ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 24 September 2008

Session 3

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ECONOMY, ENERGY AND TOURISM COMMITTEE
18th Meeting 2008, Session 3

CONVENER

*Iain Smith (North East Fife) (LD)

DEPUTY CONVENER

*Rob Gibson (Highlands and Islands) (SNP)

COMMITTEE MEMBERS

*Gavin Brown (Lothians) (Con)
*Christopher Harvie (Mid Scotland and Fife) (SNP)
*Marilyn Livingstone (Kirkcaldy) (Lab)
*Lewis Macdonald (Aberdeen Central) (Lab)
*Dave Thompson (Highlands and Islands) (SNP)
*David Whitton (Strathkelvin and Bearsden) (Lab)

COMMITTEE SUBSTITUTES

Nigel Don (North East Scotland) (SNP)
George Foulkes (Lothians) (Lab)
Alex Johnstone (North East Scotland) (Con)
Liam McArthur (Orkney) (LD)

*attended

THE FOLLOWING GAVE EVIDENCE:

Stephen Boyd (Scottish Trades Union Congress)
Graeme Dalziel (Dunfermline Building Society)
Harry Frew (Union of Construction, Allied Trades and Technicians)
John Gill (Standard Life)
Mark Hordern (Glasgow Solicitors Property Centre)
Owen Kelly (Scottish Financial Enterprise)
Eric Leenders (British Bankers Association)
Michael Levack (Scottish Building Federation)
Allan Lundmark (Homes for Scotland)
David Melhuish (Scottish Property Federation)
Roderick Pettigrew (Heating and Ventilating Contractors Association)
Professor Prem Sikka (University of Essex)
Ron Smith (Edinburgh Solicitors Property Centre)
Alan Watt (Civil Engineering Contractors Association (Scotland))
David Wright (SELECT)

CLERK TO THE COMMITTEE

Stephen Imrie

SENIOR ASSISTANT CLERK

Katy Orr

ASSISTANT CLERK

Gail Grant

LOCATION

Committee Room 1

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 24 September 2008

[THE CONVENER *opened the meeting at 09:32*]

Decision on Taking Business in Private

The Convener (Iain Smith): Good morning, colleagues, and welcome to the 18th meeting in 2008 of the Economy, Energy and Tourism Committee.

Agenda item 1 is a decision on whether to take in private items 4 and 5. Item 4 is a discussion with our budget adviser on our approach to the budget for next year, and item 5 is a discussion on a draft letter to the Scottish Government that is based on the committee's discussions last week. Are members content to take those items in private?

Members *indicated agreement*.

Credit Crunch (Impact on Scottish Economy)

09:33

The Convener: For item 2, I welcome the panel for the first of our two round-table discussions on the impact of the credit crunch on the Scottish economy. There is probably no more significant topic for the Economy, Energy and Tourism Committee to address at the moment. I am pleased that we have the opportunity today to have round-table discussions on the subject with two groups of experts. The first group is made up of representatives of interests in the banking and financial sectors, which are obviously of particular interest at the moment. It is due to great foresight on the part of the former convener and the clerks that we are having these discussions at this time.

I will try to keep the meeting as informal as possible. We will go round the table quickly to introduce ourselves—members and guests—by saying who we are and where we are from. I am happy for our guests to make an opening statement, but I ask them please to keep it brief as we have a limited amount of time.

I am the convener of the Economy, Energy and Tourism Committee.

Rob Gibson (Highlands and Islands) (SNP): I am the deputy convener of the committee.

Professor Prem Sikka (University of Essex): I am professor of accounting at the University of Essex, and director of the centre for global accountability at the same university.

Marilyn Livingstone (Kirkcaldy) (Lab): I represent Kirkcaldy and am convener of the cross-party group on construction.

Graeme Dalziel (Dunfermline Building Society): I am the chief executive of Dunfermline Building Society.

Gavin Brown (Lothians) (Con): I am an MSP for the Lothians.

John Gill (Standard Life): I am the managing director of customer service for Standard Life's United Kingdom business.

Dave Thompson (Highlands and Islands) (SNP): I am an MSP for the Highlands and Islands.

Owen Kelly (Scottish Financial Enterprise): I am the chief executive of Scottish Financial Enterprise, which is the industry representative body for the whole of the financial services industry in Scotland, including the banks, building societies and others with an interest in financial services.

Perhaps the diversity of the industry in Scotland is one issue that we could touch on in our discussion. A lot of attention has, rightly, been paid to the banks because of the historic events that are going on, but there is much more to the industry than the banks.

David Whitton (Strathkelvin and Bearsden) (Lab): I am the member for Strathkelvin and Bearsden. I was appointed Labour shadow spokesman on finance just last week.

Stephen Boyd (Scottish Trades Union Congress): I am an assistant secretary with the Scottish Trades Union Congress with responsibility for economic and industrial policy.

Lewis Macdonald (Aberdeen Central) (Lab): I am an MSP for Aberdeen Central. I speak for Labour on enterprise, among other things.

Eric Leenders (British Bankers Association): I am the executive director responsible for retail banking at the British Bankers Association.

Christopher Harvie (Mid Scotland and Fife) (SNP): I am a nationalist MSP for Mid Scotland and Fife. In a previous existence, I was professor of regional studies at the University of Tübingen and joint chair of its international economics course.

The Convener: Thank you very much.

As I said, I want to keep the discussion as informal as possible. However, members want to cover a number of areas, and I will try to ensure that that happens by bringing in appropriate members at appropriate times. They can steer the discussion in a slightly different direction if that is necessary.

I will get the ball rolling by inviting Rob Gibson to say a few words.

Rob Gibson: I am interested in the origins of the credit crunch, particularly because the current trade cycle is different from what we have had before. We know that we reach such a point roughly every 18 years, but the system is more globalised than it has ever been, and the credit crunch is only part of what is happening at this end of the cycle. My question is for Eric Leenders of the British Bankers Association. I have heard about the diversity of financial institutions. Have more kinds of bodies become banks since the beginning of the cycle?

Eric Leenders: First, it would be useful to explore the origins of the credit crunch a little. Everybody should recognise that it is a problem that we have imported from America to an extent. Its provenance is probably well known around the table. We know about the sub-prime mortgage sales that were parcelled and sold through collateralised debt obligations into international money markets. Subsequently, it was found that those mortgages were perhaps not as robust and solid as we might have thought. As a result, there is toxicity in the money markets.

It is probably more accurate to describe the credit crunch as a liquidity crunch. There was nervousness among bankers, who were not necessarily confident that they could lend to their peers as they had done historically. As a result, certain market activities, such as the securitisation of mortgages—we have adopted that model in the UK in the past five years or so—have rather dried up. That is the context in which the Bank of England is providing liquidity support through its special liquidity scheme. Henry Paulson is keen to draw the toxic element of those collateralised debt obligations out of the banking infrastructure in the United States and to restore stability to the US market. The downstream consequence for the UK and Scotland, of course, is that that would restore stability to the UK financial markets.

Rob Gibson: Are you saying that the credit crunch started with the housing market in the USA? Have practices in the housing market in Britain exacerbated matters?

Eric Leenders: Our housing market is fundamentally different from that in the US. We should consider the supply of housing in England and Scotland. Obviously, the UK is smaller and more densely populated than the US, and we have different parameters around housing. Planning permissions, green belts and so on clearly have an effect. America, however, has large sprawling land masses, so there are not necessarily the same restrictions or constrictions on housing. We therefore have perhaps more supply-side pressures than the US has.

We have a wholly different market for the funding of home loans. Regulation by the Financial Services Authority since 2004 and the preceding mortgage code mean that in the UK we have far more—dare I say it—responsible lending principles. As a result, we have a far less significant sub-prime sector. I could not get specific figures for Scotland, but in the UK that sector probably accounts for no more than 7 or 8 per cent of the marketplace. It would therefore be wrong to draw direct parallels from the unwinding of the home loan market in the US and apply those to the UK.

Rob Gibson: I was not necessarily suggesting that the situations were similar, but it is obvious that our own actions contribute to the circumstances in which we find ourselves. Perhaps Graeme Dalziel can tell us why the Dunfermline Building Society remained a building society and did not try to become a bank.

Graeme Dalziel: It is simply because we have seen over the years that the building society model is robust. There is room in the marketplace for a body that is there for and committed to growing value for its members. When I joined the building society in 1998, the big talk of the industry was about defending mutual status against carpetbaggers. We have proven beyond doubt that the mutual model is surviving.

As is the case with other building societies, more than 75 per cent of our funding comes from retail investors, which helps to make the model robust. That is important. When I talk to members up and down the country, I find that they can see how safe a local building society is; they can touch and feel it, and they know that we are putting something back into the community in an economic sense.

The fact that we are well funded by individual investors means that, at the moment, we are not as pressurised in the wholesale markets. To the extent that we have investment from the wholesale markets, there is some pressure on the cost of money, because it is expensive.

The Convener: I should perhaps declare an interest as a customer of the Nationwide Building Society. A number of the smaller building societies in England have recently been swallowed up by the Nationwide. Do you think that that trend will continue? Does it put pressure on the Dunfermline Building Society as Scotland's building society, if I may put it that way?

Graeme Dalziel: Consolidation has been a feature of the building society sector since it started up. In the two more recent cases, the building societies' assets were not in straightforward prime residential mortgages, but in other things, so the capital base was stretched. Our stress testing shows that we have the capital to withstand and ride out what might be classified as the perfect storm. There is an opportunity for our building society to grow organically in Scotland, as well as south of the border.

The Convener: I ask Rob Gibson whether he wants to follow up on that. If any member of the panel wants to comment, please raise your hand.

Rob Gibson: The liberalisation that allowed building societies to become banks happened during this cycle, in around 1997. Therefore, that change of status, which has changed the nature of the house purchase market, has occurred within the purview of the current British Government.

Graeme Dalziel: I would not say that that changed the shape of the house purchase market at all. The Abbey was the first building society to demutualise in 1989, or just prior to that. I would not say that changes in the fundamentals of the housing market have been caused by any change in the corporate status of the banking market.

In the UK and particularly in Scotland there is a shortage of property, so there is a demand for mortgages. There are many reasons why building societies decided to become banks, which are not to do with the fundamentals of the housing market.

09:45

Lewis Macdonald: Eric Leenders said that the sub-prime sector accounts for 7 or 8 per cent of the overall picture in the UK. That suggests that even though there has been a more responsible approach in the UK, as he said, about one mortgage in eight should not have been given, because the individual's credit was not sufficiently strong to cope with the repayments. Is that an unfair interpretation of the figures?

Eric Leenders: Yes. We need to make a distinction. Sub-prime is difficult to characterise. Graeme Dalziel will be aware of the classes of sub-prime in home loans—from light to extreme heavy, as it is called. It does not necessarily follow that if a person has had a county court judgment against them or arrears in previous credit arrangements they are a bad risk; it means that they are a higher risk. In lending, the judgment call is whether the higher risk remains acceptable. To suggest that 7 or 8 per cent of the total mortgage book is at risk is probably an overstatement, although those loans represent a higher-risk element of the overall book.

Lewis Macdonald: Is it fair to say that the basis on which banks—and building societies, I suspect—have offered mortgages has become more liberal in recent years? Is it also accurate to say that changes in approach to the asset-richness of the person who takes on a mortgage and the relationship between the size of the mortgage and the person's annual income have had consequences for the whole system?

Eric Leenders: In an expanding housing market there are opportunities to introduce new products and services; in a contracting market it is clear to responsible lenders that components of products need to be revised. For example, high loan-to-value deals are not necessarily useful in a market in which property values are declining, because there is a risk of negative equity. Such matters must be considered carefully.

It is equally true to say that in a rapidly expanding property market, in which prices are rising quickly, there will be classes of consumers who are in careers or professions that have quite high income growth curves, such as solicitors, doctors and accountancy professionals. Therefore, tailored products for such constituencies of consumers can make sense. We have to be clear that the individuals to whom such credit facilities are provided are manifestly able to meet their commitments.

Graeme Dalziel: There is a danger of our becoming bogged down in doom and gloom and assuming that there are huge mortgage arrears in Scotland. Our level of arrears at this point in the year is no different from last year's level, so there is not the sign of distress that some people imagine that there is. The real issues will arise if unemployment goes up.

On lending policy, all lenders who are regulated by the FSA have been forced to show that they are responsible lenders who have put in place affordability tests, to ensure that people can withstand shifts in economic circumstances. We have built in affordability tests, to ensure that our borrowers can withstand much higher interest rates or expenses, which is probably why we are not experiencing the arrears that are being experienced in some parts of the country.

Christopher Harvie: I have a question for Eric Leenders. You said that exposure to defaulting mortgages here was relatively limited. However, because of the internationalisation of finance, to what extent are we exposed to packages that have been formulated in America or elsewhere? Does any particular part of the financial sector tend to be more affected by such things?

Eric Leenders: The situation in the UK is slightly different from that in Europe; the major banks have declared their exposure in large measure. It can be difficult to attach a value to instruments where there is no market, and a debate rages as to how best to do that. If we take a step back and ask how we can address the issues, we see an emerging understanding that a consistent set of international regulations is needed. That would prevent conversations in which people ask, "How is it that we have different valuations, behaviours and processes in one nation such as the UK or the US, or in one group of countries such as Europe?" For transparency, it would be useful if we had consistent standards.

Christopher Harvie: We are taught that the computer has opened everything up and offered an overview that we never had before, so it is slightly ironic that the word that almost always follows is "opaque".

The Convener: Dave Thompson will ask about regulation.

Dave Thompson: If it is all right, convener, I would like first to follow up on the question of new products. I presume that the new products that we are talking about are the 125 per cent mortgages; the mortgages of seven or eight times people's salaries; the interest-only mortgages; the mortgages taken out over 40 years, and such like. How prevalent are such products? What percentage of the market do they take up?

Eric Leenders: I keep deferring to Graeme Dalziel, but I will give a broad overview. The staple figure used for prevalence is 3 or 4 per cent. Perspective is important. One or two of the major banks that form our membership are talking about loan to value ratios of round about 48 or 49 per cent, which they predict will rise to round about 51 or 52 per cent. That is a big equity cushion. When we talk about 125 per cent loan to value ratios, we are talking about a niche product. We need to keep things in perspective.

I hope that Graeme will expand on this point, but we say that, in the round, the mortgage market is quite stable.

Dave Thompson: You say that it is a niche market. I am no expert, but I imagine that the housing market is fairly finely balanced. Graeme Dalziel mentioned the shortage of housing in Scotland. However, more houses might suddenly become available, because of repossessions caused by the credit crunch or whatever, but there might not be enough people able to buy them, because they cannot get mortgages. I imagine that the housing market can quickly change—indeed, we are seeing that at the moment. Even if the prevalence of these products at the moment is only 3, 4, 5, 6 or 7 per cent or whatever, when people get into trouble and there are more properties for sale than there are people buying, a problem can arise with the price of property.

Eric Leenders: In a growing market, if the industry wants to facilitate home ownership through new products, the responsibility that goes along with that is to provide some form of safety net should the market turn. That is why our colleagues in the Council of Mortgage Lenders have done so much work to ensure that there is a safety net should people fall into arrears. That point was made in a report that was prepared for the committee.

We have designed a suite of new products. They have yet to be tested in any true recession or downturn—and I hope that they will not be tested by any recession or downturn—but they include overpayments, underpayments and current account mortgages.

During the previous recession, when I cut my lending teeth, we had a far narrower suite of mortgage products. They were very much based on a three-times multiplier, and they were all fixed over 25 years with monthly repayments. If one missed that repayment, one fell very quickly into arrears. Now, if people build up a cushion through overpayments, that will help them if they face unemployment or other difficult financial circumstances.

Dave Thompson: I would like to move on to some points about regulation.

The Convener: I invite Graeme Dalziel to add some comments first.

Graeme Dalziel: As Eric Leenders indicated, loans of more than 100 per cent account for a very small percentage of the overall market in the UK. In Scotland, our loans of more than 100 per cent—they were of up to 105 per cent—were aimed purely at graduates and professionals. At all times, the most important thing is to ensure that people can afford their repayments. The same stress testing applies to loans of below 100 per cent. As a member-based business, we tried to help the first-time-buyer market.

You should remember that, during the previous recession, the Scottish housing market managed to avoid the ups and downs that affected the market down south. Our Scottish housing market has been, and is still, much more stable. In our experience, the level of arrears in the loan book for loans of more than 100 per cent is exceptionally low. I can count on the fingers of one hand the number of cases: I think that only one out of 2,000 such loans is in arrears at the moment.

Dave Thompson: On regulation, I was particularly interested in the articles that Professor Prem Sikka provided us with. I have some quotations here from him about the financial system. The first reads:

> "regulators did not monitor the financial dealings of banks. They were left free to speculate and gamble on stock markets."

The professor also spoke about

> "the biggest casino of all",

which is almost unregulated, and Stephen Boyd has commented that

> "the prevailing economic model is unravelling".

Professor Sikka also wrote about the "rights of savers", who do not appear to be being looked after at all. There might be plenty of safeguards for shareholders and others, but savers—ordinary people—do not appear to be being protected in any meaningful way.

I wonder whether Professor Sikka could comment, and one or two other witnesses might wish to defend the lack of regulation.

Professor Sikka: I thank the committee for the invitation. I am very grateful.

I will expand on some of those points. It is amazing how little regulation has improved in the financial sector over the past 30 years. It is mired in scandals. In the 1970s, there was the secondary banking crash, and Britain had to go to the International Monetary Fund for a bail-out. In the 1980s, Johnson Matthey Bankers was bailed out. Pensions mis-selling took place—practically all financial institutions were in on it and making money out of it. I am not aware of any organisation having been prosecuted, of any directors being forced to return their remuneration or of any penalties being levied against them. Then, we had the Bank of Credit and Commerce International scandal, the mortgage endowment scandal and problems with split investment trusts. There have been scandals in other countries, too. In the US, there was the savings and loan bail-out, which came to $125 billion. More recently, there was the payment protection insurance scandal here, as well as excessive charges on credit cards and overdrafts.

Now, the financial world has developed what is called a shadow banking system, of which derivatives are a major part. Essentially, derivatives are clever bets, whose value can be placed at anything from zero to several million dollars, depending on how events unfold. As at December 2007, the contract face value of those derivatives was $1.14 quadrillion—a quadrillion is a one with 15 noughts. The US gross domestic product is about $14 trillion to $15 trillion a year, so that shows the scale of the issues that we are facing.

The financial world is not really regulated at all. There was a reference earlier to transparency. I often wonder what transparency actually looks like. People have been talking about it for 30, 40 or 50 years, but we never get there.

Opaqueness, however, is certainly with us. Banks' accounts are fairly large—just to see, I weighed HSBC's accounts and found that they weigh 1.5kg. However, the one thing that we cannot find out from any bank's accounts is its exposure to derivatives or defaults. There is no table indicating where the bank operates from, what its assets are in each country, what its liabilities are, what taxes it pays and what employees it has—nothing. On top of that, there is huge opaqueness about what happens offshore. Almost all financial institutions hide offshore, so we have no idea what their dealings are. Worst of all, banks have been leaders in tax avoidance, not only by avoiding taxes that they are supposed to pay, but by helping their clients to do so, legally and illegally. That is set out in a US Senate report on which I based an article that I have forwarded to the committee.

10:00

We have a huge crisis. I do not buy the idea that it is US-imported or an aberration, or that there are one or two rotten apples. None of that cuts ice, because the crisis has a long history. If we want to understand the crisis, we need to consider three aspects. If the committee wishes me to, I will elaborate on them later. Above all, the crises that we get reflect our political institutions. Scandinavian countries do not have the same financial crises as we have, because Governments there are much more consensus based than majoritarian. In the UK, a party that gets 36 per cent of the vote can control Parliament, do whatever it wants and ignore dissenting voices. Also, many people in Parliament are available to the highest bidder, through donations and consultancies, to ensure that threatening legislation simply does not appear—although I am sure that people will say that that does not happen here. We need to examine the political institutions that have got us into the state that we are in.

It will not do to say that we just need to regulate. Regulation is important, but what have we done? In setting up the FSA, we have in effect handed regulation to economic elites who bring the corporate world view. Why has the FSA not tested financial products? We do not allow medicines to be sold without testing whether they can injure people. How come banks can sell financial products without testing their capacity to cause destruction, the conditions under which they go wrong and who loses and wins? There is absolutely no prior testing, but there should be. All financial products should be registered and how they have been tested should be explained.

There is no central registration of derivatives. We could levy a 1 per cent tax on all derivatives and solve many of our financial problems, but there is no registration. The regulators do not owe a duty of care to savers or depositors. The same is true of company directors in banks. At best, they owe a duty to fellow board members or the company, but no duty of care is owed to depositors, who do not elect directors or auditors. We have a complete vacuum at the regulatory level, with no openness. Anything that any regulator receives should be publicly available. They are not discussing things that we are not allowed to know about, such as troop movements or spy satellites; they discuss things that affect ordinary people. We need far more openness, but that is not on the agenda at present. If we consider accounting, which I alluded to briefly, the picture gets worse.

I heard earlier a voice saying that we need the same regulation throughout the world. I think not. The idea that we need the same regulation in America, Afghanistan, Bolivia and Britain is simply not acceptable. Different societies are at different stages of development, with different exposures, threats and opportunities that need to be taken into account. Therefore, we do not need one set that fits everybody. I admit that regulators must co-operate and act in unison, because finance is global, but we cannot impose one straitjacket on everybody, which is what is often talked about.

To put it bluntly, the huge problem that we have is a neo-conservative ideology, which is about light-touch regulation, deregulation and profit at almost any cost. We need to unpack and examine that. I may have infuriated a number of colleagues here, but they will have an opportunity to come back on that.

The alarm bells have been ringing since 1998 when, in the US, there was a long-term capital management hedge fund collapse. The fund was managed by Nobel prize winners in economics, but the conclusion was that ultimately they could not value the securities or say what the value of the derivatives would be. I challenge any corporate executive, accountant or auditor to say that they have better skills than Nobel prize winners in economics and that they can really understand and value the risks. We need far closer monitoring.

If shareholders are happy to sit back and take the risks, they must also bear the outcomes. However, what we seem to be saying is that they can collect the dividends and rewards, but we will bail them out when problems occur. That has created huge moral hazards. What is there to prevent any director of any financial institution from continuing to take more and more risks? If the risks pay off, the directors receive huge salaries and walk away; if they do not pay off, the taxpayer bails them out. I foresee huge problems, and we need to talk about what to do. I might have more to say about that later.

The Convener: There is an awful lot there for discussion.

Stephen Boyd: Professor Sikka has covered much of what I was going to say, so you will be glad to know that I will be brief.

I want to return to the origins of the credit crunch. It is vital that we leave today with a better sense of how we got into this situation to prevent it from happening again. I will pick up on two things that Prem Sikka mentioned. First, as he said, there have been signs for a number of years. One mantra that we have heard consistently in the past few months is that no one saw this coming, but they did. Half the world’s commentariat have been predicting this situation for the past five or six years.

The model that was pursued with particular vigour in the US and, unfortunately, in the UK was entirely unsustainable, resting as it did on the rapid accumulation of debt. That was going to unravel at some point—that was blindingly obvious to anyone who was prepared to look at the situation with anything approaching an impartial eye.

Secondly, Prem Sikka said that he is not satisfied that we have imported the problem from the US. I agree; that is a complacent view, and if we abide by it, it will stop us regulating to prevent us from reaching this point again.

The origins of the crunch lie in three assumptions, which underpinned the work of the markets in the past decade. The first idea was that capital markets have become so much more sophisticated that debt securities would always be traded. The second assumption was that the new credit ratings agencies provided a credible assessment of the risk posed. The third assumption was that risk dispersion had made the system inherently more stable. All three assumptions have been shown to be demonstrably false. Far from the new, innovative products dispersing risk more widely and making the system more stable, they succeeded only in globalising the impact of reckless lending in specific markets. That is why we are all suffering at the moment.

I will not go through the various regulatory improvements that could be made. Prem Sikka has mentioned them, and I would add only that the incentives available to senior executives have played a huge role in getting us to this point, so we should do something about them. It is interesting to hear even Adair Turner talking about that in the past few days, and his suggestions are a move in the right direction.

My only other comment is that it is important that at some point today we talk about how we can rebalance the economy and move things forward in Scotland, given the powers available to the Scottish Parliament, and about any action that we can push for at a UK level too.

Owen Kelly: I have just a couple of quick comments. I agree with Stephen Boyd's comment that it is not the case that nobody saw the crisis coming. I mentioned earlier the diversity of our industry. I was in China last week with some of our fund managers, all of whom were saying that they have been lightweight on banking stocks for some time. Therefore, I agree that it is not entirely true that nobody saw the crisis coming—some of the people who manage other people's money in Scotland have been looking at the issue for some time.

Heavy regulation in itself does not stop scandals. If one looks at a country such as China, which has a heavily regulated banking system, one finds that it has had a sizeable number of scandals, so heavy regulation in itself is not the answer. I agree with Professor Sikka on that point. I also agree with him that some form of governance and regulation is absolutely necessary in light of what has been going on.

I will raise one point of principle to test whether those around the table agree on it. Surely the principle remains that informed buying and selling in a free market is the most efficient way of allocating resources. The challenge is to find systems of regulation and governance that balance the kind of interest that Mr Thompson spoke about and to maintain the dynamic that will, in the long run, give us the kind of economic success that we all want.

John Gill: I have two points to make, the first of which is on regulation and advance testing. I did not recognise much of what Professor Sikka said in that regard. We have extensive testing of our capital base; huge computing power and large numbers of people are applied in doing that. In line with all other major financial institutions, we have very close FSA supervision. The FSA tests all kinds of scenarios, including some of those that we have seen in recent times. I refute the point that no advance testing is done.

Secondly, I back up the point that Owen Kelly made on lending. Much of the discussion has been specifically on lending and the banks. If possible, I would like to see the committee move on to look at the wider financial wellbeing of the man in the street. Clearly, some issues were driven by lending practices, but we should also be discussing saving practices. How do we ensure that the man in the street is genuinely preparing for the future and making the most of opportunities to prepare for his retirement and so on? We need to ensure that we have the right balance between what goes on in lending and in saving.

The Convener: We will move to look at some of the wider economic issues in a moment. Before we do so, I will take further questions on aspects of regulation.

Lewis Macdonald: My question is more on the immediate impact of the financial crisis that hit British markets last week. The First Minister of Scotland said that the crisis in the financial markets was caused by a bunch of short-selling "spivs and speculators". How do panel members who operate in those markets respond to that description?

Owen Kelly: My only comment is that we can all share in the First Minister's frustration at what happened at the hand of the market. It appears from what I have read that 3 per cent of HBOS shares were on loan—in other words, 3 per cent of shares were available for the practice of short selling. I am not close enough to the deal to know the role that short selling played, but I guess that it must have contributed. Clearly, short selling was an issue, given that regulators on both sides of the Atlantic came out quickly to take action on it. That said, it is probably hard to say whether short selling was the decisive factor in the HBOS case.

Dave Thompson: If only 3 per cent of HBOS shares were made available for short selling, one wonders why the crisis unfolded as it did. What are panellists' views on the suggestion that Lloyds and HBOS used the situation to engineer a takeover that wrong footed the First Minister?

Lewis Macdonald: Before panel members respond to Dave Thompson's question, I would like to hear the views of other panellists to my question on the role of short selling in the crisis that occurred last week.

Eric Leenders: There is a role for short selling in normally functioning markets. It provides two broad functions: hedging and investment. The First Minister alluded to a particularly rapacious type of such investment. As Owen Kelly said, only a small proportion of shares were available in the case of the HBOS deal.

At this point in time, given the volatility and uncertainty in the markets, the action of the Financial Services Authority in suspending this type of activity for a period is probably the appropriate response. We are probably in a reasonably sensible place on short selling.

10:15

Lewis Macdonald: Are you saying that the temporary suspension of short selling is a sensible short-term response? Do you view short selling as a cause or a symptom of difficulty?

Eric Leenders: We do not want to throw out the baby with the bath water. In a normally functioning market, there is a place for short selling—we do not want to preclude that activity. Other markets that have outlawed short selling are now finding ways of introducing similar mechanisms. We do not want to rule out short selling completely, but a period of suspension is a fairly measured response at present. During that period, there should be some reflection to see what other activity might take place.

The Convener: If it was appropriate to suspend short selling last Wednesday, why was it not appropriate to do so two weeks ago?

Professor Sikka: We should bear in mind the fact that the ban on short selling is only for three months—it is not permanent. I am not sure what the Government is planning. The issue raises other interesting questions. People defend short selling on the basis that it makes markets more efficient. However, if markets are rational and people act on information that is publicly available, the opportunity to arbitrage at the margin should be very limited. The question is, what kind of information are people getting? Are they acting on insider information? In this country, we have a dismal record of dealing with insider trading. What are the sources of information for the people who are involved in short selling? Who is leaking information? Some financial institutions say that Chinese walls separate different floors and levels of organisations. I do not buy that, because the energies of people who work for an organisation are directed towards increasing profit for the same entity. There needs to be a broader inquiry into how information is manufactured, bought, sold and traded, and who benefits from that. That would be a much more useful way of exploring the matter. I am also in favour of more curbs on speculators, not only in the financial world but in other arenas.

Owen Kelly: I cannot let one of Professor Sikka's comments pass. He implied that short selling is driven by some sort of insider trading. If it is, that is a criminal offence in certain cases, but the issue must be judged case by case. Professor Sikka's comments on regulation and enforcement are perfectly legitimate, but I do not want to leave members thinking that the whole of short selling is driven by a dodgy process. It is not—it is an established part of the market mechanism.

The Convener: Time is moving on, so I would like us to turn to wider economic issues.

Dave Thompson: I would like to get an answer to the question that I asked: if the problem was not caused by short selling, did people take advantage of the situation in some way?

The Convener: The committee may have to return to the issue at a future date.

Christopher Harvie: I would like to make a short historical point about light-touch regulation. Bill Keegan of *The Observer*, who is a friend of mine, made the point to me that the division of the Bank of England into its various regulatory and banking facilities led to great demoralisation of people who found that their traditional roles had been usurped. They had to be retired, pensioned off and given golden handshakes, and new people had to be installed. Introducing light-touch regulation seems to have been extremely awkward—rather like trying to build the west coast main line while continuing to run trains on it. Because the American system is much more severe, after Enron collapsed, many people—the Sarbanes-Oxley refugees—left America and settled in this country. Has that not introduced a toxic quality to the British markets?

Professor Sikka: The business world's opposition to certain kinds of regulation is based on a misunderstanding. Businesses argue that regulation is costly. My response is that not having the right regulation is even more costly. A cost is associated with not having regulation, as we are witnessing, but it is a social cost, and social costs simply do not enter into private calculations. That is the job of the regulators, and Governments take social costs into account and design the appropriate architecture for regulation. Everybody can now see the costs of having a deregulated approach, and we need to move on from here.

The Convener: We have only about 10 minutes left with this panel, so we should move on to some of the wider economic issues.

David Whitton: That is exactly what I wanted to do. The aim of this session is to examine the credit crunch and its impact on the Scottish economy, so I would like us to get back to basics and get the views of our panellists on what that impact has been, particularly in light of the events of last week.

Eric Leenders: The point needs to be made that the Scottish economy is in slightly better shape than other aspects of the wider United Kingdom economy. On the focus of the report that was circulated in relation to Graeme Dalziel's point earlier, there is probably a recognition that one of the key indicators around arrears and repossessions is unemployment. One of the strengths of the Scottish economy is that employment levels are quite high. As the economic cycle turns, there will be pressure on employment levels. However, since previous spikes in unemployment levels, a new dynamic has developed in the UK and Scottish markets, which is the migrant workforce. That might act as a cushion when there are pressures on the jobs market.

There is a strong financial services sector in Scotland, and that skills base will remain whoever the players in the market might be. Other sectors are clearly in quite good health, as well. Will they grow at the rate at which they were expected to grow 12 or 18 months ago? That is an open question. Most commentators would suggest that they will continue to grow, but not at the rates that people imagined they would a couple of years ago.

A lot of the discussion has put forward the view that the glass is half empty, but I think there is a case for saying that the glass is half full—he added, a little cautiously.

Stephen Boyd: If the experience of the past year tells us anything, it is that economic forecasting is a mug's game. Anyone who sits here today and outlines what they expect to happen to the Scottish economy in the next year is taking a real chance. At the moment, it is important that we all speak with some responsibility and do not exacerbate the crisis of confidence that has clearly taken root in the economy. The only honest assessment that I can give today is that the STUC and all of our affiliated trade unions are not really sure how things are going to pan out.

Your next panel of witnesses will talk to you about the construction industry. The problems in the house-building sector are there for all to see, but I would not wish to take the opportunity to speculate on the consequences of the credit crunch for other industrial sectors. The best that we can say is that the times are very uncertain. People are worried. Things that have previously been advantages, such as our strong financial services sector, could become a problem if the difficulties in that sector do not resolve themselves in the next couple of months.

We will circulate a briefing to MSPs before the ministerial statement this afternoon. In it, we will call on the Scottish Government to take action to rebalance the economy. We think that the Government could design and implement a modern industrial strategy for Scotland that builds on all the levers that are available to the Scottish Government to provide as much intelligent assistance to manufacturing as possible. We are also calling for the establishment of a Scottish industrial bank. We have been calling for that for a number of years, and now I think that the time has come for that initiative to be acted on.

The current situation, in which there is a tightening of credit, only exacerbates a long-standing problem, which is the failure of Scotland's strong financial services sector to provide the capital that growing Scottish companies need. At the business in the Parliament conference that took place less than two years ago, Nicol Stephen bemoaned the lack of support that is available to the renewable energy sector, which we all know represents a major industrial opportunity for Scotland. In the context of the problems of obtaining finance, he mentioned three worrying signs. He said:

> "The first is Pelamis-ocean-power delivery, our wave-power generating company and the first in the world at a commercial level. Its latest funding round, announced in the middle of this year, was £13 million of new investment. How much of that came from the Scottish financial community? Out of £13 million of new investment, £0.5 million came from Scotland, and half of that was from the Scottish public sector. The second is Cyclacel in Dundee—a fantastic company with huge potential for the future. Its latest fundraising was through a flotation in the United States, achieved through a merger into a NASDAQ-listed company. The third is Wavegen in Inverness, one of the great companies that has huge potential for the future. It is now owned by Voit Siemens."

It might seem contradictory to criticise the behaviour of the markets while not opposing Government intervention in support of them, but we do not want a lack of intervention to drive us into a long and deep recession, so there is no contradiction. We should consider what could have been achieved if a small proportion of the money that was provided to bail out Northern Rock had been invested in Scotland's renewables sector—that would give us much food for thought.

Owen Kelly: It might reasonably be supposed that the rising cost of money, which has figured large in the discussion, will have a knock-on effect on what people call the real economy. However, from my conversations with all the banks that operate in Scotland, it is clear to me that the banks regard themselves as open for business and open for lending.

It is worth pointing out that competition in the commercial banking sector in Scotland is growing. The sector is becoming highly competitive as other players start to expand in the Scottish market, so I am not as downbeat as Stephen Boyd is, although the effects might take a little time to come through.

The point has been made that the financial services industry is a significant slice of the Scottish economy. I mentioned the industry's diversity at the beginning of this discussion. Our conversation has rightly focused on banks, but our insurance companies, asset managers and asset servicing companies are doing pretty well in the face of very difficult trading conditions. Last week, I was in China with three of our asset management companies, to present what we might call a Scottish proposition in Shanghai and Beijing. The receptiveness of Chinese interlocutors who are seeking good people to manage their money was very warm indeed. We should not talk ourselves into losing sight of the value that the Scottish brand has internationally—people regard us as good people to manage their money.

John Gill: At Standard Life, we are hearing a lot of noise, but we are not experiencing much difference in activity. Savers and investors have moved towards safer havens, but there is not yet real evidence that less money is coming in. If that happens, we have a resilient business model. Like other Scottish financial institutions, we have some dependency on new money, but we get benefit from consolidation of other moneys. We believe that we are well placed to benefit from a flight to quality.

The overall fundamentals and the importance of generating an improved saving culture do not go away. We have an ageing population. In the UK, there are more senior citizens than children, which is a fantastic statistic and is a good thing for a business like ours. We are confident, but we are certainly not complacent.

10:30

Graeme Dalziel: We carried out a survey throughout our branches to find out how our customers feel about the credit crunch and the impact that it is having on them. As might be expected, 80 per cent said that they had made reductions in spending, mainly on food shopping, holidays and socialising. That is a fact—we asked real people on the high street what the impact is on them, and that is what they are telling us.

The impact on us is that savings business has been very buoyant. Our branches are ahead of target in terms of retail inflowers, which is much the same as what John Gill said. There are increasing signs that people are worried about their jobs, which means that there has been an increase in sales of protection insurance. There is a confidence issue: uncertainty is rife, as Stephen Boyd mentioned, and it is having a psychological effect on people in making them worry about the future.

We held a Confederation of British Industry Scotland council meeting in our office two weeks ago. Half of the people in the room were pretty despondent, because they were house builders and, as might be expected, things are not too good in that sector. On the other side of the room, however, among those who represented other parts of the economy, there was not exactly buoyancy, but there was not the doom and gloom that you might expect from reading the papers. It was interesting.

The other key point that our members brought up is that, as one might expect, they trust their building society the most to give them financial advice, more so than some other players in the marketplace. That goes back to what Professor Sikka said earlier: there is room in the market for a simpler model. The man walking down the street can understand what a building society does much more than he can the workings of some of the humungous worldwide banks, particularly in the US.

Professor Sikka: My points are general rather than relating only to the Scottish economy, because Scotland is interlocked with the global financial system.

The Japanese have never really recovered from their banking crisis, even a decade later. People's incomes declined in real terms as well as in nominal terms. There are tough times ahead, and they will get tougher, because a large part of the British economy has relied on personal debt, which is currently bigger than the gross domestic product of the whole country. It is obvious that people's ability to borrow will be squeezed—it has already been indicated that that will get worse.

At the same time, employers are under pressure to control costs, so salaries will be under pressure and unemployment will increase. People will find it very difficult to maintain a particular lifestyle or even to keep their heads above water.

Income inequalities are the widest that they have been for the past 50 or 60 years, which has enormous consequences. As well as needing income just to survive, people must have income if they are to lobby regulators or members of Parliament—they have to be able to travel and write to do that. That raises other political issues in regard to which voices will be heard in this crisis, when people cannot even travel or make a phone call.

Pensioners will be squeezed because our tax revenues are going to decline. Our state pension is already the lowest in the European Union, at an average of 17 per cent of average earnings compared with 57 per cent in the rest of the EU. There will be a great deal of hardship and, if we have a moment later, we should discuss how to address that.

If we can help people at the bottom, there will be a greater multiplier effect on the economy. Ordinary people spend money on food and everyday essentials, so the multiplier effect on the economy is that much greater than if income is piled up at the top, as numerous studies have shown. Banks will perhaps be grateful, to some extent: not only are they to be bailed out by central Government but, in the UK, their profits have been guaranteed by the state under private finance initiative schemes. There is a limit, however, to how far that will go.

Eric Leenders: Perhaps I can draw together a couple of threads on secure credit, the level of debt that Prem Sikka referred to and some of the points that were highlighted by John Gill and Graeme Dalziel.

As the major banking groups recognised, the growth in unsecured credit peaked a couple of years ago, and the secured credit market is now in a different place. According to the fee-free money advice providers who deal with people in financial difficulty, those seeking advice tend to be people who took credit some years ago but now, faced with increasing fuel and food costs and a combination of other factors, find that their repayments, which were manageable a few years ago, have become more difficult to meet. In response, the industry is trying to take more proactive steps to identify customers who are facing financial difficulty.

There will always be events that will change the parameters of what was considered to be a good lend, and clearly we need to manage such matters downstream by identifying proactively those who we think are in financial difficulty. Aside from looking at what the industry is doing to address this issue, we should also consider that consumers' credit card balances dropped consistently until about January or February. They are now starting to tick upwards again, and we are trying to find out whether that is because credit cards, which are often used for more discretionary expenditure, are now being used for food and utilities bills. It is not as though we are sitting on our hands; indeed, it is not in our interests to end up having to react to a portfolio. The fact is that we need to be more front-footed.

Marilyn Livingstone: I think that, with all the talk about moving forward, we need to consider the impact of the credit crunch on the capacity of the house building industry and on our ability to fulfil the Scottish housing policy aim of building 35,000 houses a year by the next decade. After all, there has been a lot of unemployment in that sector. I believe that Eric Leenders said that new products are coming on to the market, some of which will be targeted at first-time buyers. What innovative products is the industry introducing to raise market confidence and to support first-time buyers and those who want to move on to the next rung of the property ladder, and what is it seeking to do in the future?

Eric Leenders: I apologise if I miscommunicated. I meant to say that, in an expanding housing market, there is an opportunity to develop new products and to bring them to market. That is not quite the case in a contracting market.

At the moment, about 20,000 mortgages a month are being approved. It is still early days, but it appears that the natural floor of the UK marketplace is that at any given point 20,000 people will, for whatever reason, need to move. That suggests that first-time buyers are hesitating and biding their time. After reading a lot about a declining property market and seeing prices coming down, they are thinking—rationally enough—whether to move now or to wait until the next cyclical peak, which will probably be in the spring.

David Whitton: I have a quick question about economic forecasts, but I must say that, after listening to the witnesses around the table, I am not quite sure whether to be optimistic or pessimistic. The Organisation for Economic Co-operation and Development, the European Commission and the CBI are all revising down their forecasts for the UK economy for the final two quarters of this year, which would, technically, put us into recession, but the Bank of Scotland is suggesting moderate economic growth throughout the remainder of this year and into the first quarter of next year. I am therefore a bit puzzled. Is Scotland heading into recession, or is it not? Perhaps Mr Dalziel can give us the view from the two sides that were in his headquarters the other day.

Graeme Dalziel: We have an interest rate committee that meets once a month, and its view is that there are many more risks of an economic downturn. There is a fair chance of continued economic slowdown. However, it is not all doom and gloom. Yesterday, I met a customer who is in the hotel business. He told me that he reads the papers and, each month when he looks at his accounts, he expects to see a fall in his takings and turnover. However, that has not happened yet. Indeed, his takings have been increasing gradually over the year, because more people are holidaying here at home.

Across sectors such as defence, aerospace and oil and gas, some areas are doing very well. That is not to say that some areas are not doing well—I spoke about house building earlier—but there is a fine balance and we need a bit of optimism. We should not get too caught up in what we read in the papers all the time. With all due respect to the people who write those articles, we need some good stories. I would urge the committee to look for good stories of success, where people are growing their businesses. We have to celebrate that.

Gavin Brown: I read the other day that inflation is at 4.7 per cent. In any other week during the past 10 years, that would have been the only story that people were talking about, but this week it was a small article sandwiched between others somewhere around page 9.

Obviously, interest rates are set in London and the Government here is limited in what it can do. However, do the panellists have any thoughts on what the Scottish Parliament can do to try to assist? The inflation rate is alarming.

Professor Sikka: Parliaments can do quite a lot. Different sectors of the economy have different rhythms, and some might be suffering more than others from the current economic woes.

In housing, there are two sides to the issue, the first of which is whether there are enough houses. Governments and councils can have house building programmes. The Government in the US is now that country's biggest landlord, having nationalised Fannie Mae and Freddie Mac, and on the way here I was wondering what the US was going to do with its housing stock. In the UK, the Government now owns a lot of Northern Rock houses.

The other side of the issue is whether people have income. If there are vast income inequalities and if disposable income has been squeezed, people's ability to service their debts will inevitably be constrained. How can we increase the income of people at the bottom and reduce income inequalities? If we can do that, we will have a recipe. For example, if we were to increase the personal allowances of people at the bottom by 10 per cent, thus increasing their disposable income, the cost would be £4.5 billion for the UK as a whole. That money could be recouped by levying a higher rate of tax on incomes of above £100,000. The cost of increasing pensions by 10 per cent would be £8 billion to £9 billion, which could be recouped by abolishing the ceiling on national insurance contributions. Because of the artificial ceiling, national insurance is the most regressive tax that you can find anywhere. Getting rid of the identity card project would save £9 billion. We can increase the income of people at the bottom.

There are inequalities, and people at the top create bubbles—a stock bubble, a housing bubble—which we have to find a way of controlling. A simple formula would be that nobody in any company should be able to earn more than 10 times the average wage in that company—as simple as that. Wealth is produced by joint effort, so there is no logic or morality in saying that one person or 10 people can walk away with telephone number salaries.

10:45

We also need to democratise places of work. Why cannot workers vote on the remuneration of directors? If they think that a boss is worth 10 times the average salary, let him or her have that; if they think that the boss is not worth that, let them say so. We cannot easily address such crises until we democratise places of work, because we will otherwise look for solutions within a narrow frame. As I said earlier, such crises are indicative of our social, political and economic institutional structures, which we need to address. If we do not do so, we cannot address such problems. We certainly need to address the issue of people's personal incomes, because if they do not have enough personal income, they cannot afford to buy or rent a house.

The Convener: Time is running out. Does anybody else wish to comment on the points that have been made? We will then have to draw the discussion to a close.

Eric Leenders: I would like to make a brief cautionary remark. When I was growing up, there was talk of the brain drain. The tension is that if we create something locally along the lines that Prem Sikka suggests, we could engineer or re-engineer that type of brain drain. That needs to be thought through.

Stephen Boyd: I would like to make two brief comments, the first of which is in response to Gavin Brown's question. To use Graeme Dalziel's formulation of words, the risks and the downside are such that the monetary policy committee of the Bank of England should cut interest rates at its next meeting. If it does not do so, that would be a major concern.

My second comment is on what we can do in Scotland. In the past few months, major issues have been raised about how Scotland would handle major matters such as the regulation of finance, the currency, central bank matters and sharing risks if it assumed more powers or became independent. It is now incumbent on us to open new work streams to consider those specific issues in the national conversation and the Calman commission, because the debate is horribly ill informed at the moment. Anything that can be done in those processes to reinvigorate the debate so that it is mature and informed would be much appreciated.

Owen Kelly: Mr Thompson asked about the HBOS takeover and suggested that the companies involved might have taken advantage of markets. Given that that issue did not really catch fire, I should put on the record that I have not heard or seen anything that supports that proposition.

The Convener: As no one else seems to want to comment on what the Scottish Government, the Scottish Parliament or the UK Government should do, I thank everyone very much for coming along. That is greatly appreciated. I am sorry that we have run out of time. I know that members wanted to ask other questions, but others still have to give evidence today. The discussion has been interesting, and I am sure that it could have continued for a considerable time.

I suspend the meeting for a couple of minutes while the panel changes.

10:48

Meeting suspended.

10:53

On resuming—

The Convener: In our second session, we will look at the impact of the credit crunch on the housing sector. We will use a similar format to the previous session and keep the discussion as informal as possible. To start, I invite members and guests to introduce themselves and to briefly say anything that they wish to say.

Rob Gibson: I am the deputy convener, and an MSP for the Highlands and Islands.

Roderick Pettigrew (Heating and Ventilating Contractors Association): I am the head of the commercial and legal department of the Heating and Ventilating Contractors Association. We have approximately 200 members in business across Scotland, and we represent a turnover of approximately £300 million for the Scottish economy.

Marilyn Livingstone: I am the MSP for Kirkcaldy, and convener of the cross-party group in the Scottish Parliament on construction.

Alan Watt (Civil Engineering Contractors Association (Scotland)): I am the chief executive of the Civil Engineering Contractors Association in Scotland. Our turnover is approximately £2.2 billion and we have approximately 20,000 permanent pay-as-you-earn jobs in Scotland.

Gavin Brown: I am an MSP for the Lothians.

Harry Frew (Union of Construction, Allied Trades and Technicians): I am the Scottish regional secretary for the Union of Construction, Allied Trades and Technicians, a member of the general council of the Scottish Trades Union Congress, and a member of the cross-party group on construction.

Ron Smith (Edinburgh Solicitors Property Centre): I am the chief executive of the Edinburgh Solicitors Property Centre.

David Wright (SELECT): I am the head of external affairs at SELECT, which is the trade association for the electrical contracting industry in Scotland. We represent approximately 1,150 member companies with a turnover of approximately £1 billion, employing 15,000 electricians and perhaps 5,000 others, with 4,000 apprentices in training.

Mark Hordern (Glasgow Solicitors Property Centre): I am the head of marketing for the Glasgow Solicitors Property Centre. We sell between 10,000 and 12,000 houses a year, which are worth approximately £1,300 million.

Dave Thompson: I am an MSP for the Highlands and Islands.

David Melhuish (Scottish Property Federation): I am a director at the Scottish Property Federation, representing the commercial property industry, which includes developers and investors in offices, shops, industrial parks and a few who are responsible for residential lettings.

David Whitton: I am the MSP for Strathkelvin and Bearsden, and Labour spokesman on finance.

Michael Levack (Scottish Building Federation): I am the chief executive of the Scottish Building Federation and employers' secretary for the Scottish Building Apprenticeship and Training Council. The Scottish Building Federation is 113 years young, with 700 members from Orkney to the Borders—everyone from major contractors down to sole traders, through all the small and medium-sized enterprises. Our combined turnover is probably of the order of £3.5 billion.

Lewis Macdonald: I am the MSP for Aberdeen Central.

Allan Lundmark (Homes for Scotland): I am director of planning and communications at Homes for Scotland, which is the representative body of the house building industry in Scotland. Last year, the industry was responsible for £6 billion of investment in Scotland, and my members' companies were responsible for approximately 95 per cent of the 25,000 units that were produced in Scotland.

Christopher Harvie: I am a nationalist MSP for Mid-Scotland and Fife. In a previous existence, I was professor of regional studies at the University of Tübingen in Germany for 28 years.

The Convener: The format will be similar to the one that we used earlier. If any member of the panel wants to respond to any of the questions, they should indicate to me that they want to speak. A member may indicate that they want to ask a question of a specific person, but any other person may answer, too. Marilyn Livingstone will start, because she has a particular interest in this area.

Marilyn Livingstone: What will the impact of the credit crunch be on the house building sector? Reports from the major house builders show downturns of 26 per cent, 33 per cent and so on. What impact will that have on the sector's capacity? How will it hinder the Scottish Government's policy of building 35,000 new homes every year during the next decade?

My second question is very significant. What impact will the credit crunch have on the construction industry outwith the house building sector? The rest of the industry is equally important—what about its capacity, confidence and ability to meet targets?

Roderick Pettigrew: Our members tend to work as specialist contractors, subcontractors and sub-subcontractors. A few of them work in the house building sector, and it is very clear from all the evidence that the sector is in severe decline, so the workload is significantly lower than it has been in the past.

However, the workload in the rest of the construction industry seems to be going fairly well. Of course, our members operate as specialist contractors and there is probably a nine or 12-month delay from inception of the work through to contract award, so we are still seeing the effect of the economy as it was last year. Members report a good workload and a significant order book for the coming few months, so the sector looks fairly buoyant. However, we have a question about what will happen after that.

Figures from the Royal Institution of Chartered Surveyors in Scotland are markedly different between the first and second quarters of 2008, which suggests significant pessimism about the downturn in the Scottish economy and a general lack of confidence. The concern is that a lot of work will not come through because of a general lack of confidence. However, the major PFI work that is in the pipeline and a considerable amount of commercial activity seem to be occupying our members fairly well.

On training, members report that they have about 170 modern apprentices in the sector and that placements are fairly good for the coming year. However, they feel that a problem with the workload will arise, possibly in the year after that.

11:00

Alan Watt: I should have declared earlier that I am the treasurer of the cross-party group on construction and one of its co-founders, with Marilyn Livingstone.

Civil engineering provides much of Scotland's infrastructure, so we depend to a large extent on public sector funding, but the part of the business that is in the supply chain for the house building sector—it involves groundwork services, road surfacing and landscaping of such sites—is in serious decline. That is a big concern. Three sizeable companies have gone under in the past month as a direct consequence of that downturn. In the longer term, a worrying trend could be a downturn in developer-led work in the commercial and industrial sectors, so we are monitoring that closely.

Perhaps one of the deepest problems is that public sector clients such as Scottish Water, Transport Scotland and—at arm's length—councils have finite budgets, but the construction inflation rate in Scotland is about 10 per cent. If those organisations have only a certain amount of money, they can do only a certain amount with it, so a downturn in delivery and construction will naturally result.

I echo what Rod Pettigrew said about long-term concerns, on which Marilyn Livingstone has worked hard, about recruiting, training, upskilling and qualifying the construction workforce. Fantastic progress has been made on that in the past five to 10 years, and it would be a huge pity if that slowed or stopped during any downturn.

Harry Frew: The industry is obviously experiencing a major crisis. In the house building market, several companies—including major players—are having to lay off people because they cannot sell the houses that we are building. That relates to the credit crunch and mortgage lending practices. Obtaining a mortgage seems to be becoming more difficult as the months go on.

The Scottish Government's programme to have 35,000 new homes a year by 2015 will be more difficult to achieve because of the situation with the housing market.

Several house building companies are laying off people or making them redundant. The numbers are not significant, but the situation will have a negative effect on the Scottish economy and, in the long term, affect training, skills and apprenticeships in the construction industry. In the past three or four years, we have had record numbers of apprenticeships in the construction industry. As a member of the Scottish Building Apprenticeship and Training Council, we are proud of that achievement. However, there will be a percentage reduction in the number of apprentices throughout Scotland in the biblical trades in the construction industry.

The figures that we use are based on house building representing about 15 to 20 per cent of the construction industry. We are considering the knock-on effect that the situation may have on the other 80 per cent of the construction sector, but that part of the sector seems buoyant, which we are happy about. Several major projects are in the pipeline that will, no doubt, come to fruition in the next couple of years.

The house building sector is concerned about confidence in the market and whether there will be an uplift in that confidence. It seems as though confidence will not change in the short term—there may be a longer programme for that. However, we have infrastructure projects such as the M74 extension, which is a major construction project for the civil sector of the industry; the rail link from Glasgow airport to Glasgow Central station; the Leith docks programme, which I imagine will be affected in the short term, but which has good possibilities in the long term; the Edinburgh tram project; and the coming Commonwealth games projects. There are positives for the industry, but house building seems to be on a downturn, which will have a negative effect on the construction industry overall.

Ron Smith: I preface my remarks by pointing out that they are conditioned by our close relationships with several building firms that advertise with us and use other services, and with building firms that are clients of solicitor estate agents that are member firms of the ESPC.

Across the board, house builders with which we deal are reducing staffing by means of redundancy, there is a slowdown in the number of new builds coming on to the market and there is evidence of building work that is under way being frozen or curtailed in one way or another. On top of that, we have experienced a cut in our advertising revenue as builders cut discretionary budgets; that suggests that money is tight for them.

We are also aware that prices for some new units are reducing in line with the more general market price reductions. That does not make cash flow any better for the builders. On top of that, many people among their target audience, particularly first-time buyers, have more difficulty or perceive that they have more difficulty getting a mortgage than has been the case in the past. We can add to that the fact that building companies are having to write down the value of their land banks.

Three things stem from the situation. First, there is a greater weakness in building companies' balance sheets in the short to medium term. Secondly, there is a truism that it is easy to shed capacity quickly but more difficult to build it up quickly. In that regard, my answer to the direct question is that although the Scottish Government has set a commendable target of 35,000 new houses a year, unless it moves quickly to turn that into building activity, firms may not be able to respond in the short term because of the cuts that they have had to make to survive.

Thirdly, whatever we may say about the situation and whatever effects it may have on individual firms, it will affect one key element of the house building industry—its attitude to risk. Any house builder will tell members that it is reassessing on a regular basis—if not daily—its attitude to the risk of certain projects and capacities, and its ability and wish to take on work. That will have an effect, because it will condition the way in which companies behave in the marketplace in future.

The points that I have made are based on our regular conversations with building firms that are our clients and firms that are clients of solicitors operating in east-central Scotland.

David Wright: We provide electrical services to a range of market sectors, from industrial to commercial and domestic. We serve a number of different industries, including offshore and medical, and sectors such as information technology, control systems and, of course, house building. House building is a small part—perhaps a very small part—of the total work that our members do. It certainly does not account for 15 to 20 per cent of our members' work.

There are four main indicators to which we can look as measures of economic activity. The first is turnover, on which our members' subscriptions are based. Turnover figures are calculated on an annual basis, so we will not see how they have been affected until next year or the year after that. We receive a lot of anecdotal evidence from branch meetings and casual contact with members. Many contractors are predisposed to highlight difficulties rather than to be happy with things that are going well, but at the moment there is more evidence of the latter. The feedback that we get from contractors is that economic conditions are good and plenty of work is available.

Our member companies employ many apprentices. Typically, they do not hire apprentices in the expectation of better times ahead but to do work that they have right now. This year is a record year since the introduction of modern apprenticeships—around 1,000 apprentices have entered training, up about 50 on last year. There is growth in the share of adult apprentices within that number. There is a good story on the apprenticeship front.

Recently we conducted a survey of members through our e-newsletter. We asked them what impact the credit crunch had had and offered them a graded scale of responses, ranging from "We have more work than we can handle" through to "We are very worried about the future". The survey produced interesting results. Only 9 per cent of the members who responded were in the most worried category. By contrast, 63 per cent said that they had more work than they could handle or that the credit crunch had had no noticeable effect. The story that we are getting at the moment is quite encouraging. That does not mean that we are not a little worried about what may lie ahead, but the current situation is good. If someone is a qualified electrician, they are almost certainly in employment, unless they choose not to be.

Mark Hordern: Our experience, like that of the ESPC, centres largely on our work with developers. We work with every major, and almost every minor, developer in our area. Our area of expertise is residential construction, rather than wider construction. The situation in residential construction is bad and getting quite rapidly worse. There have already been a substantial number of redundancies, many of them among direct sales staff or sales staff who would normally be on site. There have been widespread halts in construction, even in developments that we expected developers to build out and finish because they were part way through.

11:15

We have also seen redundancies, although they are less obvious and transparent to us, among construction staff. That is an inevitable consequence of developers not starting projects, stopping projects that have been started or slowing down projects, even if they intend to complete them. The credit crunch has had some fairly dramatic impacts on the residential house building industry in the west of Scotland. I expect that that applies in pretty much the rest of Scotland, too.

We, too, are seeing changes in developer behaviour; I am thinking of changes in advertising and marketing behaviour that appear to imply funding constraints. We speak to developers frequently—all the time really—and I am getting a real sense of urgency from everyone. People are asking what they are going to do. We are constantly getting calls from developers who ask whether there is a magic bullet that will help them to sell their properties and allow them to start building again and, if so, where it is.

The subsidiary question was: will we meet the 35,000 unit construction target? Given consumer demand in the current market, as measured by demand for and sales of new-build residential units, it seems very unlikely that we will meet the target. Bearing in mind that current properties are not being bought, builders will think it hugely high risk to build units in the hope that people will buy them.

A second subsidiary question was: what about the effect on the wider construction industry? I cannot speak for the industry, but many ancillary services are affected. For example, we are seeing quite substantial redundancies among surveyors. It will come as no surprise to the committee that there have also been substantial redundancies in estate agencies—indeed, we have seen office closures and there will almost certainly be more. There has also been a decline in business for companies such as removal companies.

The decline in demand for and construction of new build is having a direct effect on that market. However, the decline in the number of transactions across the market—for established properties or new build—is having a wider effect in employment terms on a range of companies; the problem affects more than just estate agents or developers.

David Melhuish: The commercial property industry has a close relationship with the house building industry. The eyes of our members are focused largely on trying to attract high-quality corporate occupiers to Scotland. A great part of the attraction has to be the availability of good, competitively priced accommodation that compares favourably with that which is found in other parts of the United Kingdom.

Of course, when we see a slowdown in the house building sector, it impacts on the confidence that the commercial sector and its investors have in taking forward developments and projects in Scotland. We are beginning to see evidence of that in our sector, although it is probably fair to say that people are taking a long-term perspective. The slowdown in the house building sector is definitely having a negative effect. Of course, the flip-side is that the undermining of confidence in commercial developers could lead to less demand in the house building sector over the long term. We need to continue to attract major corporations or occupiers to Scotland. In recent years, we have seen some noticeable successes in Glasgow and other areas.

On redundancies, our members tend to be different in their staffing make-up from house builders. They tend to have smaller numbers of direct staff and there have therefore been relatively few redundancies compared with what we have seen in house building. That said, there have been knock-on consequences for the professional services that are allied to the commercial property industry. The events of the past week in a considerable corporate presence such as Bank of Scotland are a major concern for us.

Michael Levack: I will not talk about the house building sector, which I know Allan Lundmark will cover. The general construction market appears to be holding up, so far. However, there is a strong caveat to that. The larger companies, in particular, are looking further ahead. At this time, they would normally be looking to what is on their order book for a year or 18 months' time, or perhaps even further ahead. The major projects are not coming through, and the delay with the Scottish Futures Trust is not assisting that.

In recent years, clients and consultants bemoaned the fact that contractors would not price their projects, and they struggled to get two prices; now, we find tender lists returning to six, seven or eight bidders. That is not a good place for the market to return to. Our members are saying that when they would previously have normally expected to be a close second, if not first, for a project that they were keen on, now they might come in third or fourth. There are worrying signs regarding a tightening up of tender prices.

I will put that in some perspective. The industry recently, even in the good years, has been making an operating profit of between 2 per cent and 3 per cent. Many household names—the major contractors—will have an aspirational figure of 3 per cent operating profit across all their businesses. That does not leave much room for error. Two things will be affected when we enter a tightening market—training and marketing. Those two tend to be squeezed in an overheads budget under such circumstances.

I turn now to training. Over recent years, we have constantly heard about skills shortages in the Scottish construction industry. Last year, the industry as a whole recruited just fewer than 5,000 apprentices in Scotland. We should bear in mind that they tend to be four-year apprentices, with structured on-the-job training and employment from day 1. In some respects—it might be more luck than judgment—if the industry had listened to the observers who intervened recently, we would already be paying off thousands of young people.

Over the past 10 years, the industry has modernised itself and has improved its public image—it is now a career of choice. Referring to the second part of Marilyn Livingstone's earlier question, we are concerned about capacity in the future. The position is now governed by the confidence and sentiment of the market. General construction companies are now looking over the fence at their colleagues in the house building sector. They are thinking, "My, that's spread quickly. It could be us next." Nobody can predict what the future holds, given the events of the past couple of weeks. As I say, it is now down to confidence and sentiment. Although there has not been a drastic downturn in the numbers for apprenticeship recruitment this year, I fear that unless something happens to stimulate the market—be it the Scottish Futures Trust, public sector-funded projects or work to retrofit existing stock in the drive towards low-carbon housing—the situation will be drastic next year.

I hope that our discussions will return to the question of what we can do now. There are wonderful opportunities here for a skilled labour force to divert its efforts into construction of social housing or retrofitting of housing and public and commercial buildings to meet the Scottish Government's aspirational targets.

The Convener: Last, but by no means least, we will hear from Allan Lundmark.

Allan Lundmark: Thank you for the invitation to join you for your deliberations this morning. Over the past five years, housing production in Scotland has hovered somewhere around 25,000 units a year. The Government's target of 35,000 units a year being built over eight years anticipated a 5 per cent year-on-year growth in production, in broad terms.

From the information that we have, we think that production in Scotland will drop to at least 15,000 units this year, and the emerging third-quarter data on starts and completions, which we are trying to refine, suggest that the figure could drop to 12,000—production could be halved. I will talk later about the implications for the target to build 35,000 houses a year.

At the end of June we knew that 15,000 jobs had been lost in the industry. That does not mean that 15,000 people became unemployed, but we suspect that a large proportion of those people are unemployed. Some people will find employment in other sectors and some will find employment furth of Scotland, because the house building industry is set up to be very lean and relies heavily on highly skilled professionals. Mark Hordern was right when he said that surveyors, planners, sales staff and site managers are losing their jobs. There is also a knock-on effect on the construction companies.

As of last week, we think that the figure for job losses has increased to 30,000. We are trying to refine our understanding of the figures, but information from our major companies suggests that 30,000 jobs might have been lost since the beginning of the year. That means that the infrastructure of the industry is under severe threat and we need to give careful consideration to the industry's ability to grow.

There is the potential for production to drop to a figure that is lower than the figure that we predict. We hope that that will not happen and we are monitoring the position carefully. If we are to bring production back to 25,000 units—let alone 35,000 units—we must focus quickly on three areas. First and most obvious is the lack of liquidity in the industry. There is a lack—or perceived lack—of liquidity in the mortgage market, particularly in relation to first-time buyers, who are locking up supply chains. There is also a lack of liquidity in development finance. Secondly, we need to think seriously about the opportunities that can be presented through direct investment in affordable housing stock by the Scottish Government and local authorities, to maintain production in the sector. Thirdly, we need to think carefully about the taxation regime under which the house building industry operates, and about the constraints that high taxation places on the industry, in the context of bringing land into the system and the cost of the units.

Ron Smith hinted at a fourth area, which is risk exposure. We must seriously consider how cost burdens on the industry can be reduced. The industry carries enormous cost burdens, given what it is expected to fund before it builds houses, generally through section 75 obligations, whereby developers must provide, for example, schools, roads, elaborate sustainable urban drainage systems, sports facilities and community facilities. Such burdens increase the risk to the industry, which must incur costs that cannot be contemplated. If such costs are triggered, the industry will react against the risks and projects will not be promoted.

In that respect, a myth has developed that whatever is asked for in section 75 contributions is somehow stripped out of the land price. That might be true to some extent, but the shortage of land in Scotland has meant that that is rarely the case. A lot of the demands are loaded onto the anticipated selling price of the house, which drives the industry towards higher value units and into a position in which it is exposing the risk.

Those are the four areas that need to be focused on if we are to see a return to normal production levels.

11:30

The Convener: A lot of useful and interesting points have been raised as we have heard from people around the table, but not every member of the panel has to respond to every question from now on.

Marilyn Livingstone: What I have heard today confirms what I have heard in the cross-party group on construction. I want to bring two issues to your attention. The first is that we are concerned about the level of apprenticeship training and the impact that that will have on a lot of the good work that has been done. What do you think the Government and the Scottish Parliament can do to ensure that we can keep up the level of apprenticeship training that we have achieved? It has been one of the great successes of the past few years.

I would like a little more information about the writing down of land value on the books of many developers. It seems that developers are, because of the lack of liquidity in the market, offloading land that they might have been keeping for future building. What impact will that have on all of us?

Michael Levack: It is important to focus on what can be done. Last year, the industry recruited 5,000 new apprentices across all the various trades. We hear about the demand for affordable housing, and that is certainly where some of our members are hardest hit. Many of our members in more rural areas are second or third-generation businesses that operate in the area in which their families have been born and brought up. They have switched their businesses towards house building and away from general contracting and have been employing local people. Unfortunately, those companies have been caught out and are making significant redundancies.

We must ensure that the skilled tradesmen who will be needed to teach new apprentices are not lost. I think guys in their 50s, who have been through one recession in their careers but have made good money in the past 10 years, might well consider just going out and buying a taxi, which would not be good for the industry.

In terms of keeping the apprentices employed, I think that social housing and the work that needs to be done in relation to the low-carbon building standards strategy offer us a golden opportunity. However, if the Scottish Government tomorrow were to change building standards on all new buildings so that they were more robust from a low carbon point of view, that would have little impact on what we are trying to achieve. We need to look at the retrofit market. I know that there are some challenges in that. However, I was on the working group that drew up the Sullivan report, and we were fortunate enough to be able to talk to people from Austria, Norway and Denmark, who told us that, in order for the retrofit market to be capitalised on, significant grant funding has to be available. I appreciate that public expenditure is tight, but I believe that if we put our minds to it we could divert those resources fairly quickly—I suggest that we start with old-age pensioners and those who are in fuel poverty.

Keeping capacity in the industry is a good aim, but there must be jobs if we are to do that. The great thing about construction apprenticeships is that the training is carried out on the job. People do not sit around getting bored in colleges; they learn from experienced tradesmen as they work.

Alan Watt: I certainly commend the recommendations that were made by Allan Lundmark and Michael Levack. Although they do not apply directly to our sector, they have a spin-off into it.

Other areas in the civil engineering sector could be addressed without the need for new public sector money, simply by bringing funds forward earlier. The first area is, as Michael Levack has pointed out, the Scottish Futures Trust. At the moment, a lot of the construction work for local authorities and the Government takes place through PFI or public-private partnerships. We are still awaiting detail on the trust and information on the roll-out of projects. Although there is a lot of work in progress, we need to know about that kind of follow-on work, so the sooner we have some test cases and projects are rolled out, the better. I do not want to enter into an argument about the politics of the Scottish Futures Trust; I simply point out that that model is one of the ways in which we are engaging with the system.

Secondly, as MSPs know, Scottish Water, which is a direct responsibility of the Scottish Parliament, has a four-year regulatory cycle. As we are entering the second half of year 2 of the cycle, we are getting to what is usually the peak delivery period; however, as we reach the end of the regulatory period, the level of construction and delivery will fall quickly. That will happen around the same time that other areas are going into a serious downturn. It is not beyond the capability of those who govern Scottish Water to bring forward some of the construction projects in its programme. After all, doing so will not require any new money, as the work draws on the funding that is allowable over the regulatory period. Such a move would affect not just civil engineering but many associated trades.

Finally, Transport Scotland has a known work bank of outstanding capital projects. The civil engineering sector neither has any complaints about, nor lacks confidence in, the programme's longevity but the projects are largely maintenance based, and maintenance tends to be the less-favoured son in this situation. Members know about the state of the fabric of our local trunk roads. Councils, I should add, are responsible for their own roads. I do not think that it would be impossible to bring forward the projects in the work bank to the travelling public's benefit. Many of them are certainly ready to go.

Going back to Scottish Water, I also believe that bringing forward some of this work might address Parliament's concerns about, for example, public health and leakages.

Harry Frew: With regard to figures for job losses at Homes for Scotland, someone asked about the impact of losing 15,000 jobs in the construction industry. As the trade unions have pointed out, employment in the house building industry is usually supplemented by what we call the bogus self-employed or those who are falsely classified as self-employed under the construction industry scheme. The 15,000 people who have reportedly lost their jobs will not go on to the unemployment register because, as far as the benefits system is concerned, they are self-employed. As a result, unemployment in the construction industry will not appear to rise.

I am certainly concerned to hear that 30,000 jobs have been lost. I have to say that I have not seen any evidence to back up such a figure. A number of companies in the industry have said that there have been lay-offs, but that seems to have happened to very few people who are employed by house construction companies.

When I hear some of the figures that have been mentioned, I wonder how badly some companies have done. Persimmon Homes, which has been building houses in Scotland for a number of years, stated that things were so bad that it had only made a profit of £100 million. Its profits dropped from £300 million to £100 million—I think £100 million profit is quite good, depending on how the markets pan out.

Things are not as bad as they might be. I have certainly not seen any evidence of job losses. With regard to training and apprenticeships, the construction industry in Scotland requires 87,000 people with construction skills each year until 2011, although a credit crunch effect on house building will impact on that. The figure of 30,000 job losses will have a major impact on future skills for our industries.

There will be a change in trend on the house building side—private house builders will need to move from that to building social housing in order to find a market in which they can actually build. The only difference will be that the profit margins will not be as high, because a local authority or a housing association will want the houses to be a lot cheaper than houses on the private market. That will have an effect on how well a company does in terms of profit, and it will increase the number of people in companies who are working within social housing.

We need to ask how we can increase social housing. If the programme requires 35,000 new houses each year until 2015, we need investment in social housing. If we get that investment, it can be spread out. Local authorities as well as the private sector can be given the opportunity to start building houses again.

That is a way in which we can move forward if we are to meet the targets that the Scottish Government has set. Shelter recently announced that we require 1.6 million houses in the UK. It is not that there is no demand out there: lots of people are looking for houses, but we need some investment to ensure that that demand is met.

David Melhuish: Public infrastructure is needed in order to keep jobs in the construction industry. Now is the time to invest in that. Not only will it keep skilled jobs within the industry, but it will give us a platform for when confidence returns to the markets and investors seek to get back into commercial and house building development, which needs infrastructure.

The question of how that will be paid for was asked. We know that public budgets are very tight, and there is a role for the Parliament in seeking to innovate and perhaps in considering measures such as tax increment financing, under which money can be borrowed against the prospect of future business rates revenues to invest in infrastructure today. Parliament could promote such ideas in Scotland.

I must add a brief note of caution on the points about retrofitting. It is very expensive and at the moment, when budgets are tight for landlords, investors and owners, incentives such as those Michael Levack referred to will be needed to make that effective. If we want to be effective in reducing carbon emissions, we need to consider how buildings are used. A building can be of the best quality, with the highest Building Research Establishment environmental assessment method—BREEAM—rating, but if everything is left switched on 24/7 it will not hit the ultimate objective.

Allan Lundmark: To return to Harry Frew's point, I did not say that 15,000 jobs had been lost in the construction industry, and the figure of 30,000 does not apply to that either. The housing development industry is quite separate from the housing construction industry that physically builds our houses. Michael Levack is better qualified than I am to talk about that.

11:45

The initial tranche of jobs that was lost was in the housing development industry—I indicated specifically that surveyors, planners, sales staff and site managers were affected. The figure of 15,000 does not include the knock-on effect on contractors—the industry uses subcontractors to build the units. The figure of 30,000 includes an element of that, but the bulk of it comprises the professionals who advise the industry.

Gavin Brown: Some interesting points have been made in the round-table discussion, but I would like to raise a couple of unrelated issues. I do not want to get into a political debate about the Scottish Futures Trust, but I would be grateful if you could tell us what construction inflation was a year ago—we have been told that it is 10 per cent today—and what it may be in a year's time. Is anyone willing to take a punt on that, so that we can see how important it is for us to move quickly in that area?

My second question relates specifically to house sales. We have heard that they are down quite dramatically. Anyone who drives around a neighbourhood will see far more "For sale" signs than they would have seen two years ago. We get figures for house sales periodically—usually quarterly—but it would be useful if you could provide us with absolutely up-to-date figures. The Edinburgh Solicitors Property Centre and the Glasgow Solicitors Property Centre should be able to give us a good steer on that.

Can David Melhuish explain further the issue of tax increment financing and how it might operate? That is an interesting idea that is worth listening to.

The Convener: It would be helpful to the committee if someone could explain the underlying causes of the current level of construction inflation. Witnesses may send further information to the committee after the event, if they do not have the details to hand. Who would like to have a stab at the question?

Michael Levack: I am happy to do so. In recent years I have referred many people to a report on construction demand and capacity that was commissioned by the Office of Government Commerce. The study, which covered the period 2005 to 2015, was undertaken by Deloitte and published in June 2006. When the report was published, the biggest concern was a skills shortage, but it identifies construction inflation as the biggest challenge.

There are different models and measures of construction inflation—material costs, labour costs, tender price and outturn—but it certainly runs above normal inflation. The latest figures are pushing 6 per cent, but we must be careful, because there can be regional variations. We cannot shelter from the issue because, despite the downturn in the global economy, we operate in a global market for commodities—steel, glass, cement and so on. We know the rate at which China, India and the rest of Asia are building and cannot hide from that. Construction inflation will be a major issue.

It is linked to the issue of retrofitting and all public sector projects. The Government's infrastructure programme states that certain projects must be completed. Bringing forward projects—if we can find the money somewhere to do so—will be slightly cheaper than delaying them, because we cannot stop construction inflation. We need to bring forward some projects to keep capacity. If capacity is reduced, in a couple of years, when the economy returns to some form of normality, construction inflation will be rife.

Roderick Pettigrew: Last year material prices—especially copper, steel and fuel prices—fluctuated widely. That is causing significant inflation. I agree with Michael Levack that inflation is probably much higher than 6 per cent—in some areas, it is probably in the region of 10 per cent.

It is interesting to see that some of the surveys over the past six months or so are linking the difficulties of the credit crunch and price inflation, which is to a degree causing the lack of confidence that comes from the fact that, with construction becoming more expensive, those who wish to develop are becoming less and less sure about being able to afford to pay for the construction cost.

It is difficult to forecast what the material prices are likely to do over the next 12 months or so. As Michael Levack indicated, the question involves issues of supply and demand in the global economy, particularly in India and China.

The Convener: Would David Melhuish like to answer the question about tax increment financing?

David Melhuish: Yes. I am happy to send the committee a further paper that will go into the concepts in greater depth but, briefly, the idea is that an authority would look to borrow so that, through the planning system, it can offer incentives for development, infrastructure and other requirements of economic growth. That borrowing would be based on the additional business rates that could be achieved in the future through attracting economic growth in the areas that the TIF is aimed at. That is the idea, in a nutshell.

The Convener: I think that the committee would be grateful for any further information you could give us.

David Whitton: Gavin Brown asked Mr Smith and Mr Hordern for some up-to-date numbers. I was going to ask about that as well because I saw an alarming figure of a 60 per cent drop in sales in Edinburgh.

Ron Smith: I can confirm that the figure is close to that.

David Whitton: Feel free to do so.

Ron Smith: Let me just sprinkle some figures around.

In May this year, the volume of sales, year on year, in greater Edinburgh, if I can call it that, went down 41 per cent. That trend is accelerating: in August, the rate of decline in sales, year on year, was around 60 per cent in greater Edinburgh. Because of that falling sales number and the fact that it is now taking, on average, about 100 days to sell a property, rather than the 60 days that it used to take, we are sitting with a stock of around 6,500 properties for sale, which is 60 per cent higher than we would normally expect at this time of year.

There are some interesting underlying statistics that are more alarming if you are selling a house at the moment. Only 30 per cent of properties that are being sold at a fixed price—you will see from our advertisements that fixed prices are more and more common—are achieving that fixed price. That is down from 65 per cent a year ago. In August, we recorded—for the first time—a 6.6 per cent drop in year-on-year property prices in the city of Edinburgh, and our tentative figure for September shows a fall of around 8 per cent.

It is clear that a major house price correction is under way in the marketplace. That affects everyone whose income is based on a percentage of sale prices, such as the solicitor estate agents who are among my members, and people in the building industry who are trying to shift units in the city.

I should add an important, if confusing, factor to the mix. Research that we have done indicates that first-time buyers are key to the housing market in Scotland because, on average, a first-time buyer entering the marketplace will generate around four or five housing transactions—that is a tentative figure and work is being done to refine it. As you can imagine, the ESPC concentrates heavily on giving first-time buyers advice to allow them to enter the market.

We have regular sessions and open evenings in our George Street and Dunfermline showrooms and other places to attract first-time buyers and give them advice on issues such as mortgages. In the past three months, we have been staggered by the number of first-time buyers who are sitting on a deposit and waiting to enter the housing market, but who are not doing so for what can only be described as negative sentiment reasons. They feel that if they enter the market tomorrow, the property that they buy will be worth less the following month, so they wonder why they should bother. We can argue about the pros and cons and the reality of that, given that we are a lot of people growing in number living on a small island but, nonetheless, that keeps first-time buyers out of the marketplace, although they are poised and ready to enter. It is my dream that they all take the plunge and enter, but I am not sure how we can push them over the edge. I hope that that is helpful.

Mark Hordern: Our figures are broadly similar, but I will add a couple of points to Ron Smith's analysis. One is about how quickly the situation has occurred. In April this year, we estimated that the number of sales in the west of Scotland was down by about 15 per cent. That would have been perfectly manageable—last year, the number of transactions was down by about 16 per cent, according to Registers of Scotland. A 15 per cent drop would have been an issue, but not a huge one, and not a crash. However, we now estimate that, for the most recent month, the number of transactions is down by about 53 per cent compared with the same month last year. That is not quite as bad as in Edinburgh, but it is close and it follows the trend.

It is not as obvious to us that prices are tracking downwards. Our next set of data comes out in the first week of October. We provide our raw data and an analysis of our data by the University of Glasgow directly to the Scottish Government. The data should be available to everybody, so we do not try to protect them. At least in our market, there is a stand-off. Many people would like to move and sell their homes and many people would like to buy a house, but the buyers are conscious that the market is weak and that prices might fall in the next year or so. They say to sellers, "If you want me to buy your home, you've got to discount your price at least by the possible loss that we might experience next year," because otherwise they will have a 10 per cent loss on the asset that they have just paid for. On the other hand, sellers are saying, "No, I want the best price that I can get for my house—the market price." They knew that it was worth, let us say, £200,000 in November last autumn, and that is what they want for it now.

The key issue is that sellers do not have a profound economic incentive to achieve a sale. From time to time, I bump into and speak to some of our competitor estate agents in Glasgow. One of the better-known names told me recently that he had absolutely no committed sellers. He meant that there are lots of sellers out there and if they get a decent offer for their house they will say yes, but if they do not get that offer they are happy to sit on their hands and say, "Right guys, I don't have to move." They have not moved jobs or been made redundant and they can still make the mortgage payments because interest rates are not enormous, so they decide to sit on their hands and wait for a good offer. That could change dramatically if the economic situation worsened. If unemployment rose substantially or if interest rates rose, the market might change dramatically for the worse.

I take Ron Smith's point about first-time buyers. I am sure that there are first-time buyers out there who have deposits, but we come across large numbers of first-time buyers who say that they have only a 5 or 10 per cent deposit and that the best mortgage deals are at 85 or 75 per cent loan to value. They do not have a deposit of that size so, in effect, they cannot enter the market because if they enter the market looking for a loan of 90 per cent of the value of the property, they have to pay a punishing interest rate. The credit crunch is having an effect on first-time buyers' ability to get into the market, and although I acknowledge that plenty of first-time buyers are happy to buy a house, they want to ensure that they get a really good deal.

Michael Levack: When the committee sent its invitation to the meeting, it mentioned that we would be considering ways in which to improve conditions in the future. I cannot miss the opportunity to underline the importance of public sector expenditure to the construction market. We are always being told that the public sector accounts for at least 40 per cent of expenditure and I do not disagree with that figure.

It was interesting to listen to what the bankers on the previous panel said. The question that remains unanswered is: in these turbulent times for the banking sector, will people want to participate in the Scottish Futures Trust, which is a new model? On behalf of the industry, I urge politicians of all political persuasions to work together to ensure that we unblock public sector expenditure. Projects must come to the market. The bid time for projects tends to be 12 or 18 months, so it is a long time before activity can start on a site. I cannot overemphasise the importance of the situation. We are desperate for the work to start coming through.

12:00

Allan Lundmark: I reinforce that point. Key to keeping production capacity in the house building industry, which Marilyn Livingstone asked about, is increasing investment by Government and local authorities in affordable housing. The country funds about 6,000 units per year. If a way could be found to use Government and local authority investment to double that figure we would keep production capacity in the industry and we would buy time until normal liquidity returns to the industry. That is key to what happens in future.

Lewis Macdonald: I was interested in what Michael Levack said—he made a similar point earlier, and I want to understand the situation better. Rod Pettigrew said that public sector projects are still keeping large parts of the industry busy, as a result of orders that were placed under the previous system of public sector financing. Have we reached the hiatus between the previous and new systems, or will we do so imminently? Will there be a 12 to 18-month hiatus, and can anything be done to shorten it? In other words, when will the PPP/PFI projects be finished and how long will the gap be before new projects come on stream?

Michael Levack: We have reached that point. The problem is that because procurement times and costs for projects are horrendous, teams that built up skills and expertise on the PPP/PFI models that were used during the past 10 years are being disbanded or put to work elsewhere in the UK or Europe. We are already losing those skills.

I attended a meeting of the Finance Committee about two weeks ago, on the day before the announcement on the establishment of SFT and Sir Angus Grossart's appointment as SFT's chair. I was horrified at the lack of detail in the discussion with witnesses who had been giving advice to the Scottish Government and participating in the financial markets. At no point did anyone talk about job losses and the severe impact that there will be on Scottish society and our economy if we do not get projects moving. I urge all political parties to work together to move something through the work flow. We must reach a situation in which jobs are being procured.

Roderick Pettigrew: There is a black hole for me, in that I cannot know what will happen after 12 months. Michael Levack's members get the jobs and subcontract them to my members. Although my members are fairly busy, if work does not continue to come through after 12 months I expect that we will face a black hole and there will be a significant downturn across the rest of the Scottish construction sector, particularly on the engineering side. Work needs to come on stream now.

Dave Thompson: During the discussion with the previous panel, I think that Eric Leenders, of the British Bankers Association, said that first-time buyers are biding their time. Ron Smith said that people think that they will not be able to get a mortgage. However, could the financial providers be biding their time, too? It appears to me that if they are looking for deposits of 15 per cent rather than 5 or 10 per cent, as Mark Hordern said, they are no longer willing to take risks, so why should first-time buyers be expected to take risks? How can we address that problem? What can be done about it? Should the Treasury and the Bank of England do something to try to close the gap? High deposits are being looked for because developers are scared, and first-time buyers are saying that the market will drop and that that is evidenced by the fact that huge deposits are being sought. Such deposits protect the developers if prices drop because the house can be sold, the developer can get their 85 per cent and the first-time buyer will lose their 15 per cent deposit.

Ron Smith: There are a couple of things that relate primarily to the cost of money which are beyond the wit of the Treasury and the Government to do anything about. First, money at the London interbank offered rate and other borrowing rates is far more expensive, so it costs banks more to get that money to lend out.

The second thing—which is, of course, partly a consequence of my first point—is that banks are revising their risk profiles. Banks make business decisions in all their financial transactions that are based on an element of risk. It is interesting that somebody was quoted last week as saying that to some extent the reason why things got out of hand was that nobody in the system said no; everybody said yes. People were willing to borrow large sums predicated on the growth in the value of their property; independent financial advisers looked for commissions, so they worked with clients to get the best deals possible for them; and banks were anxious to lend because there were steady returns on appreciating assets. However, all of that has now blown away, and we are looking at a different paradigm. All the money in the world from the Treasury or the Government will not sort the problem. When the money markets recover, there must be greater liquidity and greater flexibility in deals, and steady house values and prices over the longer term. Those are not things that any of us can fix.

Dave Thompson: So is it your view—or any other panel member's view—that the quicker the market reaches the bottom, the better? Is there a way in which you would encourage that?

Ron Smith: I would slightly rephrase what you have said. The quicker the market stabilises, the better, because it is highly volatile at the moment. I cannot comment on whether it will reach the bottom, whatever that might be. People are looking for a sense of stability and understanding in a highly volatile market.

The trouble is that a house is essentially a long-term buy, but people take a short-term view because the market is based on sentiment to some extent. People think, "My God, if I buy a flat today and it is worth 10 per cent less in a year, the world will end." Mark Hordern spoke about that. You might expect me to say that that is not necessarily the case, because a person must live somewhere, and if they are going to live for a long time, prices will eventually recover. It is a matter of getting that message across.

Edinburgh Solicitors Property Centre and Glasgow Solicitors Property Centre have no axe to grind; we try to give the best information, not hyped information. We are saying that opportunities now exist, as the price correction that is taking place will aid people who wish to move upmarket, but people who want stability in their transactions ought to sell before they move on. That first stage is becoming difficult because first-time buyers are sitting and wondering what to do. All that we can do is provide honest information and hope that people will react to it; if they do not, it is difficult to see how we can get a way through the problem in the short term.

Dave Thompson: Allan Lundmark mentioned that many developers and builders have been driven towards higher-value units—I think that that is how he put it. Is there enough supply at the lower end for first-time buyers?

Ron Smith: Yes; indeed, there is oversupply at the lower end. More than half the properties that we sell in Edinburgh are flats. My building industry colleagues may correct me on that, but certainly, flats account for a larger percentage of the new units that are coming on to the market in Edinburgh and the surrounding area than one might expect. Edinburgh and its surrounding area are short of good-value family homes with three or four bedrooms, a bit of land for the dog and somewhere to park the car. When such houses come on to the market, they probably sell better than flats.

Dave Thompson: I am not sure whether that is the case in the rest of the country—it is a pity that we do not have someone from the Highlands to comment on the situation there, which might well be different.

Ron Smith: I agree.

Christopher Harvie: I am sorry that I had to dash out—I had to take a phone call from Germany.

One thing that strikes me about the nature of property in Britain is that, from the point of view of carbon consumption, even the new build is, by and large, rather poor by European standards. It is with some difficulty that we obtain a C grade on the European scale. Could the building industry, with backing from the Government, put forward a retrofit project, whereby ways could be examined of mass producing units such as extremely effective windows that would fit into the frames of traditional astragalled classical houses in Edinburgh, thus getting round the planning problems and preventing such buildings' enormous wastage of heat? Provided that it involved a degree of mass production, such a project could take up building capacity and add to the attractiveness of housing by lowering maintenance costs.

Ron Smith: There may be a number of stages to that and, on a technical level, other witnesses are better able to answer the question than I am. Once the Scottish Government introduces home reports on 1 December, an issue that will come to the fore in the marketing mix will be a property's energy efficiency certificate. Depending on how consumers react—which I cannot predict—energy efficiency might become a greater factor for consideration when house purchase decisions are made. As the Government aggregates evidence from the reports that come in, it might well gain an understanding of how to invest most effectively in the retrofitting of properties to improve the overall carbon footprint of houses that are sold in this country.

Michael Levack: I mentioned that in the preparation of the Sullivan report, we were fortunate to have input from the head of Austria's building standards agency. The gentleman in question sticks in my mind. He made the point—eloquently and in highly technical English—that, as David Melhuish mentioned, there is a hierarchy of issues that we should tackle. That needs to be borne in mind. He kept stressing that in the Austrian retrofit market, significant Government grants are available to encourage people. That applies to all buildings, not just to housing.

We have numerous old buildings. We cannot change the past other than through retrofitting, which would require significant public funding. Given the present circumstances, who will volunteer to replace all their windows? No one will, because they will see that their property is falling in value. Who has the spare cash to do such work? That is leaving aside the logistics of interfering with the use of the building, whether it is a home or an office. Such a programme would require significant Government funding. Both the UK and Scottish Governments have set targets without considering the financial, logistical and capacity implications for the industry. I keep saying to people that we have no problem with improving the performance of our buildings—after all, retrofitting will give people in the industry work for the next few generations—but it will cost a lot of money.

Rob Gibson: After a period of 18 years, we are once again at the bust point in the trade cycle and you are asking us to reflate the house building market—we have discussed measures such as land price discounting. What advice do you suggest that the Scottish Parliament could give to the Westminster Government about how to stabilise and smooth the process so that we do not have peaks and troughs every 18 years?

Mark Hordern: Supply is a key issue. For some time, the Scottish Government has sensibly said that we need to increase the number of new houses that are constructed from 25,000 a year to 35,000 a year. An excess of demand relative to supply was a key factor in the driving up of house prices over the past few years. That would have been avoided if more homes that people wanted to buy had come on to the market. I echo Ron Smith's point that demand for affordable family homes that have three or four bedrooms and somewhere to park the car is still quite strong. If we had had a better supply of housing where people want to live, and in the style in which they want to live, that would have helped to mute the market.

12:15

However, we should recognise that—as far as I can make out, and I am not an economist—the whole world has been through massive asset price inflation in the past 10 years. Everybody saw inflation falling because places such as China reduced the cost of goods and at the same time made huge profits that they wanted to invest in the developed world. A huge amount of money was lying around. Interest rates could afford to be very low because inflation was low. As a consequence, borrowing was easier. In 2003, we did a quick calculation that showed that people could borrow a mortgage double the size of the one that they had in 1999 and still have lower monthly payments.

Over the past eight or nine years, a huge boom occurred, but it was driven partly by fundamental underlying factors that affected asset prices around the world; it was not just our own foolishness. For many people, borrowing money cheaply to buy assets whose value was rising was rational. Of course, houses were not the only assets whose value rose—so did the value of art, wine, racehorses and all sorts of other things.

Rob Gibson: I have been told that plenty of land is available for supply, but that its cost is an underlying measure that contributes to reaching the point at which a crash occurs.

Allan Lundmark: I invite members to think about three land-supply issues that we are thinking about and working on. First, there is a chronic undersupply of land. The issue is the quality of the land that is driven through our development plan system. We work on just about every development plan in mainland Scotland and we do housing land audits annually with planning authorities. Up to one third of the land supply that is driven into development plans is incapable of being developed, because the constraints cannot be removed. That puts enormous pressure on the balance of the land supply and drives up land values. I suspect that, 20 or 25 years ago, land accounted for about 10 per cent of a house's expected selling price, whereas it is more than 30 per cent of the price—and rising—now. That is because of the land shortage, yet the one thing that Scotland does not have is a shortage of land; we have a shortage of land that the planning system is prepared to promote. Often, the system promotes land that is difficult to develop.

The second issue is the burdens that are placed on developers. They are increasingly expected to fund the infrastructure that is necessary to support projects. We must seriously consider the state's expectation that private house builders will fund no longer just the physical infrastructure to support development, but community infrastructure such as schools and sports centres.

The third issue to examine is the inefficiency of our planning system. It is extremely cumbersome, expensive, bureaucratic and time consuming. If I promoted a housing development now on land that has been driven into a development plan, it would probably take me more than two years to obtain a planning consent, which would have conditions that created enormous burdens. We need to return to a planning system that assists house builders to drive out consents and deliver houses. As one of my members—a managing director—said eloquently, "Going forward, the planning gain is likely to be the houses and the jobs." Unless we focus on the burdens that are placed on the development industry, developers will find it increasingly difficult to bring units to the market at prices that people can afford.

Marilyn Livingstone: I understand what Rob Gibson was saying about influencing the UK Government, but most of what we are hearing today concerns what the Scottish Parliament can do, not what the UK Government can do. That is what we should focus on. This is not a political debate; it is a debate about how we can help the construction industry.

I have chaired the cross-party group in the Scottish Parliament on construction for a number of years and the issues that are coming up today are those that have come up year on year. The main issues are work flow and work supply to the housing sector and to the construction industry more generally. This committee has to take on board the points that have been raised. However we do it, we have to ensure the work flow. If we do not, we will lose big chunks of land that are being sold on or which are not being built on because of the risk, and we will lose our skilled work force. Everything hinges on land supply.

The committee has discussed planning at various times. They might not arise so much now, but issues have arisen to do with the public sector and the recruitment of skilled planners. We are hearing today from the industry that a continuous supply of work is needed. That is the message that we should take back to the Government.

Harry Frew: I understand what Allan Lundmark means when he says that the industry is affected by various factors, but I have never seen the house builder take on the responsibility or the burden. The burden is usually put on to the person who buys the house, the price of which rises accordingly. For a while, we have seen inflated house prices because of certain restrictions. However, the burden is left for the house buyer.

We should take account of what Professor Prem Sikka said about sorting out the finance side. I hope that the committee could take those points back to the UK Government. We need proper controls on lending and we need affordable housing and realistic house prices. The housing revenue accounts of local authorities could be used for the building of social housing. At the moment, that is not happening. The knock-on effects on skills requirements will have to be seriously considered. The Government has made some changes to stamp duty, and we hear about other ideas to do with equity loans and so on, but that does not seem to be having a major impact on house building. Perhaps something more radical is required from the Government.

Michael Levack: One thing that we would urge the UK Government to consider is a cut in VAT for repair, maintenance and improvement work. Such a cut would bring many benefits. We keep hearing about rising energy prices, and such a cut would allow people to tackle energy efficiency in their homes. That would reduce carbon output and it would stimulate work for the industry. Such a measure was put in place in the Isle of Man a few years ago and I would be happy to provide the committee with some background information on that.

The Convener: That would be helpful, thank you.

I thank all the panellists for coming along today and giving up so much of their time. The discussion has been extremely useful and has brought up many points for the committee to reflect on before determining how to move forward.

12:23

Meeting suspended.

12:26

On resuming—

The Convener: The two round-table discussions were valuable and gave us a great deal of information. I am reluctant to suggest immediately what we should do next. Members may want time to reflect on the evidence that they have heard and come back with ideas about how to progress matters. There is a strong case for the committee doing further work on the impacts on the Scottish economy of the HBOS-Lloyds TSB merger and I suggest that we produce a paper for a future meeting on options for doing that. If members have ideas about how we should proceed on the wider issues or on the construction industry, please feed them in to the clerks. That will help us discuss at the next meeting what to take forward.

Clearly, some of what we have heard has implications for our consideration of the budget, which will be addressed in a later agenda item. There was a great deal of information in the round-table discussions, and I would hate to rush towards conclusions without having had time to reflect on what was discussed. We will perhaps deal with the issue at our next meeting. I thank everyone for their contributions to the discussions, which were very useful.

Energy Inquiry

12:27

The Convener: The paper that the clerks are circulating suggests a two-phase approach to the energy inquiry. The first, fact-finding phase would end at the Christmas recess. After Christmas, we would have more formal evidence-taking sessions.

I invite members' comments and suggestions, particularly on the proposals for visits. To get as much as we can out of the visits, we could split into two groups and cover different visits, rather than have the whole committee going on each visit. However, if we agree to that, I would not have, say, members who are against nuclear power not going to nuclear power stations, or those who are against renewables not going to renewables projects. The committee would be split into groups in a way that would ensure that we could all have our eyes opened to different points of view.

Lewis Macdonald: The paper outlines a good and useful range of visits. We should endeavour to take up all the offered visits, which should involve some or all of us, as the convener said. Christopher Harvie and I recently made trips to offshore oil facilities, so I would be happy to see other facilities with which I am less familiar.

The Convener: Given that I have no head for heights, I might try to avoid anything that involves going up high, although I am afraid that that might be unavoidable.

Christopher Harvie: It would be worth while when visiting Dounreay—if we can go there—to consider examining the decommissioning of nuclear power stations as a possible source of income. We have enormous expertise in that area and, whether we are in favour of or against nuclear power, we can make something of that.

The Convener: That is an interesting point.

Rob Gibson: If a group visits the European Marine Energy Centre, I suggest that it should also visit the Dounreay facility in Caithness. The locations are merely a short ferry journey on the Atlantic apart. It would be useful to visit both locations because of the current effort in Dounreay to redirect skills into the renewables functions in the Pentland Firth.

The Convener: We will certainly try to ensure that we link visits geographically so that we do not end up going all over the country on different days. Rob Gibson's suggestion is sensible.

12:30

Lewis Macdonald: I have recently been offshore to look at what is going on in the oil industry. It might be helpful for the committee to hold one of the three proposed round-table evidence sessions in Aberdeen, where there would be an opportunity to hear from oil and gas interests and from some marine renewables interests, both local ones and those from further north, which tend to use Aberdeen as a base.

The Convener: That is an interesting suggestion and we will certainly investigate that option for one of the formal evidence sessions after Christmas. We have to bid for such visits.

Dave Thompson: I suggest that you consider inviting the North Scotland Industries Group to attend one of the round-table discussions, perhaps the imperatives one.

The Convener: If you give the clerks more details about that suggestion, I am sure that it can also be considered.

We must consider whether we should undertake any fact-finding visits outwith Scotland; some suggestions are made on page 5 of the report. There would be some value in our looking at what happens in other countries, particularly Scandinavian countries and Germany, where there are parallels to our climate and other similarities. The report also suggests that we may want to go to Brussels to investigate the European energy situation. Are members content that we consider those options? We could split the committee. We would not all go to both Germany and Scandinavia but the whole committee would probably visit Brussels, if that is appropriate.

Members *indicated agreement*.

Rob Gibson: That is appropriate, because the energy decisions that are now being made in Brussels tie in with our inquiry. It is the best possible timing to pick up on the decisions that Europe is making and to think about what Scotland could do to take a lead.

Christopher Harvie: Domestic energy saving in households would be one issue to examine in Germany, as household use accounts for almost 50 per cent of our total energy consumption. It would be worth seeing the passive house in Germany and the industrialised building places that build them.

The Convener: The clerks will be happy to take on board specific suggestions from members when they develop the programmes—once we have got approval to undertake the visits.

Lewis Macdonald: In Scandinavia, in addition to the energy efficiency side, there are interesting developments in energy generation. It would be interesting to examine new-generation nuclear and, if we are in the right part of Scandinavia, offshore carbon reinjection, which is part of the carbon capture and storage option at the Sleipner field in Norway. Those are useful suggestions and we could use them to cast the net more broadly.

There is one apparent omission in the suggestions for the imperatives round-table. Scottish and Southern Energy and Scottish Power are included. Given that British Energy is the third largest energy producer in Scotland and that it changed hands this morning, we might want to hear what its plans are for employment and investment in Scotland.

Rob Gibson: Did EDF take it over?

Lewis Macdonald: Yes.

Rob Gibson: Why do we not go to France to see the bosses?

Dave Thompson: If we are going to Scandinavia, it would be useful to investigate how Norway husbands its oil resources and has used them to reinvest in renewables technologies, for instance. Stephen Boyd made the valid point that in Scotland a tiny proportion of the funding of Pelamis and all these other things that have now gone abroad—Wavegen in Inverness and so on—came from commercial operations. I would be interested to see how the financial model works in Norway and whether the state sector, from its oil funds, funds the development of renewables and so on.

The Convener: We will take all those suggestions on board. There are also other options. It might not be possible to visit everything that we want to visit, particularly in Scandinavia, but if we want to get factual information and discuss how things are funded there may be an opportunity to take video evidence. We must ensure that we get the most out of the funding that we may or may not get from the Conveners Group and the Scottish Parliamentary Corporate Body.

Are members content with the proposals?

Members *indicated agreement*.

The Convener: That concludes the public part of the meeting. I thank the members of the public who attended the meeting and hope that they found it interesting.

12:34

Meeting continued in private until 12:47.

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