ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 8 October 2008

Session 3

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ECONOMY, ENERGY AND TOURISM COMMITTEE
19th Meeting 2008, Session 3

CONVENER

*Iain Smith (North East Fife) (LD)

DEPUTY CONVENER

*Rob Gibson (Highlands and Islands) (SNP)

COMMITTEE MEMBERS

*Ms Wendy Alexander (Paisley North) (Lab)
*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)

COMMITTEE SUBSTITUTES

Nigel Don (North East Scotland) (SNP)
Alex Johnstone (North East Scotland) (Con)
Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD)
*David Whitton (Strathkelvin and Bearsden) (Lab)

*attended

THE FOLLOWING GAVE EVIDENCE:

Jo Armstrong (Armstrong and Armstrong Ltd)
Kenneth Low (University of Strathclyde)
John McLaren (Centre for Public Policy for Regions)
Ben Thomson (Reform Scotland)

CLERK TO THE COMMITTEE

Stephen Imrie

SENIOR ASSISTANT CLERK

Katy Orr

ASSISTANT CLERK

Gail Grant

LOCATION

Committee Room 4

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 8 October 2008

[THE CONVENER *opened the meeting at 09:30*]

Interests

The Convener (Iain Smith): I welcome colleagues to the 19th meeting of the Economy, Energy and Tourism Committee in 2008. We are certainly meeting in interesting times and will keep abreast of events in London today. There are big concerns about the future of two of Scotland's major banks—HBOS and the Royal Bank of Scotland—which will, no doubt, feature in this morning's business.

The first item of business is to welcome Wendy Alexander to the committee and ask her whether she has any relevant interest to declare.

Ms Wendy Alexander (Paisley North) (Lab): Thank you, convener. I am delighted to join the committee. My relevant interest is that I am a visiting professor in the business school at the University of Strathclyde.

The Convener: Thank you for that, Wendy.

I was going to thank David Whitton for his contribution to the committee's work, but I will not bother doing that at the moment because he is here as a substitute for Marilyn Livingstone, who has some travel difficulties this morning—as do many people throughout Scotland, inevitably—and may join us later if she manages to get in from Fife. At that point, I will thank David for his contribution to the committee in his time as a member of it.

David Whitton (Strathkelvin and Bearsden) (Lab): Thank you very much.

Budget Process 2009-10

09:31

The Convener: Item 2 is the start of our formal scrutiny as part of the budget process for 2009-10. The committee agreed that its overall approach to scrutiny of the Scottish Government's budget would be to consider the budget's impact on the economy and whether there was any scope for the Government to make any changes to it that would help to address some of the economic issues.

I am pleased to welcome this morning a panel of some of Scotland's leading economists, economic forecasters and commentators. We will ask them to comment on the state of the economy and what they think that the Scottish Government should do, in the budget and more generally, to address some of the issues that the Scottish economy faces. I welcome Ben Thomson, John McLaren, Kenneth Low and Jo Armstrong. I ask them to introduce themselves and make a few brief comments before I open the discussion up to questions.

Jo Armstrong (Armstrong and Armstrong Ltd): Good morning and thank you for inviting me along. I run my own company, Armstrong and Armstrong Ltd. I comment on and research different aspects of the Scottish economy for a variety of clients—the Centre for Public Policy for Regions, the Scottish Council Foundation, the David Hume Institute—and advise large and small businesses on a variety of financial matters. Prior to undertaking that sort of work, I worked for 10 years in the Royal Bank of Scotland's economics department and its structured finance division, so I feel as if I have a foot in two camps at the moment.

The Convener: Do you wish to make any brief opening remarks on what is happening?

Jo Armstrong: It is a bit difficult to keep one's mind on the facts and talk about what we might do in next year's budget when what is going on is unprecedented. To have seen the Royal Bank's share price plummet almost 50 per cent within two days is quite disheartening for most of us who worked in that organisation. It is large, is profitable and will survive to some extent and in some form. However, we must keep it in mind that what is happening concerns not only the RBS and HBOS; it has repercussions around the world and, more important, throughout Scotland's corporate sector. Whatever we discuss this morning must be placed in that context.

Kenneth Low (University of Strathclyde): I am a research fellow at the Fraser of Allander institute at the University of Strathclyde. I provide economic commentary on the Scottish, United

Kingdom and world economy. I am also responsible for producing the institute’s forecasts, which I do in conjunction with Professor Brian Ashcroft. I do some teaching and have been at the institute for about 14 years.

I agree with Jo Armstrong that we are in very difficult, unprecedented times. Much of the recent attention has been focused on the credit crunch, so we need to bear that in mind.

John McLaren (Centre for Public Policy for Regions): I work for the Centre for Public Policy for Regions, which is shared between Glasgow University and Strathclyde University. The centre comments on the Scottish economy and economic aspects of Scottish government. Before I joined the centre, I was a special adviser on finance and the economy to the Government under Henry McLeish and Donald Dewar. Before that, I was a civil service economist in the Scottish Office and the Treasury.

I agree with what previous witnesses have said. In today’s discussion, we should remember that we do not know where we are going and are not sure how long the downturn will be. We will look at the budget for next year and possibly the year after that, but we must bear it in mind that we could have problems for two, five or 10 years.

There is such an international dimension to what is happening that what can be done in Scotland and via the budget is limited. However, this is a good time to rethink the long-term future—how we will come out of this recession or depression and what we want the housing market, energy and so on to look like in the long run.

Ben Thomson (Reform Scotland): I am the chairman of Reform Scotland, an independent think-tank that was newly formed in March to look at the Scottish economy and public sector. I am also chairman of Noble group, an investment bank based in Edinburgh, with offices in London and India, which I ran for 10 years as chief executive. I have been an investment banker for 25 years. I am on a number of other boards, including several investment trust boards, and am chairman of a small publishing company.

I agree with the other panellists about what is happening. It is difficult to look too far into the future on specifics when we face such a large problem currently. I endorse a lot of what has been said. There is a great deal of fear and confusion, both on an individual level and on a small company level. People are really worried about their deposits and pensions. On a corporate level, they are worried about access to loans. Although a number of the issues will have to be sorted out at UK and world level, politicians really need to show leadership and to give the motivation that is needed to help people at this difficult time. It is as much about what you say as it is about what you do.

The Convener: I invite members to put questions to the witnesses.

Gavin Brown (Lothians) (Con): Things have moved on enormously in the space of a few days, but the economic situation is almost unrecognisable from that which prevailed when the draft budget was published three weeks ago. No doubt there is more to come in the coming weeks and months; John McLaren suggested that there is the potential for problems to last much longer than that.

I accept that there is limited scope for things to be done at a Scotland level, but I am interested to know what our witnesses think could be done. Are there any high-level steps that could be taken reasonably swiftly in the budget for next year or the year after that on which we should focus now? Should we focus on education or on the overall tax burden? What actions could we take in Scotland to improve the situation here?

Ben Thomson: It would be helpful to have a more output-based document next time around. A lot of what the Government has put down in the draft budget focuses on a percentage increase or decrease in what it wants to do, rather than on what it has to pay to get the desired outcomes.

There is far too great a focus on the top-level amounts, rather than on what the Government is trying to deliver for the most efficient value. We have said that, overall, we would like the tax burden to be reduced, because a low-tax environment with good infrastructure and public services is ultimately needed to make Scotland an area that will attract business. The Government needs to make the public sector more effective and efficient, and consider ways to reduce costs to free up the private sector. You asked for a macro view.

John McLaren: We need to consider what steps we want to take at the moment, and what we are ultimately trying to achieve. Do we want to achieve higher growth this year or the year after, or to maintain the current level of employment? The Government might want to do different things for each of those targets, depending on what they are.

In relation to growth, the Government might want to consider putting more resource into research and development, infrastructure and higher education, but that will not necessarily save the most jobs at the moment. It might want to put resource into housing or something like that, depending on what the ultimate aim is.

The bottom line with regard to the budget is that if you cannot borrow money, you are just moving it from one area to another. Normally, to get out of a situation like this one, the Government might want to spend a bit more, or reduce taxes, or do both. However, if the Government is going to spend a bit more, given the current situation in Scotland, the money will come from people's pockets, whether that is via council tax or whatever. If the Government uses its tax-varying powers to cut taxes, that will leave less money to be spent. There is not an awful lot that can be done.

With regard to the current draft budget, there is a lot of proper concern about what higher education institutions will look like in five or 10 years' time, given the current funding patterns.

Kenneth Low: Your question is what we can do now. In the short term, we can probably do very little, because the current situation needs a response from central Government through the Treasury. With regard to the budget, there are many more areas of similarity than areas of difference between the Westminster Administration and the Scottish Administration. The only step that the Scottish Government could take is to bring housing forward more quickly, if that is possible. There are no further details in the budget about how that is to be done, but it says that it will be delivered. That would be particularly useful for the construction sector and for people who require that type of housing.

In the short run, my main concern is the way in which local government is to be funded, given the freeze on the council tax. I do not have systematic information on all 32 local authorities, but there is information from local authorities about services that are being curtailed. It is clear that that does not meet the objective of delivering high-quality public services—there is a mismatch between how services are funded and the targets and outcomes. An example is the provision of free school meals in East Renfrewshire. If the uptake were total—I think that 90 per cent of people in the area are not usually eligible—there would not be the capacity in the system to deliver the service. The wrong signal is being sent about what local authorities have to fund. There are big questions about how you deliver public services if you are not willing to fund local authorities properly.

09:45

Jo Armstrong: I agree with John McLaren's statement that you need to decide what you want to achieve in the next 18 to 24 months, which is the timescale over which you have budget control. Is the issue to do with dealing with an increasing unemployment problem, keeping Scotland's growth rate higher than it would otherwise be, dealing with liquidity problems that small businesses are likely to face or helping those on fixed incomes who are facing additional spending pressures? You need to decide what you are asking the Scottish Government to deliver, given that it has identified seven targets that are, to some extent, not mutually reinforcing. The difficulty in achieving cohesion might be even more difficult in a situation in which growth is falling. My concern is that, when we look at what the budget capacity is, there are extremely limited ways in which substantial changes can be made. Some work is possible at the margins, but there is little leeway.

My reckoning—and I would not pretend that this is auditable—suggests that, based on the figures that are in the budget document, there is a potential shortfall in 2009-10 of around £40 million. That includes the £100 million rephasing for the construction of new housing, but that money relies on local government agreeing to fund its £40 million share.

When you look at what it is possible to do, you see that the flexibility in the budget is so limited that you will have to ask yourselves what it is that you want to stop being done so that something else can be done. I am sorry to take such a doom-and-gloom approach, but I am afraid that you will have to hold the Government to account by asking what outputs it wants to achieve with the fairly hefty sum of £30 billion, what it thinks needs to be radically different in the next two years, and whether it thinks that that radical difference will compensate for the things that will have ceased to be done.

Gavin Brown: Mr Thomson, has Reform Scotland any specific details about what areas of taxation should be focused on in order to reduce the tax burden?

Ben Thomson: Yes. We did some research on local government and found that Scotland has one of the lowest levels in Europe of taxes that are set and raised at a local level—we are at the same level as Greece. We think that to get efficient local services you need to make people responsible for raising revenue at a local level, so that there is greater accountability for and a better focus on the services. That is one specific recommendation.

We are also looking at responding to the Calman commission and we are producing a paper that will consider the split between how tax is raised at a United Kingdom level for UK services, at a Scotland level for Scottish services, and at a local level for local services. That goes back to our position that it is better to associate the place where taxes are raised with the place where they are spent, as that delivers greater accountability.

Gavin Brown: This question is for anyone on the panel. Although there were underspends in previous years, last year spending was, I think,

£100 million over budget. The position is the same again this year. Given the current conditions, is such an overspend as wise an idea as it might have been last year?

Jo Armstrong: The underspend in 2007-08 was about £40 million and the budget for 2007-08, including an overallocation, was light by £42 million. That underspend is way below the average for the preceding four or five years. I do not have the actual figures here, but the amount came to more than £200 million, on average, in each of the four years preceding 2007-08. EYF is seriously diminishing. 2009-10's budget has a drawdown from the reserve that was sitting in the Treasury underpinning it. There is an overallocation of £100 million underpinning it, too. The numbers suggest that it is about £40 million light. The EYF from last year might just mean that the 2008-09 budget is covered off, assuming that we achieve an underspend elsewhere in the budget to allow that £100 million to be realised. In my view, the cupboard is bare. There is no flexibility within the system.

Lewis Macdonald (Aberdeen Central) (Lab): I am very interested to hear all those points. It is important to be clear about priorities, choices and what Government seeks to achieve with the money that it spends. I think that it was John McLaren who said that there was a significant difference between what the Government would do if the focus was on sustaining economic growth and what it would do if it was on sustaining employment.

At our previous meeting we heard evidence from the finance and construction sectors. We have heard that we are facing tough times and that unemployment will grow. The things that we need to do in the short term to get through those tough times with the least damage, and the things that we need to do in the long term to get ourselves to a place where we can grow the economy in future, might coincide. The Scottish Government could most usefully address housing and infrastructure, including water, sewerage, electricity transmission, roads, rail projects and so on. Is that right? In other words, is it possible to construct a set of priorities that ease the pain in the short term and also put in place what is required for growth in the medium term?

John McLaren: It is difficult to be certain. The housing side is going through difficulties and it will lose a lot of employment, and perhaps skills, which we would like to keep. How long will it be before the housing market comes back and people are employed normally? The Economic and Social Research Institute in Ireland gave its assessment for the Irish economy yesterday. On policy challenges, it said that it was necessary to avoid measures designed to stimulate the housing sector. How should that be read? Saving is different from stimulating, but the two look quite similar. In Ireland—it will probably end up the same in Scotland and the rest of the UK—house prices have fallen by 11 per cent, I think, and they are expected to have fallen by 30 per cent by the end of next year.

If someone was considering whether to buy land for building houses, which is currently going relatively cheap, why would they do that now if prices are going to fall further? They might be better waiting a couple of years, when they will get everything cheaper. Then again, virtually every business area—not just construction—is reporting that it will lose key staff and will be getting into difficult times. It is difficult to say whether one sector should be privileged over another at this time.

Tourism is another example. I think that it was John Kay who said that the two areas in Scotland with the most obvious competitive advantage are tourism and financial services—well, he said that a few months ago. If we want to keep tourism ticking over, you might wish to address that area. To me, there are no obvious areas. We need to keep an eye on what will be best for productivity in the long term. In Scotland, levels of R and D and start-ups are not very good. Higher education infrastructure is good for high-level graduates and for research, so you might want to ensure that it is in good condition for the end of the recession.

Rob Gibson (Highlands and Islands) (SNP): Could I come in there, convener?

The Convener: I will let the other witnesses comment first.

Kenneth Low: Lewis Macdonald mentioned several things that the Government might do, including larger infrastructure projects. Again, I am thinking about the short term and the Government's role in the present situation. The Government may want to act in a counter-cyclical manner. Therefore, pump-priming would meet the situation.

On larger projects, one action that could be taken is to streamline the planning system. Earlier, I focused on housing, as it is relatively easy to do and it can keep some of the skilled labour in the construction industry. One clear feature that underpins the housing market and incomes is Scotland's labour market advantage. The employment rate in Scotland is higher than that for the UK. Although most commentators will say that unemployment will rise, we do not know where that is going to go. In recent episodes, particularly in the electronics slowdown, other sectors have picked up, so unemployment in Scotland has not risen substantially. The new situation may be completely different—we will have to wait and see—but in that case it is probably critical to support the labour market, because that will keep people's incomes going and is likely to lessen unemployment.

Jo Armstrong: I have three short points on Lewis Macdonald's question. First, we must keep it in mind that two forces are at play. A downturn in the business cycle is taking place at the same time as a structural change in the financial services sector. The impact of the structural change will have an effect on how long and hard the downturn in the business cycle is.

Secondly, Lewis Macdonald asks whether we should have more infrastructure projects. Ideally, we would, because that would help with long-term economic growth to an extent. However, I return to the question of where the trade-off will be if we do that, because the budget is tight and there is nothing to play with. If you want infrastructure projects rather than something else, I urge you to carry out a cost benefit analysis and consider what the true net benefit might be.

My third point is on Scottish Water, which is one of my hobby horses. Lewis Macdonald suggests bringing forward Scottish Water's investment programme, but it has stated clearly that the size of its current programme is more than enough for it to handle physically. I ask whether it would be counterproductive to do that. Carrying out such programmes quickly, particularly with large projects, tends to produce poor outputs. We can spend money, but it does not necessarily give us what we want.

Kenneth Low: On that point, large construction firms specialise in certain areas. If we bring too much on stream at one time, we will run into bottlenecks, which will move up the costs.

Lewis Macdonald: But we could prioritise in that context.

Kenneth Low: Sure.

Ben Thomson: In the short term, unemployment will rise because there will be a slowdown. That will happen because, first of all, individuals will not have access to the funds that drive the property market. People already have difficulties getting the mortgages that they want, and that will continue until there is a price correction. The industry will naturally go down and then come back up again. The next time round, the Government can help with planning. The way in which prices in Scotland have risen suggests that the planning system forms a bottleneck in proper housing development in Scotland.

10:00

In addition, companies will have problems refinancing existing loans and getting access to new loans. While that continues, there will be problems. The quick sop to that would be to say, "Let us create some employment", but that would be a mistake in the long term. We want value-added employment, not employment for employment's sake. I welcome the Government's focus on trying to develop certain industries such as the renewables, financial services and offshore oil industries, in which high-value-added jobs match Scotland's skills base. That skills base gives us a significant competitive advantage.

What can Government do? It could do a couple of things. First—I say this wearing a smaller-companies hat—it could ensure quick payment of bills. I know that the Confederation of British Industry has raised this gripe on several occasions, but quick payment of bills by Government really helps cash flow. Government should also be prepared to accept bids from smaller companies for services that are contracted out. Rather than give grants to companies but not use their services, the Government should use Scottish companies where possible. That would help.

Another helpful response would be to deal with the stagnation that we have experienced with infrastructure projects because the Scottish Futures Trust has not yet replaced the private finance initiative. We need to get on with agreeing how major infrastructure projects in Scotland will be taken forward so that we can get the industry behind that. We need leadership on that and a timetable.

The Convener: If Lewis Macdonald has no further questions on that issue, I will let Rob Gibson pick up on the housing issue.

Rob Gibson: The panel has focused on house building, but house builders are clear that, given the loss of jobs and the drop in prices, we ought to maintain employment by switching the focus to the 700,000 houses in Scotland that need to be climate-change proofed. Improving energy efficiency is one basic way in which we could employ lots of people, improve our living conditions and reduce the amount of money that people need to spend on fuel. Should parts of the enterprise budget be directed in that way? The house builders made it clear that the Government will need to back any such development of energy efficiency.

Jo Armstrong: I might be wrong, but I think that part of the £100 million funding for housing will potentially come from private sector housing support. I could be wrong about that, but it certainly looks as if those numbers will drop next year, so some of the money must come from something like that. However, it seems to me that the £100 million for housing need not necessarily all go to social housing if retrofitting energy efficiency measures in existing housing stock is deemed a more effective means of dispersing that benefit around the economy.

Kenneth Low: Ad hoc evidence from discussions with builders suggests that building houses that are completely environmentally friendly adds significantly to costs. The Stewart Milne Group and another builder are carrying out a trial by building six such houses. Current estimates are that the measures might add about £50,000 to the cost of those houses. In some of those projects, the spend on such measures is not insignificant.

Rob Gibson: I suggest that we leave aside the designs that Stewart Milne works with. We should concentrate on the fact that our construction industry has the necessary technology, ability and workforce. Should we press the Government to help with existing housing stock? The forthcoming climate change bill could well include such measures.

Kenneth Low: Absolutely. If the stock can be improved in a cost-effective way, that is a laudable objective.

Ben Thomson: One area in which you could help tremendously is education. There have been very interesting reports from America about what people can do to have an impact on climate change, and efficiency measures come far higher up the list than the fuel that people use and fuel changes. Such measures include making people aware by putting meters in their houses and providing tests to show them how they can measure their carbon footprint.

To an extent, the market price of fuel will drive efficiencies, whatever the Government does. People are now looking to insulate their loft and double glaze their windows, because their energy bills have doubled in the past year, so it has become economically attractive to do such things. People are starting to buy more ecologically sound things for their house; we have seen a rise in such sales. It is as much about cost as it is about education; in the end, the public will see the economic benefit of taking such measures on board.

John McLaren: It really does not surprise me that housing representatives suggested that they should be helped out. Presumably, everybody whose job prospects are not looking good would say that at the moment. If you are to help out on the housing side, what do you think your main targets should be? In the long term, is it more important to consider how environmentally friendly and sustainable housing in Scotland is, or to address the affordability aspect, which, even after the house-price falls, might be an issue in places such as Edinburgh? Do you want to address both issues? You have to consider how you want to allocate the money between two desirable outturns.

Dave Thompson (Highlands and Islands) (SNP): It has been said that the budget is tight and that there is no flexibility. Jo Armstrong said that the cupboard is bare. However, talking about rearranging the deckchairs on the Titanic will not do us an awful lot of good.

Local authorities got a better settlement; they got an above-inflation settlement to deliver various things. However, we have all been caught out by the fact that inflation is up; everybody is suffering because of that. With a fixed budget, limited capital and limited borrowing powers, there is not an awful lot that the Scottish Government can do. That means that we have to rely on the UK Government to come up with meaningful, major improvements in the situation. We can bring forward capital spend in a limited way, but if we want to do more, we have to get more revenue and capital from Westminster, and that is a decision that only the Westminster Government can take. What do you think the Westminster Government should do to help the Scottish situation, given that it holds the levers of power?

John McLaren: In normal circumstances, it might want to reduce taxes and increase spending to try to reinflate the economy, but public finances are very tight. Yesterday in Ireland, the ESRI said that Ireland cannot really have a package that does that, because its deficit is aiming to be 5.5 per cent of gross domestic product. The UK's deficit will probably go somewhere near that soon, too, so there is not an awful lot of scope for the Government to do what, traditionally, we would have liked it to do.

It is too early in this crisis to know where we are going to end up. You do not necessarily want to put all your eggs in one basket for next year if we are still going to have problems in five years' time. It is difficult for the Government to say that it will double the level of deficit or go into a huge infrastructure building programme. Equally, if it starts to cut taxes, it is difficult to know whether that will feed through into growing the economy. The autumn budget statement is some time away, so we will see what the Government does then.

I guess that the European Union could also help out, as it has the potential to move spending to different areas, increase it or bring it forward.

Jo Armstrong: Whatever is done this morning and this week needs to be done with some aplomb so that people start to believe that the capital markets and financial sector can operate effectively. We need to ensure that businesses can borrow and that they can access cash-flow facilities. We need that, irrespective of whether the Government accelerates investment activities.

More important, we need to accept that the restructuring of the financial capital markets means that the rate of growth that we have seen in previous years is something to aspire to rather than something to expect to achieve. We have perhaps had a business model—that of living off other significantly debt-driven business models—that is no longer sustainable. We have to take stock and think through what is now a sustainable business model for the UK, Scotland and businesses.

We have to hope that the UK Government's current activities work effectively in trying to bail out the financial sector and unclog the capital in the system. John McLaren referred to the autumn budget statement, which will probably not give us much more additional revenue in the next 12 months.

Ben Thomson: It might be worth putting the numbers in perspective to show the size of the problem. The UK's total GDP is about £1.3 trillion, and the total amount of UK debt is just over £500 billion—depending on what is on and off balance sheet. The total level of PFI debt in the market, available figures for which go up to a couple of years ago, is about £50 billion. Today's announcement was for a £50 billion package, which throws a spanner in the works of anything that is going to be decided in Westminster for the time being.

Let us consider what Sweden and the other Nordic countries did in 1990 when things went wrong. Sweden set up a banking fund to take on all the problem assets. That is one answer to the problem, although there are a number of others, including putting equity into banks. To give the committee an idea of the size of the problem, Sweden put in $70 billion, which represented 50 per cent of its GDP. We do not know whether the problem is as bad as it was in Sweden in the 1990s, but an equivalent figure for the UK would be £600 billion if we used the same quantum of fund as Sweden used to sort out the problem.

From the point of view of what the UK Government is looking at, the numbers dwarf what may be an additional £100 million here or there to deal with what it will see as regional problems. Until we can get through the current situation, it is difficult to see what priorities the UK Government will come up with in the longer term.

The Convener: Does Jo Armstrong want to come back on that?

Jo Armstrong: I want to turn the debate back to what the Scottish Government can do, because we have not covered that much. A third of its budget goes to local government. There is a huge efficiency programme under way, and there is a serious desire to deliver it. It is now even more imperative that that programme is effective and is potentially pushed even further. Budgets are tight now, but the situation will get worse for the services that we all need and want. They will start to creak if efficiencies, which are built into already tight numbers, are not delivered.

John McLaren: I agree with that, but it is important to understand the political ramifications. Jobs will probably be lost, and now is perhaps not the best time for that to happen. Efficiencies are the right thing to happen in the long term, and I am not saying that they should not be achieved, but it would be politically brave to go a long way down that route at the moment.

10:15

Kenneth Low: A stark choice faces the Westminster Government at the moment. Although borrowing could increase significantly, as Ben Thomson says, it is really about choice for the financial markets, which have to function. A key point is that it is not only a UK problem: until house prices—the toxic assets—in the US are stabilised and people know what they are doing with those assets, the problem will not go away from the UK, so we cannot simply pour billions of pounds into banks without knowing what they will spend it on or what the return will be for the taxpayer. It is a separate issue. If the UK Government focuses on that and gets the capital markets functioning again, that will make a huge contribution. The Scottish Government should focus on the points that Jo Armstrong mentioned, although I agree with John McLaren that, in the short term, that might be difficult to do without disrupting the labour market.

The Convener: I am happy to have allowed that one question on the UK Government position, but the committee is examining the Scottish Government's budget and it is difficult for it to consider the wider issues.

Dave Thompson: That is fine.

Jo Armstrong mentioned that we need to consider a longer-term, rather than a short-term, sustainable business model for the UK and Scotland. Are there any lessons to be learned for the long term, given that there is so little that we can do in the current situation? What powers would it be beneficial for the Scottish Government to have so that it can act more beneficially for Scotland in such a situation in the future?

The Convener: That is perhaps straying a little bit away from next year's budget, but the witnesses can make comments if they have any. Perhaps it is more an issue for the Calman commission.

Kenneth Low: History teaches us that the situation will be repeated, but its severity means that I hope that that will not happen for a very long time. The fact that we have overextended ourselves across the globe means that it is imperative to have some global co-ordination. That is really important, but we should get back to the Scottish economy.

John McLaren: Nonetheless, there are some relevant points. We should think about the difference that other powers for the Scottish Government might make. As I said, normally, one might want to increase borrowing, but we cannot do that in Scotland. However, in some senses, we are already doing it because the UK borrowing capacity includes Scotland. If Scotland were to come out of that position, it would have to give back the money that is already part of the deficit and borrow again. In effect, we would end up at almost the same point.

We do not know what the net position would be if there was fiscal federalism or fiscal autonomy, although it would be largely reliant on North Sea oil revenues. A couple of months ago, the price of oil was $145 a barrel but now it is $90 a barrel, so it is extremely difficult to know what we would get and to plan any distance into the future on that basis.

There are no easy solutions. There are interesting measures that we could think about, but there is no obvious way out.

Ben Thomson: We can take two actions on regulation. It was a mistake to have a split of responsibility, with the Treasury, the Financial Services Authority and the Bank of England all looking after the banks but none of them taking full responsibility. That is a UK problem; it is not necessarily the case worldwide.

Going forward, it would be useful to have one organisation that looked after the banks. A proposal has been made for the Bank of England to take on the problem areas of the banking industry under a red, amber and green scenario. That would be a mistake because, if it takes on the problem areas, it will need to know in advance what is happening and because it is much better to stop the problems before they get too bad than to have to take them on. I would like one organisation to take responsibility for the banks because they are such an important part of the economy. That is not a Scottish matter, but a UK one.

When things go wrong, it is important to be proactive rather than going on to the back foot, and to have a strike force that is ready to go. Problems occur: there are problems in UK banking every 17 years and in the insurance industry every nine years. That is about how long it takes before the next generation forgets why people are prudent and fussy about details. A proper, proactive remedy is needed. One organisation that is responsible for the banks and the means to react rapidly and proactively when things go wrong will be useful tools for when such things happen again.

Dave Thompson: I have a final question on the Scottish budget. From what you have said, it seems to me that, although certain things can be done—the Government has already pulled money forward for housing and so on—it would be a mistake to react in a knee-jerk way and to move big tranches of revenue from parts of the budget to other parts of it, because nobody knows where we are heading. Therefore, it might be more prudent for us simply to batten down the hatches and hold firm for a wee while until we see exactly where things will lead us.

Jo Armstrong: Parliament approved a budget last year, and there has not been much movement this year. Given the current uncertainty, unless there is a burning desire for significant change, I ask members what the cost benefit would be of making a substantial change. You talked about battening down the hatches, which is one way of describing things. We must ensure that we can react when we are more aware of where the land will lie. I do not think that anybody can forecast now what the outcome of what is happening will be and what will be most affected. As a result, I urge members to consider the cost benefit of such a significant change before making it.

Christopher Harvie (Mid Scotland and Fife) (SNP): I have a general question. In this post-light-touch-regulation situation, is Scotland more exposed than Britain as a whole is because of the size of our formal financial sector?

Ben Thomson: London is probably just as exposed as Edinburgh is, and England is probably just as exposed as Scotland is. London and Edinburgh are the two financial centres. However, Scotland does not have the same very high concentration on investment banking or the same stock market focus, and those areas will probably be hit hardest. It has a big exposure with the banks, which have been hit, and it has a very high exposure with its fund management businesses, although so far they have not been hit as hard as other businesses have been. However, I do not think that Scotland is any more or less exposed than Britain as a whole.

On whether regulation should be light or heavy, I would be cautious about throwing in a lot more regulation in reaction to the events that have taken place, because some regulations have caused part of the problem. Basle II, for example, with its quite heavy regulation on where capital should lie in return for certain risks, has resulted in quite a lot of risks being transferred off balance sheet, and that has caused quite a lot of structural problems. One must be careful about overregulation and ensure that the consequences of regulation do not increase rather than reduce risks. It would be best for Governments to have people who understand and are prepared to manage risks. That takes us back to looking at how bank boards are governed and monitored rather than considering a series of detailed rules that people will look to get around.

Jo Armstrong: I echo what has been said. We do not want to take knee-jerk action on regulation at the moment because a lot of discussion is taking place about what is appropriate—about the appropriate spatial level and depth of regulation that is required. It is essential that any regulations that are in place are effectively monitored and implemented. What has been said about governance arrangements is right. People who understand and monitor the risks and shout loud enough and soon enough are needed, but light regulation, and the light touch that has been taken, have probably meant that such things have not been done effectively enough. We need effective, but not necessarily more, regulation.

Kenneth Low: We should also bear in mind the fact that financial services account for 8.3 per cent of the Scottish economy and 7.9 per cent of the UK economy. Up to the first quarter of 2008, the rest of the sector was performing relatively well. Of course, we still have to see how it performs in subsequent quarters, but we cannot simply assume that just because the financial services sector has run into problems the rest of the economy is in the same situation.

Christopher Harvie: With regard to the lower end of the economy, all sides have been talking about a comparatively favourable employment situation in Scotland. My information is rather old, but I was comparing the figures in Bill Jamieson's "An Illustrated Guide to the Scottish Economy"—which, admittedly, came out in 1999—

Kenneth Low: That is old.

Christopher Harvie: Indeed, but nothing on the Scottish economy has come out since then. When I compared the figures in that book with those in the Jahresbericht of the Baden-Württemberg Government, I found that, at that time, the level of part-time employment was 25 per cent in the Scottish economy and 15 per cent in the Baden-Württemberg economy. I deduce from various developments and inferences that the level of such employment has probably gone up in Scotland; indeed, that supposition is reflected in the fact that the poverty level in Scotland has remained obstinately above 20 per cent, whereas the level in Germany is about 9 per cent. Do you agree that having a high level of employment does not ipso facto mean greater prosperity?

Ben Thomson: In March, Reform Scotland published "Powers for Growth", which compares the employment figures in Scotland up to 2006—and the figures for productivity, which represent the flip side of that—with all the other European countries. We reached the conclusion that Scottish employment levels are high; of course, it is difficult to get comparables, because in the different cultures involved there might be more or less part-time work, more or fewer women in work as a percentage of the population and so on. However, if we look at the employment rate among men aged 15 to 64—which is the rate that tends to be used most often, as it provides the most consistent statistics—Scotland does very well. On the other hand, its productivity is poor; indeed, Scotland is right at the bottom in Europe in that respect. As I said earlier, if you want to build industries, you should focus on industries that produce high-value-added jobs in order to increase productivity. I am more than happy to let the committee have the report at the end of the evidence session.

Kenneth Low: I am not surprised to learn that poverty levels in Baden-Württemberg—and, indeed, in Bavaria—are so low, given the high concentration of R and D jobs there and the fact that real incomes are much higher.

As far as the high employment rate is concerned, I note that one of the Scottish Government's objectives is to halve the gap between total R and D spending in Scotland and the EU average. However, according to the draft budget for 2009-10, innovation and investment grants are being cut by 2.8 per cent in real terms each year. If we are serious about increasing growth—and, indeed, if we want to meet the 2011 and 2017 targets for growth—we have to focus on drivers such as R and D, productivity and participation. Such an approach will have long-term benefits for the economy.

10:30

Ms Alexander: While you have been talking, I have had the pleasure of being able to read what the Treasury said this morning.

Ben Thomson made the interesting point that paralleling the scale of intervention that took place in Sweden would require something in the order of £600 billion. It is extraordinary that the Treasury note makes provision not just for £50 billion for recapitalisation but for an additional £200 billion for short-term special liquidity schemes and, most significant, a further £250 billion to help to meet wholesale funding obligations as they fall due—I was not hitherto aware of that. It is interesting that those three items add up to £600 billion that is being made available today but was only speculation yesterday. Does anyone on the panel not think that Scottish institutions will benefit differentially from that package? Six hundred billion pounds is available to eight institutions through the three measures that I have described. Standard Chartered Bank, HSBC and the Nationwide Building Society are unlikely to be the principal beneficiaries of the package or to seek to draw down the £600 billion that is on the table this morning. Will Scottish institutions seek differentially to draw on that £600 billion?

My second question is more general. Because I was returning to the committee, I had cause to revisit the Government's economic strategy. I was struck by the extent to which it encourages us to look to our near neighbours for lessons. There is an interesting issue relating to regulation. Although in Iceland notional guarantees have been extended, there has been a huge run on the Icelandic currency over the past week. Although notional guarantees have also been extended in Ireland, there has been no run on its currency because Ireland participates in the euro. That raises fundamental issues of whether regulation can be divorced from having a strong central bank that acts as a lender of last resort in a currency that can match the obligations that Government or regulators extend. Can you offer any observations on the risks of divorcing regulation from a central banking function or a lender of last resort function, and on the role of currency in that process? It would be interesting to hear your thoughts on the importance of the euro. How do we explore such issues, which are not unimportant? The Government economic strategy says that we should look to our near neighbours, two of whom have undergone remarkably different experiences when deploying the same policy instruments in the past week. How can Scotland learn from that?

Finally, would members of the panel like to offer any observations on the implications that the events of the past 72 hours—both the decline in bank share values and today's package—may have for the merger of Lloyds TSB and HBOS and the prospects of RBS in the short to medium term?

The Convener: Who would like to answer those small questions?

Ms Alexander: I made my contribution long enough to allow witnesses to pick and choose which questions to respond to.

Ben Thomson: I have been trying desperately to write down all the different questions. I promise Wendy Alexander that I did not have notice of what the Treasury figure would be—I did not cheat on that. The package will be negotiated with the banks case by case. You are completely right about the likes of HSBC, which has so many deposits that it is overcapitalised. Because many people have seen Standard Chartered Bank and HSBC as the strongest banks, they have taken their money out of other institutions and deposited it in those banks, which are in a rather interesting position. Lloyds TSB, RBS, HBOS and Barclays will most likely get the bulk of the capital. The size of their asset base is significantly larger than the UK GDP, so they are sorting out that problem.

This is a time when politicians generally can really help as part of the leadership process. Both HBOS and RBS will now be looking to negotiate terms and I suspect that the taxpayer, through the Government, will end up with significant shares in those banks and will have a much greater hand in the short term in how matters are negotiated and what happens. That will throw up issues about what will happen with mergers and how banks will be run in future. To an extent, this is the time when we in the private sector are in politicians' hands. People in the private sector are saying that politicians at all levels need to come to the fore. Irrespective of whether the decision is taken at UK level, the private sector will need support and input from different levels of government throughout all this.

Looking forward on HBOS and RBS, there is an argument that we should focus on how we can help those two banks create businesses. I know that that is an odd thing to say at this juncture. However, businesses can be created that will benefit Scotland. For example, the pensions area will need to be developed further. We have Standard Life, but if Lloyds TSB and HBOS come together, can Edinburgh be a centre for both Clerical Medical and Scottish Widows? Lloyds TSB, HBOS and RBS have huge fund management businesses, but if the merger of Lloyds TSB and HBOS goes ahead, there is the question about what will happen to Scottish Widows Investment Partnership and to Insight Investment.

On wealth management, people will want to have a different banking service. Can we in Scotland help facilitate how people run their money and how they are educated about it? Otto Thoreson, who runs Aegon UK, produced a good report on money guidance and how we can link that in to create an environment whereby people will perceive Scottish financial institutions in such a way that they will want to come to them. There is much in the financial services industry that you, as politicians, can do something about in the short term to help, but you can also do something in the long term to create the right environment.

That has answered about three of the questions. I will try to answer a few of the others. I concur with the view that divorcing regulation of the liquidity of the banking system from regulation of banks is a mistake. I think that I said in my answer to Christopher Harvie that it was a mistake to have a tripartite arrangement. It did not work in Rome 2,000 years ago and it has not worked to date. It is much better to have one institution that is clearly responsible for the whole banking sector, including ensuring that the liquidity in the market is regulated and that banks are run prudently and sensibly—the Bank of England used to do that.

Iceland is an odd case. It is easy to say that after the date, but many people in the financial sector had a funny feeling about what was happening there and thought that something odd was going on. A country with a population of 250,000 had two, if not three, banks that were buying up everything around the place. I do not think that anyone would want to use Iceland as an example for comparison, because there was something not quite right about how things happened there and how those two large banks had bought so many financial institutions and high street institutions in the UK. However, it is worth comparing what others have done and how they have managed their industries.

The debate on currency and whether we should be pegged to and continue with sterling or move to the euro probably has a wider scope than today's argument about what is happening financially. We produced an interesting paper recently—it is on the Reform Scotland website—that examines free market currencies. Scotland is the leading pioneer on how free market currencies work, as there was a time when it had no central bank and it used different currencies from different banks. However, I do not want to get into that argument now.

In answer to the question about how we can learn, it is very difficult to learn when we are in a crisis situation. We will get through the crisis. I am hugely optimistic that when we are facing the abyss, people will step up: we will find a solution, even though things look bleak at the moment.

It is at the very moment when people say, "Capitalism is dead—it'll never be the same again," that people are prepared to find the right solutions and do things the right way, and I am confident that they will do that. The time to learn the lessons will be when we look back and reflect on the situation after things have calmed down, in months—or possibly years—from now.

The Convener: I thought for a second that you were going to say that we are facing the abyss and taking a great step forward, but you avoided that particular trap.

Kenneth Low: I will tackle the question about how we can learn from our neighbours' different responses. In the context of the immediate financial crisis, it might be okay for a small country to give a notional guarantee to savers, even for a short period, but I have severe doubts about whether a small country could bail out banks to that extent if it actually had to act on such a guarantee, particularly in the case of Ireland, which has issued a blanket guarantee.

In terms of GDP per head and purchasing power parity, one finds four of the arc of prosperity countries in the top 10. However, if one considers gross national income per head, there is a complete change. Only two of those countries—Norway and Denmark—remain, and much bigger and more well-developed economies take the place of the others.

Scotland compares relatively well with the UK, but I am not convinced that we should compare ourselves with those smaller countries and say that they represent our aspiration, because the UK does better in terms of gross national income. I would not want to throw out the baby with the bath water—more research needs to be done.

With regard to the Lloyds TSB merger, there will be benefits for all banks in Scotland. Last night, the Royal Bank of Scotland was valued at £3 billion. That is bizarre—I do not think that anyone at this table thinks that it is worth £3 billion. At times like this, we have to recognise that markets can be irrational. There needs to be a period of time for things to settle down; we can then see in detail how the money is used in the banks.

Jo Armstrong: I imagine that RBS, HBOS, Barclays—and Lloyds TSB, interestingly—will be the main beneficiaries of the Treasury facility. I have not seen the statement, so the numbers are new to me, but they are sufficiently large for me to wonder whether the Lloyds TSB-HBOS merger will actually go ahead.

The merger has to be signed off by shareholders. Would they prefer that the Government had a stake in the business, as opposed to Lloyds TSB owning it? If Lloyds TSB seeks to use the facility, does that mean that dividend payments to the Lloyds TSB-HBOS shareholders will be limited anyway? What is worse? It is an interesting debate—I suspect that those who have been discussing alternative options for HBOS and Lloyds TSB might well have picked that up this morning.

With regard to Iceland and Ireland, I will say only that I am intrigued to discover that Iceland is now seeking membership of the euro—the press that I have been reading certainly suggests that it is actively seeking to do so. There is a point about flight to quality winning out when there is trouble, such as the current situation.

10:45

My third point is on the debate on monetary policy. People from a variety of political perspectives are walking towards the 2010 agenda with a very poor understanding of the monetary implications of whatever politicians might seek to implement post 2010, be that full independence or some new version of fiscal federalism or fiscal autonomy. The debate around monetary issues is non-existent.

One consequence of the current crisis is the greater importance that will be placed on this committee asking questions such as what monetary issues we should be addressing and how we go about getting the appropriate research. Those questions need to be answered if the electorate is to understand the implications of the vote that they may be asked to make in 2010. I note that none other than the Scottish Trades Union Congress addressed that point in the committee's previous evidence-taking session. I concur absolutely with Stephen Boyd of the STUC's suggestion that, whatever the new funding arrangements, there is a serious dearth of understanding of monetary issues.

John McLaren: I have two things to say. First, from what is going on, we can see that the crisis is affecting industries such as banking and that it can take over countries, as is happening in Iceland and—to some extent—Ireland. Not only small countries are affected: the crisis has taken over the USA, too. The impact can become so large that the bubble affects a whole country. We need to bear that in mind in thinking of what should be done in Scotland.

My second point is on regulation. In terms of the euro, I understand that Spanish banks are doing okay, despite the huge housing boom in Spain, whereas German banks are in trouble, despite there having been no housing boom in Germany. Regulation can help or hinder, depending on the circumstances. We are not looking at the same story in all countries.

In the end, the most difficult thing for us to do is to get regulation that lasts. In 10, 15 or 20 years time, when somebody says, "The ground rules have changed. In the past, we couldn't do this sort of lending, but now we can," they need to be told, "No. That is just another way of getting us into the same position as we were in at the end of the 1980s." We need regulation that says that kind of thing and holds the line, even if everyone else is saying that they are making massive profits and doing rather well from the sort of lending that they propose we do, but which we know in our bones is not sustainable.

As Ben Thomson said, something is wrong in the state of Iceland, which people have been seeing for a couple of years. In fact, the problem has been at the back of people's minds for much longer than that.

Dave Thompson: Does the current situation put a different perspective on the Lloyds TSB-HBOS merger? Jo Armstrong said that shareholders might want to look again at the merger. I assume that HBOS could take advantage of what the Chancellor of the Exchequer has done. If so, could that allow HBOS to continue as a bank in its own right?

Jo Armstrong: Clearly, seeking funding from the Treasury will be done on a bank-by-bank basis, although I find it difficult to believe that the chancellor would feel comfortable giving funding to a bank for which competition rules rights had been waived in order to solve a problem that it had had for some considerable time. The extent of the capital requirement is also unclear.

As I said, HBOS shareholders still have to sign off the Lloyds TSB deal. They might have been given the sell that Lloyds TSB will provide them with a better return in the future, but if Lloyds TSB decides to call on the Treasury facility, the ability to deliver that return is called into question. Those ideas are only starting to form in my head. I do not know how comfortable the chancellor, or whoever is responsible for allocating funding, would feel about trying to unpick a deal that has been put together.

Dave Thompson: Things are moving rapidly—the situation has changed markedly since the merger of HBOS and Lloyds TSB was mooted and the Prime Minister said that he would waive the competition rules. I hope that the situation will be considered with fresh minds.

Jo Armstrong: Our knowledge of the extent of the problem has increased, but that does not mean that the business model that HBOS has been running is fundamentally different or more sustainable than was the case two, three or four weeks ago. I wonder to what extent people out there might be making mischief as opposed to proposing alternatives that would have tangible benefits.

The Convener: Some of the issues that we are discussing will come up under item 3.

Kenneth Low: What Jo Armstrong said about banks being allocated funding on a case-by-case basis is entirely true. The problem is that calculations have been done on the basis that Lloyds TSB and HBOS are to come together as a private sector solution. The fact that Lloyds TSB says that it needs more capital to strengthen its balance sheet is a separate issue. To go back to the Treasury and say, "There is talk in the press about the possibility that the Bank of Scotland and Halifax might de-merge," would be to open a can of worms. How would the banks de-merge? What would happen if Halifax said, "The Mound is ours"? It is about the bank's business model, exposure and deficiencies, which will not become public knowledge.

It is obvious that there have been discussions about the benefit of the deal to Lloyds TSB. I presume that the bank will put that to its shareholders. If the shareholders agree to a merger, I do not think that there will be a way back.

Ben Thomson: I think that Dave Thompson's question can be answered on three levels. First, in theory he is right in that the reason that HBOS was to merge with Lloyds TSB was the bank's liquidity problems, which were caused by concerns about its underlying balance sheet. No one really knows the level of those concerns and it is difficult for us to comment on the matter, because only people who are on the board or in the Financial Services Authority know the position.

Secondly, there is an issue about shareholders. I disagree somewhat with Kenneth Low in that I think the information will have to become public, because shareholders will have to be given a document on which they must vote. At that point, many people will pick holes in the proposal in different ways. Consideration will be given to whether a merger makes sense for HBOS and for Lloyds TSB—shareholders of both banks will have a vote. There will be heated debate.

Thirdly, there is a political dimension. It has been said that the merger will happen, so a face-saving way out would have to be found. Ultimately, we must get the right result, which is what is best for all the stakeholders—employees, depositors, loan holders and shareholders. The best possible deal must be secured.

John McLaren: The deal has apparently been talked about for weeks, months and years—it has been under consideration for a long time. Given what the leaders of both banks have said about the merger being a natural fit and the right thing to do, it is difficult to see how anyone in HBOS can start to back away from a merger. The shareholders could vote against the deal, but surely the management would tell them that they must do the right thing and support the approach that they have been proposing for quite a while.

Lewis Macdonald: I share colleagues' fascination with the subject, but I want to bring the discussion back to the Scottish Government's draft budget for the coming year. Witnesses have seen the excellent briefing that the Scottish Parliament information centre has produced. If you think that targeted investment in enterprise, energy and tourism is the way to stimulate the economy, you might share my feelings of depression on reading the projections for that budget in the coming year, which suggest that there will be real-terms reductions of 2.8 per cent in innovation and investment grants, in business growth and innovation and in European structural funds, and real-terms reductions of 4.2 per cent in energy and telecommunications and of 4.8 per cent in tourism, which has been mentioned. There will be a real-terms reduction of 6.4 per cent in funding of the enterprise networks, which are the largest part of the budget, and there will also be a real-terms reduction of 60 per cent in the funding of Scottish Development International, which obviously has a particular role to play.

Jo Armstrong made the important point at the outset that it is irresponsible for a committee to conclude that we should grow one budget line without reducing another. Nonetheless, at this early stage in the process, I would like the witnesses' views. Given that the Scottish Government proposes cuts in all those budget lines for the coming year, which of them do you think the current financial and economic circumstances should persuade ministers to look at again and consider not making?

John McLaren: I will make a relevant point that does not necessarily help the committee a lot, but it is important.

As I said, John Kay thinks that tourism is an area of natural advantage for Scotland. Tourism's main impact on the Scottish economy will be through hotels and catering. According to the official figures on the Scottish economy, that sector has not grown for 10 years. I do not know what all those cafes, pubs, restaurants and hotels are doing, but apparently they are not contributing anything to the Scottish economy, which means that tourism is not doing so either. I do not believe that. We are being asked to believe that tourism, which is one of the fastest growing sectors of the UK economy, has not grown for 10 years in Scotland. When politicians ask what policies they should implement and where they should spend money, they must ask: do we think that tourism is good for Scotland? The data say that it is not, so they should not waste money on it, but everything around us suggests that it probably is, in which case they should spend money on it.

It is necessary for us to understand the economy better and to be able to have greater faith in the statistics. The same applies to the financial services. According to the so-called official data, financial services fell 10 per cent in one quarter—not now, but at the end of last year. We do not know why that might have happened; nobody has explained, or tried to explain, what that might be due to. If you do not have data that help you to understand your economy, it is very difficult to know where you would get the best bang for your buck by investing it in the economy.

Having said that, I would say—although it is slightly tangential to the question—that one of the most worrying absences of an increase, if not an actual cut, is in higher education. I know that it is no longer within the economy and enterprise portfolio, but it has a huge impact on the future development of the economy. I see why the Government might not want to give so much money to Scottish Enterprise for whatever reason, but uncertainty about the funding future of research and quality teaching in higher education poses a big risk.

Jo Armstrong: I agree with John McLaren that if we want to make best use of innovation grants and research and development spend, we must ensure that we have the capacity to make use of them. That can be achieved only through delivery of quality education. It is necessary to ensure that education is effectively funded and that it is of the right quality. It is not about only inputs; the quality of the outputs is essential. There are real-terms cuts across some of the budget lines, but the quantum is not huge in the grand scheme of things. It does not look good and it brings into question whether the rhetoric about going for a step change in economic growth is deliverable within the current budget arrangements.

However, other than in respect of the enterprise networks, we are not talking about a huge amount of money. I am not sufficiently close to what is happening to know exactly what is being done with the funds and to understand where resources might be better used by shifting them from one budget line into another. I come back to the costs and benefits of shifting resources.

11:00

Kenneth Low: I would like to re-emphasise this point: if you are talking about raising the rate of growth in the long term, you have to invest in education. The two areas in which a reduction would most concern me are, first, business growth and innovation, and secondly, innovation and investment grants. My lowest priority might be tourism, because I am not convinced that tourism has all that significant an impact on the Scottish economy. Of course, looking at it another way, you could argue that you need to find out why tourism is not contributing as it should.

If you are going to make changes to the budget—to improve business growth and innovation, or innovation and investment grants, or education—you must consider what the benefits would be. It is critical that benefits can be quantified, so that you can say, "This will contribute to growth." If you cannot say that, I am not sure that there is any point in making changes to the budget.

Ben Thomson: Right at the start, I said that it is important to know what outputs you want. I would divorce education from grants—education is a necessary long-term investment from the public sector to ensure that you have a workforce and can create jobs that add value. No one would question the importance of education or the need to focus on it. However, although grants to commercial enterprises might improve job ratios, it is questionable whether they would improve the value-added productivity that you are looking for. An alternative would be to reduce the number of grants and lower the amount of taxation. Reform Scotland feels that, to create employment, creating an environment that allows enterprise to grow is better than central Government trying to predict which businesses within industries should be backed by grants. You should consider reducing the number of those grants.

Kenneth Low: Transferring economic development and the business gateway to local authorities will have to be properly funded. You might want to ask the Government about that. The Government says that the concordat with local authorities covers it, but you have to consider the provision of services at local authority level. A glaring example is Aberdeen City Council, where real difficulties have arisen. It would be wrong of this committee not to ensure that the delivery of economic development is properly funded.

The Convener: Scottish Enterprise is scheduled to come to one of our budget sessions.

Before inviting other members to ask brief final questions, I invite Marilyn Livingstone to make her points.

Marilyn Livingstone (Kirkcaldy) (Lab): I want to pick up on John McLaren's point on higher education. Some of us on the committee have argued that it was a mistake to remove higher education from the committee's remit, because of the links between higher education and economic success. I worked in further and higher education for 20 years before becoming a member of this committee, and I know that there are rumblings in the sector, which the committee will have to take seriously.

I also want to pick up on Kenneth Low's point. This committee has views—on which I have been trying to take the lead—on the transfer of functions from Scottish Enterprise to local councils. In Fife, we had a 38-strong Scottish Enterprise local economic development agency, but we are now down to fewer than 10 people, and they are the managers of large companies. It is very concerning. The Convention of Scottish Local Authorities thought that £48 million should be transferred to support local economic development, but only £25 million was transferred, and £12.5 million of that was already committed to urban regeneration companies that were already in the area. In effect, only £12.5 million is moving over from Scottish Enterprise to local economic development. That is a huge issue, and the Government must take it seriously. The witnesses might be able to help us to understand what is happening throughout the country. We have written to the Government asking questions. I am concerned about the situation, because it is affecting places such as Fife.

Kenneth Low: Fifedirect, for example, is an excellent example of joint venture arrangements between Fife Council and Scottish Enterprise Fife.

I do not have specific details on the funding for each local area, but I am slightly concerned that, in most councils, the economic development department will be small, because it has not had a significant role. I spoke to the head of economic development in the City of Edinburgh Council on Monday. Edinburgh obviously has had a significant shock to its local economy. It is clear that the council wants to work with the chambers of commerce, trade unions and employers, and it has a joined-up approach to tackling the issues. There is also the question of providing employment.

Economic development departments provide a range of services in supporting income and employment, so they are important. I cannot be too critical, because there is not enough detail in the draft budget to reach a conclusion, but the committee could ask for more detail, because in some cases no targets have been set and no arrangements have been finalised. It is incumbent on the committee to push the Government on exactly how the system will work, how much money will be involved and what exactly will contribute to growth. What will be the outcomes?

The Convener: We have requested the level 4 funding figures, so we should have more information when the minister appears before us on 5 November.

Ben Thomson: We agree that higher and further education are incredibly important. When wearing another hat, sitting on the Financial Services Advisory Board and Scottish Financial Enterprise, I have looked at our sector, because it is important to work out as an industry what skills are needed for the future, so that the right education, whether it is academic or skills based, provides the right workforce. I will not comment on the politics of where the responsibilities lie in the various parliamentary committees, but it would help if this committee liaised with the Education, Lifelong Learning and Culture Committee on what skills are required.

SFE is conducting a survey of the financial services sector to try to ascertain the skills that are required, which is resulting in new courses being set up—for example, a new course in financial services has been set up in Edinburgh. We are trying to work out what we require for the next generation. There will be a lot of changes. I refer again to Otto Thoresen’s paper on financial guidance. How people are advised will change in the future, and people need to be educated so that they can provide and understand that advice.

Reform Scotland believes that, if helping to generate local business is a local government matter, councils should have the ability and responsibility to do so. There obviously has been a shift. That work was done centrally through Scottish Enterprise, and now it is done at a local level. There are teething problems in any such shift, and it takes time for the kinks to be ironed out. If Marilyn Livingstone is suggesting that the work should be passed back to the centre, that would be a mistake. We should try to ensure that local authorities are given the responsibility to look after that work.

Marilyn Livingstone: Let me clarify my views: I am not suggesting that. I like local delivery, but it should be properly staffed and funded. That is the issue.

Ben Thomson: That comes back to local accountability. It should be up to local authorities to control that work, which takes us back to my earlier comment that Scotland has one of the lowest rates of tax-raising powers at a local authority level. If local authorities had more tax-raising powers and an ability to control their finances, perhaps we would not be debating all the time how much money central Government passes to local authorities for each aspect of the businesses that they operate.

John McLaren: Fife is a particularly interesting area in that its economic development and future involves Fife itself as well as Edinburgh and, at the other end, Dundee, both of which are important. The Perth and Stirling markets also have an influence. The biggest influences on Fife’s economy are probably outside the area—it is certainly extremely influenced by those other areas. I believe that it is the only area in Scotland that is in two planning regions. I am not sure quite what that means—probably that it gets squeezed in both. When we consider the issue in those terms, we start to think that perhaps we should have a co-ordination body for the eastern side of Scotland—a Scottish Enterprise for the east. That would almost take us back to the previous situation. Several markets are involved, which requires the old trick of getting local knowledge and co-ordination.

To go back to the targets, how is the move from Scottish Enterprise supposed to improve progress on the regional equity target? It might do so, but I am not sure what the obvious steps are so that A results in B.

Ms Alexander: I am mindful of time, convener, so I will make a suggestion, rather than ask a question. The committee should give a profile to John McLaren's point about data quality. It is lunacy for us to survive on statistics that say that tourism has not increased in 10 years. I suggest that the only obvious point in our calendar to raise that is when we have the minister before us to discuss the budget. It might be helpful if the convener, probably with input from our expert adviser, wrote to the chief economic adviser pointing out a couple of the data quality issues. The issues have been around for a long time, particularly with respect to financial services and tourism. We could invite the Government to comment in writing in advance of the minister's appearance on 5 November. That would give us an opportunity to give the issue the profile that it deserves. Are you willing to consider writing in those terms on behalf of the committee, convener?

The Convener: My helpful clerk has informed me that my predecessor wrote to John Swinney towards the end of last year asking for improvements in the quality of data. We have not had a response to that. I am more than happy to follow that up and ask for an update on progress on the provision of improved data, which we sought a year ago.

Ms Alexander: Thank you.

Christopher Harvie: We have talked a lot about issues such as light-touch regulation and the impenetrability of the banking system. Many of the winners in the system have chosen to buy large estates or houses in Scotland or to moor large yachts here. Is there not an obligation to ensure that the fortunes that are made and parked in Scotland contribute in some way to the development of the country?

John McLaren: I am not sure whether that means you personally, Ben.

Ben Thomson: We must appreciate that wealth is transportable. People can now move their wealth much more freely from one place to another. I totally agree that every citizen who resides in Scotland should pay a fair rate of taxation, but how the cake is sliced is a political decision on which the electorate vote, and it is worth attracting people at the wealthier end of the spectrum, because they bring money into the country that can help to run estates. I would love to be an estate owner, but I am not there yet. Such people help rural communities tremendously.

Christopher Harvie: You will have seen the statistic in *The Sunday Times* that £550 billion of wealth in the country pays about £15 million in taxation to the British state, although that is rather more than the proprietor of *The Sunday Times* pays.

11:15

Ben Thomson: If we could develop a system that ensured that people with wealth wanted to pay their taxes in Scotland rather than anywhere else, we could harness their wealth. They will pay tax somewhere, so we want to ensure that they do it in our local area. That is what the Swiss have done. In Switzerland, they say, "If you come in and pay £0.5 million as a tax hit, we will be delighted to give you residency, so that you do not have to pay tax anywhere else in the world."

The issue is output. One has to realise that if we want wealthy people to be in Scotland, it would be much better for us to have them pay their worldwide tax here. Devising a tax system that ensures that they do that means being more imaginative than slapping a whole load of taxes on them, because we will not get them if we do that. The question is how we can compete with other jurisdictions that might be trying to attract the same people, if they are the sort of people whom we want.

The Convener: Perhaps Sir Sean Connery would come back in those circumstances.

Dave Thompson: I have a comment on the business gateway. COSLA agreed the budget that Marilyn Livingstone talked about and was happy with the transfer. As Kenneth Low said, it has not been finalised yet; the councils are still working their way through it. People have been caught up in the wider economic problems, which makes their decisions even more difficult. I point out that Lewis Macdonald did not mention that the business growth and innovation budget has been increased by 94 per cent.

The Convener: Those are comments more than questions.

I have a question on the impact that the lack of liquidity in the markets might have on some of the infrastructure funding that has been talked about as helping to position us for the period after the recession, especially in relation to renewable energy. The money must come from somewhere, but if there is no liquidity in the market, will it have an impact on the ability of PFI projects and the Scottish Futures Trust to deliver?

Jo Armstrong: If somebody went looking today for a significant amount of PFI funding—let us start with that—for a radical new infrastructure project, such as a brand new bridge over the Forth, they might find it a bit more expensive, but they would probably get it. However, that is only "probably" because, at the moment, we do not know how comfortable banks are with lending. I have heard stories of them not being prepared to fund oil and gas deals at the moment. If they are not funding the sector that clearly is growing, there must be a question about their current ability to fund virtually anything that is large and complex and stretches over a long period of time.

One could probably find some funding for a PFI-type structure because the markets understand it and it would be a relatively straightforward proposition, but that funding would probably be more expensive. As we move away from something that the markets understand, the risk and uncertainty increase, which means higher prices. That has nothing to do with whether the market likes the vehicle; it is just that increased uncertainty causes prices to rise. The fact that we do not have enough detail on the Scottish Futures Trust is creating uncertainty about what is possible under that model. The existing not-for-profit structures should have given the markets comfort that they have already funded that kind of model, but the lack of sufficient detail is creating uncertainty and potentially making people feel that they do not want to get involved. That uncertainty prolongs the process. PFI and public-private partnership-type structures take a long time to put in place, so the longer the detail about what is required is lacking, the more the timescale is prolonged. Therefore, even if the capital were available, it would take longer to deliver more infrastructure, simply because of the lack of understanding of the SFT.

Ben Thomson: Most PFI structures have worked. They have 90 per cent debt, which earns about 1 per cent over the London interbank offered rate, and about 10 per cent equity—or exactly 10 per cent, if that was how the structure was formed—which usually earns about 13 or 14 per cent interest. Investors have always considered such structures, particularly the debt element, to be quasi-governmental risk, in that the Government supports them.

On the cost of that money, I think that, for whatever reason, people will still want to invest in things that have quasi-governmental risk. In future projects, to get the same sort of return, they might want to receive more letters of comfort or even guarantees, in which case the pricing might even come down, but then it will go on to the Government's balance sheet. The Government has to decide whether it wants to have more on its balance sheet. The pricing for Government risk will depend on what people see as the risk of lending to particular Governments around the world.

On the banks providing the risk, we have to look at what is going to happen to banks such as Macquarie in Australia, which is big in this area. If they go away, I suspect that a number of new investors will look to park their cash with quasi-governmental risk.

On the equity element of PFI deals, I suspect that, unless there is more Government assurance, the 14 per cent will go up. I certainly think that the secondary market, where PFI deals have been taken out, which tends to yield about 7 per cent—people come in on the basis that once the project is finished, they will refinance it—will change, because people will perceive greater risks in PFI, particularly over the longer term, than they ever envisaged when they went into these projects. I think that funds will be available, but they will come from different sources if the current banks run into problems, and the price is likely to go up, unless Government is prepared to take more on to the balance sheet.

Kenneth Low: I want to comment on local authorities. The Scottish Government's national indicators state that our

"public services need to be high quality, efficient, continually improving and responsive to the needs of local people."

One of the national indicators and targets is to

"Improve people's perception of the quality of public services delivered".

That is in the concordat that the Government signed with local authorities. If that is the objective, one has to be clear that these things have to be funded and properly costed. Otherwise, some of the targets on which we are asking local authorities to deliver will come into conflict with efficiency savings and budgets.

The Convener: I thank the panel for what has been a fairly lengthy and interesting session, which I am sure will illuminate our budget consideration in due course. I thank all the witnesses for coming along. I hope that they did not have too many travel difficulties getting here and that they will not have too many difficulties getting back to wherever they have to go.

I draw to members' attention the note that was circulated in our papers on the budget process and ask them to note the proposals for phase 2 and phases 3(a) and 3(b) of the budget process. Are members content to note that?

Members *indicated agreement*.

11:23

Meeting suspended.

11:32

On resuming—

Credit Crunch (Impact on Scottish Economy)

The Convener: Item 3 is on the impact of the credit crunch on the Scottish economy. We covered a few issues on this topic during the previous item.

Members have the options paper in front of them. It contains possible approaches to following up the evidence session at our previous meeting. Events have overtaken us since the paper was written and there are major issues to do with the funding package that was announced this morning, what has happened to the Royal Bank of Scotland during the past couple of days, and what is continuing to happen with the HBOS-Lloyds TSB potential merger. However, there would be some merit in exploring with the House of Commons Treasury Select Committee what can be done under option 3(a), taking account of the changes in circumstances since the options paper was put together. Obviously, the Treasury Committee has yet to meet to consider the matter, but we will see during recess what its response is and we can then explore further whether some form of short joint inquiry would be possible, especially given the constraints of standing orders. That is my recommended way forward, but I am open to comments from others.

Rob Gibson: The paper's scope has been overtaken. There are a lot of issues that we might want to take a look at, but perhaps we should take a step back and ask ourselves whether a joint approach is the right way to make progress. I question the convener's party's view that that would be a good thing to do.

For a start, I do not know how the concordats work. I would like to know whether this committee can question Westminster officials and whether they would be prepared to come here to answer questions. There are many underlying issues that could cause the committee to appear to be going off at half-cock over the credit crunch and the circumstances that we face. I would like the committee to consider what our relationship is with John McFall's committee and the Treasury, and to find out whether there are steps that we can take to achieve some clarity about that relationship before we approach the Treasury Committee. My impression is that it might well say that it is not interested in joint meetings. What would we do then?

The Convener: That is clearly a matter for the Treasury Committee. At the moment, it is just a question of exploring the possibilities, given that a number of the issues to do with the credit crunch are reserved and the Scottish Parliament cannot address them on its own. That is why a joint inquiry is suggested; it would be beneficial to use the skills of both Parliaments.

Ms Alexander: I want to deal with a devolved aspect of the credit crunch. I realise that the options paper deals with all aspects of it, and I might stand back from the discussion about joint working because other committee members have more experience than I do.

In his statement to Parliament the week before last, the First Minister indicated that he had secured a meeting with the chairman of Lloyds TSB to present Scotland's case. I hope that the committee can unanimously agree to write to the First Minister to ask whether the date for such a meeting has been set and, given that the First Minister was keen to preserve a united front on the issue, whether he would be willing to give the committee advance sight of his presentation. I am mindful that it was indicated that the meeting would take place within three weeks, although I suspect that it might be slightly delayed as a result of recent events. It would be in the Parliament's interests for us to write to the First Minister to ask whether the date for his meeting with Victor Blank has been set and whether he would be willing to share the case for Scotland with the committee in advance. If the committee is not due to meet, perhaps the convener could make the appropriate comments on the presentation.

The Convener: Thank you for that suggestion. Do any other members want to comment?

Gavin Brown: That suggestion is perfectly acceptable.

The paper in front of us contains five possible options. The idea of simply taking a watching brief sounds as if the committee would be taking too much of a step back; we should be doing something slightly more than holding a watching brief.

Three potential inquiries have been proposed, but I have some difficulties with them. I would not rule out the possibility of joint working, although the details need to be looked at, as Rob Gibson said. The principle of a joint inquiry is perfectly reasonable and could give us some useful stuff. However, in relation to the issues that we face today, I would be nervous about the specifics of such an inquiry. The pace of change in events in the marketplace as opposed to the pace at which this or any committee can act causes me concern. The letter from the convener to the chairman of the House of Commons Treasury Committee is dated 26 September, but we will not know whether that committee is up for it until a week today; it will have taken us three weeks to figure out whether the idea is a goer in principle. We should look at what has happened during the past three weeks, and consider what might happen during the next three weeks. That is my first concern about a joint inquiry.

My second concern is that if an inquiry is worth doing, it is worth doing well. It should be a comprehensive piece of work that can be presented to Governments and which draws out useful lessons, as our tourism inquiry did. That inquiry was found to be useful by the Government and all parts of the sector. I am not sure about the idea of doing a short inquiry into something so complicated. The issues that are outlined include Government changes, regulators, derivatives, central banks, global issues, credit rating agencies, and the bonus culture. There is a great breadth and depth of issues there and we have limited time and powers to deal with them. If we cannot do such an inquiry extremely well, we would do better not to sign up to it at this stage. We are still in the middle of the storm.

The paper outlines HBOS issues. When two shareholder votes are due to happen, I am nervous about holding an inquiry into whether the HBOS arrangement is right and how it came about. Whether the proposal is right or wrong is surely for the shareholders of HBOS and Lloyds TSB to decide. We could confuse matters and cause difficulties by going into that at this stage.

Option 2—mainstreaming—is the most sensible option. We could consider the situation at every meeting and make it part of our budget scrutiny in the next couple of months. I do not rule out an inquiry, but I am not sure how useful signing up to that would be at the moment.

Lewis Macdonald: I share some of Gavin Brown's concerns. We should not go off at half-cock and undertake an inquiry that we will not do thoroughly. That is important. Gavin Brown suggested mainstreaming, which we began to do this morning—we mainstreamed the credit crunch in our work.

The suggestion of informal contact with the House of Commons Treasury Committee is helpful in several respects. We cannot prejudge that committee's priorities, but I suspect that it is likely to be interested in many issues to which the paper refers, as they are important to the UK economy and financial sector regulation. In informal contact with that committee, we could offer to share the conclusions of our mainstreaming work on the credit crunch and its impact on financial services in Scotland and ask it to share with us its conclusions or its developing conclusions, if it examines such issues.

As Gavin Brown implied, once that process has started, we could take up Wendy Alexander's suggestion that we focus on and seek to be fully informed about what the Scottish Government has said that it will do, which we can feed into the Treasury Committee's considerations. Returning to consider what has happened once the storm has passed its peak might be helpful.

Dave Thompson: Option 2—mainstreaming—appeals to me, too. It would allow us to keep up to date with what is going on each week. We heard a lot of good material for nearly two hours this morning, which was extremely useful. What emerged was that nobody knows where the situation is going. We must be well aware of that. The committee will not meet for the next two weeks, but thereafter we will meet every week.

We cannot divorce the Westminster aspect from our considerations—it is important. The European Union's economic and financial affairs council is considering allowing VAT on house repairs to be reduced from 17.5 per cent to 5 per cent. We cannot implement that reduction, but we could say that we support Europe's proposal to allow the UK Government to make that reduction and that we think that it would boost many small businesses in the building trades. People are being paid off instead of building new houses, but many people might want to improve their houses. If the VAT rate on doing that were only 5 per cent, that could be a big boost.

If somebody from the UK Treasury could give us a view on the likes of that, that might help us—Rob Gibson talked about that. What do we need to do to get such people to come along to have the sort of chat that we had this morning about the impact on Scotland of broader issues, given that the levers of power are held in Westminster and that measures such as reducing VAT on house repairs are not in our gift? There are lots of other ideas, such as bringing forward construction projects, which we touched on this morning. Mainstreaming the work would allow us to be flexible week to week.

Christopher Harvie: Two subjects are worth considering. One is the European assessment of the relative performance of London and Scotland in the HBOS imbroglio. I think that the Scots came out reasonably clean from that; that cannot be said of operations on the London stock exchange. The other, which has already been mentioned, is the question of funding for infrastructural and industrial projects. The BOS bit of HBOS used to do that well, but there is a great deal of scepticism about whether Lloyds TSB would be so minded.

The Convener: Having listened to members' views, I propose that, first, we take up Wendy Alexander's suggestion that we write to the First Minister to request more details of his proposed meeting with Lloyds TSB; secondly, that we agree to mainstream the matter in the meantime, perhaps returning to it at a future date; and thirdly, that we continue to explore with the Treasury Committee areas in which the two committees can co-operate to address the matter. Is that an acceptable way forward?

Members *indicated agreement*.

Council of Economic Advisers (Invitation)

11:46

The Convener: Item 4 concerns our invitation to the Council of Economic Advisers. The original intention was that Sir George Mathewson should attend the committee's meeting of 8 October, but for various reasons—I do not need to go into detail—that has not proved possible. There is an exchange of correspondence on the matter between the First Minister and me. It would have been particularly useful if Sir George Mathewson could have been here today for our consideration of some economic aspects of the budget. As part of the budget process, it would have been useful for us to hear what the Council of Economic Advisers is advising the Government in relation to the budget. The correspondence to which I referred has been included in committee papers for information. If members have views on the matter, they are free to express them.

Lewis Macdonald: It is disappointing that Sir George Mathewson has not seen fit to respond positively to the committee's invitation, which has been lying with the Scottish Government since July. That causes me some concern. It is a reasonable expectation that anyone who is engaged in any way with public service should see accountability as a primary part of their duties. When the Council of Economic Advisers was established, that was specifically and explicitly described as one of the roles that Sir George would play on behalf of the council in relation to committees of the Parliament. Since we issued our invitation this year, questions have been raised about the quality of advice that has been given to the First Minister on Scottish economic matters and about the consistency of his views on current banking and financial issues with those of members of the Council of Economic Advisers, as their views appear to be at variance with one another. It would have been particularly helpful—today of all days—for us to have heard from Sir George on that point.

When I was looking at the papers for today's meeting, I glanced up to see that Sir George Mathewson was on television enunciating his views on the performance of the UK Treasury, to which he is not an adviser. That happened yesterday—the day before the date on which he was invited to give evidence to the committee. It struck me as odd that he was so willing to make known his views on the performance of the Treasury. He was critical of the chancellor in ways that I found quite surprising, given his role in relation to the Scottish Government. At the same time, he finds it impossible to agree to attend a meeting of a parliamentary committee to which he has already spoken. We are surprised and disappointed at that. There is cause for us to pursue the matter and to seek not only his attendance at an early meeting of the committee but his agreement that it is part of his remit to describe the quality of advice that he is providing to ministers.

Rob Gibson: To take the politics out of the issue, I note that the annual report of the Council of Economic Advisers will be published in early November. Given how long it may take this situation to play out, it may be appropriate for Sir George Mathewson to appear before the committee on 19 November, as has been suggested. It is up to us to ensure that we get that timetable.

I wonder whether comments in the current hothouse atmosphere might deflect us from the fact that a timescale for the Council of Economic Advisers was agreed last October. Given that the annual report is about to be published, surely that would be a good time to hear from the council.

Dave Thompson: I am not sure that this kind of tit-for-tat situation, with one body accusing the other of not responding, helps anyone. For example, in his response dated 25 September, the First Minister claims that the clerk did not respond

"until early September … to the Scottish Government Secretariat's initial response".

We really do not want to go down that road.

I do not recall deciding after our previous session with Sir George Mathewson to call him before us again before the council's first year was up. I know that we said that we certainly wanted to speak to him again. Given that, for whatever reason—and I do not wish to get into whose fault it was—he did not get the invitation until well after July, it would have been very difficult for him to come before us before November. We should simply accept that we are going to see him in November, make the best of it and not get bogged down in who was right and who was wrong with regard to the correspondence.

The Convener: I remind you that in the work programme that was agreed on 10 September it was decided that we would seek to have Sir George Mathewson at this meeting.

Dave Thompson: I was talking about last year—

The Convener: Indeed, but I do not want to get into a debate about what happened last year. All I am saying is that on 10 September the committee agreed a work programme that included an evidence session with Sir George Mathewson at this meeting.

Dave Thompson: I know that, convener, but he could not come because he did not get notice. No one agreed to send the letter in July, inviting him to this meeting. I certainly did not; after all, we were in recess at the time. It is important that we get these things in perspective.

The Convener: Well, that matter had obviously been agreed by the convener at the time.

Gavin Brown: By and large, convener, your letters capture and take care of most of the issues. If, as it appears, Sir George Mathewson received the invitation too late and simply could not make it to today's meeting because of a pre-existing commitment, we cannot really complain about it. A commitment has been made for 19 November, so we should take that opportunity.

In general, though, you are right to say that, if necessary and where it can be arranged, we should be able to call on witnesses to attend meetings at short notice. As you said, we did not agree that we would not call back a representative from the council until the annual report was published; I believe that we said that that would be a good time to call someone back, but there has to be some flexibility. If the committee wants information, it should be able to request witnesses to attend.

On this occasion, it appears that Sir George Mathewson got the invitation late and was too busy to attend. I certainly accept that at face value.

The Convener: I am not blaming Sir George Mathewson for not being able to attend today. It is clear that he had a prior commitment. However, in my letter to the First Minister dated 19 September, I suggested that another member of the council or indeed the First Minister himself could attend in Sir George's stead. I find it slightly unfortunate that the First Minister did not respond to that part of the letter.

Lewis Macdonald: Indeed. I entirely accept the point that if the Scottish Government failed to pass the invitation on to the chair of its Council of Economic Advisers, the blame lies with that decision, not with Sir George Mathewson.

I am disturbed by how much all of this reminds me of our recent debates on the Energy Technologies Institute and on how things that might seem very clear and straightforward can get lost in the thicket. It would have been very good to hear what Sir George Mathewson had to say about, for example, the role of short selling in what has happened to HBOS and the Royal Bank of Scotland. However, despite the committee, convener and the clerk taking the necessary steps to get Sir George to attend this morning, problems with the Government's mailing system mean that that will not happen until the middle of November.

Given that we are in the eye of the storm, that is unfortunate, and we should make that view known to Government. After all, when a parliamentary committee contacts Government and says, “This is what we’d like to happen,” it should reasonably expect the Government to expedite the request.

Marilyn Livingstone: It is important that we let the Government know our view on the matter. This is a point of principle. I accept that an error was made, but the fact is that we are in a crisis and we must be able to call witnesses before the committee. I agree with Lewis Macdonald that we should set out our stall and say that we hope that this does not happen again. It is unfortunate, to say the least, that we now have to wait until 19 November.

The Convener: It certainly is unfortunate, not least because in our consideration of the budget we have decided to focus on how the Government intends to deal with the current economic situation. The best people who can tell us about the advice that is being given to Government sit on the Council of Economic Advisers, and I would prefer it if someone from the council came before us during rather than after our consideration of the budget.

On that basis, I recommend that we write again to the Government to ask whether someone from the council—or, if he prefers, the First Minister—can attend one of our meetings between now and the end of the budget process. If no other date is available, I am willing to include the meeting of 12 November, given that our report will not be finalised until then. Obviously, if that is not possible, we will have to accept the offer of 19 November, but the committee would be better served by a member of the council coming before us before then.

Are members agreed?

Rob Gibson: Do we have to finalise our deliberations by 12 November?

The Convener: Yes. The report has to be with the Finance Committee thereafter.

Dave Thompson: I do not disagree that it would be good if someone from the Council of Economic Advisers could attend before we finalise our report on the budget on 12 November. However, I do not think that we should go down the road suggested by Lewis Macdonald and start blaming the Government. That would mean that we would have to look at the Government’s claims that it did not receive a response from us “until early September”. That is sterile ground.

The Convener: I am not getting into any of that. I am simply suggesting that the committee write back to the Government, saying that it would allow us to get the best out of our consideration of the budget if the chairman or another member of the council gave evidence to the committee on the council’s advice to Government before we conclude our deliberations on the budget. I assure members that I will be as diplomatic as possible.

Are members agreed?

Members *indicated agreement*.

Scottish Trades Union Congress (Seminar)

11:57

The Convener: The final item relates to the annual seminar with the Scottish Trades Union Congress, on which the clerk has produced a paper outlining various proposals. Do members have any comments?

Gavin Brown: It is a good paper. I simply wonder whether, given the events of the past week or two, the seminar's title, "Trade Unions and the Arc of Prosperity", should be changed to something more appropriate—"Trade unions and our nearest European neighbours", perhaps.

The Convener: We will certainly consider that.

Ms Alexander: On that note, to ensure that we are not living in some parallel universe come February, I suggest that we ask SPICe for a background note on the current economic performance of the nations under consideration in the seminar. That would be a good way of contextualising and informing the discussion on the current state of their partnership relationships.

The Convener: We will request that from our good friends in SPICe.

Dave Thompson: At our previous joint meeting with the STUC, I felt that there was a very strong view that productivity should be the main issue at the next joint meeting. Indeed, the witnesses this morning pointed out that, although Scotland's employment rate is high, our productivity does not match that of other European countries. When did we decide that the seminar should focus on "Trade Unions and the Arc of Prosperity"?

The Convener: The suggestion has been made by the trade unions.

Dave Thompson: Surely we should also have an input into the matter and not base our ideas purely on what the trade unions want to discuss. How long ago did the unions make this suggestion? Was it well before the worst effects of the credit crunch became apparent?

The Convener: I do not have those details. I am sure that the clerk can provide them in due course.

Dave Thompson: I should say that I have no problem with the current suggestion. It is just that, at last year's seminar, it struck me very forcibly that productivity was the subject of a lot of discussion. Indeed, after the meeting with the STUC, the committee discussed the fact that it was a major issue and that it should be examined. I am surprised that it seems to have been ditched.

The Convener: As I say, the suggestion has been made by the trade unions themselves.

Lewis Macdonald: I support the STUC's suggestion that it would be very useful to examine this issue. As Gavin Brown has said, we might learn a bit about weaknesses as well as about prosperity and strength. I would certainly find it extremely informative to consider the different models used in smaller economies such as Ireland and Norway, and a trade union perspective on the matter would be particularly valuable.

The Convener: Taking into account Dave Thompson's points, are members content with the proposal?

Dave Thompson: I am certainly happy to agree to the proposal, because we will get a lot of useful information from both sides of the coin.

The Convener: I am sure that the key part played by productivity in prosperity will be discussed during the seminar.

Christopher Harvie: The STUC is certainly interested in finding out about systems of training, for example. It might be too much to get involved in yet another economic autopsy.

The Convener: As the programme builds up, the clerk will discuss the various details with the committee to ensure that the seminar covers topics that members and the STUC want to talk about.

Before I conclude the meeting, I pay tribute to David Whitton for his work on the committee. We look forward to following his suggestion and visiting the Scottish Power control centre in his constituency as part of our energy inquiry.

Meeting closed at 12:01.

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