers bidding for contracts … not least on comparable pension costs".

I would like a wee bit of explanation about that. I would also like to know how that ties in with paragraph 17, which states that "Freedom of Information obligations" should not be placed on private firms that "supply public services" as they are placed on public service organisations. How does that tie in with the view that there should be a level playing field?

The Deputy Convener: There were several questions there—all for David Lonsdale to answer.

14:30

David Lonsdale: Thank you, convener. I apologise to Linda Fabiani if I forget to cover all the questions. I think that there were five or six, so please refresh my memory if I forget. I will try to answer as best I can. I am obviously delighted that the member has taken a good close look at our submission.

The first question was about other sectors. The answer is that we were in paragraph 6 thinking very much about the voluntary sector, or third sector—there might be a new term, of which I am not aware. Our comments related to charitable and other non-profit-making bodies.

Linda Fabiani asked about outcomes and inputs. The Scottish Government said in its programme for government that instead of focusing on processes we need to focus much more on outcomes—that is what I was driving at. As far as I am concerned, inputs and outcomes are pretty interchangeable in that respect. That is very much where we are coming from. You read our submission, so you will expect us to support the Scottish Government in its attempts to achieve its aspiration, although, as we said, we think that in some areas the Government is going about things the wrong way.

You referred to paragraph 12 of our submission, in which we said that Scotland has an opportunity to be "world class" on "public service reform". Scotland has a larger public sector than the rest of the United Kingdom has—I think most people accept that there are a variety of good reasons for that. Given that, we have argued that if Scotland gets heavily involved in engaging the private sector, we could be at the cutting edge. I am the first to admit that the private sector is not best in every instance, which is why we talked about expanding the range of sectors and outfits that can provide services. We have not said that engaging the private sector has to be the linear answer to every problem.

The UK Government has put a great deal of emphasis on the agenda over the years. Last year it led a trade mission to the States, in which it was joined by companies that are leading the field south of the border, to consider opportunities in the States, which is a large market.

Did you mention paragraphs 15 and 17?

Linda Fabiani: Yes. On one hand, in paragraph 15 you said that

"a level playing field for providers bidding for contracts is crucial, not least on comparable pension costs".

On the other hand, in paragraph 17 you said that private sector providers should not have to bother with the freedom of information obligations that are placed on public authorities. How do you reconcile those comments?

David Lonsdale: Some of our members have alleged that there have been problems when they have bid for contracts against other bodies, primarily in-house outfits. Concern has been expressed about whether bidders have been operating on a level playing field, for example in relation to pension costs. The CBI is doing more work on that and a paper is due in the next couple of months—I will be happy to circulate it among committee members when it has been published. There have been recent allegations about Glasgow Housing Association on that front. I have not followed the case closely, but the issues that have cropped up might be worthy of study.

We submitted a paper on freedom of information obligations to the Scottish Government in December or January, in response to the Government's consultation on the issue. We said that the public authorities to which firms contract are subject to FOI rules. Our understanding is that problems in accessing information under FOI rules have been to do with the public authority that was in charge of the contract. In the vast majority of cases of FOI requests, private firms that provide public services are more than willing to help to provide information. However, the public authority that lets the contract is itself subject to FOI.

For example, one practical problem could be that if one sent an FOI request to both the public authority and the company that was contracted to provide the service, there could be a dichotomy in relation to who is responsible for responding, or in relation to costs, which might have to be put back on to the public authority. There are a number of issues. We have put together quite a detailed paper, which I am more than happy to send to Linda Fabiani and other committee members.

Linda Fabiani: I want to move on to the Federation of Small Businesses. I was interested in James Kelly's question about what the UK Government can do to assist small businesses, which I think are having quite a hard time just now. Do you have a view on what other things could be done to help? Some small companies feel that if they were given a bit more assistance, perhaps through the benefits system, they could ride a rough storm for a few months. They would not pay people off and would still be in business at the end of it, rather than feeling that they will get no help unless they go under. Is there a requirement for representations to be made to ease some of the problems? I understand that the Construction Industry Training Board levy is paid retrospectively. In lean times, can things be done to help when people are asked to pay a levy on a successful year?

Colin Borland: Linda Fabiani is absolutely right that the Westminster Government and the Scottish Government both have key roles to play, as do local authorities. If we are to ensure that the current downturn is no longer and deeper than it has to be, we must not repeat the mistakes that resulted in long-term mass unemployment.

Small businesses have a record of creating jobs, particularly when big business is shedding them. Not a huge amount would have to be done to help people retain those jobs. One of the proposals that we—along with the Trades Union Congress and the STUC in Scotland—made in advance of the budget to the Westminster Government was for some form of supported employment, whereby companies that were considering redundancies but which could demonstrate that they were otherwise viable could get a form of help to stop jobs being lost to the company and skills being lost to the economy.

I said to someone the other day that in this year of homecoming we do not seem to be asking ourselves why all those people of Scottish descent are living overseas. The reason is that they left in periods of economic difficulty. We cannot allow that to happen again. Expenditure of the sort that I suggested would save money.

In answer to Mr Kelly, I touched on the simple HMRC measure on flexibility in payments, which has been of real help to a number of our members. I do not know how much that measure is costing HMRC, but I do not imagine that it is a vast amount in the grand scheme of things, because it simply allows for a bit of flexibility and common sense in the process.

On what the Scottish Government can do, there is great untapped potential around companies that are looking to do business. It is not all doom and gloom; some companies are looking to do business and, indeed, some are looking to expand. There are about 100,000 self-employed individuals in Scotland. It would not be practical for all of them to become employers; some are professionals who are self-employed for tax-efficiency reasons and simply cannot take on other people. However, we have to consider the barriers to self-employed people taking the first step to becoming employers. There are fiscal barriers that can be addressed at Westminster through the national insurance thresholds. We could also give practical help—although, at the moment, it could not be delivered effectively through any public body.

We should look again at the business gateway and the practical advice that could be given about the barriers and the liabilities that people would incur to see whether we could take people through the process for the first time. Once you take on your first employee it becomes easier to take on your second, your third and your 103rd.

Those are a couple of examples of where the Scottish Government and the Westminster Government could work together to help small firms retain jobs, keep on contributing to the economy and get us out of this economic situation as quickly as we can.

The Deputy Convener: Would other panel members like to comment?

Garry Clark: I underline a lot of what Colin Borland said. We think that a targeted cut in VAT would have more value than the across-the-board cut in VAT that we have had. In addition, we have called on the UK Government to act on national insurance contributions, which are a tax on employment at any time, but which are causing even more difficulties at the moment. National insurance contributions are due to increase in 2011. We need to look at the cost of employment, of which national insurance is a big part.

Some firms are moving towards short-time working, which is an issue on which we, alongside the FSB and the STUC, have argued that Government could step in to ease the financial blow. The Scottish Government has more limited resources and fewer levers at its disposal. However, it has a great opportunity to ensure that business rates for all companies in Scotland, not just those for the very smallest businesses, are even lower than they are in the rest of the United Kingdom. The Scottish Government reacted extremely quickly to the situation that employers would have faced in April this year, when business rates would have gone up by 5 per cent had the chancellor not arranged a last-minute deal to reduce them for this year. The fact that the Scottish Government reacted quickly is welcome. We must identify what future opportunities exist in that regard.

David Lonsdale mentioned public procurement, which is an area in which huge opportunities exist to ensure that SMEs in Scotland can benefit from public sector contracts. We need to ensure that public sector contracts are broken down into small but efficient chunks so that most small businesses can access those opportunities.

Stephen Boyd: I will add to the consensus on the need for Government support for short-term training and/or wage subsidy programmes. I do not know whether the committee is aware that such a programme is already up and running in Wales—it is called the ProAct initiative. It is important to emphasise that if such programmes are run or administered badly, they can have enormous deadweight costs. That is why the ProAct programme has a number of stipulations that must be met before a company can access assistance. I would be more than happy to send the committee further information on that, if it would be interested.

The Deputy Convener: That would be helpful.

David Lonsdale: I will pick up on the issue of cash flow. Like the Scottish Chambers of Commerce, we were in touch with Scottish ministers and lobbied them on the deferral of the 5 per cent rise in non-domestic rates that was due to come into effect in the spring. We are delighted that the Scottish Government moved on that and that firms are being allowed to defer the increase over the next few years, if they so choose.

In a similar vein, we have campaigned to encourage the wider public sector in Scotland to live up to the Scottish Government's target of paying suppliers within 10 days. That target clearly has cash-flow implications for Government and the public sector, but it is one that has been set by ministers. The Scottish Government published some extremely useful figures on that a few days ago, which showed that it paid more than 90 per cent of its bills within 10 days. That is extremely beneficial for the firms that benefit from that. There is a question about the performance of other parts of the public sector, which we touch on in our submission and to which we might come back later in the meeting.

Allied to that are the efforts to get all public bodies to advertise their tendering opportunities on the public contracts Scotland website, on which I know that Mr Whitton has lodged parliamentary questions in the past. There are various things that the devolved Government can do within its limited powers. On a number of fronts, it is taking action that is extremely helpful.

14:45

Linda Fabiani: Over the past few years, I have heard various arguments from those who represent employees, in the STUC, and those who are deemed to be pro-employer; it is nice to have all of you in one room.

Stephen Boyd: It happens all the time.

Linda Fabiani: The CBI and the Scottish Chambers of Commerce always say that there is far too much regulation of business, complain about gold plating of European directives and see overregulation as a burden; I imagine that the problem is even greater in these times. However, the STUC always says that UK businesses are among the least regulated in Europe and the western world. I invite you to comment on that point.

The Deputy Convener: Stephen Boyd can take up the challenge, given that his microphone is already on.

Linda Fabiani: You are outnumbered, Stephen.

Stephen Boyd: We discuss the issue all the time. It is important to point out that all the organisations that we represent are engaged in the Scottish Government's regulatory review group, where I hope we are taking a proportionate, mature approach to better regulation. You said that the STUC argues that UK companies are among the least regulated. We do so because that is a demonstrable fact, which we can back up with comparative information from the world over. Time and again, international surveys show that the UK labour and product markets are lightly regulated by international standards. I am more than happy to furnish the committee with that information, if members wish.

The Deputy Convener: I will take one survey.

Colin Borland: As Stephen Boyd said, all our organisations are represented on the RRG. Regulation as a concept is not good or bad, any more than weather as a concept is good or bad, but there are good and bad regulations, just as there is good and bad weather. Regulations have a disproportionate impact on smaller businesses, which do not have large human resources departments and support organisations to implement them. Although pieces of regulation may be completely inoffensive and fairly easy to comply with on their own, we continue to argue, through the RRG, that greater prominence must be given to their cumulative effects.

The Deputy Convener: We look forward to seeing the group's work.

David Whitton (Strathkelvin and Bearsden) (Lab): I will give a brief shorthand version of the CBI's submission—Mr Lonsdale may correct me if I am wrong. Basically, the CBI is saying that the public sector is bad, that we should privatise as much as possible and that we will have to pay off people and to end the policy of no compulsory redundancies.

David Lonsdale: I would not put it like that.

David Whitton: The submission states:

"Similarly, the 'no compulsory redundancies policy' needs to be reviewed to see whether it is sustainable."

David Lonsdale: The challenge for you as politicians is that you are about to enter a far leaner period for finances. I do not envy you and Scottish ministers in that task; we are here today to offer some suggestions as to how you might approach it. One of the issues that you face is spending restraint. One of the largest elements of the devolved Government's budget is pay, pensions and associated costs, so the total envelope will have to be looked at. It is clear in the harsh light of day that the policy of having no compulsory redundancies will have to be examined, even though that may not be pleasant, if the Parliament is to wash its face financially.

David Whitton: Which services are you suggesting should be privatised?

David Lonsdale: In our submission, we focus on Scottish Water. Regardless of whether you believe that Scottish Water should be privatised, mutualised or retained in public ownership, the amount of support that is on offer to it will be at risk, given that the devolved Government is operating in a much tougher financial climate and will want to protect a number of other public services. In its inquiry, the committee needs to determine whether it is reasonable for Scottish Water to continue to receive much-needed support at the current level or whether that support will be affected by the squeeze on public spending.

Our members do not think that allowing support for the water industry to be affected by the squeeze on public spending is an attractive option, so we ask whether other models are available, such as privatisation, mutualisation or allowing Scottish Water to remain in public ownership but to borrow in other markets to finance the meeting of its infrastructure needs and requirements. Scottish Water is implementing a big programme and it will continue to need a big programme of investment and capital spend. Does the squeeze on the devolved Government's finances put that at risk? How can we protect that? Perhaps pursuing the options of mutualisation and privatisation would achieve that.

David Whitton: One interesting result of holding an inquiry such as this one is that we receive submissions from various organisations. Last week, a panel said that Scottish Water had been successful in reducing costs. I do not remember any of the witnesses then suggesting that Scottish Water should be privatised or mutualised; I do not remember whether Mr Brownlee suggested that. Water in Scotland costs less than it does in many areas of England, so why should we privatise or mutualise Scottish Water?

David Lonsdale: Such a move would have several benefits. The committee is examining the devolved finances and where the Scottish Government can best deploy its resources. Perhaps you can tell me whether the inquiry covers the question whether support will be affected by the squeeze on the devolved Government's spending. If so, how else can we continue to invest in much-needed infrastructure?

David Whitton: I am sure that you do not mean just privatisation or mutualisation of Scottish Water; you are talking about pay and pensions throughout the public sector. CBI Scotland seems to be saying that we must reduce the head count in the public sector and that we must consider pay and pension levels in the public sector.

David Lonsdale: Professor Bell's research for the committee pointed out that public sector pay levels are higher than private sector pay levels in Scotland, so the committee should look at that.

David Whitton: Is that difference a bad thing?

David Lonsdale: Not necessarily, but it is not me who is going to have to live within my means—that is for politicians, parliamentarians and the Government of the day. The biggest item in the budget is pay and pensions, so the committee will have to examine and tackle that.

Similarly, the committee will have to consider wider spending. There are other ways of trimming costs—our submission outlines several of them. We can think differently about how services are provided. Ms Fabiani asked me about the focus on outcomes. We should not get hung up on who provides the service, which happens too often. Paragraph 17 of our submission talks about the idea that the public sector must provide everything. Why should it do that? If the public sector is still the procurer, the regulator and the funder, it does not always have to be the provider—that can be a private company that makes profits. "Profit" is a good word. Profit allows investment in growth and innovation in companies. Why cannot profit-making companies and other non-profit-making bodies provide services?

David Whitton: In case Mr Boyd thinks that I am just picking on the CBI, I will now turn the tables on him and ask him to defend the STUC's submission. I presume that his view is completely opposite to the one that Mr Lonsdale espouses.

Stephen Boyd: I guess that it is—members will not be surprised to hear that. I will consider some of the reasons for the trends that underpin the CBI's arguments. A discrepancy between public sector and private sector wages is claimed. How has that come about? The figures that Professor Bell's helpful paper provides are stark. UK private sector wage levels are hugely skewed by the inclusion of south-east England. If Scotland were compared with the other devolved Administrations or with the majority of the English regions, I imagine that a different picture would emerge.

There is also the stark discrepancy in Scotland between public sector and private sector wages. Why has it come about? The assumption is that public sector wages have risen exponentially, whereas private sector wages have not, but what has actually happened? If we look back over the past 10, 20 or 30 years, we cannot identify any 10-year period when public sector wage growth has outpaced private sector wage growth. The very low-paid occupations in the public sector have been privatised or outsourced to the private sector, so the public sector wage average has increased. I am not saying that anybody—certainly not Professor Bell—is doing this, but to argue that public sector wages have been on a never-ending upward curve and to underpin arguments about privatisation in that way would be wrong.

I am keen to talk about Scottish Water. I read the evidence from last week, which I found very interesting, but a couple of issues were not tested. What has happened in Scottish Water was presented as an unmitigated good-news story. I would question the sustainability of the efficiencies that have been derived in Scottish Water. It is the easiest thing in the world to merge three different companies, suck the capacity out of the organisation and call that efficiencies. Our people who work in Scottish Water have worked very hard to deliver those efficiencies, but they have not been rewarded for that in the way that senior managers have been. Those workers would argue that Scottish Water is not operating according to a sustainable business model.

There is also the huge democratic deficit in the regulatory structure. There is an unelected regulator, a key decision maker, in the water industry, who has—I take no pleasure in saying this—an agenda to privatise or mutualise the industry. He has been quite happy to speak about that publicly. The assumption that the regulatory model is automatically relevant to the wider public sector does not stand up to a great deal of scrutiny. What would that regulatory model mean if it was applied to health or education? A lot of substantial work needs to be done there, and we cannot take it as an article of faith that the model has worked for Scottish Water just because some targets have been achieved, and that it will automatically work elsewhere. I think that—

David Whitton: I am sorry to interrupt your flow—just as you were talking about Scottish Water—but the written evidence contains some suggestions for potential savings. What would the STUC say? How would you make savings given that, as the evidence points out, 60 per cent of the Scottish Government's budget is spent on wages?

Stephen Boyd: I am not going to say anything here to undermine the collective bargaining agenda of our affiliates. It is important to mention that the wage claims of the majority of public sector workers are up for renegotiation next year, which will be a very difficult year for the budget. Like all other pay negotiations, they will take into account the current rate of inflation.

David Whitton: So, with interest rates at 0.5 per cent and inflation at almost zero, there will be an argument for no increase.

Stephen Boyd: The figures will be taken into account, but last year the opposite was the case, and I do not think that there was a great deal of support for public sector workers getting 4 to 5 per cent then. It is always up to negotiation and, as I say, those factors will be taken into account. I do not shy away from the fact that it will be a particularly difficult time next year.

We should not forget that a third of public sector workers are currently on under £16,000 a year. They will find it very difficult to understand why they are being asked to pick up the tab for an economic crisis that was precipitated by the Fred Goodwins of this world, who have walked away as millionaires. It is a very difficult time to be persuading low-paid public sector workers that they are the ones who must restrain wage growth in order to pay for the current crisis.

I emphasise that agreements are up for renegotiation. All the various factors that you have mentioned will be taken into account, as they always are.

David Whitton: I have one more question for Mr Borland. You have heard about the Scottish Government's commitment towards payment within 10 days. This point is with a view to one of our later panels. I notice from your panel's evidence that Scottish Enterprise is not paying your members within 10 days. Is that correct?

Colin Borland: I am not sure about that. Is that from our written submission?

David Whitton: It is. It is in the little panel at the back.

Colin Borland: That is from Garry Clark's submission, I think; no, it is from—

David Whitton: Have I got the wrong person?

Colin Borland: It is from appendix 3 in David Lonsdale's submission. Is that right?

David Whitton: I am sorry. Whichever of you submitted the helpful table that says that Scottish Enterprise uses 30-day terms. Is that correct or not?

David Lonsdale: Yes, it was in my submission. One could argue that it has too much information.

[*Laughter.*]

David Whitton: It is your own fault.

David Lonsdale: However, I personally would not argue that.

The information about 30-day terms was genuine feedback from some of our members. I am sure that those are the contractual or normal terms. As I stated in the submission, the Scottish Government said last autumn that it wanted to pay suppliers within 10 days and that it would encourage all agencies and other parts of the public sector to do likewise. The committee may have someone from Scottish Enterprise before it later in the meeting.

15:00

David Whitton: Yes, we do.

David Lonsdale: You may want to ask them about payment terms.

David Whitton: I add that I am dismayed to note from the table that the figure for East Dunbartonshire Council is 36 days. I will have words with it as well.

The Deputy Convener: Watch this space.

Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD): I want to ask first about where we are because we are not necessarily starting from the basis of everything being equal. We have had a couple of budgets from the Scottish Government and we are in the middle of the Government's strategic spending review period. So far, all the witnesses have mentioned investing in infrastructure and in skills and training, none of which I picked up from their written evidence. There was reference in the submissions to the past two budgets and the fact that the budget for universities and colleges has flatlined, which seems to be the most favourable assessment of it. The CBI and the Scottish Chambers of Commerce seem to be a bit impatient with the Scottish Futures Trust but still wish it well. How strong a position do you think Scotland is in to have faster growth than the UK as we come out of the recession?

Stephen Boyd: One lesson from the past couple of years is that we must be careful about making such forecasts. I do not know whether Scotland is likely to emerge from the recession at a faster rate than the UK is. We could build a case for that being likely and for it being unlikely. However, the important point is that we must invest during the recession to the best of our ability to ensure that Scotland is as well placed as it can be to meet future economic challenges, which will be substantial. We hinted at that view when referring to investment in skills, higher education, innovation, infrastructure and the effective use of skills in the workplace, which is often overlooked. Those are all essential components of the package.

Nick Fletcher: From the CIHS's perspective, it is difficult to assess when we will come out of the recession. However, the key argument in our written evidence is similar to Stephen Boyd's argument: we must invest now to deliver in the future and build ourselves out of the recession. The Scottish Government has brought forward money from next year to this year to invest in housing. Part of that is about trying to sustain the housing construction industry. So far, about 26,000 jobs have been lost in the construction industry, which is a challenge not only for now but for the future. The Scottish Government has a target of building 35,000 homes a year by the middle of the next decade. However, the contraction in the construction industry will continue way beyond the recession.

Homes for Scotland, the umbrella organisation for the building industry, did work that suggests that, if we lose many more jobs in the industry, it could take 10 or 15 years to get the industry back up to the capacity that it has had for the past few years. No doubt, just as the industry gets back up to capacity in 10 or 15 years, we will be heading towards another cycle of recession, so we will not achieve the level of building that we need. We argue that we should look beyond the recession and ensure that we have budgets in place now to invest in training and employment to help to sustain jobs, which will help us to grow much more significantly beyond the recession than other countries might be able to.

Jeremy Purvis: I read with interest the CIHS's written evidence, which states that the impact of the recession

"has been compounded to some extent by Scottish Government policy on the levels of subsidy"

for the affordable housing sector.

Nick Fletcher: That is right. We did a piece of research among developing housing associations to find out the combined impact of the change in the level of housing association grant that they get from the Government and the difficulty that they face—indeed, everybody now faces—in raising private finance because of the credit crunch. The results suggested that the changes that the Government had made, coupled with the challenges of getting access to private finance, have made it more difficult for housing associations to build houses.

The available figures for quarter 3 of 2008 show that housing association building programmes have started to decline. Although the Scottish Government is bringing money forward in its budget, it is more difficult for housing associations to build because the level of subsidy that they get for each house has reduced. Some rebalancing is necessary. It would be useful for the Government to reconsider the figures and decide whether it can return the subsidy to the pre-credit-crunch level. We can reconsider reducing it again after the credit crunch.

It is important that we get the best value that we can for the public pound, so we need to drive an efficiency agenda. However, the current recession is probably not the best time for that because the changes to HAG were made on the assumption that private finance was still readily available. Indeed, housing associations tended to get better value for private finance because they were regarded as safe investments. They tended to get the London interbank offered rate—LIBOR—plus only a couple of points. The rate is now way above that and many more covenants are being imposed on them. In the current climate, it would be useful to reconsider the HAG subsidy.

David Lonsdale: I am going back to the previous question. In the CBI, we produce a UK economic forecast, not a specifically Scottish one, so we cannot comment with the same degree of authority on the Scottish forecasts. There are far more eminent economic analysts in the room than I, but the Scottish figures seem to me to be largely in parallel with the UK figures, although there is a time lag for when the Scottish data come out.

As we say in our submission, it is necessary to protect infrastructure and capital spend, as well as the spend on skills development, while continuing to support exporters. Scottish Development International, which is a part of Scottish Enterprise, has made some good announcements on that. Given that there will be a shift in the economy in due course as it relies less on the financial sector, the question is how we will earn our corn in the future. We will have to build on our good record in exporting, so we need to think about how we encourage more firms to internationalise their efforts and earn income from abroad.

Garry Clark: Recession creates not just problems but opportunities for business. How we react and take advantage of those opportunities will define whether we are successful in outstripping UK economic growth over the next few years. If we are to seize all those opportunities, there are certain policy areas in which we cannot afford to let up investment. Skills are probably top of that list. We need to ensure that Scotland has a workforce that is geared towards the challenges of the future, which means investing in skills at all levels. Business and the public sector both have a key role to play in delivering skills for the future.

Businesses in Scotland must also look towards greater internationalisation, trade in the global marketplace and, where possible, strengthen their hand internationally. That, too, will be a key definer of success in future.

As has been mentioned, the Scottish and UK Governments have made some good interventions to support business. I highlight the Scottish manufacturing advisory service as a key example, as it is of massive benefit to many Scottish manufacturers. Doubling the number of businesses with which it interacts this year is a great way of ensuring that we are as geared up as possible to seize the opportunities that emerge from the recession.

Colin Borland: Like the other panellists, we in the FSB tend to leave economic forecasting to the experts and I am certainly not qualified to comment on that. One of the differences between Scotland and the rest of the UK is that we are more reliant on the tourism industry. We are interested in how the fluctuations in the currency markets will play out, particularly this year—are people more likely to come and are domestic tourists more likely to remain in Scotland? It will be interesting to see those figures.

Jeremy Purvis mentioned how investment in infrastructure will help—not just the physical infrastructure to which Garry Clark referred but the skills infrastructure. Historically, it has been difficult to quantify exactly what is the economic benefit of such projects, but if there is to be investment in skills, we have to take account of the shape of the Scottish economy and the fact that 93 per cent of our firms employ fewer than 10 people. We have to ensure both that those businesses are able to take up opportunities to deliver those services and that the help that is provided is appropriate to them.

How we emerge from the recession will depend a lot on whether we are effective in getting cash flow started. Earlier, we spoke about making money flow around a little bit easier, for example by allowing flexibility in payments to HMRC. A point was raised on payment times and making sure that we are paid for our work. Work has been done in the public sector and we fully expect the pressure to be kept up not just on central Government but on local government.

However, we also have a big problem with large private sector companies. Technically, many of the powers are under the Companies Acts and therefore reserved to Westminster, and the legislative route is not the most effective one because, for practical reasons, people do not want to use it. In the coming months, we will examine closely how we can identify those companies that are using small independent suppliers as a free overdraft and how we can use soft pressure—or pressure outside the legal system—to get them to start to pay fairly.

To try to put a figure on it, approximately £18.6 billion is outstanding in late payments to small firms in the UK. That is not insignificant even if Scotland accounts for only 10 per cent of it. If we could get that money into people's bank accounts and reinvested in those businesses, we could come out of this a lot quicker than we otherwise will.

Jeremy Purvis: I asked that fairly general question because—and I do not mean to be pejorative—I was not sure who to ask. Would any members of your organisations commit to saying they were confident that the way in which the Scottish budget has been used means that Scotland will come out of the recession stronger than other parts of the United Kingdom? None of the business organisations that are here today has said that—either they do not know or they do not want to say that.

In its evidence to us, the Scottish Chambers of Commerce said:

> "SCC believes that the Scottish Government have made a bold and correct decision to place the need to increase sustainable economic growth at the very heart of public sector policy in Scotland, and this must remain the central focus in future years and this must continue to guide Government policy and spending."

There could be widespread agreement with that approach, but it is fairly meaningless unless the Scottish budget is shaped to help deliver it. We have not received any evidence that will help us to shape the budget in that way, or which will highlight or inform the debate about moving in a different direction or shaping expenditure differently.

Colin Borland: I wish to make one point. You will see that, in our submission, we mentioned the move towards a fairer system of business rates for smaller firms, which is one example. The Scottish Government's budget is making us the least taxed part of the UK in terms of business rates, which is having an effect. The scheme has been partially implemented for a year; it was fully implemented only recently. Recent FSB research shows that, for one in eight recipients, the scheme made the difference over the past 12 months between sinking and swimming. That is significant, particularly if it were to be extrapolated across the whole economy. The scheme is one concrete example of where Scottish Government spending can have an effect.

15:15

Garry Clark: That is absolutely right. As I mentioned earlier, the Scottish manufacturing advisory service is another good example of where the Government has directed policy in such a way as to be of direct assistance to business.

Our more general point is that the challenges will really come in the future. Obviously, we are looking towards a time when budgets will become a lot tighter—whether in real terms or otherwise. That is pretty much guaranteed to happen over the next few years. It is therefore more important than ever to ensure that the Government's overarching purpose is to grow our economy. That has to be front and centre of everything that it does. We welcome the action that it has taken thus far, although we did not welcome every proposal. For example, we were very much against the idea of a local income tax. We are glad that the Government has compromised on the issue. The Government has taken a number of positive steps forward.

The situation will become far more challenging as we move forward. It is therefore more important than ever that growing the economy is the Government's number 1 agenda item.

Jeremy Purvis: I appreciate that. If we were to remove the Government's accelerated reprofiling of expenditure, which it undertook with the agreement of HM Treasury, the change to the budget would be 0.2 per cent. The increase in spending on the SMAS may help some businesses, but it will not help the majority of businesses in my area, which are not client managed by Scottish Enterprise or by other mechanisms. It also will not help the smallest businesses, which are already exempt from business rates.

I am interested in the overall thrust and movement of the Scottish budget in the years ahead, given that there seems to be no desire for large-scale structural change. In a budget of £30 billion, the examples that we have heard amount to less than 0.01 per cent. That may well satisfy business groups, but I seek further information on the subject.

Colin Borland: Garry Clark made an interesting point about the SMAS. For all our members who are outside the Scottish Enterprise account-managed stable, the business gateway is the source of business support, the delivery of which has changed. The backdrop against which that change was made is radically different from the present backdrop against which we are trying to do business. A number of interesting questions arise when we couple the current situation with local authorities' extra responsibilities for economic development. For example, how can the committee, the Parliament or the Government keep a tighter control on direct economic support and development spending and ensure that that money has been allocated to the purpose for which it was intended? Subject to the caveat that it is early days, the issue merits exploration.

Nick Fletcher: I return to the question whether people are happy with the way in which the budget is going. We do not think that they are. Indeed, we have been saying that for many years, as have other housing organisations, such as Shelter Scotland, the Scottish Federation of Housing Associations, Glasgow Housing Association and the Scottish Council for Single Homeless. We have consistently made the case that Scotland has a definite need for 10,000 affordable rented homes a year. This Government and previous Governments have delivered around half that number, despite our argument that the Government needs to invest more in affordable housing.

Professor Bell's paper includes a comparison of Government spending in 2002-03 and 2010-11 that shows that the housing and regeneration budget has gone down slightly on a percentage basis, whereas most other areas of Scottish Government spending have seen an increase.

Given the current climate, now is the time to start looking at reprofiling the Scottish budget for next year and future years to gear up the amount of investment that goes into housing. We are now seeing the important role that housing plays in the whole Scottish economy by sustaining and creating jobs in the building industry as well as meeting people's housing needs. The big role that housing plays in tackling health inequalities, poverty and worklessness is also starting to come through. For many years, housing has been the Cinderella of Scottish Government policies. With the recession, we are now seeing the big impact that lack of investment in housing is having now and the big impact that it could have in future. We would like the amount of money that goes into the housing budget to increase. We would also like to consider how it can be used more efficiently.

The Deputy Convener: I take it that you would want the £53.8 million budget consequentials from the UK Government's budget for housing to be spent on housing.

Nick Fletcher: Indeed we would; we say that in our submission. The Chartered Institute of Housing in Scotland, Shelter, the Scottish Federation of Housing Associations and Homes for Scotland wrote to John Swinney to ask for that money to go directly into housing. One of the reasons why we want that to happen is that the Scottish Government has brought forward money from the final year of the spending period to invest in the delivery of affordable housing and affordable rented housing. The downside to that is that there will be less money next year. We supported the Government in writing earlier to the UK Treasury to ask for £500 million to be brought into Scotland, although that has not happened. Therefore, we would like the £58 million to go into the budget for housing in Scotland next year. If that does not happen, there is a danger that housing investment in Scotland will fall next year, through no fault of the Government, other than that it brought the money forward to try to keep house building rates up, to take advantage of the opportunities out there to build more affordable houses through low construction costs and lower land prices, and to protect jobs.

Joe FitzPatrick (Dundee West) (SNP): Jeremy Purvis suggested that the changes in the budget were relatively small. In a fixed budget, moving money from one place to another means having to make a cut somewhere. In discussions on the budget, all the main parties suggested relatively small changes of less than 1 per cent. Most people will be pleased to hear that, in general, the Parliament made choices that they can support.

However, it was suggested that one of the radical changes that could have been made was a 2p cut in income tax in Scotland, which would have resulted in an £800 million cut in the money that the Scottish Government and Scottish Parliament could spend. Do the witnesses think that, on balance, the Parliament made the correct choice by not agreeing to that £800 million cut, particularly given that we have a £500 million cut coming at us?

The Deputy Convener: There are issues of accuracy there, but go ahead with your answer, Mr Lonsdale.

David Lonsdale: You will see from appendix 1 in our submission that we called on the Parliament and the Scottish Government to resist the use of the tax-varying powers, because of the extra cost and administrative burden that that could place on firms. We were happy with the outcome.

Garry Clark: Our members have not expressed support for the use of the Scottish Parliament's or Scottish Government's ability to alter the rate of income tax in Scotland. We would welcome there being no change in that regard.

Stephen Boyd: I agree with that, although perhaps for slightly different reasons. I talked earlier about what works in terms of fiscal stimulus. A general 2p tax cut across the board would not have worked; it would have been very inefficient in stimulating the economy. Granted, the types of tax cuts that I sought could not be introduced at a Scottish level. Our main argument was that the priority was to stimulate the UK economy and that targeted tax cuts for low-paid workers and benefit recipients would be far more effective.

The Deputy Convener: I am conscious of the time, but I will let Mr Lonsdale back in.

David Lonsdale: One quick caveat is that if Parliament was minded to vary the rate, our preference would be for it to go down, rather than up.

The Deputy Convener: You do not surprise me.

Kenneth Gibson (Cunninghame North) (SNP): I have a couple of questions, the first of which is a general one to all the members of the panel.

It is always easy for people to say that we should spend more money on this or that. We have issues about reprofiling and more money being spent on housing. I am sure that some people who are not here today would like more money to be spent on health, education or whatever. The written submission from the Scottish Chambers of Commerce states:

> "not all publicly funded bodies can take much more in the way of efficiency savings which in some cases could see irreversible damage being done to key sectors in the Scottish economy."

Only the CBI—in a bold or perhaps foolhardy attempt—has considered possible ways of saving money. The fact is that we are going to be faced with reductions next year. Given that we all value your contributions to the debate, where do you think that the axe should fall if it has to fall? The Government will make its own decisions, but I am sure that it would much rather that its decisions were influenced by you.

There seems to be a lack of courage, with perhaps one notable exception. No one wants reductions. If they can be avoided, that will be fantastic. However, if we have to make reductions, where should they fall? We all know that we should spend more on infrastructure, skills and so on, but where can savings be made if they have to be made?

Colin Borland: The easiest place to start is on the ground. We all deal on a daily basis with various official bodies and parts of the Government, as do people who work in other policy areas. If someone wants to open a restaurant, for example, they have to have a number of contacts with their local authority over the number of licences they need, who they need to speak to and all the rest of it. If we are to maintain a level of service but achieve some form of efficiency, what back-office costs could be addressed by technology? Could we get someone to visit the premises, tell the person what licences and so on they need and then process all their details? That would save the person having to spend a fortnight contacting different people. From the start, there must be a way of streamlining the process of getting a planning application granted for a change of use and a liquor licence. There must be a way of cutting down on all the different steps—although, if there were an easier way, I am sure that it would have been found by now. Given what we have at our disposal, there must be a way of improving the process.

An example that I discussed the other day is that of someone who wants to get a new bathroom easily. They go to a single company that provides all the trades—they do not talk separately to plumbers, plasterers, wholesalers, tile importers and all the rest of it but go to someone who will organise all those things for them. If we could get someone who did that, that would make the experience better for my members and make it easier for them to do business; also, there must be back-office bureaucratic savings to be made. The potential for that must exist.

Kenneth Gibson: That is very helpful.

Garry Clark: As we say in our submission, to which you referred, before any direct cuts are made in any budget there are areas of the Scottish Government's budget and public sector budgets that would bear greater spending rather than less. The Government must reconsider how it currently provides services and ensure that those services are provided as efficiently and effectively as possible.

The Government is not alone in this situation. Businesses up and down the country have less money coming in than they would like, yet they still have to carry out expenditure to ensure that their business continues. Those businesses have to make tough decisions day in, day out, in order to make ends meet and ensure that they are planning for growth for the future. The Government must act in an efficient, businesslike way in order to replicate that at a Scottish level. It is a much bigger task at that level, with massive budgets that are much more than most of our members have to deal with. Nonetheless, the Government must take a long, hard look at the way in which it provides services in Scotland. It must come to conclusions about what can be done to provide the same level of service for less money, which services need to be cut to provide other essential services, and where we can spend more money. It is a difficult question.

15:30

Kenneth Gibson: That is why I am asking it.

Garry Clark: I probably do not have the answers. Essentially, Government must look at itself as a business and react accordingly.

The Deputy Convener: We have already heard the CBI's suggestions from Mr Lonsdale. In fairness, he made some helpful suggestions.

Nick Fletcher: It is a bit beyond the scope of the CIH to suggest where savings could be made. We are focused on one issue—professionalising the housing sector and delivering better-quality housing services throughout Scotland. I am in danger of giving a politician's answer to the question, if I am not careful.

The Deputy Convener: You do not need to answer. If you have no suggestions to make, that is fine—I will move on to Mr Boyd.

Nick Fletcher: The only suggestion that I will make is that you should look not only at how savings will impact on the Scottish Government but at their wider impact. If you can make savings in areas where they will not have an impact on the wider economy, you should do so. Savings should not be made in areas, such as housing, where they will have a wider impact. However, I would say that, would I not?

The Deputy Convener: You would.

Stephen Boyd: Our public sector affiliates struggle to see where the next set of efficiencies will come from and are constantly baffled by the false distinction that is made between back-office and front-line services. The people who deliver services do not see services shaping up in that way. If the efficiencies that were demanded in the UK budget are available and identifiable, why were they not identified and delivered a number of years ago? Most of the quick wins in public sector efficiency have already been won. It is difficult to see how the proposed level of efficiencies can be delivered without job losses.

Mr Gibson asked a straightforward question about what we would cut. I struggle to identify any areas that I would want to cut, but I will mention one. In doing so, I may puncture the consensus around the table, but it is important that the issue is addressed if we are to move towards a new policy agenda. The small business bonus scheme that has been introduced costs more than £200 million a year. If we are moving to a far tighter budget settlement, we must opt for what works and have a sound evidence base for spending.

Earlier we spoke about training and wage support. The money for the small business bonus scheme would be far better spent if it were targeted at companies that really needed it to keep people in jobs, especially companies in priority sectors that could grow and provide more employment in the future. Disbursing it in a general fashion to all small businesses, without tying it in any way to job-related investment, is a very poor use of money. Five per cent of respondents to the FSB's survey on the issue said that the money was reinvested in the business; surely that is worrying and suggests that the money could be better spent. However, I would be the first one to admit that it is highly marginal in the context of the Scottish budget as a whole.

Kenneth Gibson: Colin Borland said that one in eight FSB members would have gone bust or struggled to survive had it not been for the small business bonus scheme. Given that 93 per cent of businesses are small businesses and that small businesses become medium-sized businesses—which, hopefully, become larger businesses—surely there would be further unemployment if the money were withdrawn.

Stephen Boyd: I hate to be really brutal about the issue, but small businesses go to the wall all the time—sometimes, unfortunately, because they are not viable companies. The public money that is given to all small businesses could be far better targeted to provide more quality employment opportunities in Scotland in the future. I hope that the committee will not make future decisions on the basis of a survey of FSB members. Rightly, the FSB has campaigned in the interest of its members for the introduction of the small business bonus scheme, but we need far more comprehensive monitoring and evaluation of the initiative. We have discussed the matter with the First Minister for a couple of years, but he has never really committed himself to undertaking such work. However, I recognise that the scheme is marginal in the context of the Scottish budget as a whole.

Kenneth Gibson: I have a second question, convener.

The Deputy Convener: I am conscious of the time. Is the question urgent?

Kenneth Gibson: I said earlier that I had another question; Mr Purvis has asked a number of questions.

The Deputy Convener: I gave him permission to do so, Mr Gibson.

Kenneth Gibson: You did indeed, and I am sure that he is grateful for that.

Mr Fletcher, you have made several comments about the housing association grant. What is the HAG in Scotland relative to that in England? What is the difference in the average house prices north and south of the border?

Nick Fletcher: It is valid to raise that issue. The HAG rates in England and Scotland are significantly different. Over the past few years, England has managed to drive down its grant rates to its social rented sector, so housing organisations get less public subsidy and must raise more money privately. However, the upshot has been concerns about the quality of the products in England and the lifetime of the houses that the sector has produced. There have also been issues to do with the size of the properties that have been produced in England, and there are now issues to do with the viability of housing associations there. A number of housing associations have had to consider their future viability because they are starting to struggle a little more. The rates that apply in the two countries definitely differ.

Kenneth Gibson: The Scottish Government reduced the HAG subsidy so that more houses could be built with the same amount of money. I know of one housing association—

Jeremy Purvis: More has been borrowed.

Kenneth Gibson: Aye, that is right. Perhaps Mr Purvis does not understand that economic concept.

I know of one social provider that put out a tender and expected the cost to be around £8 million, but it came back at £6 million because of the reduced opportunities for construction firms. There was therefore a 25 per cent reduction in the cost to that registered social landlord. The HAG has been reduced by only 6 or 7 per cent. That means that that provider can build more houses, which makes it easier to reach the target. Surely the difficulty is not the size of the HAG; rather, it is the access to capital from the banks. Indeed, the Chartered Institute of Housing's submission points out that that is housing associations' biggest problem.

Nick Fletcher: The difficulty arises from a combination of the HAG and access to developer finance. We are aware that construction costs have been coming down—we are doing a piece of work on that at the moment—but one concern is the length of time that those costs will stay down for. Evidence suggests that there might not be a big window of opportunity.

If construction costs come down, the overall housing construction grant budget can potentially deliver more houses, but housing associations submit funding bids to the Scottish Government based on what the costs of a scheme will be. If the cost comes in at £8 million, the budget will be based on that figure; if it comes in at £6 million, the budget will be based on that figure. That does not give housing associations advantages in relation to individual schemes, because they will still have to raise a big element of private finance, if you get my meaning. If, for example, a house costs £100,000 to build and a subsidy of £50,000 to £60,000 is received from the Scottish Government for each house, that will remain the same, regardless of how much the scheme costs to build. If the construction cost comes down, the HAG subsidy might stay at 60 per cent, but it will be only 60 per cent of the overall cost of the scheme. The 40 per cent will still have to be raised through private finance.

Kenneth Gibson: But there is still a saving. Sixty per cent of £80,000 is less than 60 per cent of £100,000. People might have to find the difference between £80,000 and £48,000, which is £32,000, as opposed to the difference between £100,000 and £60,000, which is £40,000. Therefore, £8,000 a house will still be saved.

Nick Fletcher: Some £8,000 a house will be saved, but the private finance will still have to be—

Kenneth Gibson: But surely that means that money has to be borrowed from—

Nick Fletcher: Changes to the HAG subsidy could work, but not in the current climate. Once the recession is out of the way, we could go back and look at the HAG subsidy, because it is public money. Housing associations spend that public money, and they need to ensure that they are spending it as efficiently as possible. The changes were based on the fact that people could get long-term finance from their bank at LIBOR plus 2 per cent, which was a really good deal, but they will not get that now, and that makes things more difficult. A number of housing associations are having to reconsider their building programmes. They are saying that they can probably afford to build just now, but when they do their business planning and consider when the maintenance issues will kick in for that housing, they see long-term sustainability issues. Some associations are saying that they may find that they have big viability issues in 15 to 20 years. Unless they change the way in which they do things now, they might not be able to sustain themselves beyond 15 or 20 years, when the maintenance—

Kenneth Gibson: They should borrow collectively rather than individually. That would save a few quid.

The Deputy Convener: I am conscious of the time. I suspect that we could spend all afternoon discussing housing, but we will not do so.

I thank all the witnesses for coming to the meeting. I apologise for the technical difficulties that we have had, but we have managed in spite of them.

We will have a suspension for two minutes, after which we will resume with our second panel.

15:39

Meeting suspended.

15:43

On resuming—

The Deputy Convener: I advise witnesses and members that the technology has been fixed, so nobody needs to press any buttons. However, I control the microphones, which means that you can be cut off in your prime.

I welcome the second panel, which consists of Jeremy Peat, director of the David Hume Institute, and Alf Young, former member of the financial issues advisory group. Do the witnesses wish to make a short opening statement?

Jeremy Peat (David Hume Institute): No, thank you.

Alf Young: I am quite happy to go to questions

The Deputy Convener: Excellent. We will go straight to questions.

David Whitton: One of the beauties of *The Herald* is being able to read the two columnists from that newspaper who are with us today. Indeed, Mr Peat had a column in yesterday's paper that I will pick him up on, because it is as good as having an opening statement from him. He talked about the Chancellor of the Exchequer being overoptimistic with his growth figures. Would he care to explain that, to start with?

15:45

Jeremy Peat: Certainly. I wrote the column in anticipation of appearing before the committee. I regarded it as something of a joint product, in that I was doing some work for the column and preparing for the committee. The chancellor is optimistic about the UK economy's growth rate in 2010 and beyond, once we emerge from the nasty dose of recession in which we are embroiled. I hope that the chancellor is accurate and I very much hope to be proved wrong, but my view is that to expect growth of more than 3 per cent per annum to continue for several years, particularly when the public finances have to be restructured and sorted, is overoptimistic—I return to that word. I expect a slower pick-up post-recession and I expect it to take longer to fill the output gap that has emerged in the years of recession and to return to where we would be if we had not gone into the pit that we are in. On that basis, the chancellor's economic forecasts err on the optimistic side, so his public finance forecasts also err on the optimistic side.

David Whitton: Given that, you say that positive action is required. What positive action do you suggest?

Jeremy Peat: As the previous panel showed, producing a range of specific proposals is not easy—that is what you and your colleagues will advise on. However, it is necessary to look again at ways in which the extent and quality of public services can be delivered at a lower cost.

Scottish Water provides evidence that reducing significantly the costs of provision is possible while maintaining service quality. Scottish Water appears to have reduced costs by about 8 per cent per annum, which is remarkable. We at the

David Hume Institute considered whether the lessons that might be learned from that could be applied to other sectors in the Scottish economy, such as social housing, waste management and social care. Our view was that some means of more efficient delivery of public services could lead to significant savings, over and above the 2 per cent per annum that is built into expectations.

David Whitton: Would more efficient delivery mean privatising some services or just being more efficient in the public sector?

Jeremy Peat: It could mean more delivery by the private sector or more efficient delivery in the public sector; I am not particularly slanted in one direction or the other. The mantra that I quote has four features. The first is having absolute clarity about and defining clearly the objectives for the public services. That is for the Parliament and the Government. The second feature is considering whether competition can be introduced into the delivery of services, whether between the public and private sectors or whatever, and if that cannot be done, whether effective regulation can be a proxy for competition.

The third element is having good measures of output, so that not just inputs, but outputs and outcomes are determined; David Bell referred to that. The fourth aspect is delivering incentives to reward those who are more efficient and who deliver better, whether they are in the public or the private sector. Scope exists to increase efficiency by going down that path.

David Whitton: I am glad that you mentioned that, because that is what my next question is about. The UK Government is looking for 5 per cent efficiency savings, but the Scottish Government says that it cannot match that. What do you think?

Jeremy Peat: I have no global figure to nail to my mast. Savings of 2 per cent might err on the low side. I suggest just that the more that is achieved through efficiency savings, the less that activities must be cut, so my first priority would be to do everything possible to maintain quality and services at a lower cost to the budget.

David Whitton: I put the same question on efficiency savings to Alf Young.

Alf Young: One issue that has not yet been discussed intrigues me, given my sideline as chairman of a pathfinder urban regeneration company with a very small budget and an even smaller team of people. To regenerate the waterfront on the lower Clyde in Inverclyde, we have had to consider new models of delivery, including partnerships. For example, we have a limited liability partnership with our main landowner and developer on the waterfront, with whom we are sharing profits. We are also creating models that have not really been tried before. After all, if, as everyone says, we are in dire times, we should be looking not simply at what needs to be cut or privatised but at whether there are better ways of delivering.

Another issue that has not been discussed this afternoon is the contribution that a re-energised third sector could play, particularly in the delivery of care services, in dealing with the elderly and the young and so on. If we reduce the debate to one that is simply about numbers, jobs, losers and winners, we will not come up with the sophisticated new answers that we need if, in a strategic sense, we are entering a different era. The committee's inquiry is focusing on the 2010-11 budget, but this is all part of a bigger process. If the borrowing figures that the Chancellor of the Exchequer announced in his budget are even remotely right, we are, as Robert Chote of the Institute of Fiscal Studies pointed out, looking at two sessions of the Westminster Parliament and two sessions of the Holyrood Parliament of, at best, stand-still budgets. In effect, that means a generation of a new public spending landscape. If that situation is anywhere near reality, we will have to rethink the entire architecture of the delivery of public goods.

David Whitton: On that point about architecture, what are your views on the suggestion that was made last week by the Centre for Public Policy for Regions on the establishment of a budget department that would do nothing but look after the money and which would, for example, not have a spending department tacked on to it?

Alf Young: I was aware of the CPPR proposal; indeed, the suggestion has been discussed prior to that. In this new climate, it might be necessary for Government at the devolved level to have such a body or function. There was a lot to be said for the new Administration's decision to reduce the number of departments, as it allowed Government to gain a new focus. Indeed, a focus on finance and sustainable growth sounds as if it might provide a good set of tasks in a world in which there is growth, in which spending grows and in which resources are freely available—in other words, the world that we lived in through the first decade of devolution.

However, if, in the next decade of devolution, there is a more constrained public spending environment, there is clearly a role for someone within the portfolio of ministerial responsibilities to call to account the spending departments and ask the hard and awkward questions. I have never been a politician but, having watched them, I think that they find it easier to spend money than not to spend it, and the hard choices have to be made when the money is not there to spend. I suspect that within Government there needs to be someone who plays the role of constraining expenditure and asking the hard questions.

The CPPR's proposal has merit and I hope that, as the committee examines the strategic aspects of its inquiry, it will spend quite a bit of time thinking about whether it is an essential part of the changing delivery architecture that I mentioned.

Jeremy Peat: I very much agree. Twenty-five years ago, I spent a year at HM Treasury before I came to the Scottish Office, and I found that the challenge function was in operation. Indeed, I was briefly part of that activity. It is very important to have that kind of lean and mean machine that is able to consider evidence on outcomes and to judge demands for finance on the basis of their contribution to economic welfare in Scotland. It could be helpful to have a separate body to do that work, particularly if financial devolution is extended to include, for example, borrowing powers. I agree with Alf Young that it would be valuable for the committee to spend some time thinking about that.

Alf Young: I was introduced as a former member of FIAG. That was more than 10 years ago, and it seems like a different universe. As the group tried to devise a financial architecture for the early stages of devolution, I remember that it had some quite heated debates about accountability and what might be called in tabloid-speak attaching a price tag to commitments. It is very easy to make commitments when real-terms spending is rising year on year in the way that it did over the past decade. For example, it is nice to have a free bus pass; indeed, having reached that venerable stage, I have one in my wallet. I do not use it very often; I usually use it to go to football matches. However, I wonder whether, when the policy was being decided, enough thought was given to the downside of the fact that it is demand driven and that, when I retire in five or six months' time, I might use my bus pass more often. Indeed, as my relatives are quite far-flung, I might use it to travel around quite a bit. If a lot of people like me who are grey but still mobile decide to do the same thing, one might well begin to wonder whether the £190 million—or whatever the cost is in the current budget—will cover the policy and whether people who have decent pensions and can afford to pay for their own travel should get a free bus pass.

The same applies to other decisions such as free personal care for the elderly, about which my background thinking has always been sceptical. Perhaps in making such decisions we need not only a treasury function; perhaps we need people to ask what a policy that looks good and stacks up well in the current climate will look like against, for example, the demographics that we face and the changing health of our ageing population, or if people start doing things en masse in the way that they have taken to the buses or to certain other policies. Taking away a public good that has been given for nothing is a terrible and politically very difficult challenge. In that respect, FIAG probably would have liked to see more emphasis on price-tagging political decisions and checking outcomes against all future scenarios, instead of simply seeing them as being popular in the short term.

Jeremy Purvis: I will return to that point in a moment, but first I want to ask a question that I put to the previous panel. Can—and, indeed, should—we delineate the Scottish economy's growth? The Government's central purpose is to "grow the Scottish economy" and its main target is to match the growth of the UK economy. That has not been revised—and I have to say that I am not sure where it stands with regard to negative growth. Do you have a view on what the Scottish GDP will look like over the period in question? Indeed, is the issue relevant? If it is, what state is it in and how equipped are we to come out of the recession either stronger than other parts of the UK or at the UK average?

16:00

Jeremy Peat: It is difficult to form a view on whether Scotland will outperform the UK in recovering from the recession. What is very important is to examine the sectors that are likely to help Scotland perform well in the post-recession period. I have great confidence that Scotland has several sectors that are capable of being strongly competitive in an international environment. It also has areas in which we can expect growth to be reasonably rapid once we emerge from recession, such as high-tech engineering, energy and the energy services field, high-quality food and drink, tourism—if we get it right—and the creative sector. Scotland is close to being globally competitive in a number of sectors and could be extremely competitive in rapidly growing sectors.

What would be valuable would be to examine very carefully how we use the time between now and next year to prioritise actions—not necessarily all expenditures through the public purse—that will assist those sectors to be well prepared for the post-recession environment. We must ensure that they will help companies and those who work with them to prepare those sectors for the new environment. If we get that right and if those sectors are internationally competitive, just getting one, two or three of them really flying would help Scotland to grow very fast. I add to that list those elements of financial services that have performed well and can perform well.

I would like a focus on those potentially and actually competitive sectors to examine what can be done to help them to perform. If that is done right, Scotland can outperform the rest of the UK. If we do not get it right, Scotland could return to a phase of underperforming as it has tended to for several decades.

Alf Young: I do not take quite the same view as Jeremy Peat on how bad things are, or how bad they are likely to continue to be. He talked about years of recession. I used to be quite downbeat about those things and when the former chairman of the old Scottish Hydro-Electric Board, Sir Michael Joughin, phoned me at the office he used to ask whether he was speaking to Cassandra when I lifted the phone.

Much of the comment about the chancellor's growth forecast has been extraordinary. Some of it has plundered the language of mental illness. There has been a lot of talk about him being delusional and words like that are used to describe just how off the ballpark those forecasts are. They are actually almost identical to what the Bank of England suggested in February and next week we will find out what the Bank of England decides when it produces its forecasts in the May inflation report.

It is instructional to go back to what the Bank of England said in February, because its famous fan charts have a degree of uncertainty built into them. According to the Bank of England's February fan chart, growth in the UK over the next two years could involve anything from still having growth of 1 per cent in 2011 to growth of 6 per cent on the upside. Including anything between -1 and 6 per cent is having your cake and eating it squared—it includes almost every conceivable possibility.

My general point is that because of the extraordinary genesis of this crisis, there is almost no economic model out there that is capable of forecasting future trends on growth. I am not an economist by training—I am a scientist by background—and it seems to me that economists have not had a very good crisis. Their models are virtually useless at trying to chart a way through the current crisis.

An extraordinary armoury of measures has been taken: the Bank of England taking the rate down to 0.5 per cent; quantitative easing, or, in everybody's language, printing money; guaranteeing dodgy assets; buying in commercial paper and gilts; and introducing a stimulus that, as David Bell said in his paper, is not big by international standards and adding to it all the other stimuli in other countries. It is perfectly feasible—or at least not inconceivable, considering that the model making is useless at delivering any clear idea of where all that will take us—that those measures will have an impact.

If nothing else, even the VAT cut that the committee spent some time discussing earlier means £12 billion that is not going to HMRC between last November and this December. That money is still out there in the economy, and it is doing something. If we add together all those things, the idea that we will return to zero growth by the end of the year, with 3 per cent plus next year, is not inconceivable, against historical precedent and against the inability of economic models to identify what happens next. In all this, do not underestimate the psychology of slump. People who did not see it coming will probably not see the upturn when it happens.

Jeremy Purvis: I was interested to note yesterday that there is a new conspiracy theory on the web, saying that swine flu has been invented by bankers to divert attention.

This is not necessarily a criticism, but neither of you—nor anyone on the previous panel—has addressed the question of what we do in the devolved Scottish Government and Parliament. In the last two budgets, and probably in the next one, as we will see when we get the draft budget, the Cabinet Secretary for Finance and Sustainable Growth has started his preface, in the very first paragraph, with the assertion that the main purpose of the Scottish Government is to grow Scottish GDP, and that the work of the Government is to configure things for that aim. That is the highlight of everything that the Government mentions.

I have not picked up today the thought that that growth is a worthwhile thing to aim for, perhaps because it is not possible to achieve that. Even if it is possible, no one has been able to provide an indication of what the aim is. If the aim, in recession, is a revision of that, so that the central purpose of the Government is to grow the Scottish economy at a faster rate to ensure that we come out the recession stronger, we can scrutinise the budget by considering which elements will go towards meeting that aim.

My impression is that there is a considerable disconnect. There does not seem to be much appetite to narrow things down so that, in a number of months when we receive the next draft budget, which will shape the direction of travel over the next couple of years, we can judge whether it will have any relevance to the opening element, which is the aim to grow Scottish GDP. We do not know at what level that will be.

Alf Young: The ambition is sustainable growth—the saving word is "sustainable". From my perspective, given how dramatic this episode has been, it behoves all politicians to ask themselves some searching questions about a world in which we measure progress by 2, 3 or 4 per cent GDP growth per year every year, year after year, and then to match that against the wellbeing of the individual who is seeking so much stuff in the process, hitting the high street, buying more, changing clothes every other week, changing car every nine months. As people used to say when North Sea fishermen were doing well, "You change your kitchen every three months." That was a sign that someone was fishing well. Politicians should ask themselves whether such a world is sustainable any longer, whether or not we get back to growth.

There seems to be a lot of debate among young people—certainly the young people whom I know through my two sons—about whether the world that they want to live in is one that is simply predicated on another 3 per cent of GDP year upon year and whether that articulates a vision or ambition to which they subscribe.

Jeremy Peat: I suggest that it would be wiser to focus on a phrase that I used earlier—economic welfare—rather than simply on growth. I define it as including not only as rapid an increase as possible in the resources that are available to Scotland and the Scottish people, but caring about the distribution of those resources and about environmental and other sustainability.

With objectives set in that context, it would be up to this committee and others to challenge how resource allocations within the Scottish budget were aimed at improvements in economic welfare. The scope for change will always be at the margin. From David Bell's paper, we know the share of public sector spending for wages and other fixed costs. In addition, we know the extent of activities that are not susceptible to rapid change and probably stay fixed for a considerable period. However, it would be appropriate to challenge the proposed changes, particularly at a time when resources will be scarce for a long time. It would be important to seek to know how each change is intended to improve economic welfare and to ask the searching questions—the challenge function to which Alf Young and I referred earlier.

Economic welfare is a broader objective than growth per se. It is welfare, however the Parliament on behalf of Scotland's citizens wishes to define it.

James Kelly: I am interested in the witnesses' comments on two aspects. Alf Young has already referred to the first: the VAT cut, which the first panel of witnesses also raised. There has been some debate about whether it has had a positive impact on the UK economy and, if it has, whether that has fed down into Scotland.

The second aspect is the quantitative easing that the Bank of England introduced. There was some scepticism about that when it was first mooted and introduced, but some recent commentary suggests that it is starting to have a degree of success.

Jeremy Peat: I have some sympathy with the comments that the STUC representative made on the VAT cut. Its impact was probably less than could have been achieved by targeted tax cuts for people with a high propensity to spend and to whom the benefits would have been significant.

Alf Young referred to the amount extra that was in the economy as a result of the VAT reduction. It is difficult to know how much of the cut impacted on prices because they were so volatile when it was introduced. Was the full 5 per cent passed through in each and every instance or did some amendment to core prices that took place at the same time mean that the total impact was somewhat less than 5 per cent? Did it lead to extra expenditure? Consumption was low and the elasticity of demand to that degree of cut at that time would not have been great, so I suspect that we may find, when we see the full evaluation in David Bell's econometric analysis in five years' time, that the impact was relatively muted and that alternative means of getting a greater percentage of money more directly to those who were likely to spend would have been more effective.

One has to set quantitative easing in context. The Bank of England and other central banks had already taken interest rates as low as they could. The extent of fiscal easing that had taken place in the UK and elsewhere was significant and we still did not know whether the economy would bottom out during this year or early next year. We also had the great fear of deflation, which scares me rigid. It was important to make every effort as early as possible to return confidence and liquidity and to encourage investment and consumption. Careful quantitative easing undertaken in a measured manner, on top of the interest rate reductions and fiscal easing, was appropriate in order to get as big an impact as possible as early as possible to fight off the spectre of deflation. The risk of deflation still nags away at me, but the likely impact of the full set of measures that have been taken will be the economy picking up by early next year. I am not talking about years of recession; I am talking about a more muted recovery.

The approach was the right one, for which I praise the central banks. They perhaps started taking action belatedly but, on monetary easing, they got going fully and in a co-operative manner. That is part of a package of measures that are necessary if we are to avoid the problems that the Japanese had in the 1990s.

16:15

Alf Young: I will not say much more about VAT, although I note for the record that Jeremy Peat talked about a 5 per cent cut, whereas it was actually a 2.5 per cent cut, from 17.5 per cent to 15 per cent.

Jeremy Peat: I apologise.

Alf Young: I still argue that leaving £12 billion in the system as a result of the VAT cut has some kind of impact.

On quantitative easing and the behaviour of central banks, part of the story that will have to be examined more closely is the period before we felt the full impact of the financial crisis and the subsequent recession, when the banks chased price rises, which were driven almost entirely by commodities. There was the oil price rise—that extraordinary surge to $147 a barrel—and associated surges in the prices of copper, coal, cement and almost every basic commodity we could imagine. As consumer prices index inflation headed towards 5 per cent, the central bank and, in particular, the monetary policy committee focused almost all their attention on how to combat that inflationary threat, which was a remarkably unique inflationary threat. In the aftermath of the crisis, big questions will have to be asked about whether the MPC remit was so narrowly drawn that it took its eye off the ball, or did not see the other side of the story, and so was rather late in reacting with a reduction in rates. It will have to be considered whether, if the MPC had acted more quickly, the crisis might have been less severe. That is certainly an issue.

Having got to the bottom and having no other weapon in the system, the central bank's quantitative easing, which involves buying gilts and corporate paper and, in effect, printing money—or central bank money as the bank calls it—seems to be having an impact. We seem to be getting back to a more manageable situation. Jeremy Peat said, in effect, that he thinks that the deflationary threat has receded and I agree that that is what the signals show. Retail prices index inflation might go very low and might cause politicians and civil servants headaches for some time to come in relation to how they benchmark pension uprating and public sector pay rises. If RPI inflation is down at -3 per cent for a period, that is an issue that will have to be dealt with. However, the chances of our getting into a Japanese-style lost decade have receded significantly in the past few months.

Jeremy Peat: I very much agree with Alf Young that the MPC got it wrong early on in the cycle. That applies to most of its members, with the notable exception of Professor Blanchflower, who was a lone voice in the wilderness. It is important that we consider that lesson. I suspect that, some time in 2010 or 2011, we will have a further bout of inflation. The way in which monetary policy is managed at that time will be hugely important for Scotland and the rest of the UK. We should ask the Bank of England to learn lessons from what went wrong in the early stages of this bout.

Kenneth Gibson: That last point is important, particularly when one considers how important tourists and the tourism and manufacturing sectors are.

The debate was getting a bit mellow and philosophical earlier on, convener; I was expecting you to call for the lights to be dimmed and the spliffs to be passed round. We were back in the early 1970s, talking about the Club of Rome idea of an end to GDP.

The Deputy Convener: I am clearly younger than you.

Kenneth Gibson: Not by much, I imagine.

If, a couple of decades ago, we had taken that view on GDP, the standard of living would probably be significantly lower than it is today. Many communities would disagree with the idea of an end to growth. People doubt whether they would get their fair share in any other type of system.

We have heard a number of important points about key sectors of the economy. It is important that, where it can, the Scottish Government should try to nurture those sectors. Obviously, we want to have our cake and eat it; we want to nurture sectors that can grow and, at the same time, protect services that have to be delivered. How can that be done? How can we move in that direction?

Jeremy Peat: John Kay, of the Council of Economic Advisers, has done some good thinking on nurturing key sectors. Also, Jim Murphy, the Secretary of State for Scotland, has asked the David Hume Institute to set up a series of seminars on the key sectors. We agreed to do that only if the Scottish Government was fully involved. I have spoken to John Swinney and Jim Mather about the proposal, and I hope that we will set up the first of four seminars within the next couple of months. With the full support of Scottish Enterprise and Highlands and Islands Enterprise and everyone else who is involved, including the academics, the intention is to look at sectors and ask questions. Where are they now? Where do they need to be? How do we get from A to B? We want to get people in a room together for two or three hours, in the way that Jim Mather has done in the past. We can then take away what they say, distil it and give messages to the different arms of government. The intention is simply to get people thinking and to involve the people who run the businesses, including smaller companies, and the CBI and Institute of Directors.

The best starting point is for us to make an intensive examination of the key sectors and the key means by which they can move forward. That may have implications for allocation of funds, but it is more likely to have implications for how business operates and how business and the public sector interact in ways that do not directly cost money. We should not examine every sector—we should choose only those that exhibit real prospects of being internationally competitive in growth areas. We should focus hard on those areas. I hope that MSPs will, where they have expertise and interests, take part in the sector studies.

Alf Young: I cannot go into all that without rising to the jibe. An enormous volume of powerful literature suggests that, despite 30 years of growth since the 1970s, the sense of wellbeing and contentment in the population—not only in this country but in all sorts of countries—has flatlined. The general picture from all the survey evidence is that people are no happier today. David Bell has been involved in that work from an academic point of view. [*Interruption.*] I am not suggesting him as a role model. He has been deeply involved in that work, as have David Blanchflower—who was mentioned earlier—and others. As I said, there is powerful literature that suggests that the cure-all of unending growth does not deliver the human goods to which many people aspire. It is worth thinking about that and considering it in the debate about where we go from here.

In turning to address the sectors, I return to Jeremy Purvis's questions. One service that we could do for our sectors would be for Scottish GDP growth numbers to reflect what actually happens in the sectors. One outstanding and classic mistake in the Scottish GDP numbers—it can, at least, be called the unexplained phenomenon—is that, despite the fact that, over the past 10 years, we have lived through an absolute revolution in dining out and growth in the hotel, leisure and recreation sector, the Scottish GDP figures show the sector as having barely moved as a contributor to national output. The numbers are meaningless, as anyone who walks around this city, Glasgow, Dundee or the smaller towns, and considers the explosion of businesses in that sector, would tell you. The numbers tell us nothing that we want to know about what is happening in our towns and cities.

There are other intriguing aspects. Many of us yearn for the days of the large manufacturing sector, partly because we come from that heritage and that tradition, but did you know that in the current numbers, the output contribution from manufacturing in the Scottish growth figures is equal to that of banking? We talk about a financial crisis, and about the size that the banking sector will have to slim down to, but in terms of its contribution to Scottish GDP, it is almost exactly the same size as the Scottish manufacturing sector, despite the latter's current woes

Last September, I spoke in front of 20 or 30 people at the Scottish Engineering executive dinner. As I tend to do in these situations, I went round the table and asked everyone how they were doing. Most of the people in that room were doing very well. That was only last September. The sector then fell off a cliff. I hope that, having fallen off a cliff, it is not going to stay there, because there are some remarkably innovative and well-focused lean companies in Scottish manufacturing that are doing fantastic stuff. I hope that most of them make it through.

On that issue, let us not assume—since this is a political environment—that the only way for those companies to survive is to mollycoddle them. In my lifetime, manufacturing has gone through some horrendous times. Whole industries have disappeared, and the engineers and others in manufacturing who have survived have done so because they have found within themselves the genetic dynamic to do so. Some of those businesses were bombed out 10, 20 or 30 years ago. I was standing at the door as one of the undertakers, waiting to write stories when they finally went down. In 1981, the Weir Group was almost dead. Look at it today. Some manufacturing businesses have transformed themselves. We should be careful, in the language that we use, that rather than try to mollycoddle them the whole way to a sustainable future, we give them an environment in which to continue to make those transformations happen.

Kenneth Gibson: I agree with a lot of what you have said. First, what would be the bottlenecks to growth in the key sectors?

Secondly, on the £12.5 billion, I agree that the VAT cut has done some good, but we could argue—as the STUC has done—that it would be better to give tax cuts to the low paid or even to spend the money on infrastructure. There are a number of arguments. If you put that amount of money into the system, it must have some impact. However, I am very much interested in the bottlenecks.

On your quality of life argument, most folk would like an improvement in the quality of life and, if possible, in economic growth. I take your point, however, because last year's survey from the United Nations showed that children in Scotland had the poorest quality of life of 21 OECD countries.

I want to ask a more difficult question. Given the current economic situation, how sustainable are the key policies of the Scottish Government, and indeed the Scottish Parliament—for example free personal care—in terms of our ability to deliver? In my view, the Chancellor of the Exchequer was being deceitful rather than delusional in his economic projections. The 3 or 3.5 per cent growth targets were more about getting through the election. Given the current demographics, and our likely budgets, how realistic is it that we can continue with some of our more cherished policies?

Jeremy Peat: On bottlenecks in sectors, I totally agree that one of the objectives of looking at sectors is to see how the environment can be improved within which those sectors can blossom and flourish. If there are bottlenecks in infrastructure, regulation or whatever, one should look at those. I agree that that is a critical part of considering how to make our sectors as successful as they can be.

16:30

On particular aspects of Scottish policy, I think that it will mean that some tough choices are going to have to be made. The forecast for a likely real-terms reduction in the Scottish Government budget over the next few years is realistic. I do not know how great that reduction will be; it depends on assumptions that are made. Even with a significant improvement in the efficiency of delivery, which I believe is achievable, there are going to have to be reductions. I suggest that the Scottish Government think about whether certain policies—such as free care for the elderly and tuition fees—are enhancing our economic welfare and contributing to the strategy to deliver the sort of Scotland we want to live in, or whether the cost of those policies should be reduced.

Demographic change is the other shoe that is yet to drop, and it will add significantly to the budgetary problem over the next decade. The reduction in the percentage of the population that is going to be of standard working age will reduce the tax base as the increase in the percentage of people above working age—such as Alf Young and I—adds more and more burdens to the budget.

The cost of certain activities, most of which fall to the Scottish Government's budget, will increase while the tax take will tend to reduce, unless steps are taken. I believe that it will be necessary to consider whether it is possible to reduce the cost of certain central policies while largely retaining the benefits that the policies are delivering, even if that means taking Alf's bus pass away from him.

Alf Young: One of the constraints is our model of enterprise and entrepreneurship. It is a model that started quite well but has become skewed in ways that have not been helpful. At one end, someone who has built a viable business based on a good idea is likely to feel that they should get out when the first cheque is waved under their nose. There is not enough of a culture that says that building a business over a longer period is a greater social good than selling out at the first opportunity. At the other end, the venture capital sector has lost all appetite for smaller start-up businesses. It seems that it is getting harder for someone with an idea but not a lot of resource to get the thing off the ground in the first place.

The other week, the London Government floated the idea of reviving the old Industrial and Commercial Finance Corporation, which was formed just after the war and went through its heyday in the great phase of industrial restructuring in the late 1970s and early 1980s. When it changed its name to 3i, it became a private equity business that did not look at the stuff that the ICFC looked at 10, 15 or 20 years ago.

Some big hitters in Scotland cut their teeth in the ICFC: Lord Smith of Kelvin, the chairman of the Weir Group and Scottish and Southern Energy is one, and George Mathewson, the chairman of the Council of Economic Advisers, is another. There might be some merit in asking George Mathewson what he thinks about the possibility of having a similar body that would bypass some of the worst features of venture capital and the current entrepreneurial model and would return to the more basic model that produced some startling results in the past.

The Deputy Convener: I am sure that the committee might wish to write to Sir George on that matter.

Linda Fabiani: People keep talking about what will happen when we emerge from the recession, although there are various views about when that will be. David Bell's paper and subsequent explanations suggest that the level of debt that has been taken on by the Government will result in interest payments over many years that will reduce the departmental expenditure limits and so on. There is a long-term problem there, which will be increased if we end up with huge inflation, which will raise interest rates. I would like to hear your views on that.

I am interested in the suggestion that there should be a minister whose portfolio is purely concerned with challenging spending, budgets and so on. Both of you have given us a fairly upbeat presentation, and have suggested that we should also be thinking about opportunities. We have talked about targeting particular skills sectors, and about other ways of doing things—I liked the idea of the four seminars that Jeremy Peat mentioned.

However, rather than focus on the need to cut, cut, cut because of cuts in the block grant, is it not also worth our while to focus to some extent on the positive issues around coming out of recession and the long-term effects of that recession? In the interests of party-group balance, I say that I also think that GDP should be more about wellbeing and that we should focus on that, as well. I am aware that some European legislatures have futures committees or futures fora that are seriously concerned with such issues. I know that Scotland has a Futures Forum, but I do not think that it has distilled its approach to include that kind of work. What do you think about that possibility?

Jeremy Peat: I should preface my comments by saying that we are at an uncertain stage. We have not, in all my time as an economist, been in a situation in which forecasts are subject to such massive uncertainties as they are in the current climate. The Bank of England fan chart might take the position to extremes, but it is true to say that the range of scenarios for where we could go over the next few years is vast. Anyone who bases policies on one forecast is dotty. We have to consider the scenarios that are around, take a reasonable view of how they could impinge on us and be ready for that range of scenarios. That will apply to thinking around the Scottish budget as well as everything else. The only thing we can say with certainty is that the central case will be wrong.

The point about the longer-term situation is absolutely correct. Let us assume that growth in the UK starts again early next year, rapidly reaches a rate of 2.5 or 3 per cent and stays at that level for several years. Even under those circumstances, it will take until 2015 and beyond before the budget is back to something approaching the Maastricht criteria limit of the debt burden, let alone the 40 per cent figure. That assumption is based on an extremely stringent public expenditure regime, accompanied by some tax increases. That means that, even with a positive recovery from recession, we face a tight public expenditure climate. As David Bell's paper demonstrates, that might hit slightly less here because the share of public expenditure is higher, but the environment will be very tight. That fact of the time that it will take to get back to prudence is another reason for seeking to have the challenge function over this period.

If ever there is a time when questions need to be asked—objectively but fully and frankly—of expenditure departments, that time is during a recession. They need to be asked why expenditure is necessary, exactly what it is intended to achieve, exactly how it will fit in with policies and how it will work under the different circumstances that might pertain. That role must be played by people who have significant authority in the process. Having such a function now is critical and will be critical over the next several years, while these very difficult decisions are taken.

I am not sure whether we can link that to positive developments, but I think that it would be valuable for the Futures Forum to consider the impact of different recovery scenarios alongside other long-term factors, such as demographic change and the desire to introduce various patterns in order to change activity in different sectors to reduce emissions. There is a need to look at the interaction between the various economic scenarios and those other features that will influence life and the economy in Scotland in the years ahead. To some degree, those broad-brush scenarios will help with decision making. However, I think that it will take time to see the positives.

Alf Young: I do not have a great deal to add.

I talked earlier about the psychology of slump, but for many people in this city and elsewhere—those who are still in jobs, those who are not seeking to move house and those who have a variable rate mortgage and who now have an extra couple of hundred quid in their bank account each month—life at the moment is not very different from what it was during the boom, in the sense that their lives have not been dramatically affected. Clearly, other people have been very badly affected. However, sometimes the language and rhetoric that we use—for which I take some responsibility from a media point of view—builds on itself to create a mindset that suggests that we have come to the end of the world as we know it and that we will never claw our way out of recession.

In all that, we tend to forget that we have many years of cumulative growth between each bout of economic decline, so we do not return to where we were in the 1990s or 1980s and we certainly do not return to where we were in the 1930s. All the attempts to suggest that things are currently as bad as they have been since the great depression or the depression of the 1890s are actually pointless. We are 100 years on from the 1890s and we have had many years of cumulative growth. We live a life of electronic empowerment—when it works—of which our forebears would never have dreamed, although they found many other strengths in their lives. When I walk around Glasgow, I still think that the architecture from the Victorian era beats anything that has been built in the past 50 years—I am just an old fogey, at the end of the day.

There is a lot to be positive about. As I said earlier, I hope that the committee takes seriously the CPPR's proposal for a challenge function within Government. In the environment of the next two parliamentary sessions, something like that will probably be necessary and it might even be desirable to go further. Given that that portfolio would include local government, the challenge might extend to ways of delivery other than conventional local government so that alternative delivery models can begin to be tested against each other.

That is happening anyway. If I may go back to where I started, nothing happened on the lower Clyde waterfront for 25 years despite all the big agencies having a go at doing something about it. Self-awareness within a local authority—which at the time was in considerable difficulty and was receiving bad reports from the Accounts Commission—led to people saying, "There must be a better way of doing this." That is how we ended up with this little fleet-footed vehicle that I mentioned. Just by working with everyone, we are beginning to deliver something on the ground. It is not an easy time to be delivering urban regeneration, given the current economic environment. However, luckily, we are in the phase of doing the groundwork rather than looking for house-builders and others to put the stuff on the reclaimed sites.

We are having a measurable impact, which says to me that there must be lots of other new models if we only have the vision, the open-mindedness and the lack of almost sectarian commitment to this or that side of the divide. Can we bin the idea that only the private sector creates wealth? If the education and health services are not contributing to wealth creation, what are they doing? We need to junk an awful lot of the old language. Maybe if it went out at the end of this downturn, we would be in a better position to have a debate. Kenny Gibson and I might even go together to a New Economics Foundation seminar on wellbeing and find that there is something beyond GDP.

The Deputy Convener: Some things are possible, but others might be more challenging.

I hate to cut you off, but I am conscious of the time. I thank you both very much for a thought-provoking session. I am sure that members agree that it has given us a considerable number of issues to think our way through. I say to Alf Young that although I am not an old fogey, his comments about Glasgow architecture are spot on. To Jeremy Peat, I say that we would like to be kept informed about the seminar series that you are planning. I suspect that members of the committee will take an active interest in that.

I suspend the meeting for one minute to allow witnesses to change over.

16:46

Meeting suspended.

16:49

On resuming—

The Deputy Convener: I call the committee to order and welcome our third and final panel of witnesses. Thank you for your patience. It has been a long afternoon; nevertheless, the committee is keen to engage with you. Sandy Brady and Sandy Cumming are both from Highlands and Islands Enterprise, and Jack Perry and Stephen Gallagher are both from Scottish Enterprise. I take it that nobody wants to make a short opening statement.

Jack Perry (Scottish Enterprise): Despite that warm invitation, deputy convener, we will decline.

The Deputy Convener: Thank you very much. Who wants to ask questions first?

Jeremy Purvis: I will ask the panel the same question about the Government's central purpose that I asked the previous two panels. Your two organisations are tasked in no small part with delivering the Government's central purpose. What is the current position as you understand it on Scottish growth? I think that both organisations' operating plans reflect the fact that the purpose of the Government's economic strategy is to match United Kingdom growth, whether in the long term or the short term. What should we look at to judge your budgets for delivering GDP growth?

Jack Perry: The subtitle of Scottish Enterprise's business plan for 2009 to 2012 is "Working for Economic Recovery and Growth". Having considered our budget and programme of interventions, we know that we are operating in a very different environment from the one that we had in much more benign years. It is a case of recasting what we are doing to work more closely and intensively with companies on economic recovery and to work on individual, tailored recovery plans for them, but with an eye to helping them to position themselves so that they are poised to take advantage of opportunities for growth during the recession, as many companies are still growing. The remainder are well placed to take advantage of opportunities for growth when we come out of the recession. There has been a mixture of making short-term shifts in resource allocations to help companies during this time and staying the course with our longer-term programmes that we still believe are right for helping us to emerge out of the recession.

Jeremy Purvis: I would like to clarify something before HIE responds to my question. Is the understanding that, regardless of what the UK growth rate is over the coming years—I assume that it will be positive—the position is still to match it? In his foreword to Scottish Enterprise's business plan for 2009 to 2012, the chairman of Scottish Enterprise says that the Government's economic strategy "remains solid". My impression, therefore, is that the ambition to match the UK growth rate still holds, so the Scottish levels should be tagged and our GDP growth rate should be no less than the UK rate if it is negative and higher if it is positive. Is that still your understanding?

Jack Perry: You should direct that question to the Government as well as to us. Our role is to contribute towards achieving the Government's economic goals. We think that the contributions that are described in our business plan and the changes that we have made as a consequence of the changed environment are right, and that we should continue to make a positive contribution towards achieving the Government's goals. However, the achievability of those goals is subject to all of the uncertainties and the reliability of economic forecasts that the previous witnesses talked about.

Sandy Cumming (Highlands and Islands Enterprise): Obviously, Highlands and Islands Enterprise is charged with responsibility for the northern half of Scotland. As a very rusty economist, I think that it is difficult to provide hard information about regional GDP. The issue is complex. That said, we entirely understand the importance of making progress in the area for which we have responsibility.

We have seen great progress over the past 30 to 40 years, but we are not kidding ourselves. Certain indicators suggest that we are not achieving the rate of economic progress in the Highlands and Islands that the Government would like us to achieve. The Highlands and Islands economy has a very low unemployment rate—the rate has increased with the recession, but it is still below the Scottish level—and very high levels of employment, but not a significant number of high-value-added jobs.

The Government's economic strategy, which is to focus on getting into key industries that will help areas such as the north of Scotland to achieve some of the success stories that the rest of Scotland has had, is where we are. It is difficult to focus on the GDP growth rate in the Highlands and Islands per se; that has been part of the overall Scottish economy. For instance, the life sciences offer Scotland great opportunities. I am proud of the fact that it so happens that the biggest life sciences company in Scotland is based in Inverness. We are part of the Scottish life sciences industry. Our task—working with Jack Perry and others—is to grow the key industries. In time, we will have a better measurement framework. At the moment, measuring regional GDP is difficult. Sandy Brady, who is more of an economist than I am nowadays, has a supplementary point.

Sandy Brady (Highlands and Islands Enterprise): Sandy Cumming has described a challenge for us. The Highlands and Islands need to grow in those sectors of the Scottish economy—about which we have heard—in which we can do the most in the next five, 10 or 15 years. Our economy has been held back for decades because we have focused on relatively low-growth sectors. We now have the opportunity to change that through the renewable energy sector, the life sciences sector, which Sandy Cumming mentioned, and the university sector. We are building the university of the Highlands and Islands; the lack of a university has been a structural weakness from which our region has suffered for decades, and we are trying to do something about it. That all contributes to taking Scottish national growth forward.

Jeremy Purvis: Jack Perry makes a fair point about addressing my question to the cabinet secretary. I will make a point of doing that when the cabinet secretary appears before the committee. As the two economic agencies in Scotland, you are saying that you do not think that the Government's target of matching UK GDP growth has been revised—that still stands.

I will ask about one of the areas for delivery. We have the future budgets and we can see the share of the overall Scottish budget that goes to supporting the economy. We have a clearer picture of the business plans, and there is no way that they can be contaminated by changes to skills or other areas—we now have a direct read-across. On that basis, is it fair to assume that support for innovation and investment in businesses should grow in the operating plans for HIE and Scottish Enterprise? Support and expenditure direct to Scottish businesses through those bodies should be growing.

Jack Perry: As you will see from our business plan, which you have read, the budget has reduced overall. I suspect that I understand the reason for your question. We have tried as best we can to target the budget where it will have the most impact. We have therefore increased direct company support and we are increasing our efforts on commercialising Scottish intellectual property. As a consequence, we will spend a little less on directly initiating more intellectual property. The intention is to improve the strike rate and the commercialisation of what is available to us and to get more stuff to market more quickly. We are increasing our provision in the ways that I described but, overall, the budget is reducing.

We are also realising efficiencies as much as we can. Significant reductions in head count and operating costs have occurred in the past five years and they were accelerated last year. Stephen Gallagher will amplify what I said.

Stephen Gallagher (Scottish Enterprise): Perhaps it is opportune for us to consider some of the decision making on spending allocations in our business plan. The overall trend is downwards—nobody can ignore that—but we have considered certain areas in which we will invest. The strategic fit is a key driver for that, as is the value that we can deliver to the economy through the gross value added return.

Leverage from the private sector and other public sector partners is an important facet that we should build on in the future. We have initiated many projects throughout Scotland that have had a significant follow-on from other bodies. We should not miss that. Coupled with that is the ability to deliver. There is illiquidity in the market, but we still have a healthy pipeline of demand for more cash than is available.

17:00

Sandy Cumming: An economic development agency needs to be well fleshed out, in the sense of being truly integrated in its approach. There is a difference between a business support agency and an economic development agency. Our sharp focus is on three areas of activity. I believe passionately that the interaction of the three creates economic growth in our part of Scotland. The three areas are similar to those on which my colleagues in Scottish Enterprise focus. The first is a focus on significant and high-growth businesses, particularly those in the key sectors. I am happy to take further questions on that.

The second area on which we focus is improving the competitiveness of our infrastructure. Sandy Brady mentioned that the university of the Highlands and Islands has taken about 300 years to get to its present stage. However, I firmly believe that it will have a dramatic positive impact in our area in the years ahead. The improvement in transport infrastructure in the Highlands and Islands is recognised, but we must also make progress on issues such as broadband connectivity. We need all parts of Scotland, including the rural parts, to have wonderful access to 21st century technologies.

The third and critical ingredient that brings all our work together is our focus on strengthening communities. Although progress has been made on that in the part of the HIE area that I am particularly proud of, it is by no means universal. The success, which has been largely on the east coast of the mainland, has not really been enjoyed by the island communities and those on the west coast. We are trying to bring the mix together to achieve as much sustainable economic growth as possible in all parts of the Highlands and Islands.

To return to Mr Purvis's point, I believe firmly that at this time, for businesses in our area, a focus on innovation and helping them to access investment is vital. We will play a role in that, but we will also try to weave in our activities on regional competitiveness and strengthening communities. Together, those three sets of measures are powerful.

Jeremy Purvis: I hear what you say. Mr Perry is right that I have read the business plan figures for Scottish Enterprise, although I do not have the comparable figures for HIE, so forgive me for that. For Scottish Enterprise, the innovation subtotal falls from £80.5 million in 2008-09 to £72.2 million in 2011-12. I believe that the Government grant and the indicative levels for future years were set prior to any discussion about efficiency savings that might be dictated by the Treasury. Is that correct?

Jack Perry: Yes, that is correct.

Jeremy Purvis: Is the same true for HIE?

Sandy Cumming: Absolutely.

Kenneth Gibson: I was interested in Sandy Cumming's point that HIE takes a truly integrated approach. The second page of the HIE submission states:

> "In the last two years, we have vigorously pursued shared services with other parts of the public sector in the area, including co-location of our local service delivery with those of local authorities. Cowan House in Inverness now houses staff of VisitScotland, Skills Development Scotland and the Highland Employer Coalition alongside HIE staff".

How important are one-stop-shops for building relationships and synergies and for introducing the efficiencies that we want while improving the outcomes that you are trying to deliver and that we want to be delivered?

Sandy Cumming: Co-location is a vital part of the journey that we should be on. We should have a platform, portal or gateway through which the public sector provides services to businesses and the wider community. That is really important, but in some ways it is only the start of the journey. To get the maximum value out of that approach, we should be a lot smarter in providing an integrated service behind that door. For example, colleagues of ours in Scottish Natural Heritage have led an excellent project in Golspie in Sutherland, but the committee would do well to invite the corporate director of SNH and hear about his frustration in trying, in a fairly small situation, to bring together five or six Government agencies and departments. There are always issues with information technology services; for example, we each still have our own servers.

We are only starting on the journey of making real economies. It is a cultural issue as much as anything. It is about trusting, sharing and recognising that the customer is the person whom we are charged with and are responsible for serving. We have made an important start by reducing our office footprint from 32 offices throughout the Highlands and Islands to 15. We are now co-located in Stornoway, Lerwick, Golspie and Kirkwall, so we are getting there, but the real value of that approach is yet to be realised. The easy bit is living together; the more difficult bit is joining up our services and giving our customers a better service.

Kenneth Gibson: Could that approach be rolled out? What level of opposition would there be to that? It is not easy for every agency to decide to go into another's building or have other agencies come into its building. It is necessary to have the right facilities. How practical is that from a broader perspective? Could other organisations come under the roofs of the Scottish Government or local authorities? How practical would it be to deliver services in one location instead of having separate housing offices and cleansing offices, for example? How effective is the one-stop-shop synergy in delivering not only your services but other Government services?

Sandy Cumming: There is a pretty compelling argument in favour of it, but there are some difficult issues. The flesh is willing—you will find that people in the public sector are comfortable with the journey—but there are some genuine reality-checkers, such as what we do with our existing properties when we come out of them. That may seem obvious to you, but it is a difficult area, as is establishing shared back-office services such as IT and finance.

I salute the people in the public sector who are leading the way. The Scottish Government has been bold in its rural services and is progressing with some interesting models, but there is a need to think about whether we can introduce similar platforms in each community and each economic sub-region of Scotland. It is early days, but it is worth continuing with the journey.

Kenneth Gibson: I will ask a question of Scottish Enterprise in a minute or two, but I have one more question for Sandy Cumming. You have talked about the 500 growth companies, although I am afraid to say that on one of the islands in my constituency—Cumbrae—there is none. You also talked about strengthening communities. What does that mean in reality? How would organisations such as Highlands and Islands Enterprise and Scottish Enterprise help to do that?

Sandy Cumming: My experience in the Highlands and Islands is that strengthening communities is about confidence building, which is similar to what Alf Young said to the committee earlier: where communities are confident, the economy flourishes. The best example that I can give is the island of Gigha. Through community ownership and leadership, it has transformed its economic prospects. New small businesses are starting up and, believe it or not, inward investment is taking place. The island needs a second teacher in the school—that is a real problem—and its housing is being improved. There is therefore evidence that the community ownership policy is worth following through, but the difficulty is that lottery funding for those communities that dream of following the Gigha model has been reduced.

I have a point of clarification: we work with 500 account-managed businesses, but we also work with 150 social enterprises. The islands that you talked about have some of those account-managed social enterprises. We work with them closely.

Jack Perry: Scottish Enterprise serves 2,300 account-managed companies in the lowlands of Scotland. The split between us and Highlands and Islands Enterprise is different. Although Sandy Cumming's area is probably comparable in size to ours—and possibly even bigger—we serve 92 per cent of Scotland's population. When Highlands and Islands Enterprise was created, it had a community remit, like its predecessor, the Highlands and Islands Development Board. Scottish Enterprise has never had such a remit. As a consequence, there is quite a difference in the per capita budgets.

Scottish Enterprise serves companies in every single constituency in our region and is working with them more intensively than ever. Like Sandy Brady, we are also engaged with other companies—up to 10,000, in our case—that can draw some form of support, albeit at a much lower level than the companies that we work with on an account-managed basis.

Kenneth Gibson: It is important, especially during a recession, to try to grow indigenous companies, but I wonder what Scottish Enterprise and Highlands and Islands Enterprise are doing to attract inward investment from overseas and to attract highly skilled personnel who may want to make their futures here in Scotland.

Jack Perry: Scottish Enterprise is intensely engaged in such work, as part of the joint venture with the Scottish Government's Scottish Development International. Our budget line for internationalisation is one of the few lines that we have protected. We are not diminishing that line in the current environment; despite the recession, we have been enjoying significant success. We have not yet published our results for the year ending 31 March, but among the targets that we expect to meet will be the targets that we set ourselves for inward investment in Scotland.

There is also renewed interest in opportunities that may present themselves as a consequence of the recession. For example, there is significant consolidation among financial institutions. In particular, work is being done on financial institutions' operating locations as they seek greater efficiencies.

Scotland is well positioned. It has high skills and a competitive cost base. We are not a low-cost location, but we are increasingly attractive and we are seeing new interest. If we look across Scotland, we can see new investments. For example, Welcon acquired the Vestas facility at Machrihanish, esure has created 500 new jobs in Glasgow and BNP Paribas is creating a further 80 jobs on top of the jobs that it has created. Scotland remains an attractive place and we are trading on the factors that will make us competitive in this climate and beyond.

Stephen Gallagher: There have been other successes too. For example, Tesco Personal Finance has opened up in Edinburgh, offering some 200 jobs.

Scottish Enterprise's key projects around Scotland are multifaceted, and there is a big drive to tap into the international networks that SDI presents to us. There are tremendous opportunities in the life sciences, and we predict a large growth trajectory for renewables over the next few years. There have been Crown Estate releases in the North Sea, in the Moray Firth and the Firth of Forth, and there will be infrastructural investment in sites along the east coast. We have recently announced a major and forward-thinking investment in the central waterfront in Dundee, to take advantage of future renewables infrastructure and fabrication works in the port.

Over the past few years, our investment in research and development has been significant. It has anchored high-value jobs, attracted new jobs and safeguarded jobs in Scotland. We have invested some £61 million in research and development, which has leveraged in about £450 million of investment from companies that are indigenous to Scotland and from international companies that are based here.

Sandy Cumming: I entirely agree with Jack Perry and Stephen Gallagher. Over the past 20 years, we have seen waves of potential inward investment, but I am very optimistic at the moment. Machrihanish has given me a great deal of confidence. However, the potential does not lie in the renewables sector alone. In the Highlands and Islands, we will see the benefits of inward investment in golf tourism this year. The opening of new courses in Machrihanish and outside Inverness represents fantastic international investment in our area.

As Stephen Gallagher has said, the whole renewables scene—particularly the interest in marine renewables around the shores of the Highlands and Islands—is dramatic. In fact, it has never been better. SDI is a high-performance organisation that is doing a great job for us right now, and I am sure that it will continue to do a great job for us in the future.

17:15

David Whitton: I have a quick question to start with. Your organisations' budgets and head counts have been cut over the past year. Has that had any effect on your ability to deliver the services that you are tasked with delivering?

Jack Perry: Up till now, the answer is no. We have driven year-on-year productivity improvement within the organisation.

You are right to say that the budget has been cut, but the head-count reductions were of our design—they were not mandated by the Scottish Government. There has been a continual programme of challenging our ways of doing business, our ways of working, our productivity and the head count that we need to deliver our services. The head-count reductions were started by my predecessor, through the business transformation programme, when our head count was reduced by 560. We lost a further 100 people through natural wastage and we had a senior director and senior management voluntary severance programme, which took out a further 40. This year, we are losing 260 people. That is like-for-like business, ignoring transfers out.

We have seen nothing but an improvement in our productivity, and our output measures have actually increased over the period.

Sandy Cumming: There is no evidence of any negative impact. We are slightly behind Scottish Enterprise in the sense that some of the changes that came out of the enterprise networks review that were announced in September 2007 were made only in spring this year, following the establishment of the business gateway in the Highlands and Islands. We must allow that to bed down. I believe that that is a good move and that it will work well in the weeks and months ahead.

My answer to your question is, to date, no. However, the issue for me going forward is the fact that we seem to have an amazing series of ambitious projects in the pipeline. The task for Highlands and Islands Enterprise is to be smarter and to find new ways of enabling some of the excellent new projects that are out there to be delivered in short order in the Highlands and Islands. How we conduct our business going forward might change, and we will need to be smarter in how we make those projects happen.

David Whitton: Mr Perry, you said that your results will be published shortly and that inward investment has hit the target. What about new company start-ups?

Jack Perry: As you know, volume start-ups are now delivered by the business gateway and have been for the past year, so I cannot comment on the progress that will be made on them. For the high-growth start-up unit in Scottish Enterprise, which is for larger start-ups and ones with established management track records, it has been a challenging year, mainly because of the difficulties with sources of finance. I do not want to pre-empt the publication of our results, which are still being audited, but it has been a challenging year.

David Whitton: I presume that that does not mean that we will get just the good news.

Jack Perry: The results will be what they will be. As I say, they are currently being audited.

David Whitton: I am sure that they will.

The numbers for your reprofiled budget suggest that 2010-11 will be a particularly difficult year. Would you care to comment on that? It is true that you are moving money about, but 2010-11 is the year that we are focusing on for our strategic review. What are your thoughts on that?

Jack Perry: I cannot help but agree with you that it is going to be a very challenging year. All that I can do is echo Sandy Cumming's words. We must continue to work hard to find new solutions to some of the problems that we face, including innovative ways of financing and new partners. I will hand over to Stephen Gallagher in a moment, as he is working on that area.

Over the years, we have managed to leverage in increasing amounts of private sector finance for many of our programmes. Stephen Gallagher talked about the research and development programme. The position regarding our investment funds is similar. Coincidentally, the figures are almost identical: we have invested £69 million over the past five years in our investment funds, which has leveraged in £211 million of private sector finance. Sorry—I should have said that £211 million is the total amount of new equity that has now gone into early-stage Scottish companies.

We might be able to tackle the challenges that we face through some other projects. In fact, I have some good examples of how we have done that.

Stephen Gallagher: While 2010-11 will be a challenging year, we are taking part in initiatives, such as a couple of European initiatives. One is called JESSICA—joint European support for sustainable investment in city areas—which provides an opportunity for the wider Scottish public sector to leverage in money from Europe for urban development. Some schemes in our business infrastructure area could benefit from that. Likewise, with our local authority partners we have been actively pursuing measures around tax increment financing. We have taken several measures over the past few years to enable local authorities to capture business rates locally and to invest in infrastructure, which reduces the burden on others. We suggest that a widening of prudential borrowing powers to other public sector agencies could be considered.

David Whitton: Have you faced the same challenges, Mr Cumming?

Sandy Cumming: Yes. We have always had a significant revenue stream—we call it other income—from a number of sources, particularly from European funds, capital receipts, revenue receipts and a rental stream from the properties that we own. However, we have had to revisit our model. Last year, we had of the order of £18 million of other income. In the current year, that will probably fall to about £12 million. That means that £6 million has come out of our budget, which we cannot just claw back somehow. That shows the sort of change factors that we now have to build into the model. We hope that the level of other income will begin to pick up, but it might take two, three or four years to get it back to £18 million. We are building that sort of reality into our forecast and thinking about how we can be smarter with slightly less budget.

David Whitton: Mr Perry, you said that you are working more intensively than ever with your account-managed companies. I note anecdotally that there are two account-managed companies in my area, both of which have been having a bit of difficulty. Neither of them had heard from their account manager for a wee while until I phoned them up, after which, I am glad to say, they heard from their account managers. I simply draw that to your attention as something that you might want to keep an eye on.

Jack Perry: I certainly shall. I am grateful for that information. I know that of the 2,300 such companies, we have completed individual recovery plans for more than 1,700 of them. We still need to get to some of them.

Linda Fabiani: Members of all the panels have acknowledged that any changes to the Scottish budget—to the block grant money—will be around the margins and fairly small. Paragraph 12 of Mr Perry's submission states:

> "Ideally with a greater share of the overall Scottish Government block budget, Scottish Enterprise could do even more",

and then lists four things. As a Government agency, which of your public sector partners would you cut to increase your budget?

Jack Perry: You cannot blame us for trying. It is the job of the Government and the Parliament to work on the allocations. I argue that there is a case for investing in economic development at the current time, mainly because we get good levels of leverage through investment, which makes our money go further. In terms of gross value added, we get a very good return on investment. There is a strong case for such investment, and where it is taken from is just one of the difficult choices that Government has to make.

Linda Fabiani: And Government agencies.

Jack Perry: Indeed.

Jeremy Purvis: On that basis, given that your grant has been cut, are you aware of where the money has been spent in the fixed budget?

Linda Fabiani: Oh, Jeremy.

Jack Perry: I wish I knew but, I am sorry, I do not.

The Deputy Convener: It is clearly late—we are trading insults, albeit in the most genteel fashion. No further substantive points require to be made. I thank the witnesses for waiting so long. Your evidence has been very instructive.

Jack Perry: It has been a pleasure. Thank you.

The Deputy Convener: I do not intend to suspend the meeting at this point, as I am sure that our witnesses will leave quietly.

Marine (Scotland) Bill: Financial Memorandum

17:25

The Deputy Convener: Item 2 is consideration of our approach to scrutiny of the financial memorandum to the Marine (Scotland) Bill. The clerk's paper suggests level 2 scrutiny.

Linda Fabiani: Quite right. I agree.

The Deputy Convener: That means that we take oral evidence from the Scottish Government's bill team and seek written evidence from any other relevant parties. Do members agree to conduct level 2 scrutiny?

Members *indicated agreement.*

The Deputy Convener: I could ask anything, and you would just agree.

Do members agree to seek written evidence from all local authorities?

Members *indicated agreement.*

The Deputy Convener: Do members wish to suggest any other bodies from which to seek written evidence?

Linda Fabiani: I am not going to suggest any other bodies, but I wonder whether we could have a wee scan about to see what other agencies—non-departmental public bodies and others—might be directly affected by the bill.

The Deputy Convener: We will invite the clerks to do that.

Annual Report

17:26

The Deputy Convener: Item 3 is on our annual report, the draft of which has been circulated. Beyond one or two spelling errors, I take it that the committee is content to approve it.

Members *indicated agreement.*

17:26

Meeting continued in private until 17:28.

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