# ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 21 January 2009

Session 3

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CONTENTS

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## ECONOMY, ENERGY AND TOURISM COMMITTEE
**2nd Meeting 2009, 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:**

Colin Borland (Federation of Small Businesses)
Stephen Boyd (Scottish Trades Union Congress)
Garry Clark (Scottish Chambers of Commerce)
Eric Leenders (British Bankers Association)

**CLERK TO THE COMMITTEE**

Stephen Imrie

**SENIOR ASSISTANT CLERK**

Katy Orr

**ASSISTANT CLERK**

Gail Grant

**LOCATION**

Committee Room 2

# Scottish Parliament

## Economy, Energy and Tourism Committee

*Wednesday 21 January 2009*

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

## Decision on Taking Business in Private

**The Convener (Iain Smith):** I welcome everyone to the Economy, Energy and Tourism Committee's second meeting in 2009. Agenda item 1 is consideration of whether to take in private item 4, which is on a draft report that we will submit to another committee. Discussing that report in public is inappropriate until we have approved it and the committee to which we are reporting has seen it. Do members agree to take that item in private?

**Members** *indicated agreement*.

## State of the Economy

09:33

**The Convener:** Item 2 is evidence on the state of the economy. Given the news about that in the past couple of days, the committee's decision to hold this hearing is especially appropriate. We are concerned in particular about issues such as the impact of the credit squeeze on small businesses. I am pleased to welcome a panel of witnesses whom I hope will describe the background to such matters.

In a moment, I will ask the witnesses to say a few words of introduction. We are interested in information from the panel about the current state of the Scottish economy and in any concerns that they wish to express about the effectiveness to date of initiatives that have been launched by the Scottish Government, the United Kingdom Government, the Bank of England or the European Union. We would like the witnesses to comment on the problems that small and medium-sized enterprises are reported to be encountering in accessing finance for working capital and investment capital with reasonable terms and conditions from banks. We invited representatives of the Bank of England to be on the panel, but they declined because of their concerns about accountability issues, such as the bank's direct accountability to Westminster. We will consider that further in due course. I invite the panel members to say a few words of introduction.

**Eric Leenders (British Bankers Association):** I am the executive director of retail banking at the British Bankers Association. Thank you for the opportunity to talk to you about the Scottish economy and, in particular, the support that the banks continue to provide to small businesses in the region.

My opening remarks should be confined to the depth and severity of the recession that we are now facing. When I gave evidence to the committee a couple of months ago, we seemed to be on the cusp of some sort of recession; it is now clear that we are in for quite a long, deep and severe recession. We are seeing that primarily in the up-tick in unemployment figures. Small businesses, as employers, have a role to play there.

It will be useful to try to explore some of the discrepancies in the research—I am sure that this will come from other witnesses—about the withdrawal of support for small businesses from banks. That is set against the macro figures that suggest that, although the level of support has declined, during quarter 4 of last year—certainly in quarter 3—there was an additional £1 billion of financial support to small businesses. Based on October and November figures, it looks like that number has reduced to about £100 million or £150-odd million per month. There is a reduction in the amount of additional credit that is being provided, but there is additional credit nonetheless. It would be useful to explore that area.

We should also concentrate on certain initiatives that the devolved Assembly might look to progress to support the economy in Scotland.

**Stephen Boyd (Scottish Trades Union Congress):** I am the assistant secretary at the Scottish Trades Union Congress with responsibility for economic and industrial policy. On the state of the Scottish economy, it is clear that things are very worrying. Because of deficiencies in Scottish economic data, we have yet to see the full impact of what has been happening in the economy over the past six months feed into the official data.

The anecdotal evidence from our affiliates, who represent workers right across the economy in all industrial sectors, is increasingly pessimistic. Over the past two quarters that have been reported on, we have seen reasonably substantial rises in unemployment. Unfortunately, we anticipate seeing another reasonably substantial rise this morning. In looking at the statistics, we have to bear it in mind that we have yet to witness the direct consequences of the banking crisis in terms of job losses in the financial sector in Scotland, which is our specific concern at the moment.

I do not think that it will come as news to the committee that the job losses to date have mainly been in construction of houses and commercial property and related services. Food processing and retail and distribution are also increasingly being hit.

We have real concerns about manufacturing. When we appeared before the committee in September, one of the pluses was the potential boost to manufacturing provided by the falling pound. I am afraid that that has not really come to fruition. In any case, it has been more than offset by the global downturn in demand, which has not produced the benefits for Scottish manufacturers that we had hoped to see by now.

That said, we must bear it in mind that certain sections of Scottish manufacturing continue to do well. Last week, I met the chief executive of a major Scottish employer that has increased its workforce by about 15 per cent since last September. That employer is in the energy sector, which is generally doing quite well.

It will come as no surprise to you to hear that the availability and price of credit are the greatest barriers to stabilisation in the economy and the major problems that our companies face at the moment. I am sure that my colleagues are better placed than I am to give you specific examples from their members. The continuing volatility of energy prices is also not helping. We have yet to see the fall in prices that we hoped to see following the fall in the price of oil since late last year.

The helpful written submissions from both Highlands and Islands Enterprise and Scottish Enterprise are a sober and mature assessment of what is happening in their areas. Scottish Enterprise is trying to get the message across to people that companies that are able to invest in the economic cycle at this stage will benefit when the upturn hits, as it inevitably will—hopefully, sooner rather than later. Getting credit flowing again is vital to making that happen.

**Garry Clark (Scottish Chambers of Commerce):** I am the head of policy and public affairs at the Scottish Chambers of Commerce. Most of you will have seen the quarterly business survey that we published yesterday. The figures, and what they reveal about the state of the Scottish economy, speak for themselves. They are the worst for business confidence, orders, expected orders and demand since such reporting commenced in 1984. It is the worst report in a quarter of a century. To some extent there is still a mixed picture in Scotland. There are some good-news stories out there—it is by no means all doom and gloom.

We think that there are three key issues. First, the issue of credit facilities for businesses needs to be resolved. Without those facilities, some businesses will be unable to continue and many perfectly viable businesses will be unable to invest in development so that, when we emerge from the recession—as we inevitably will—they will be in the best possible place to compete globally. That is where we want them to be.

Secondly, once we have the credit situation under control, we need measures from both the Scottish Government and the UK Government that are aimed at cushioning the impact of the recession on business. We have seen some progress on that from both Governments, but we need more and, in some cases, better-directed assistance.

Thirdly, we must ensure that we are geared up for the recovery when it happens, which means ensuring that we maintain our skills base in Scotland. There is no more important asset among our businesses than our skills. We must ensure that those skills are maintained and built on so that we have the kind of economy that will hit the ground running at the end of the recession.

**Colin Borland (Federation of Small Businesses):** As you know from the committee papers, the FSB has prepared a brief written submission. I do not propose to detain you by going over it in detail.

I echo what Garry Clark from the Scottish Chambers of Commerce said. The root causes of the situation are that demand has dropped, as we would expect given the prevailing economic climate. Allied to that there have been problems with smaller firms not getting paid for work that they have done—especially work that they have laid out money to complete. We have also seen that, when firms have gone to their banks and financial institutions for help to ease their cash-flow difficulties, that help has either not been forthcoming or has come at prohibitive terms. Those three factors combine to make this a concerning time for our members. Although we would say that the most dire predictions that we have heard are not inevitable if certain concrete actions are taken at every level, we should not allow that to disguise the need for action to be taken where possible.

09:45

Rather than focusing on how bad the situation is, we have tried to consider what exactly we can do about it—rather than measuring how overgrown our lawn is, we have been trying to get the lawnmower out. It is probably too early to tell whether the recent dramatic and unprecedented action has had the desired effect, but it has been necessary and, on the whole, welcome. The Westminster Government and Scottish Government are certainly correct that the number one priority for getting us out of the problem is to get credit flowing again, on sustainable terms, to businesses that need it. As Garry Clark said, businesses are getting into financial difficulty not because they are not busy and not because they are flawed businesses, but because they have preventable cash flow issues.

That has to be tackled on a range of fronts. The measures that we have considered over which the Scottish Government has power include public sector payment times, and there is anecdotal evidence that those are moving in the right direction. We have had other discussions that suggest that a great deal of effort is being put into that on the other side of the fence and it seems to be coming through. Long may that continue. However, it is not purely about central Government: local authorities and other publicly funded bodies and agencies also need to act on it.

We are also considering the practical support that will be available to businesses. What Scottish Enterprise is doing on that is welcome, but we must appreciate that the typical, run-of-the-mill small business is not within Scottish Enterprise's client group, so we must consider how support is delivered to it. Perhaps we will talk a bit more about that later on.

We have also suggested that some of the regulation and primary legislation that is being introduced should be reconsidered. We can argue about the rights, wrongs and merits of it, but we have consistently questioned whether, if the measures do not have to be imposed at the moment, this is the right time to pursue them. We also need to ensure that the public procurement agenda—the £8 billion that public bodies in Scotland spend on goods and services—is used to the best economic effect.

**The Convener:** I thank the witnesses for their opening statements. There is a great deal that we can cover this morning, and they have given us more food for thought.

I suggest to members that we try to split the evidence. We will start by considering the general state of the economy and the measures that the UK and Scottish Governments have taken to date to address it. We will then move on to some of the more specific issues that are addressed in the Federation of Small Businesses survey and the more recent Scottish Chambers of Commerce survey, which came out on Monday, about the specific issues that businesses face and what can be done in Scotland to help them.

I will start with a general question. Do the witnesses have any thoughts on the Scottish Government's six-point economic recovery plan, the UK Government's VAT reduction and banking bail-outs—marks 1 and 2—or the Bank of England's interest rate cuts? Are those measures having any demonstrable positive impact on the economy and on getting Scotland and the UK out of recession?

**Eric Leenders:** I will start with the banking interventions, as you mentioned them specifically. We welcomed the October 2008 measures and those announced earlier this week. The issue that persists is the lack of liquidity and lending between banks. We must remember that the measures that the Government has taken are unprecedented and untested, so it is perhaps unfair to suggest that the first tranche failed. The Government was testing what seemed to be an appropriate measure and has clearly felt the need to supplement its initial interventions, which are welcome and will make a difference. It is helpful that in the Bank of England's asset purchase scheme we have, in effect, a new line of credit that will supplement the retrenchment of overseas lenders and banks that has caused a funding gap of some £100 billion-plus in the economy. The scheme goes some way, in buying commercial paper from corporate entities, to help support them and I think that its ambition is to ensure that that funding trickles down.

On more specific market interventions, such as the cut in VAT, others will be better placed to comment. Typically, financial services do not attract VAT, so the effect will not have been that great. When we go on to talk more specifically about small businesses, we could perhaps talk about Lord Mandelson's announcements—in particular, the announcement on the widening of the loan guarantee scheme. Those measures should help viable small businesses with cash-flow difficulties.

**Colin Borland:** If the question is, "Are your members reporting that they can now get access to credit more easily and on more favourable terms?" then it is too early to give an answer. However, the early indications are that the answer would be, "Not at this stage."

Our most recent survey of our members was in December, just at the end of last year, when about 31 per cent of them reported a rise in the cost of new credit. That was an increase on the figure from two months previously; when we asked the same question in October, the comparable figure was 26 per cent. We are not so naive as to think that any measures will take effect overnight, but it is concerning that the figures seem to be going in the wrong direction. However, the data were compiled before the most recent announcement—last Wednesday—on loan guarantees. We very much hope that that announcement will stimulate the banks to lend again. It has been said that the banks now have one fewer excuse not to lend to our members, because the risk has been reduced. When members go to banks with viable business propositions that will make the banks money, we are confident that they will not be shown the door.

My evidence is not simply anecdotal. Bank of England figures from December were that about a quarter of firms had refused potentially profitable contracts because trade credit was either unavailable or available only on unfavourable terms. Of course, a balance must be struck. Banks cannot throw good money after bad and prop up bad businesses; that is not what we are arguing for. However, the balance is not being struck; people are looking at the wrong end of the spectrum. Because of a lack of credit, good work cannot be done. That work could be profitable and could help to get the economy going again.

**Garry Clark:** We support the UK Government's intervention in the banking system. It was necessary and had to be done. However, it is in no way a silver bullet. The massive investment in the fourth quarter of last year was never going to be a one-off buyout that would solve banks' liquidity problems overnight. Issues have arisen since then. This week's announcement of additional loan guarantee availability for the banks will probably not solve the problems overnight either. There will have to be a process of continued intervention by the UK Government in order to ensure that banking gets back to normal and to ensure that normal credit facilities are again available to businesses.

We have received many reports from throughout the country of businesses' loan rates increasing from 1 percentage point above the base rate to 2 and 3 percentage points above it. Interest rates that are charged on overdraft facilities have increased and a number of businesses' overdraft facilities have been withdrawn. It is galling that, in many cases, businesses are charged by their bank for the privilege of having that happen to them. That has clearly soured many relationships that have been built up over many years between small and medium-sized businesses and their banks.

We must re-establish those relationships. Perhaps one way of doing so is by considering the finance that has been made available to the banks through the European Investment Bank, which they can—it is to be hoped—pass on to small businesses. It is important that we work with the banks. The Government, business and the banks must work together in partnership to identify where that investment can best be directed to ensure the continued growth of our economy and safeguard many businesses throughout the country. As Colin Borland said, many businesses are suffering from serious cash flow issues as a direct result of the cost and lack of availability of credit, and the knock-on effects of late payments, whether from the public or the private sector or anywhere else. We welcome the efforts that the public sector has made to ensure that payments are made on time to help cash flows in many of our businesses.

On the other specific measures that have been taken, we broadly agree with the six-point plan that the Scottish Government has announced, but action needs to be taken to ensure that what has been proposed is delivered to business and that it makes a real difference to business as early as possible. Some things may take a while. Obviously, in accelerating large-scale capital projects, it takes a few months for businesses to benefit from the accelerated spend.

Procurement is still a major factor for many businesses. I accept that successive Scottish Governments have done their level best to try to improve the availability of public procurement opportunities to small businesses, but many businesses still find it difficult to access procurement opportunities. It is difficult for people in such businesses to put their head above the parapet and say that they are having problems, because they will rightly be concerned about the effect that doing so could have on future contract negotiations. Major efforts still need to be made. The Government is heading in the right direction, but we need to ensure that what has been promised is delivered.

I turn to the UK Government's actions. We have not discerned any effect on our members' ability to do business as a result of VAT being cut from 17.5 to 15 per cent. We see that as an expensive Government measure, but we have not so far detected any benefits as a result of it. Perhaps that is a function of the fact that it was introduced at a time when, for example, many retailers were already discounting goods by 20, 30, 40 or 50 per cent in advance of the Christmas and new year sales period. We will certainly keep an eye on what happens throughout the year, but the cut has so far not had the effect that the Government perhaps intended it to have. I do not know whether there will be a beneficial economic effect in respect of the Government's control of inflation at this time next year, when VAT goes back up to 17.5 per cent, but my responsibility is to Scottish Chambers of Commerce members and businesses, and we have certainly not discerned any effect so far as a result of the policy.

10:00

We certainly welcome the investment that the UK Government is making to ensure that there are incentives for businesses to employ people who have been unemployed for a long period. We should look closely at how the funding will be applied in Scotland as compared to England, where it will in part be directed at business through the train to gain scheme. We need to consider which of our processes could best be used to pass that welcome funding on to Scottish businesses.

Above all, we want the Chancellor to consider a reduction in the employer national insurance contribution. That would make the cost of employment cheaper, which we would like to see. We are keen to ensure that the Scottish business sector maintains the skills base that will ensure that our country is best placed to emerge from the recession stronger and more successful. The cost of employment needs to be reduced as much as possible to do so.

**Stephen Boyd:** It is a big question. We need to distinguish between the different measures that have been implemented over the past few months. Three main areas are involved, the first of which is the measures that are being targeted at the banking crisis. The package of measures in October had the primary purpose of bringing an element of stabilisation. It is easy to forget how perilous the situation of the banks was then. It is apparent that the Government is learning as it goes along. Given that we are living in remarkably unusual times, it was always likely that a further package of measures would be required. Earlier this week, such a package was introduced.

The editorial in the *Financial Times* today welcomes the measures. People needed a couple of days to analyse the impact of the measures, which are probably the best that we could hope for in the circumstances. I have no doubt that we will have to revisit the situation for some time to come: further action is likely to be required. Generally speaking, the measures are welcome.

The second and perhaps most important area relates to the measures that were introduced at UK and Scottish levels to try to mitigate the extent and depth of the recession. The first element is monetary policy. It is important to record that the Bank of England monetary policy committee was horribly behind the curve for most of last year. It did not act until it was far too late. It should have acted in the late spring or late summer of last year, but it was far too panicky about inflation and took a very narrow view of the factors that were impinging on inflation at the time. If it had acted then, we might not be facing the circumstances that we are now experiencing, or at least not to the same extent. Major questions need to be asked about the future role, remit and membership of the MPC. Albeit that its decisions were necessary, they are far from being sufficient to address the recession.

A package of stimulus measures was required in the autumn. We gave a general welcome to the measures that the Government introduced as part of its pre-budget report. That said, the STUC would not have chosen VAT as the main plank of the measures. We would have preferred the Government to direct more targeted measures at those who are hardest hit by the recession. I am thinking of the unemployed and people who are at risk of being made redundant. We would have ensured that the money went to those who would spend it, thus providing a demand boost at this key time.

Nonetheless, we should recognise that the choice at the time was between a stimulus package and no stimulus package, and our preference is for a flawed stimulus package rather than none at all. We should be mindful of the lessons of the recessions of the 1980s and 1990s. Over the years, Governments had to pay vast sums of money to deal with the long-term consequences of the disastrous labour market policies and with the extent and depth of the recessions.

We welcome some parts of the Scottish Government's six-point plan but have concerns about other parts. However, the Government's message that further deregulation or holding back new regulation would provide a boost to the economy was wholly misplaced. We are in the midst of a crisis that was caused by deregulation. We have to be careful about how regulation is implemented. I am sure that the committee will return to that issue in its questioning. The Government's message was poor.

The comments about planning were largely welcome. We discussed the national planning framework in the committee last week, and we recorded our concerns about the resourcing of planning departments around Scotland. It is fine to talk about changes to policy and culture and so on, but they have to be adequately resourced, and we are not convinced that that is the case.

The third set of measures has sought to deal with the consequences of recession, including people who are at risk of being made redundant or who have, unfortunately, already been made redundant. The Scottish Government has been somewhat behind the curve on that, but it is getting to the right stage. Its announcement last week about improvements to partnership action for continuing employment—PACE, as we know it—was welcome. The national helpline and the revamped website will be invaluable to our representatives who are trying to advise members who are at risk of being made redundant.

Garry Clark made some pertinent points about the Prime Minister's announcement at the beginning of last week about the employer subsidy and support for training in England. Quite how all that will pan out in Scotland is not yet clear. We are meeting Scottish Government officials regularly to discuss those important issues. I know that they are keen to pull together a clear package of measures for people who are at risk of being made redundant. The Scottish Government is keen to nail down what the announcements at UK level last week mean for Scotland. That will allow us, first, to inform our workplace representatives adequately so that they can assist members who are at risk of being made redundant, and, secondly, to compare properly what is on offer in Scotland with other parts of the UK. There is a lot of ill-informed analysis on that point. If, in future, we are assured that what is on offer in Scotland is less than what is on offer elsewhere, we will make a strong case to the Scottish Government to remedy that quickly. Until we see what is on offer in all the component parts of the UK, we will have to be quite mature in how we address the situation.

**Eric Leenders:** I return to the point about pricing, particularly for small business credit. You are right that pricing has moved out—I would like to explain some of the reasons why. First, where the base rate has been cut, those cuts have been passed on to small businesses in full. However, the base rate does not reflect the cost of funds for business; typically, that is reflected by three-month sterling LIBOR—the London interbank offered rate—which sits at about 2.3 per cent as against the base rate of 1.5 per cent. When we look at facilities that are priced at, say, 1 per cent plus base rate, we are looking at 20 basis points to cover all the overhead costs, such as risk, administration costs and so on.

Beyond that, pricing has increased because we, as an industry, are not immune to increased costs in our businesses either. The same overhead increases that small businesses face are typically reflected in the banking industry as well. Further, risk has returned. In a benign economy there was far less risk, but in a recessionary environment there is a far greater degree of risk, which has to be priced into any credit interest.

Finally, there is the issue of competition. During the past 10 to 15 years, there has been intense competition for small businesses. However, demand for new facilities has slackened somewhat, and the downward pressure that has competed away margin has started to ease. The combination of those factors means that it is necessary to widen spreads. I should say that 80 per cent of finance to small businesses remains funded at below 3 per cent plus base rate, so the relative cost of funding to small businesses should be only a very marginal consideration in terms of business viability.

**The Convener:** We will come back to some of those issues later in the discussion.

**Rob Gibson (Highlands and Islands) (SNP):** We face a difficulty because of the absence of the Bank of England today. It may have a line of responsibility to Westminster, but I deprecate the fact that it has not come to take part in this discussion. Our messages to London about banking structures and the banking system might help the people who are here from the Scottish Chambers of Commerce and the Federation of Small Businesses, as well as the workforces, so I deprecate the Bank of England's absence considerably.

Surely we are not dealing with untested measures. We are dealing with untested measures in terms of the scale, but other countries dealt with such situations, for example Norway and Sweden at the end of the 1980s, by setting up models in which they made the banks come clean. Those countries downsized activity and focused on the development of the local economy.

Although the loan guarantee scheme is welcome, should we be looking for a model that not only channels European Investment Bank money but ensures that the high street banks are transparent about what they are going to do to help savers and borrowers? We can rule out the shareholders at the moment, as they have taken the hit.

**Colin Borland:** Your point about transparency is a good one. We are not bankers or financiers, and would not present ourselves as such. Our members feel that they are being penalised for the availability and obviousness of their assets. The question of finance is not purely about costs and rates, although they are part of it; it is also about the securitisation of assets. People who have had a flexible overdraft for many years are now being asked to provide security for it. Some of it comes down to the fact that our members' assets tend to be tangible—they have stock, business premises and a family home—so the finance that they get can be secured against them. Loans, too, are secured on those assets and can be recouped, so institutions' exposure is limited.

I have been told that some of what we are now referring to as the toxic assets of the financial institutions are so complicated that even the people who handle them for a living do not understand what the institutions own. I will give you an analogy. I remember going to the market as a boy, and there was a guy standing at the front asking who wanted to buy the mystery box for £20. No one was interested until another guy in the audience said that he would buy it for £20. The person in the audience opened it up—this was in the 1980s—and found a cordless phone or a microwave or something. Seeing that, everyone else piled in. It was only when they got home that they realised that they had bought a box of bricks. Part of the current problem is that no one really knows what they bought. However, our members' businesses are simpler and have more tangible assets. For an institution that is seeking to reduce its exposure, it is easier to go after a smaller company.

So, my answer to your question is yes. While it is not for me to propose detailed recommendations on the reform of banking regulation or questions about how the finance system as a whole operates, anything that increases transparency will, in the long term, be good news.

**Stephen Boyd:** The question is very important. I should probably have prefaced my earlier comments with the proviso that we want all measures not just to deal with the impact of the recession but to be consistent with a new economic and social model that is considerably more sustainable than the one that has just imploded. We want a new banking sector to emerge; we do not want one that is the same as that which collapsed in the autumn.

We should learn lessons from Sweden and Norway. Colin Borland makes an important point about the complexity of the products that brought about the collapse, which are not easy to disentangle—doing so will take time. The scale and complexity of those products and the scale of the banking sector in the UK means that it is not particularly helpful to make direct comparisons at the moment. The general point is about wanting to get to a different place.

It was interesting to listen to John Kay the other night on "Newsnight Scotland", who made a typically brilliant intervention in the debate by emphasising the importance of not restarting the party. I support the measures that have been introduced in the banking sector so far, but we really need to keep our eye on the ball. There are people in the banking sector and the wider financial services sector who are still being paid vast amounts of money for delivering not very much to the rest of society. There will be people who are looking to restart the party as quickly as they can, so we need to keep our eye on that.

10:15

**Garry Clark:** There has to be a fundamental reassessment of the way that lenders and borrowers interact. The quickest way to resolve the issues and to get to where we want to be is to ensure that there is a genuine partnership between the banks, their clients—whether business or personal—and the public sector. Only by working in partnership will we ensure that we get to the other end as quickly as possible and re-establish the bonds of trust that have been somewhat corroded over the past year.

**Eric Leenders:** I refer you to the asset protection scheme, the idea of which is to provide a guarantee for the toxic assets that sit within bank balance sheets. The structure in the UK is that, rather than have a toxic bank, the banks bear a cost for accessing the guarantee scheme. The banks pay for the facility, which is right, rather than pass toxic assets on to a Government-owned facility. Let us not forget that the banks take the first loss and the third loss—only a section of the loss is guaranteed. The Treasury has looked to construct a vehicle whereby the assets that need to be guaranteed stay on the banks' balance sheet and there is a cost for that guarantee for any potential loss.

We are talking about new, unprecedented measures. This is a global crisis, so other Governments are thinking of similar schemes. Governments are looking for different ways of addressing the sometimes conflicting aims of rebuilding balance sheets and capital strength while continuing to lend, which is a dichotomy. That approach has extended into some of the other schemes for providing liquidity in the markets.

**Rob Gibson:** Although I would rather talk about how we are supporting people to stay in work or get back into work, surely there is a question of transparency. After four months—and longer—we still do not have a clear idea of the toxic assets and how much of a problem it is for banks to get into an active mode again and to regain the trust that the Scottish Chambers of Commerce representative mentioned.

**Eric Leenders:** A lot of banks are in a closed period for accounting purposes. A lot will become clearer as they produce their final accounts. It would be wrong of us to speculate at this stage.

**Marilyn Livingstone (Kirkcaldy) (Lab):** I want to concentrate for a moment on the construction sector. I convene the cross-party group on construction in the Parliament. As the witnesses said, the construction sector—and the SMEs within it—has taken the biggest hit. It started with house builders and has moved on to construction generally—we have seen the impact moving downstream.

I have two issues to raise with the witnesses. First, we have heard that one thing that the Government can do is bring forward projects to ensure that there is an appropriate work flow. I invite the panel's views on that.

Secondly, we have talked about lending to businesses, which is important, but if we want to kick-start the housing market—which would give the economy a big boost—how will progress be made on lending to first-time buyers in particular? I invite our banking representative, Eric Leenders, to comment on that.

**Eric Leenders:** I will deal with the first issue before I move on to the second, if I may.

Your first question was about construction initiatives that the Government could take forward. Accelerating capital projects is good and useful. I have talked to local builders at the other end of the United Kingdom, in Brighton. Contractors are now buying in business and pricing it at a loss to maintain their workforce. We have not seen that happening since the early 1990s. That demonstrates the severity of the recession and its impact on construction. Of course, construction is typically the first sector, or one of the first sectors, to go into recession and one of the last sectors to come out of it, which has severe implications for employment.

In the mortgage market, there are around 20,000 to 25,000 approvals a month. That level has been fairly constant over the past three or four months. When I was last at an Economy, Energy and Tourism Committee meeting, I spoke about what we thought might be a natural demand floor in the housing market. Typically, at any given point in the UK, around 20,000 people need to move. I think that consumers are, rationally, playing a wait-and-see game. All the forecasts and media commentaries suggest that there will be further falls in property prices by anything up to 30 per cent over the next 12 months, although the figure depends on which paper one reads. I suppose that there is a question in any potential home purchaser's mind about whether they want to buy now or perhaps enjoy a discounted property at a subsequent date, which impacts on demand.

There is a conundrum with first-time buyers. Six or 12 months ago, there was a high number of high loan-to-value products, which were designed to get first-time buyers into the market with lower deposits. In a declining property market, of course, a cushion of equity is needed to protect against property price falls, otherwise home owners will move into negative equity fairly quickly. A balance must therefore be struck. One or two high loan-to-value products are still available. Typically, the five major banks, perhaps alongside the Nationwide, currently provide the vast majority of home loan finance. The building society sector has very much reduced its capacity to lend, and the availability of credit to the non-performing sector—previously known as the sub-prime sector—has largely dried up as the risks in that area increase.

That is my summation. We must get through this period of house price uncertainty and try to define a bottom to the market. As demand returns, I think that products will return to satisfy it.

**Garry Clark:** Marilyn Livingstone is right to highlight the construction industry as the first industry to suffer as a result of the current credit crunch. We were beginning to see effects in the construction sector around a year ago, and things have gradually got worse since then.

I will put things in perspective. A year ago, 58 per cent of businesses in the construction sector told us that they were recruiting staff. That figure has dropped to 8 per cent this year. The percentage of businesses in that sector that are reporting below-optimum levels of work has risen from 30 per cent to 81 per cent over a year. The sector has been pretty dramatically affected.

Government has some tools to try to ameliorate the situation and repair some of the damage, for example by accelerating new contracts. The survey that we published yesterday shows that public sector orders have perhaps been the least worst-performing area for businesses. Having said that, we did not detect a single business that had experienced an upturn in public sector orders over the past quarter, up to last week. Clearly, work remains to be done. As I said earlier, we have to ensure that orders get to businesses as quickly as possible.

The Forth road bridge is an example of a high-profile public sector project. Politicians, businesspeople and society have to take such projects completely out of the political arena and give them the priority that they deserve. They are an economic priority, not a political priority. We cannot allow any doubt to be cast upon such projects. When public sector projects are possible, we have to ensure that Government brings them forward as quickly as possible so that employment is generated.

I mentioned skills earlier. In the construction sector, many skills may be being wasted. Apprentices have been laid off before the end of their apprenticeships. Society must not lose those skills, because we will need them in a couple of years' time when we emerge from the recession. If the skills are not available, we will have a really tough time. The construction sector led us into the recession—in that the effects were felt there first—and the construction sector is likely to lead us out. Skills must be maintained.

A fairly major house builder has reported to us that, a year ago, around 2,000 contractors were working for it. The figure has now dropped to 300. The drop-off is dramatic. However, the one thing that we cannot afford to lose is skills.

**Marilyn Livingstone:** The skills issue really concerns me. One of our witnesses has spoken about the flight of skills from the construction industry. As Mr Clark says, come the upturn, we will need a vibrant workforce.

I want to ask about modern apprenticeships and the people who are losing their jobs. Should ensuring that those apprentices are able to finish their training be a priority for the Government? We are talking about key skills. For example, only a handful of people in the country have skills in stonemasonry. Stephen Boyd spoke about what is happening in England. I would like to hear views about what is happening with our modern apprenticeships. We really need to get a grip, because people are losing their jobs. Come the upturn, we will need them to come back and help us to reflate the economy.

**Garry Clark:** Allowing apprentices to complete their apprenticeships and training would be an extremely good use of resources.

10:30

**Stephen Boyd:** I agree whole-heartedly.

A general point arises about how the recession might hit the youngest people the hardest. From experience of previous recessions, we know that we must at all costs avoid exacerbating the problem of ingrained persistent economic inactivity in society. Anything that can be done to keep young people in jobs must take priority—I am thinking especially about the young people who are learning skills that will be strategically important for the economy.

There is also a widespread misunderstanding of skills in the construction industry. We have seen job losses mainly in the house building sector, and there is an assumption that the people can transfer to bigger, public sector projects, such as the M74 extension. However, the skills are quite different, and such opportunities do not necessarily open up for those people.

I return to Marilyn Livingstone's earlier point. Wherever possible, major public sector projects should be brought forward. The STUC supports immediately amending the Scotland Act 1998 to allow Scotland to assume prudential borrowing powers. That would be important in ensuring that projects come to fruition.

How do we get house building going again? We need to be careful. We do not want to start working our way towards another bubble in the housing sector a couple of years down the line, because that would be absolutely disastrous. I therefore have concerns about a lot of the noises that are being made about the key to getting the housing market back in order being to get the market in mortgage-backed securities flowing again. I do not want to talk him up too much, but John Kay has published an article in the *Financial Times* this morning in which he explains in cogent terms why that would be disastrous. We must ensure that any measures that are introduced to tackle the current situation are consistent with a more sustainable model.

**Dave Thompson (Highlands and Islands) (SNP):** Good morning, gentlemen. Just a few months ago, a number of commentators and others were not sure whether we were in recession. Some folk were almost in denial. Well, it is very clear that we are there now.

Dr Andrew Goudie forecasts—I know that forecasting is difficult in the present climate—that

"the Scottish economy will contract by between 0.4% and 1.9% in 2009."

Other forecasts estimate an average reduction this year of between 1 and 2 per cent and possibly a bit of growth, but perhaps a further decline, in 2010. The Scottish purchasing managers index has shown a decline since April last year in output, new business and employment.

We should not be trying to talk things down, but we must be realistic because it is only by being realistic that we will tackle the problem. If we think that the situation is not as bad as it is, we will implement measures that are not strong enough. The British Chambers of Commerce has stated that it is "a very serious recession" and that the situation is "particularly ominous".

Where do you think that we will be in another 12 months? I know that this is not an easy question to answer, but are we heading—as Sir George Mathewson seems to think we are—into depression, not recession? I think that we need to be realistic and I would appreciate your views on that.

**Garry Clark:** There is a risk of depression if we do not get the basics right, and the main basic is getting the banks lending again. That is a fundamental, on which all further action will be based.

You have seen our survey this week, and the picture is not rosy. It is probably less important that we look at where we are. We are where we are and we know what we have to do, in broad terms, to address the current situation. We need to look forward, as well, to the other end of the recession and to coming out of it.

From time to time, we have all looked at the doom and gloom out there and thought that the position is going to get worse, and it will get worse this year. There are going to be far greater problems with unemployment this year than we have seen up to now. We have already seen, in the post-Christmas and new year period, a lot of high-profile businesses go to the wall. The ones that the public does not hear about are the small businesses that are going to the wall as well. All of that adds up to the loss of a significant number of jobs.

There are still pockets of optimism and new jobs are being created in various industries, but the situation will get pretty depressed this year. Certainly, unemployment will be a major feature of the year, along with all the ills that accompany it.

We need to look forward to the opportunities that will emerge when we come out of recession. There will be plenty of opportunities out there, and Scotland needs to be in a position to grasp them with both hands. We need to have in place the businesses and skills to do that.

**Eric Leenders:** We are in a global recession. Co-ordinated international action is needed to ensure that what we perceive to be a recession stays a recession and does not become a depression. A number of wider interventions are needed than those that can be done simply at the Scotland or UK level.

Significant political changes are afoot. Yesterday saw the inauguration of President Obama, and we are likely to have a UK election during the recession. Given the EU's calendar, we will almost certainly have a new European Parliament and European Commission.

In addition to focusing on the immediate fire fighting, I agree that we should look to the future and to future opportunities. We also need to consider what the world might look like in two or three years' time. When we exit the recession, I very much doubt that we will return to the world as it was in the first quarter of 2008; instead, we will move into a different type of world, with a different political environment and different economic drivers. Our understanding of that will be the framework within which recovery sits.

**Colin Borland:** Further to what Garry Clark said, the only prediction that we can make with any confidence is that if we do not get the basics right, the recession will be longer and deeper than it has to be. We have to avoid using language that gives the impression that there is nothing that we can do or which gives cover to people who try to argue that we just have to sit back and watch or hang on for the ride.

Measures can be taken, and the first must be getting businesses access to credit and finance. We need to ensure that viable businesses do not go under, thereby adding to unemployment. If access to credit is the most important issue for our members at the moment, the spectre of unemployment has to be the biggest concern for the economy as a whole, as it is for our members and their staff.

Garry Clark made the point that the fact that firms are laying off small numbers of staff is not hitting the headlines. As we said, if half our 20,000 members in Scotland were to lay off one member of staff, an additional 10,000 people would be out of work—another 10,000 households would face an uncertain future. The retention of jobs has to be considered. We need to make firms less likely to take the drastic step of reducing their workforce.

We also have to look at job creation. Small firms have a record of creating jobs, particularly when larger firms are shedding jobs. We have to identify the best measures that will support small businesses to do that. One suggestion is that the Government should cut employment taxes. Obviously, that is a matter not for the Scottish Parliament but for the Westminster Parliament. That said, we should look at how employing staff can be made more affordable and easier.

I return to where we want to be at the end of the recession. We need to be able to tell the wood from the trees if we are to ensure that we are ready to take advantage of opportunities as they arise. There are opportunities out there for those of entrepreneurial spirit. We will see acquisitive growth over the year—there are already reports of such growth.

As Garry Clark said, we have to ensure that skills are retained and that those that are lost are not lost completely to the economy. We need to get ourselves into a strong position to take advantage of opportunities when the economy is back on the up. We believe that that will happen and that it does not have to take as long to happen as some are predicting.

**Stephen Boyd:** The economic forecasting profession has not done itself any favours over the past couple of years. Only yesterday, it got the inflation statistics miles wrong. Andrew Goudie is quite clever in allowing himself considerable room for manoeuvre there, and I suspect that he largely got it right.

We stand at a difficult juncture. Is depression a possibility? What if things do not change and the measures that have been introduced to get credit flowing again do not work? These are clearly very worrying times. Eric Leenders hit the nail on the head: this is a global situation and what transpires in the global economy, particularly in the United States, is of fundamental importance.

Obama has been looking at a stimulus package, but I do not think that it is sufficient to meet the extent of the challenge that the US economy faces. Of course, he will face considerable further challenges in getting that package through. It is interesting to note the burden of proof that Obama has been asked to meet in the context of the effect of his proposed stimulus package—that is never requested when the imperative is tax cuts. That point has wider relevance. If he does not get the package through, or it is not sufficient, the United States will undoubtedly stand on the verge of a depression, which, unfortunately, will have an impact on us all.

My colleagues have made pertinent points about skills and job creation. An interesting point has emerged over the past couple of weeks, with the Prime Minister talking about a low-carbon industrial strategy. As members know, the STUC has been talking about that for years, but insufficient efforts have been made by current and previous Scottish and UK Administrations. We desperately need to start generating jobs in our environmental industries. It is hugely encouraging that the Prime Minister is talking in those terms—I nearly fell off my seat in delight when I heard him utter the words “industrial strategy”. I was quite stunned, but absolutely delighted, because policy is clearly moving in the right direction.

We are still awaiting the detail of what is proposed at the UK level. We will have to wait and see how it translates at the Scotland level and what more the Scottish Government can do to support the strategy. I suspect that it can do a lot, and that a lot of what it can do will be cost neutral. We have talked about these opportunities for far too long; we really must start to make some headway.

**Dave Thompson:** We heard about creating jobs, and Garry Clark made some comments on VAT. I have long argued for zero VAT for restaurants and small cafes, because they are important in relation to not only the volume of employees but the development of a good cafe culture in this country. I think that Garry Clark said that there was no clear evidence that the 2.5 per cent reduction in VAT has had any major impact. Would it be worth pursuing a further cut in VAT for restaurants and small cafes, given that a lot of them are closing? A VAT cut of 15 per cent to zero might well give that sector a major boost. Do you think that we should press for that?

**Garry Clark:** That would be one option for the UK Government, should it wish to pursue it. Other options might include zero rating VAT on home extensions and repairs, which could help parts of the construction industry, and on new cars, which might help the car industry—although that might be a less targeted measure, in relation to foreign cars. I understand that there can be issues with that approach, given European taxation rules, but in certain areas, such as the one that you mentioned, it could have a far greater impact than the across-the-board 2.5 per cent cut, which our members feel has had an indiscernible impact.

**Eric Leenders:** We would also have to look carefully at displacement. In cafes in particular, we have seen a move towards multiples, franchises and brands and away from family-owned or independent outlets. We would have to consider whether there was an underlying dynamic that would continue, notwithstanding any recalibrations of VAT. Other dimensions would need to be considered, too.

10:45

**Stephen Boyd:** There is a danger in continuing to address fiscal policy in an ad hoc way. I do not have a particular view on the dimensions that Eric Leenders mentions, but the UK has ended up with a hugely complex fiscal framework in which low-paid workers—the people whom the STUC represents—pay a greater part of their income and wealth in taxation than the super-wealthy and corporations. That is unsustainable.

We argue for a complete overhaul of the fiscal framework—a massive piece of work that would take all elements of taxation into account. Chipping away at different aspects of the taxation regime is unhelpful; a fundamental overhaul is needed. I am not necessarily arguing for an increase in the total tax take, but the burden within the tax take could be far more equitably distributed.

**Dave Thompson:** You will be aware of calls for an inquiry into how we got here. It may be a bit premature, but do you feel that we should have such an inquiry? If so, how broad should it be? Whom should we ask to appear before us to discuss the matter? When should it take place?

**Colin Borland:** We have argued that politicians, businesspeople and people in financial services have to focus all their efforts on the immediate concerns—even though there may be other perfectly worthy pieces of work to be undertaken. The current situation is sufficiently exceptional to warrant such a focus.

Knowledge is power, and if we do not want to end up back in the same situation in future, we will have to find out how we got here. This is not the time to embark on such an inquiry, but when the time is right I have no doubt that some pretty hard questions will have to be answered.

**Garry Clark:** We could not agree more: if we do not learn the lessons, we will be condemned to repeat our errors. However, now is not the time to learn the lessons; all our efforts must be aimed at softening the blow and getting us out of this situation.

**Stephen Boyd:** The STUC has discussed the possibility of a Scottish Parliament inquiry, although the other day we supported the TUC's call for a public inquiry.

Garry Clark said that lessons have to be learned, but I would argue that they have to be learned quite quickly. I repeat my earlier point that we have to re-regulate the finance industry. That should be done effectively and quickly; otherwise, we might repeat the mistakes of the recent past.

Although I acknowledge that everybody should focus clearly on how we can improve the current economic situation, I would argue that an important component of that will be learning the lessons of the banking crisis so that we do not repeat the mistakes in future. We have to regulate the industry more effectively.

**Eric Leenders:** From my perspective, I would say that the industry has been under a high level of scrutiny for entirely understandable reasons. Clearly, there is a lot of contrition in the industry for the circumstances within which we find ourselves. Activity in the Treasury Select Committee and other committees has brought parliamentary scrutiny—from Westminster at least—to the finance sector, to ensure that lessons are learned and reflected on, and to ensure that changes are implemented where necessary. The first manifestation of those changes is within the Banking Bill that is going through the Westminster Parliament as we speak.

**Gavin Brown (Lothians) (Con):** I would like the panel members to comment on three distinct points. Everybody has talked about businesses' difficulty in gaining access to credit, and what you have said has certainly chimed with the comments in my mailbag from businesses.

First, most people would welcome last week's loan guarantee scheme, but are the size and scope of the scheme anything like enough? Germany has a population one and a half times the size of the UK's, but their loan guarantee scheme is about five or six times the size of ours. Do we need to move in the German direction?

Secondly, Garry Clark has commented on the temporary cut in VAT to 15 per cent, and I am interested in what other panel members think about that, based on what their members say. Some would say that it is quite early to try to analyse the cut's effects, but as it is only a 13-month cut, and as most retailers reckon that they do about 40 per cent of their annual business over the Christmas period, we should have a clear—or at least a reasonably good—picture of how effective it has been. Garry Clark can exempt himself from answering that question if he wishes.

Thirdly, what would any of you—on behalf of your members—have said to the Bank of England representatives if they had been present today about the big macroeconomic lever of interest rates? Although all businesses want interest rates to come down as far as possible, I would be slightly nervous about taking them much lower. Doing so would have an effect on savers, and on pensioners in particular. In addition, many banks need people to put money into them in the first place, so that they can give out loans. If we go much further on that, is the danger that the side effects from the medicine could become worse than the disease? I am interested in hearing the panel's views on all or any of those three points.

**Garry Clark:** An important element of the loan guarantee scheme will be ensuring that it is directed effectively where it is needed. It can be quite difficult to do that, because the Government has committed a finite amount of finance, although there is additional cash from the European Investment Bank. We need to ensure that the right businesses are getting that help. How do we determine need? Will the UK Government make that decision, or will it be down to the regional development agencies in Scotland, such as the business gateway, Scottish Enterprise or Highlands and Islands Enterprise? There are a lot of unanswered questions.

It is important for Government, the banks and business to work together in order to build the bonds of trust and make best use of the available money. We would always like more money to be available, and there is no one silver bullet to solve the current financial situation. The Government might at some stage extend the provision, which we would welcome, but it is important that we all work together to arrive at the other end.

As Gavin Brown said, I have made clear our members' views on the VAT cut. We do not think that it has had the discernable effect that was perhaps anticipated. As Dave Thompson said, other options for VAT cuts could perhaps be more targeted and might therefore have a more discernable effect in certain areas of our economy. It is important to bear in mind the fact that there might be an effect next December, when, as everyone knows, VAT will go back up by 2.5 per cent—perhaps that will get people to spend. However, we should also bear it in mind that unemployment will be pretty high by then.

It is also important to remember that, alongside the temporary reduction in VAT, the Government announced increases in 2011 to national insurance rates for employers. That is entirely the wrong way to go: at a time when business is seeking to emerge from recession, we should cut the cost of employment rather than increase it.

This morning I listened to Mervyn King, the governor of the Bank of England. He believes that cuts in interest rates have perhaps reached the end of their usefulness with regard to dealing with the current recession, and he may well be right. We certainly need to consider that. As Stephen Boyd mentioned, the position of the Bank of England over the past year, and everything that it does, is determined by its duty—and it is a duty—to control inflation. I understand why it made the decisions that it made last summer, given that duty, but those were perhaps not the right decisions for our economy as a whole. As Stephen Boyd said, there might be some scope for examining the role of the Bank of England in future and refocusing some of its duty on monetary policy.

**Colin Borland:** On access to credit and Gavin Brown's point about the scale of the loan guarantee scheme, it is important to remember that the part of the scheme that is of most interest to our members is the enterprise finance scheme. In the context of the amounts involved—we are talking about £10 billion here and another £1 billion there—the amounts of money that our members are looking for are not significant. They are looking for £15,000 here and £6,000 there, which are not massive amounts of money. Provided that that level of working capital can be made available, we welcome the scheme and will be promoting it to our members. We are sending them the message that if they have been to their bank in the past few weeks and have been refused a loan, they should knock on that door again, because the situation has changed.

On the VAT cut, as our submission says, the jury is probably still out—that is the most balanced way of putting it. As Garry Clark said, it has not had a demonstrable impact. That is particularly true of high-volume, low-margin retailers. Small independent retailers who sell low-margin goods in high volumes are finding the present situation particularly difficult and are not seeing the benefit of the VAT cut. It might be having an impact on larger one-off purchases—people might think that now is the time to make them. When it comes to car prices, it is certainly a buyer's market for people who are thinking about replacing their car, but the problem is that no one has the confidence to spend because they are worried about their jobs. For people who are in the position to do so, now is the time to spend.

The reductions in interest rates were the correct move—they had to be made. Seven months ago, we would have been discussing our worries about inflation. We would do well to remember how the situation has turned around. Those inflationary pressures are no longer with us, and the level of interest rates is improving access to affordable credit. Mr Brown is right that there is a balance to be struck. We do not want people not to invest or save. An issue exists for people who live off their investments but, generally speaking, it is not a huge issue for people in small businesses, who are more concerned about loans.

When times are good, we are canny and we put money aside. Before the current situation arose, we had roughly the same amount on deposit as we had out in loans. That situation is changing slightly. Instead of watching their savings make very little interest, some people are using that money to prop up their businesses. Figures from the BBA show that in October and November, nearly £900 million in savings was being used to keep businesses going. That is partly because, for the reasons that I have mentioned, people are more reluctant to go to their bank to ask for an extension to credit. We have heard that the financial institutions are experiencing a drop in demand. People are looking for ways to use their savings, which are not making a lot of interest, and some are putting that money into their businesses.

We will have to let things settle down and see how long it takes for the recent cuts to filter through. It is about not simply the rate, but the availability of money and the strings that come with that. If the package of measures gets lending flowing again, we will probably not need another interest rate cut, but the fact that we are in an exceptional situation means that a further cut cannot be ruled out at this stage.

11:00

**Stephen Boyd:** I do not really have a view on whether the funds in the loan guarantee scheme are sufficient. I caution against international comparisons, because the SME sector in Germany is very different from that in Scotland and the UK, which may or may not explain the discrepancy. I do not really have a view on that; I simply raise it as a point.

I have already said in no uncertain terms that the STUC would not have chosen VAT as the main point of fiscal stimulus in the pre-budget report package. We would have far preferred income tax cuts targeted at the low waged and/or increases in benefits and statutory redundancy pay. I understand that those measures might be somewhat more politically difficult to introduce, but we argue for them on the basis of excellent research produced recently in the United States by the Brookings Institution’s Anderson project. The research examined the effectiveness of the fiscal stimuli that have been introduced in a range of previous recessions and came out clearly in favour of fiscal policy that is targeted at the low waged and those who will spend the money. It was possible to introduce the VAT cut almost immediately, which was helpful, but I am afraid that it will be extremely difficult to analyse its effectiveness. Something of a hostage to fortune has been created and I do not envy the Treasury officials who will have to try to do that work.

I understand Mr Gibson’s earlier comments about the Bank of England’s non-participation in the meeting but, notwithstanding my earlier criticisms of the monetary policy committee, I must emphasise that the bank’s representatives in Scotland are excellent at engaging with stakeholders. We get an opportunity to meet not only those representatives but members of the monetary policy committee whenever they are in Scotland. The STUC met Kate Barker just before Christmas and Rachel Lomax earlier in the year, just before she left the MPC. The last time that we met MPC members, we made our case again in no uncertain terms that they had been horribly behind the curve. We welcomed the recent cuts in interest rates but said that they came too late in the day to have the effect that they might have had if they had been introduced earlier in the year.

The impact on savers has been mentioned, and the point was well made. Looking forward to a new, more sustainable model, we certainly want savings in the UK to be increased, although I am not convinced that making that a key policy objective at this moment in time is the best way forward. It would be particularly dangerous to do so at the moment, when we are looking to increase demand, but it is a laudable objective for the future.

We must reconsider the MPC’s remit. Garry Clark made the fair point that it has a narrow remit, and we have argued that—like the Federal Reserve in the United States, which is asked to give equal weight to inflation and employment—it should be given a dual mandate. If that dual mandate had been in place, we would have expected quicker action this year. The bank will respond to that by saying that its remit takes employment into account, but I am not convinced that it does so sufficiently.

**Eric Leenders:** There is a law of diminishing returns on rate cuts. One of the tensions that has been played out in the media is our responsibility as bankers to savers and borrowers; balancing our responsibility to those two groups has proved extremely tricky. However, if inflationary pressures return, there could be a role for using interest rates as a lever. Deflationary pressures appeared quickly in a volatile economy and inflationary pressures could return with the same alacrity. Using interest rates is not necessarily redundant per se; it is just that, at this stage of the cycle, further cuts would probably not have the same effect as the more recent ones.

I mentioned VAT earlier. There is limited application of VAT within financial services, so that is more for others to comment on.

We come back to access to credit. Only a third of small businesses borrow. The FSB in Scotland is right that businesses are considering drawing on their own cash reserves, which is what one would expect them to do, particularly if the return on that money from straightforward interest—when the money is held on deposit—can be used to better effect elsewhere within the business. It would be useful to understand how that money is being used, but I imagine that it is being used as working capital and to bridge the invoicing gap that arises when businesses expect settlement in 30 days but have to wait 40 days, 50 days or longer.

That is where the loan guarantee scheme will be particularly beneficial. The ability to consolidate a portion of an overdraft facility that has got stuck and is perennially overdrawn to create a loan but keep the overdraft facility at its existing level is a useful tool in the provision of additional working capital. That widening of scope and utility is good, and the discounted guarantee of 50 basis points is also helpful. However, we must remember that the facility needs to be provided to those businesses that continue to be viable.

There remains a question about the business model. The analogy that is often used is of a restaurant—no amount of funding will help a restaurant that has nobody sitting at its tables. I suppose that that gives a broader answer to the question, but we and the Scottish Parliament could look at how we can help businesses whose business model might have worked over the past three or four years, but might not be as effective over the next two or three years. We should ask how that model can change. In case studies that I have used, the question is, “Is it about moving from restaurant to bistro, extending hours or changing menus?” All those things need to be thought through. A lot of small businesses would welcome such support at the moment.

**Lewis Macdonald (Aberdeen Central) (Lab):** When the witnesses were asked what is required to avoid recession, it was interesting that both Garry Clark and Colin Borland talked about access to credit as the single most important thing, Colin Borland talked about avoiding unemployment and Stephen Boyd talked about having a low-carbon industrial strategy. All those things depend on the direction that the banks choose to take. Eric Leenders talked about scrutiny and high levels of contrition, which was an interesting phrase. I would like to hear more about that because it is not necessarily the public’s perception that senior managers in banks who have got us here recognise their responsibility and are acting on it.

I am interested in hearing from all the witnesses what it is that Government needs to do to ensure that the choices that banks make increase access to credit and recognise those sectors of the economy that can drive forward the economy and ensure that jobs are protected and grown. Is Government doing enough? Last week, the Irish Government nationalised its major bank and there has been speculation in the Scottish press in recent days about that happening here. Is that the right direction, or should Government provide a level of protection within the context of at least partially publicly owned retail banks? Alternatively, should we continue to pursue the formula that has been adopted this week?

**Colin Borland:** It has to be made clear to the banks that we are expecting some sort of ultimate return on our investment that goes beyond the simply financial. We have to get some bang for our buck. Every one of us sitting round this table is a major shareholder in big high street banks. Although we would not expect ministers to take day-to-day investment decisions in banks—I am sure that they did not get into politics and become ministers to do so—we need some of the faith that we taxpayers have shown in those banks to be repaid.

I have no doubt that such discussions are taking place between ministers and the banks and I understand why they do not want those discussions to be conducted through newspaper columns or other media. However, there is a feeling among some of our members that announcements are made and then little comes on the back of them. We need a tangible outcome from the pressure that is being exerted on the banks.

Even if the current suite of measures that has been unveiled and implemented does not have the desired effect, there will not be a plan B. If the banks hang on, they will not get a better deal. The N-word—nationalisation—has been mentioned. That option cannot be ruled out. The banks must know that if the measures do not start to work, that ultimate sanction is there. That is not an ideal option, of course, and it would come with many caveats, riders and qualifications, but that ultimate sanction must be available if the financial institutions that have benefited from our largesse as taxpayers do not start to play fair.

**Eric Leenders:** In seeking Government assistance, banks made commitments to lend to, or make credit available to, small businesses and to lend in the mortgage market at 2007 levels. In restructuring its deal from preference to ordinary shares, the Royal Bank of Scotland Group has committed to make a further £6 billion available. Clearly, the banks have made those commitments.

We must remember that there is a clear requirement to lend only in cases where the money can be repaid. Unaffordable or irresponsible lending is not going to help in the present circumstances. It is not as straightforward as saying that, having been provided with support, the banks should relax credit criteria at the very point of a tightening in the economy. The situation needs to be worked through, and the vehicle for doing that is UK Financial Investments, which in effect operates the Government-owned interests in the banks at arm’s length from the banks themselves. It is correct to say that there is no ministerial interest in getting into the day-to-day operations of the banks. Through UKFI, there is an expectation that the commitments will be discharged.

There is an understanding on the part of the banks as to their responsibilities. There is a distinction between the banks that have taken Government support and those that have not. Those that have not are still responsible to their shareholders and therefore have to stay within the parameters of responsible lending in more difficult economic circumstances. There are different drivers for different banks.

**Lewis Macdonald:** I am interested in hearing what Stephen Boyd and Garry Clark have to say in response to the initial question, but how would Eric Leenders respond, on behalf of the sector, to the evidence—although it is apocryphal, there is a good deal of it—about small businesses with good credit histories and good relationships with their lenders suddenly facing tougher conditions for the use of their overdraft facilities? Is that in line with the commitments that have been given to Government? That would seem to create a tougher business environment, even in cases where businesses are still a good bet and a good risk, judging from their track records.

**Eric Leenders:** Fundamentally, it would not be rational for a bank to withdraw facilities or support from a good, viable business. Banks' business lies in lending money. That is how they generate a return, and those banks that need to will boost their capital reserves, bolster their balance sheets and, in turn, create pools for greater lending. As I said at the start, I have always been interested to understand the weight of anecdotal evidence, and I am sure that you get evidence from your constituency mailbags and from other members expressing concern that banks are not providing support.

When I have had discussions with the Federation of Small Businesses in London, some of the concerns that have surfaced have related to pricing. I have sought to explain to you why pricing is widening. Some concerns have been about the availability of credit. I mentioned the case study of a restaurant in which cash flow or the lack of cash flow or liquidity was in fact a symptom of the business's viability.

Another component that we must think about is planning and the consideration of facilities that some small businesses are currently given. For example, asking for an overdraft to help with the wage bill on Thursday afternoon when wages fall due on the Friday is a more difficult conversation than consideration of a forward cash flow forecast over three to six months or so. Many small businesses, with an average life of seven or eight years, have not necessarily been used to such scrutiny of their business, because they have operated in a growth economy. Some of the searching questions that bank managers might now put to the small business community, such as "What is your forward profit? What is your cash flow forecast?" come as new news in the sense that previously the conversations were more informal. That is a component of the view that attitudes are tightening, whereas it is perhaps more appropriate to suggest that that is about the bank looking to better understand the risk that it is taking on in the lending proposition.

11:15

**Garry Clark:** To be simplistic about it, many businesspeople come to us and say, "Interest rates are coming down and my mortgage repayments are coming down, but my business overdraft has been withdrawn." They say, "My business taxes are being used to bail out the banks"—for want of a better phrase—"so when will I see a return on that in my business dealings with the bank?" That tends to be a fairly common view, which is repeated to us throughout the country. As chambers of commerce, we speak to the banks regularly and we understand many of the pressures that they are under in relation to the valuation of assets and so on and their interaction with Government. We deal with banks at a Scottish level and, through local chambers of commerce, at a local level. We are keen to ensure that the positive attitude of many banks towards small businesses at a corporate level is reflected at a local level in the decisions of staff in branches about businesses' credit facilities and overdrafts.

We agree that the Government has taken and is continuing to take necessary steps. Colin Borland is right to say that there always has to be an element of carrot and stick but, when dealing with any business, Government should aim to use the carrot rather than the stick. We support the path that the Government has taken so far.

**Eric Leenders:** We should not forget that the £37 billion that was introduced to the banking sector in October was about restoring financial stability across the piece. It was not about providing a pool of funding for credit; it served a different purpose. The simplistic view that has become the urban myth is unhelpful, because it obscures what lies behind the approach that is being taken, which is a proper assessment of a lending proposition.

**Stephen Boyd:** A couple of issues are wrapped up in your question. First, the STUC has not called for outright nationalisation. I do not think that the situation calls for such a stark intervention, which would not be helpful.

In the same way as Garry Clark's members ask why they are not receiving services from the bank after they have assisted in the bail-out, our members look at a situation in which the Government owns 70 per cent of the Royal Bank of Scotland but appears unable to exert sufficient direct control over its activities. I do not think that that is sustainable for much longer.

You also asked what more Government can do. When we gave evidence in September, I was keen to emphasise that, even in the good times, British banks have not been good at providing patient, committed capital to our growing companies, which is why we have a range of public interventions in Scotland that seek to address that market failure. I would have thought that now was the time to enhance the public sector's role in that respect.

It is interesting that the submission from Scottish Enterprise refers to the possibility of accessing European funds to boost its co-investment models. If that is an option, ministers should be strongly encouraged to look favourably on it. It is not entirely clear from the paper what stage that project has reached, but it should be regarded as an important intervention that the Government could make at this time. It is vital that we do anything that we can to enhance co-investment and long-term, patient capital in order to grow Scottish companies and, in particular, to boost research and development and innovation—the type of economic activities that the British banking sector has not been good at cultivating, given its short investment horizons and the large returns that it has traditionally demanded.

**Eric Leenders:** It comes down to what was known five or 10 years ago as the equity gap. Banks provide debt finance for research and development and for innovation and growth-type businesses, but the better funding vehicle is some form of equity injection, which is not what a retail bank typically provides. If there was an initiative to start thinking through how that sort of support could be provided in Scotland to take advantage of the turn in the economic cycle, that would be a useful exercise to undertake. However, it would not be for a retail bank to provide that sort of support through its typical high street operations.

**Colin Borland:** We talked about the wealth of anecdotal evidence from organisations such as ours about the lack of working capital to take on potentially profitable work. We do not agree that viability is intrinsically linked to cash flow at the moment. That is not true; there are businesses that have cash flow problems even though their business models are perfectly valid and they are perfectly busy. Late payment can put businesses without large cash reserves into serious financial difficulties quite quickly.

I mentioned in passing earlier some Bank of England figures from December 2008, which highlight that about a quarter of firms have refused potentially profitable orders because of difficulties in getting working capital. I can leave that information with the clerks at the end of the meeting. I know that the Bank of England is not represented on the panel, but I am more than happy to give you the figures if you would find them helpful.

**The Convener:** I call Christopher Harvie. Please keep your questions brief, Chris, because we are approaching our deadline.

**Christopher Harvie (Mid Scotland and Fife) (SNP):** You can read my opinions about the situation in today's *Scotsman*, so I do not have to introduce them. What we are facing is far worse than 1929. The banking system is virtually kaputt. Look at studies of private equity and hedge funds and you are looking at ruins. We have to trade on our one longer-term possibility, which is renewable energy. How can that be funded? How can we get trading capital for it? How can we start the revenue stream working as rapidly as possible?

Bank funding and finance can be injected into the Scottish economy through, for instance, construction-linked projects, which are not necessarily to do with the housing market. A national corporation could provide co-ordination for an insulation programme, which would considerably reduce the energy demands on the country and train up a generation of people whom we will need to carry through renewables in, say, seven years' time, when tidal energy and so on come through. That is our possible collateral. We have to devise the means of finance that would enable all that to happen.

We have already landed up with a nationalised bank. In the 1930s, Montagu Norman was practically constantly in Scotland to try to shore up heavy industry; we have seen the attitude of Mervyn King. What we require in Scotland is something along the lines of a German Landesbank or for the direction and policy making of the Scottish banks—now that they are nationalised—to be devolved to the Scottish Parliament. Action along those lines must be taken. If we wait, we will find that the pressure to bail out the toxic assets in the south will prevail over the pressure to make capital available to small and medium-sized industries in Scotland. The revenue stream is running in the wrong direction.

**Eric Leenders:** Over the past few months, we have seen a couple of initiatives to start regional banks. We have been fully supportive of those and we will help where we can. The details of structuring, setting up and capitalising a bank and then getting a customer base are quite complex and involve a long-term process. We will help where we can and we are happy to provide support. I think that our members would be happy to see that competition in the sector.

**Garry Clark:** You are absolutely right to identify energy as a sector that will provide huge opportunities coming out of the recession. Renewable energy is certainly a part of that, but we believe that our nuclear industry is also a strong part of that. This week, Scottish Power and Scottish and Southern Energy have come together to pursue nuclear power options. Those are two locally based—although perhaps not locally owned—companies.

**Christopher Harvie:** That is great news for Mr Sarkozy but not for anyone else.

**Garry Clark:** We view our energy future as crucial not only for powering businesses but for generating business in Scotland. Our energy industry very much includes the renewables sector, but it also includes the nuclear sector.

**Stephen Boyd:** I would add the coal sector to that list. One criticism of the Scottish Enterprise submission is that its section on energy does not mention coal. Coal provides massive opportunities for sustainable production through clean coal technology and carbon capture and storage. As well as providing investment in Scotland, the coal industry has future export potential. I have a long-standing concern that Scottish Enterprise seems to see coal as the poor relation of the energy sector. However, I agree with Garry Clark's comments.

As I said to the committee back in September, I would emphasise the importance of having a Scottish investment bank. Perhaps Scottish Enterprise's proposals will negate the necessity for such a vehicle, but such a bank has been a long-standing policy priority of the STUC. We believe that an investment bank could have a major role in funding the type of projects that we are discussing. I might add—this will not go down well with my colleagues—that the £250 million that has been spent on the small business bonus scheme would have been far more effectively targeted at a Scottish investment bank. However, we are where we are.

Other things could be done at UK level, such as providing a feed-in tariff for electricity from renewable sources. The reason why Germany is now the world leader in solar technology is that it has a feed-in tariff. Bavarian farmers are now the greatest generators of solar energy in the world because they have covered their barns in solar devices. That would never have happened without the feed-in tariff.

Lots of things can be done that are cost neutral, for example—I keep going on about this—on public procurement, which my colleagues have also mentioned. Yes, the more contracts that go to Scottish businesses, the better. However, we also argue that, wherever possible within EU law, public procurement should be used to support wider public policy priorities on fair employment, climate change, renewable energy and so on. The Government could also facilitate forward procurement programmes in the private sector. That has been done in Sweden and could be considered here. A range of interventions could be made.

If I may go back to an old chestnut—I seem to mention this every time that I appear before the committee—I suggest that the implementation of the Natura 2000 agenda in Scotland should enable renewables development in our most fragile rural economies. To date, the Natura 2000 agenda has been a barrier. We have seen that not only in Lewis but potentially elsewhere.

We need not just investment in renewables but a massive package of measures for the sector to bring to fruition the jobs that we have all been talking about for more than a decade. The degree to which that has happened has been wholly insufficient to date.

11:30

**Colin Borland:** Stephen Boyd will not be surprised to learn that we strongly disagree with him about the impact of the small business bonus scheme, which has helped a great number of our members to keep their heads above water in what has been an extremely difficult year. Thousands of businesses might otherwise have gone to the wall, which would have led to further job losses, reduced the revenue generated in communities and, indeed, deprived communities of the services provided by the businesses. The small business bonus scheme has meant the difference between survival and failure for many of our members—

**Stephen Boyd:** It has also provided assistance to a few MSPs' offices.

**Colin Borland:** It has helped small businesses to stay in business, to employ people and to continue to carry out their work of providing services to communities and creating jobs.

With regard to renewables, I think that what you suggest is right. When one of the recent stimulus packages was announced, for example, there was talk of green-collar jobs, but the idea was dismissed—rather hastily, I believe. One of the issues with bringing forward capital projects is the tension between strategic projects, which tend to sit on people's drawing boards and are a long time in the planning, and simple measures that might not have the same strategic importance but which might well deliver real benefits. By bringing forward such relatively simple measures now, we can create stimulus now. One key area that we certainly have to explore is renewables; not only will such projects improve energy efficiency, they might present other opportunities. After all, someone has to develop the technology, which will have to be subcontracted out to the others who will have to build, maintain and run the facilities.

We cannot really comment on the issue of regional banks. We would not rule such ideas out on principle, but we would leave any detailed comments on the matter to the guys who know more about macroeconomic issues.

**Christopher Harvie:** Is there not an historical pattern to all this? Perhaps we should go back to 1914, when disaster struck. Indeed, in his report, Dr Andrew Goudie says that this is 1914—not 1929—all over again. The munitions directorate, which was set up during the first world war, was in its way a very controversial public-private partnership; although it gave Scotland some clout in central Government, it also worked in co-operation with small to medium-sized enterprises to produce machine guns, high explosive and so on. Surely the same approach could be taken towards the mass production of, say, insulation equipment and the training of those who would be responsible. We have to be flexible in our thinking about the use of state power and private enterprise and suitable finance arrangements in that respect. We have moved away from the market and back to forms of barter, and the question is how we use those forms in our dealings with continental producers, continental technologies and so on. We have to remember that our industrial manpower has fallen to 9 per cent; in such circumstances, we have to borrow technology from abroad, because we simply will not get it here.

**Colin Borland:** You are absolutely right. We were saying earlier that we all have a responsibility to ensure that, when we come out the other side of all this and the Scottish and UK economies are on the up again, we are ready to take advantage of such opportunities and to face any challenges. As Garry Clark said, energy will be a key issue and we should investigate how we maximise the opportunities in that respect.

**The Convener:** We could discuss this topic not only for the rest of the day but for the rest of the week. I am afraid, however, that our time is limited. I thank our witnesses for their valuable insights into the current state of the Scottish economy, and I am sure that the committee will reflect on their evidence.

It is a matter of regret that the Bank of England declined our invitation to give evidence. Although I am pleased that, as Stephen Boyd made clear, it engages with stakeholders in Scotland, I remind it that the Scottish Parliament is perhaps the ultimate stakeholder in Scotland, as it represents the Scottish people. It might consider engaging a bit more with the Scottish Parliament; indeed, I am sure that information about its engagement with stakeholders would have been invaluable this morning.

I suspend the meeting to allow the witnesses to depart. After the suspension, we will discuss whether we wish to take any further action on this item.

11:34

*Meeting suspended.*

11:40

*On resuming—*

**The Convener:** Before we move on to the next item, do members have any thoughts about the session that we have just had? Do you have any issues to raise, or is there any work that you think the committee should do?

**Rob Gibson:** In light of earlier comments and your remarks on the record at the end of the evidence session, we should write to the Bank of England to say that, like other British institutions such as the BBC and the Office of Communications, and even ministers from London, it could perhaps find a way to send representatives here. It would be useful to point out that we are not seeking accountability but merely the sharing of information. If the committee thought that such a letter was valuable, it would put down a marker.

**The Convener:** I am happy to write again if the committee wishes me to do so.

**Lewis Macdonald:** Rob Gibson's suggestion that we point out that we are not seeking to duplicate the work of the Treasury Committee—which is the Bank of England's primary point of parliamentary accountability—would be a reasonable and helpful way to proceed.

**Gavin Brown:** That a fair point but, if I read Mervyn King's letter right, it contained the offer of a private session. Although a public session is preferable, and we can argue about that, we should at least take him up on the offer of a private session. It would not be in the public domain, but we would have an opportunity to influence thinking and give a Scottish perspective.

**Lewis Macdonald:** I agree that taking up that offer, rather than simply complaining, would be a constructive approach.

**The Convener:** I cannot recollect whether the offer was of a private briefing for the committee or just for me as convener. We would certainly prefer to have it with the whole committee—or at least a cross-party group of members if the bank representatives were not willing to meet the whole committee.

**Lewis Macdonald:** We can interpret the offer broadly.

**The Convener:** We will explore that issue, and I am sure that we will continue to come back to the general issue in the next few months.

**Lewis Macdonald:** We will continue our watching brief on all the issues that have been raised.

## Council of Economic Advisers Annual Report (Scottish Government's Response)

11:42

**The Convener:** Item 3 is the Scottish Government's response to the annual report of the Council of Economic Advisers. I felt that it would be useful to put the issue on the agenda as we met the chairman of the council shortly after its report was published. Members may wish to comment or take action on points in the Government's response. There is a debate on the issue in the Parliament tomorrow, so I do not propose to have a full-scale debate now, but there may be issues of clarification that members wish to take up with the Government.

**Ms Wendy Alexander (Paisley North) (Lab):** I have a few points. The Government's response is interesting, as it takes the opportunity in the first two pages to give us the first version of its Scottish economic recovery plan in a public document, rather than merely a press release. That is encouraging for those of us who have been asking the Government to put the strategy on paper.

I have several specific issues on which it might be helpful to write to the Government to seek clarification. On many occasions, the document says that discussions are taking place on an issue, and I detect a desire not to share those discussions with the rest of us. Encouraging transparency would be helpful, and one example is the Government's response to the council's recommendation 5, in which it encourages greater efficiency in public services—an issue that has risen to the top of the agenda recently. The response deprecates the potential £500 million additional efficiency savings. It would be helpful to ask the minister to clarify in percentage terms the current targets for efficiency savings—both cash and non-cash releasing—and how they compare with the targets in the rest of the UK. Are our targets for efficiency savings in cash and time both for the past couple of years and for the next couple of years higher or lower than those in the rest of the UK?

11:45

The second issue on which we might write to the minister for clarification is the Government's response to recommendation 6, which relates to our energy inquiry. Recommendation 6 reads:

> "The Council recommends that the Scottish Government commissions an independent assessment of the full economic costs and abatement potential of the various energy options open to Scotland."

The Scottish Government's response states:

> "The Scottish Government is commissioning this study."

That is interesting because, although there is not a generation-neutral approach in the national planning framework, by definition it is a generation-neutral inquiry that is being initiated by the Government. I wonder whether the implication of generation-neutral technology is reflected in its terms of reference. The Government's response also states that

> "the paper will be considered by the Council during 2009",

so I presume that it will be a short-life study. Nevertheless, it would be helpful if we were to ask for the terms of reference of and the timescale for the study and who is carrying it out.

In a similar vein, the Government's response to recommendation 8 is, as we would expect, upbeat about energy efficiency measures, but concerns have been raised about its timetable for producing its own energy efficiency strategy. We could ask for clarity on the Government's original timetable for the energy efficiency strategy and when it now expects to produce it. That information would be helpful.

The response to recommendation 11 is:

> "The Scottish Government is … working closely with the third sector, COSLA and SOLACE to ensure that there are effective relationships between the third sector and national and local government across Scotland."

We might simply say that we are aware that the third sector has anxieties about how to conduct its activities in 32 different local authorities, and we could ask about the state of play of the discussions on that. Does the Government intend to take any steps to facilitate co-ordination by the sector in its dealings with local government?

The response to recommendation 12, on planning, contains the following interesting sentence:

> "The Scottish Government has explored a number of ways to incentivise local authorities to promote economic development and is examining, with local government partners, options such as tax increment financing."

It goes on to talk about the possibility of incentivising business rates income, but it implies that tax increment financing is something distinct and different from or more all-encompassing than that. We might ask the Government for clarity about what tax increment financing is. Is it just business rates, or is it something else? The Council of Economic Advisers refers to it in the context of what we might do to speed up the planning process.

On the Government's response to recommendation 13, we could ask why we have ceased to collect any data on the performance of local authority planning departments. Members will already know my concerns about that. Is there any intention to address the issue in the short-term by collecting comparative data on the performance of local authority planning departments? The idea is that every local authority should produce an improvement plan, but that does not allow us to look across the field.

Those are the main issues that I want to raise—other members may have others. If we can get answers to those questions, we will have some meat for our subsequent discussion with the Council of Economic Advisers. I felt that we had a rather opaque discussion with it last time, and the information that I have mentioned may give us some pointers about issues to approach even as far away as November, when we will have a rematch.

**Christopher Harvie:** I have a point on planning and sustainable development. It would be logical to require that there is no major increase in carbon emissions from the construction of retail facilities. The position with industrial facilities might be different, because they almost inevitably have higher carbon outputs, but huge out-of-town shopping centres place demands on road haulage and car use and consist of big sheds that have to be warmed and cooled. We should query whether they are the only way in which to supply services.

**Lewis Macdonald:** I, too, am interested in the recommendations on energy and emissions. Wendy Alexander is right to point out that we need to understand the nature of the energy study and whether it will be independent, as the Council of Economic Advisers recommended. I saw some press coverage in which ministers accepted the recommendation but said, before the study had even been commissioned, “Of course, we know that it will justify our policy.” That did not fill me with confidence that it will be an independent study that considers the evidence carefully. We need some reassurance on that.

Something that concerns me even more—I think it was quietly announced on the same day that the Government’s response was more publicly announced—is the decision to bring the network of intermediary technology institutes into Scottish Enterprise and close down ITI Energy. That is an extraordinary, backward step, given what we heard today about the importance of strengthening the pipeline of support for innovation in renewable energy. ITI Energy has been doing precisely that, yet the Government has chosen to close it down. Recommendation 7 is to

“ensure that environmental and economic goals are given due weight, and … considered in parallel”.

ITI Energy was designed to do precisely that.

Perhaps the publication of the Government’s response gives us an opportunity to ask ministers immediately to explain their decision to cease the independent operation of the ITIs with an independent board and bring their operations into the fold of Scottish Enterprise.

**Gavin Brown:** Wendy Alexander and Lewis Macdonald both touched on recommendation 6. It will be good if there is

“an independent assessment of the full economic costs”

of the various energy options that is technology neutral, but given that the study is to be commissioned and considered during 2009, the recommendation should also be translated into NPF 2, which we will discuss later. That document is not technology neutral, but we are now commissioning a full, independent study that will be technology neutral. There is an argument for translating recommendation 6 into NPF 2.

**The Convener:** We will discuss that shortly.

**Dave Thompson:** I have a couple of quick points in response to Wendy Alexander’s comments on efficiency savings. We have to consider the potentially damaging effects of the additional £500 million of efficiency savings that the Government will have to make in a couple of years’ time. We must also pick up on recommendation 20, on the freedom to borrow. Getting the power to borrow is crucial if the Scottish Government is to have the flexibility to manage the budget.

**Ms Alexander:** May I guide the clerks, convener? It would be helpful to ask the Government to clarify its efficiency savings targets in percentage terms. Since the outset, efficiency targets have required, for example, 2.5 or 3 per cent savings, with 1.5 per cent in time savings and 1.5 per cent in cash savings. We now have targets in percentage terms for time and cash savings in Scotland and England. Examining whether those targets are comparable or different would be a helpful way of managing the debate that will emerge in the next two years, when both north and south of the border we may be called on to make a slightly bigger contribution to efficiency savings than we have in the recent past.

**The Convener:** I will make a couple of points. The first relates to evidence that we received this morning. It may be worth our asking the Government about the scheme for the long-term unemployed, which was mentioned by Stephen Boyd, and how it will translate to Scotland. That is relevant to the skills and training section of the report.

**Marilyn Livingstone:** Can we also raise the issue of modern apprenticeships?

**The Convener:** Yes, that ties in with the section. It may also be worth our bringing the report and the Government's response to the attention of appropriate committees. The Education, Lifelong Learning and Culture Committee should be particularly interested in the report.

The Council of Economic Advisers makes the point that it is looking at the longer term, but my primary concern is that the economic specialists on the council are not looking at the current crisis. It was Keynes who said:

"In the long run, we are all dead."

If we do not get through the short term, we will not have a long term to look to. I would like to ask the Government whether it is asking the Council of Economic Advisers to advise it on how to react to the current economic crisis, because that is not covered in the annual report or the response and was not addressed satisfactorily when we took evidence from the council's chairman.

**Ms Alexander:** We anticipate a tight spending climate, which may make more acute the issues relating to the funding of higher education in Scotland and the emerging distinctive models for that. In its response to recommendation 17, on how additional costs might be funded, the Government states:

"The new TAG"—

the tripartite advisory group—

"will look at the costs of keeping Scottish universities competitive."

We should ask the Government whether it intends to make public any of that work and, if so, on what timescale. It is obviously desirable that the work be published, as there should be meaningful public debate on the issue before the next spending review.

**The Convener:** I thought that it might be useful to bring the education and skills section of the report, in particular, to the attention of the Education, Lifelong Learning and Culture Committee, but there is no reason not to add the issue that Wendy Alexander raises to our questions to the Government.

**Christopher Harvie:** I have taught in German universities, so the notion of a social year between leaving school and going to university as an indirect student contribution to higher education funding is close to my heart. Replacing the gap year with something much more committed would be valuable in any case.

**The Convener:** We will put to the First Minister the questions that members have suggested. The clerk will draft a letter for me to send, and we will see what response we get.

That concludes the public part of our business. At next week's meeting, we will return to our energy inquiry, looking at energy prices, affordability and fuel poverty. I am not sure whether Stephen Boyd is due to come to that meeting; I suggested to him that if he does he will have attended three meetings in a row, which means that he wins the committee.

11:59

*Meeting continued in private until 12:34.*

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