ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 23 September 2009

Session 3

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ECONOMY, ENERGY AND TOURISM COMMITTEE
24th Meeting 2009, Session 3

CONVENER

Iain Smith (North East Fife) (LD)

DEPUTY CONVENER

*Rob Gibson (Highlands and Islands) (SNP)

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*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)
*Stuart McMillan (West of Scotland) (SNP)

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

*attended

THE FOLLOWING ALSO ATTENDED:

Nigel Don (North East Scotland) (SNP)

THE FOLLOWING GAVE EVIDENCE:

Dr Gary Gillespie (Scottish Government Strategy and Ministerial Support Directorate)
Dr Andrew Goudie (Scottish Government Director General Economy and Chief Economic Adviser)

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Stephen Imrie

SENIOR ASSISTANT CLERK

Katy Orr

ASSISTANT CLERK

Gail Grant

LOCATION

Committee Room 4

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 23 September 2009

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

Decision on Taking Business in Private

The Deputy Convener (Rob Gibson): Welcome to the 24th meeting this year of the Economy, Energy and Tourism Committee. I remind everybody to turn off all mobile devices, as they affect the sound. We have one apology, from the convener, Iain Smith. As deputy convener, I will take his place today.

Under agenda item 1, I seek the committee's agreement to take in private item 4, which is a discussion with our budget adviser. Do we agree so to do?

Members *indicated agreement.*

Financial Services Inquiry

09:31

The Deputy Convener: Item 2 is another evidence-taking session as part of our inquiry into the banking and financial services sector. We have agreed to start our inquiry with some scene setting that will enable us to understand better some of the main issues before we take detailed evidence from November onwards.

Access to finance by our business sector, and the terms on which such finance is offered, is a central issue. It is critical that we get to the bottom of the conundrum that we heard about last week. Every bank is telling the committee that it is continuing to lend, but many businesses and their representatives are saying that that is not the case. Those views cannot both be correct.

During the summer, the Scottish Government produced a research paper on access to finance by small and medium-sized enterprises, which was based on a survey in Scotland.

Dr Andrew Goudie, the chief economist at the Scottish Government, and his colleagues are here to present their findings and answer questions. Dr Goudie is here only for 45 minutes, so I invite him to make a short presentation of 10 to 15 minutes before we move to questions. I ask members to be brief and focused when they ask questions and in the main to stick to the specific issue of access to finance. Later, we will have lots of opportunities to hear from Scottish Government ministers and officials on the work that the Scottish Government is doing through the Financial Services Advisory Board, the jobs task force and so on.

Dr Andrew Goudie (Scottish Government Director General Economy and Chief Economic Adviser): I apologise for my very strange voice; I hope that it survives.

We have circulated a note to the committee. I will briefly talk you through some of the slides that it contains, and we can return to any issues that you would like to discuss further.

I want first to talk about recent economic developments and employment, which is an interesting area at the moment. I will then deal with access to finance and credit before speaking about what we think about the outlook for the future.

Slide 4 in the paper that we have circulated captures neatly the shape of what has been going on for quite a while. As you know, we have been in quite a serious global recession, particularly in the second half of 2008 and the first quarter of 2009. However, you can see from the right-hand side of that slide that, in the second quarter, there has been a substantial easing in the rate of contraction across the global economy. Most of the global economy is still contracting, but there are some important exceptions to that, particularly Japan, Germany and France, and the rate of contraction is substantially less than it was in the previous three quarters. There are a lot of reasons for that, which I will not go into, but, undoubtedly, the fiscal and monetary stimulus across the world has played a big part, as has the fact that we are coming to the end of the period in which companies have been running down their stocks. There are signs that world trade has hit the bottom, having contracted extremely sharply in the past year.

The United Kingdom has followed the same sort of pattern, as you can see from the diagram. I will not go into the detailed numbers, but in a month's time, we will get the second-quarter data for Scotland, and we have no reason to believe that they will show a pattern that is different from what we have seen in the UK and in European Union countries. That means that we expect to be somewhere up in that bunch of countries on the right-hand side of the diagram, all of which show a much slower rate of contraction.

As we have said to you before, we rely on the business survey data to guide us on what is happening in the third quarter of this year. You will see in the top left-hand corner of slide 5 the data from the Markit Economics purchasing managers index for Scotland, which has had a pretty good record so far this cycle in predicting the movements of gross domestic product both in Scotland and across Europe. The most recent data that we have show that services have now moved above the magic 50, which shows some growth in services. Manufacturing is still below that at the moment, but it has come up from a very low point a few months ago to somewhere close to stabilisation.

In the bottom right-hand corner of slide 5, you will see the slightly more forward-looking indicator that is the business optimism survey work. You can see quite a sharp upward movement in levels of optimism. Indeed, the Scottish Chambers of Commerce figure is now positive, showing that, on balance, companies expect there to be growth in the near term.

Slide 6 picks up one aspect that we watch quite closely—the housing market, which is both an indicator of growth trends and a sign of what might come. The contraction in the housing market, in terms of both prices and the number of transactions, hit the bottom some time ago. There are still signs of contraction with some price falls, but that is happening at a much slower rate than before. Indeed, there are signs that we are moving towards some stabilisation.

I will spend a few minutes talking about employment in the recession, which is addressed in slide 7. What is happening now is interesting because the recovery that we are seeing means that the labour market will probably be very soft for quite a period of time. So, although we may see some small increases in output, we are unlikely to see much strengthening in the labour market for a while.

Slide 8 shows the aggregate picture for employment and unemployment. Employment has fallen by about 82,000 in the year, which is quite a rapid decline from where we were. Indeed, that rate of decline has been faster, in percentage-point terms, than the rate of decline in the UK as a whole. Because we started from quite a strong position, with an employment rate close to 77 per cent, we are still in a relatively good position. Nevertheless, the change has been quite striking.

We see very much the opposite picture in unemployment. Unemployment has risen by 75,000 in the year, at a slightly faster rate than in the UK as a whole. Again, however, that reflects the fact that we started from a relatively strong position of just over 4 per cent about a year or more ago.

The next dimension of the labour market that I thought it would be interesting to point out is shown in slide 9, which shows the age profile of unemployment. You will be aware that the level of unemployment among 16 to 24-year-olds has traditionally been quite a bit higher than the level of unemployment in other age groups. Interestingly, however, slide 9 shows a rapid jump, over the past year, in unemployment in that age group. There have been important increases in unemployment in the other age groups, but the increase is striking in the 16 to 24 age group. The jump in Scotland has, nevertheless, been smaller than the jump south of the border. That is also reflected in the rates for the other age groups.

In slide 10, I have summarised the impact of the recession on employment across sectors. You will see that there has been a broad impact in manufacturing. As we have known for a while, the falls have been substantial, with employment falling by 6 per cent in the year from June 2008. In construction, employment was down by 4 per cent and in services, employment was down by more than 3.5 per cent.

The bottom right-hand corner of slide 10 gives you a feel for what is going on at the regional level. The variation across the regions reflects the different composition and performance of different sectors in the regions.

We can pick out the size of the change in unemployment in different regions in different ways. One is to look at the changes in the percentage increases, and that is what that diagram does. You can see that the biggest percentage changes have been around the central belt—in East Renfrewshire, Midlothian, East Lothian and South Lanarkshire. If we look at it in a slightly different way and consider the levels—in other words, if we ask which areas or regions of Scotland tend to have the greatest proportion of their working-age populations in unemployment—we get a slightly different picture. The highest levels tend to be in the west of the country—in North Ayrshire, Glasgow, West Dunbartonshire, East Ayrshire and Inverclyde. Our perception of the issue depends on whether we look at the levels or the changes.

I move on to slide 11. Another interesting aspect of the recession has been the way in which companies have responded to falls in demand. Some have capped staff, which is why the unemployment figures have increased. Some have hoarded staff because of the capital investment that they have made in their people. One result is that working hours have fallen, perhaps because companies have closed down for a week or two but not actually laid people off. Slide 11 shows that, in the first half of this year, working hours fell by about 3 per cent compared with the previous year.

Slide 12 gives a sense of what is happening in the current recession compared with previous recessions. On the left-hand side, you can see that the rate of increase in unemployment in Scotland during the current recession has been quite marked compared with previous recessions in the 1970s, 1980s and 1990s. Again, that reflects, to some extent at least, the favourable position from which we started, so it is unsurprising that the rate of increase is much higher in percentage terms.

The diagram in slide 12 also gives you a feel, although no more than that, for what recessions look like in terms of their duration and the depth of deterioration in the labour market. We can see that, in previous recessions, the deterioration has sometimes gone on for two or three years. We are a year and a bit into the current recession. The diagram offers no proof of what will come next, but it certainly raises questions about the period of time over which we might see that deterioration.

The diagram in the bottom right-hand corner of slide 12 picks up the claimant count, or the number of people who are claiming benefits at the moment. Again, you can see that, in the current recession, we start from a much lower level because the number of claimants had fallen quite a lot in the previous 15 years, but the figure is rising relatively quickly as people move into unemployment and a large number of them are included in the claimant count.

I will say a little about access to credit, which is covered in slide 13 onwards, because I know that that is a key interest of the committee. Slide 14 is a quick way of reminding ourselves that there has been considerable stabilisation of the financial sector and the financial system in the past six or nine months. A year ago, we were all too familiar with the crisis situation. The picture in slide 14 uses one indicator to show how the stabilisation has gone forward. It shows that the inter-bank lending rates have fallen significantly from where they were at the end of last year. Indeed, they are now pretty close to where they were before the financial crisis. However, that does not imply that we are at the end of the financial crisis. Although the International Monetary Fund and the Bank of England believe that there is now much less systemic risk, there is quite a lot of readjustment still to take place in relation to the capital position that companies need to have before they feel able to lend in the way that they were lending before.

In slide 15, we have captured a few perspectives on the survey that the deputy convener mentioned. We used to depend—indeed, we still depend, to some extent—on the Bank of England credit conditions survey, but that is a UK survey that focuses on the lender. We were keen to do something that focused on Scotland and covered the perspective of borrowers rather than lenders, in order to see whether the picture was different. I can go into more detail if you wish but, in a nutshell, the supply-side story is similar to the one in the UK survey. We heard that the supply of finance had indeed fallen quite a lot, as had the proportion of approved applications and the percentage of the requested money that companies actually received from lenders. That was a fairly general picture across the economy and it squared fairly well with the results of the Bank of England survey.

09:45

The difference was more on the demand side. We questioned the way in which demand was picked up in the Bank of England's survey. We felt that the definition that it used was much closer to a supply definition than a demand definition, because it focused on approved lending as opposed to what we would regard as demand, which is what companies ask for in the first place, before any filtering takes place.

The survey that we conducted showed that the demand for credit had in fact increased during the period from 2007 to 2009. Interestingly, the emphasis had moved away from the purchase of fixed assets or credit for emergency purposes, and much more towards the financing of working capital and cash-flow requirements. We felt that there were important differences between the results of our survey and some of the evidence from the UK work, which gave us confidence that the survey was a good investment of our time.

Another aspect is that, unsurprisingly, the cost of finance to all firms increased substantially during that period, which is very much in line with the other evidence that we examined.

I will not talk about the graphs in huge detail, but slide 15 gives a sense of how demand has increased during the period, because much larger numbers of enterprises of different sizes were looking for credit. Similarly, we found that their success in securing 100 per cent of what they were asking for declined quite sharply too, because the supply of credit has fallen.

Slide 16 shows that the reasons for asking for credit changed quite a lot as the recession impacted. Again, that is not necessarily surprising, but it is interesting to see the evidence.

Slide 17 shows companies' success in getting what they asked for—that is, what proportion of the requested loan was actually granted. Interestingly, even in pre-crisis times, there is very much a yes/no climate—people either get 100 per cent or they get zero per cent, and there is not a huge amount of people in the middle. What has changed during the recession is that there is a quite striking drop—from about 69 per cent to about 50 per cent—in the number of firms that got 100 per cent of what they asked for. That 20 per cent difference is picked up on the left-hand side of the diagram, which shows that 20 per cent more companies now get zero per cent of what they asked for.

Slide 18 gives a quick summary of the differential impact across the industry. In 2007, the areas that were regarded by lenders as being risky were quite different, to some extent—transport and communications, and business activities, for example. In 2009, everything is viewed as much more risky overall, as we would expect, but there is a much greater emphasis on the risks that are posed by hotels and restaurants, the wholesale and retail sectors, construction and manufacturing. That is another interesting part of the overall story that we have been putting together about the nature of the recession.

I will say just a few words on the future—I will not labour my points, because you are probably familiar with much of them. The depth of the recession in 2009 has generally been greater than it was perceived to be in the early part of this year. However, we have seen evidence to suggest that there will be some recovery in 2010, although the consensus is that on the whole it will be pretty weak and will be protracted through 2010-11.

The diagram in the bottom left-hand corner of slide 20 reflects the fact that it is expected that growth in advanced countries will be somewhere between 0 and 2 per cent in 2010. A lot of the growth will come from emerging economies, particularly China and countries in east Asia, where growth rates of 5 to 6 per cent are anticipated. I will not go into the detail of why those rates of recovery are relatively slow, but it is probably important to reiterate the fact that a huge amount of readjustment will still be going on in personal, business and financial and public sector balance sheets during that period.

Slide 21 shows a representation of the forecasts that have been made for the Scottish economy by the forecasters that we track. It shows a similar picture—it forecasts a slightly lower growth rate in 2010, but I would not read a huge amount into that.

In slide 23, I wanted to make a quick reference to the importance of the link between what goes on in the UK and what goes on in Scotland, particularly in terms of the UK's growth and the impact on the public finances of the UK and Scotland. Slide 23 shows a now-familiar picture of rapidly rising expenditure in the recession, revenues that fall back pretty rapidly, and the resultant impact on net borrowing. That is the picture that HM Treasury's budget projected back in March. You can see a rapid deterioration and then, from next year, an attempt to pull the deficit back quite rapidly.

A lot of important assumptions are embedded in the slide. So far this year, the revenue and expenditure numbers that have come through suggest that the Government was pretty much on track until June. July and August looked a bit more difficult, particularly on the revenue side. At the moment, however, independent forecasters are not projecting a dramatically different outcome from what was in the budget.

Slide 24 is interesting. It shows what the Bank of England forecast looks like. Members will be familiar with its fan diagrams, which try to give an idea of the range of forecasts that it anticipates. The breadth of the band of colour reflects the fact that the bank is hugely uncertain about the outcome. You might look at that slide and feel rather cynical about the value of the bank's projection, which is very wide at the moment.

I have drawn two quite important lines on the graph in slide 24. The yellow line shows what a fairly rapid UK and global recovery might look like. It builds up relatively quickly to where we were some time ago. The red line represents a much more conservative or relatively subdued recovery through 2010 and into 2011. The consensus is, I suppose, slightly towards the red line, although the budget forecast was slightly more towards the yellow line. Where that line lies in reality is very important.

If we go the way of the yellow line, any macroeconomic adjustment can be done sooner than if the red line prevails. The critical economic policy question is how to transfer from a substantial UK and global dependence on the public sector, through monetary and fiscal policy to stimulate the economy, to dependence on the private sector. The movement between those two degrees of dependence is critical in relation to not only the timing but the rate of adjustment. That greatly depends on the yellow and the red lines in my little diagram in slide 24.

If we are closer to the red line, the picture for public finances will be much more difficult. If the UK Treasury wishes to keep closely to its UK deficit projections, more squeeze will be needed. If we are closer to the yellow line, it should be possible to sustain our current projections for public finances. The whole picture depends on what happens with the global and UK recovery pattern and the knock-on effects for our public finances and growth.

I will stop there because I know that the committee wants to take a bit of time for questions. I will just point to the conclusions in slide 25 because they are pretty important. At the moment, there are predictable signs that we are reaching the trough. With a trough, the classic picture is one of mixed signals: some areas of the economy are looking better than others—some are going up while others are still going down.

We can expect on-going readjustment in the balance sheets of the different parts of the economy for some time. The big question is how long that will go on for before we stabilise. The expectations are for a slow, protracted recovery at the end of this year and into 2010 for most advanced economies. As I said, the transition from a recovery based on the public sector to one based on the private sector is critically important. What goes on with the UK's growth and finances has implications for the Scottish economy.

Finally, as I demonstrated earlier, we should anticipate a deterioration in the labour market well into 2010. Obviously that will have different impacts across the different sectors and regions of the UK and Scotland.

The Deputy Convener: Thank you, Dr Goudie. In our short question session, we will concentrate on the ability of small and medium-sized enterprises to secure the finance for which they apply. Last week, the British Bankers Association assured us that banks are lending, but your survey suggests the opposite. Where does the truth lie?

Dr Goudie: There is little doubt that the supply of finance from lenders has reduced quite significantly. There is a degree of consistency between the Bank of England figures and our survey, as one of my diagrams showed, but there are also important differences in supply. Gary Gillespie might want to pick out a bit more detail from the survey, but I emphasise the importance of understanding the demand that is coming through from SMEs.

One of the key economic questions that we consider is the extent to which, as recovery comes and as we try to make the transition from a public-sector-led recovery to a private-sector-led recovery, firms will be constrained by the supply of finance. The evidence suggests that quite a lot of the demand for working capital is not being met, but we are dubious about the extent to which surveys of lenders pick that up, because they seem to filter out much of the demand at a fairly early stage, before they record it as demand.

I invite Gary Gillespie to say a little more about the detail of our survey in that respect.

Dr Gary Gillespie (Scottish Government Strategy and Ministerial Support Directorate): I will give some additional background information. In Scotland, SMEs represent 99 per cent of all enterprises and employ more than 1 million people. Our survey deliberately oversampled the smallest of businesses because we wanted to get a feel for the position of microbusinesses and the self-employed. From previous surveys and business breakfasts, we picked up the fact that SMEs face difficulties in accessing finance. That is why we looked into the matter. To add to the point that Andrew Goudie made, there has been a withdrawal from the economy of foreign lending, which will impact on companies in Scotland as well.

One of the survey's most striking findings is that the focus or nature of the demand for funding has changed. Businesses are seeking short-term capital rather than longer-term capital or investment. The rejection rates are also striking. The survey shows that microbusinesses have been hit the hardest. Approval rates for microbusinesses fell from about 82 per cent in 2007 to about 60 per cent in 2009. The rates for small businesses fell from about 93 per cent to about 79 per cent, and the rates for medium-sized businesses, which are the slightly bigger companies in the sample, fell from almost 100 per cent to about 89 per cent. We were keen to pick that up and drill into the data within the sectors.

The Deputy Convener: So you are saying that your survey is much more representative of the truth than what we heard from the British Bankers Association.

Dr Gillespie: There is a point to be made about the nature of demand. We need to understand whether the lending patterns have resulted from the tightening of supply or from a fall in demand. In a recession, we would expect businesses' demand for finance for long-term investment to fall. However, what we picked up, in contrast to what the credit conditions survey and other surveys are saying, is that there is more unmet demand for finance, particularly from microbusinesses, than there was in 2007.

You asked which side is right, and they are probably both right. The bankers have focused on viable demand. I suppose the question that comes back to the committee is whether businesses' unmet need for finance is damaging the economy or preventing recovery. Our survey brings the demand perspective a bit closer to the supply perspective, but the answer lies somewhere in the middle.

10:00

Christopher Harvie (Mid Scotland and Fife) (SNP): It is an ironic position to be in when banks are paying 0.5 per cent interest to their customers but the charges to borrowers are higher than they have been for a very long time. I tend to contrast that with the situation in Germany, where I used to work. There, the Kreissparkasse, or local savings bank, would pay a reasonable dividend to its depositors and out of that would come a lot of microfinance for the local Mittelstand. However, that system appears to have broken down in this country. Why are the banks demanding such amounts of interest? Does it have anything to do with the fact that they need to sustain some of the lending policies that they introduced in the balloon years, which have led to their taking on colossal amounts of bad debt? That seems to be particularly the case in Scotland.

Dr Goudie: I have two points to make on that. If we examine not only the theoretical position but observations that have been made over many years and in more normal circumstances, we can see that there has been quite a close link between deposit and lending rates and that the spread between them should be much smaller. Over the past year or more, two crucial things have happened, the first of which is the very substantial change in the risk assessment of banks and, indeed, borrowers. When a huge change in risk assessment is made, one expects lending rates to rise to a certain extent.

Secondly, the banking system is in a very different situation. It could be argued that, at the moment, banks are very much focusing their attention on realigning their balance sheets rather than on extending their businesses, which I suppose has more to do with sustainability and survivability than with market growth. It is perhaps unsurprising that the banks' current behaviour reflects their wish to move rapidly to some sort of stability and to restore a balance sheet that they feel satisfies their stakeholders and keeps them as much as possible from entering into Government-supported guarantees or other Government schemes.

Christopher Harvie: Even if that means reverting to the actions in which they have been previously engaged. I am sure that you saw Monday's "Panorama", which showed how banks that are funded by the state were involved in the naughty business of making £4 million disappear from the taxman's sight.

Has there been an increase in what could be called the personal loans factor among families and people in the neighbourhood? According to anecdotal evidence, people who have found that their deposits are paying out nothing have been more willing to subsidise and help friends and local concerns. Indeed, the evidence that I have gathered suggests that quite a lot of it is going on in an informal way. Such activity ought to be encouraged but, at the same time, rules ought to be drawn up to govern it.

Dr Goudie: Did that get picked up in the survey, Gary?

Dr Gillespie: Yes. We found that smaller businesses that were not getting formal access to finance were increasingly going to families and other funding sources, although a small proportion was still unable to secure finance from any source. Those other sources certainly came through in the survey and are covered in a slide in the report.

Ms Wendy Alexander (Paisley North) (Lab): The Scottish Government's submission to the inquiry concludes with the suggestion that we need to learn lessons from what has happened. However, the submission itself is rather short on Scotland-specific analysis. In particular, I think that the Scottish public will find it bizarre that it fails to quantify the support that taxpayers have offered to the principal banks in Scotland.

As a result, I invite you to itemise in writing for us the total support that has been given. I realise that that is dependent on decisions about the Government asset protection scheme that will be taken over the next two weeks, and it would be fine if you wanted to wait until after then to send us the information. As I say, people will find it bizarre that you can talk about prospective savings of £1 billion that will be made from banking institutions in three years' time without quantifying the amount of public support that has been offered. Is it possible to write to us in those terms?

Dr Goudie: We can certainly do that to the best of our ability.

The Deputy Convener: We are asking members to concentrate on the needs of small businesses at the moment, because we will be able to ask the cabinet secretary these questions in due course.

Ms Alexander: Sure. I have another couple of questions. There is really no analysis in the Scottish Government submission about what went wrong with the Scottish banks. As the chief economic adviser to the Scottish Government, Dr Goudie, what do you think went wrong with the Scottish banks? Why did Scottish institutions rather than their UK counterparts end up with such large public shareholdings?

Dr Goudie: I do not pretend to know the detailed decision-making processes within the key banks. I would not presume to have that degree of knowledge. However, what has become evident from the analysis of others is that certain decisions were made when there was a fundamental lack of understanding of the nature of the products that were being dealt with in some institutions. That stemmed from a lack of understanding about some of the products that derived from the US mortgage market. A clear picture is now emerging of the buying and selling of huge quantities of such products for which the understanding of the risk and therefore of the appropriate price was seriously misjudged. That seems to be one of the key issues that ran through the financial sector around the globe. I am afraid that I am not able to provide any insight into why those decisions were made, but it seems to be clear that the failure to understand the impact of such trading on the fundamental balance sheets of financial institutions took us to a position of huge insecurity in the end.

Ms Alexander: Thank you. If you have any further reflections on the specific Scottish dimensions of that, we would welcome those in writing.

My third question is about the perceived absence of competition in the Scottish banking market. Again, people will find it rather odd that the Scottish Government's submission mentions the Conservative party's policy white paper but makes no mention whatsoever of the current European Commission investigation by Neelie Kroes into banking competition in Scotland. That is an oversight, so it would be helpful if you could write to us itemising any work that the Scottish Government has undertaken on the current absence of competition in Scottish banking services, and any representation that the Scottish Government has made either to the UK Government or to the European Commission on the matter. Have any representations been made in writing to either the UK Government or the European Commission on the current inquiry?

Dr Goudie: We are certainly happy to fill you in on what is going on. To be frank, I am not sure whether any written submissions have been made, but I am happy to check and come back to the committee on that.

Gavin Brown (Lothians) (Con): I have a couple of questions on the paper that you supplied entitled "SME Access to Finance 2009". How many individual companies responded to that survey?

Dr Gillespie: The survey received responses from 1,001 companies. Each company was interviewed for approximately one hour.

Gavin Brown: You drew a comparison with the 2007 survey which, if I read the notes right, was extrapolated from a UK survey. Was the 2007 survey conducted by asking lenders or individual SMEs?

Dr Gillespie: The surveys are directly comparable. The 2007 survey was UK-wide and it included a sample of 500 companies in Scotland. We took the 2007 results from those companies and the follow-up survey focused on specific issues relating to the downturn and recession. The 2007 survey used the same questions and provided a comparable base.

Gavin Brown: Slide 18 in Dr Goudie's presentation surprises me a little because it suggests that the banks regard health care and social work, which take place mainly in the public sector, as representing approximately the same risk as hotels and restaurants, which are primarily private sector businesses and have had an absolute kicking in the past year or two. Health and social work are seen as being a greater risk than construction, which has had a torrid time in the past year or two. Did those results surprise you? Can you explain them?

Dr Gillespie: We can provide the background information, if you like, including the number of firms we are talking about. That might provide the context. The reason for showing the slide was to give a flavour of the responses that we got from the firms. Your point about health and social work might be explained by the numbers, because a very small number of companies in the private sector will be involved. As Andrew Goudie mentioned earlier in relation to employment, there will be a kind of level-and-change effect. We can provide the level figures for you.

Gavin Brown: That would be helpful. Access to credit is central to the committee's inquiry. Last week, as you know, we heard from the BBA that lending has broadly held up. That is in stark contrast to the picture that we get from your survey, and probably also in contrast to our mailbags. Any data that you can provide would be useful so that we can do a deeper analysis of it.

Dr Goudie: I reiterate an important point that Gary Gillespie made. If we look back, particularly to 2005 and 2006, we find that the growth of lending to businesses was, broadly speaking, half attributable to UK lenders and half to non-UK lenders. Overseas lending almost entirely disappeared from the scene in 2007 and there is no sign of its return. Even if the UK lenders return to where they were, half of the process will still be missing. That is an important aspect. You may well hear from UK lenders that they are doing a good job in getting back to where they were but, in a sense, we have still lost half of the contribution that we had before. That is why you might sense that there is an absence of supply even though some people are saying that they are doing what they did before.

Lewis Macdonald (Aberdeen Central) (Lab): You will be aware that the Federation of Small Businesses—as well as its many members, some of which you have spoken to—is concerned about access to capital. Its point is that, where there were four major high street banks providing finance to small businesses in Scotland, there are now only three, and the largest of those now has a very substantial share of the SME lending market. Do you share the FSB's concern that we now have a duopoly and almost a monopoly in loans to small businesses? Is it right to worry that the terms on which credit is available to small businesses are therefore less competitive than they were a year ago?

Dr Goudie: Gary Gillespie might want to comment in the context of our survey, but I will make a general comment to start with. It relates partly to Ms Alexander's question about competition more generally. In principle, we would obviously prefer a situation in which a greater level of competition was generated by more actors in that market. However, I am not sure that there is any evidence that there is a lack of competition or that the absence of lenders is leading to much greater costs of borrowing, as opposed to the other elements that I raised before, such as risk.

The Scottish Government's view is that we wish to encourage competition in the market and to introduce new banking and financial institutions to Scotland to increase competition and supply. From that point of view, we support the FSB's general point. Obviously, the expectation would be that that competition will drive better terms and conditions for borrowers of all sizes.

10:15

Dr Gillespie: The survey shows that Scotland has always had a concentrated business finance sector anyway, with HBOS and the Royal Bank of Scotland accounting for 28 per cent and 40 per cent of the SME business market respectively. The addition of Lloyds TSB's share to that of HBOS adds an extra 8 per cent. The two main banks therefore now account for 76 per cent of the market. In the survey, we picked up that there were no differences in those banks' lending practices, but the real risk for Scotland would be differential lending in Scotland relative to that in the rest of the United Kingdom or internationally as a result of those banks having to repair their balance sheets, for example. That issue has been flagged up. However, we have no evidence from the survey that shows that one particular bank in the group has reined in or refused loans at a greater rate than other banks.

Lewis Macdonald: I am conscious that banks such as HSBC and Barclays Bank are trying to grow their share of the Scottish market. Obviously, Clydesdale Bank is the other major provider that traditionally operates in Scotland.

The FSB has suggested that low-margin business banking perhaps requires additional support in order to be attractive to financial institutions, given that many small businesses are bound to operate with relatively low margins. Does the Scottish Government have any locus or interest in that?

Dr Goudie: On your first point, it is true that there have been encouraging signs recently that relatively small players wish to have a presence in Scotland or to expand. That is a positive sign in trying to overcome potential issues arising from weak competition.

On your second point, the general approach at the moment should be caution at assuming such a function, which is fundamentally a function of private sector lenders. I do not doubt that, theoretically, the possibility of some sort of Government subsidy might lead to more activity, but we must always be cautious about the costs of such schemes and the additionality that they would drive. At the moment, attention should be much more on trying to increase the competitive side of the market and supply from the private sector lenders.

Lewis Macdonald: The other alternative to Government subsidy is stimulating or supporting a mixed market. It was suggested from a small business perspective that the post office network could enter the market and that post offices could be bankers for small businesses. Last week, the Building Societies Association suggested to the committee that mutualisation rather than privatisation of some of the institutions that have been nationalised might make for a more varied and diverse marketplace for businesses. Does that proposal have merit?

Dr Goudie: You have mentioned a range of channels by which we would, fundamentally, get more players. We would potentially get a range of players that are better able to work at the smaller end—the micro, small-company end—of the market. Both things are to be hugely welcomed, because there is no doubt that the better the access and costs, the easier it is for small companies to take advantage of them, particularly in a recovery phase. The development of any such channels is therefore to be hugely welcomed.

Stuart McMillan (West of Scotland) (SNP): I want to ask about slides 10 and 16. Slide 10 highlights reductions in employment levels. The greatest reduction has been in employment in manufacturing. Slide 16 is entitled “Change in reasons for using overdraft between 2007 and 2009”. One of the smaller percentage changes is for stock. Is there any evidence of any movements in the manufacturing sector and in the supply chain of stock levels as a result of increased access to funding for smaller and medium-sized businesses?

Dr Goudie: I do not have any knowledge on that point. In manufacturing, we have seen a strong stock cycle within companies. There has been a strong running down of stocks. Indeed, that is one of the elements that account for why we feel we are reaching or have reached the bottom of the cycle, because there comes a point when companies start to restock again. That is not a Scotland-specific point but a characteristic of recessional failings throughout the advanced world. The decline of manufacturing would, not surprisingly, lead to quite a rundown of stocks and, therefore, less demand for credit to finance those stocks. That is the whole point of running down the stocks in the first place.

I expect that, as we get to the bottom of the cycle and into the recovery stage and as companies feel the need to restock because they see the prospect of demand, demand for credit to finance that process would grow. However, our analysis might not pick up that point. It was conducted in May and June, and I expect that it just predates the point at which the trough of the stock cycle was reached. Were we to conduct the same analysis in a few months’ time, it would not be surprising if we found evidence of a much stronger demand for finance to help with that restocking in the latter part of the year.

Stuart McMillan: Will you keep the committee up to speed with any developments in that area?

Dr Goudie: Certainly.

Marilyn Livingstone (Kirkcaldy) (Lab): I have a follow-up to Lewis Macdonald’s question on mutualisation. I am glad that you welcome mutualisation as a possibility, but is the Government having any discussions with Scottish Enterprise vis-à-vis Co-operative Development Scotland, which is a Government agency? Is any work being done through it to consider a mutual solution?

Dr Goudie: I am not aware that it is, but I am happy to check and write to the committee to let you know. I am afraid that I am not familiar with what is going on.

Marilyn Livingstone: That would be really helpful. Thank you very much.

On page 42 of “SME Access to Finance 2009”, you detail approval rates. There is quite a difference between the sectors. Do you have any further explanations of why that is and why some sectors are faring reasonably while others are struggling?

Dr Gillespie: We found that the process for approving loans had changed and become more centralised and that different weights were being attached to different sectors. Therefore, a different risk factor will be applied to an application from a business in a sector such as house building or construction. That is the centralised process within the banks, but the other side of the matter is the individual applications from businesses. That is how we explain the figures.

Marilyn Livingstone: You say:

> “The majority of sectors have revised growth expectation downwards—the notable exception being in Construction”.

Does that refer to construction companies working on large projects or to house builders? Was there any differentiation, or were they just lumped in together?

Dr Gillespie: Given the nature of our sample, it would typically be smaller construction players. We had more of the self-employed and very small firms.

Marilyn Livingstone: Do you not know what projects they were working on? I am trying to determine whether the growth is in large projects—such as new technologies, hospitals and schools—as opposed to house building. I am trying to determine confidence.

Dr Gillespie: I will pull out whatever information we have and come back to you on that.

Marilyn Livingstone: That would be very interesting. I chair the cross-party group on construction and it would be extremely helpful to have information on where the growth is. Did you do any work on the impacts on skills development and modern apprenticeships? Have firms been reluctant to take on trainees and modern apprentices? What impact does that have on developing a skilled workforce for the future?

Dr Goudie: I am not aware of any specific work being done on that, but the trends in the 16-to-24 age group and the concerns that I referred to earlier should give you some sense of what is going on—albeit not a very precise sense. You have identified one of the important factors underlying those trends. I am not sure whether there are more detailed data on that, but I am happy to look. You will find that the situation is reflected strongly in the series of data that are available.

Marilyn Livingstone: I thought that that was indeed obvious in what you were saying, but it would be helpful if the committee could get a bit more information and a bit more of a breakdown.

Dr Goudie: Okay.

Marilyn Livingstone: It is an important issue for the economy.

Dr Goudie: We are happy to look for more information, and we will come back to you.

Marilyn Livingstone: Thank you.

The Deputy Convener: We are near the end of this short evidence session. Nigel Don is here as a guest member—do you have a question?

Nigel Don: Thank you, convener. I wish to ask two, if I may.

I take Dr Goudie back to slide 17. You eloquently highlighted the 20 per cent of firms applying for funding that suddenly found that they were getting 0 per cent, rather than 100 per cent. Have you or your staff been able to do any assessment of the wisdom of those decisions? The message that I got from the bankers last week was that they are reassessing some of their lending. They seem to be deciding that some of the things that might have been judged to be viable previously are not any more. Is somebody cross-checking the social and economic implications of those decisions?

Dr Goudie: To my knowledge, we do no work that goes into that level of detail regarding the decisions that are being made.

There are two aspects to the matter, and the balance between them is very difficult to judge. One aspect concerns the readjustment process that the banks are going through, which I mentioned earlier with reference to their balance sheets. The other aspect is that, in a recession, the risks that attach to individual companies and their expected output and demand and—at the extreme end—their very sustainability over the coming years are very legitimate risks, depending on the shape of the recovery. Unsurprisingly, and irrespective of any balance-sheet considerations, banks will be much more cautious if they perceive the risks to be very serious.

Some of the change will be due to what is going on in the financial system and to the restructuring there; some of it is a reasonable reflection of what is a traditional recession. The nature and the length of the recession will dictate the extent to which some companies are viable or not, and banks will reflect that in their decision making.

As for the particular decisions that are being made by lenders, I do not believe that we are in a position to make a judgment.

Nigel Don: I am reflecting on the way in which the Government does its research. This is not a particular comment about economics. I worry, however, about the lack of longitudinal studies on such things. You are considering the issues according to high economic theory. That is reasonable, but I wonder whether we ever do the research to underpin that over a period of time, or whether we could persuade somebody to do so. It is never the right time to start such research, and it always costs money that we do not have, but that might be helpful.

I will pick up one further point. Have you done any assessment at Government level of the impact of current capital expenditure by the Government on the construction industry? That is the prime taker of the money. Do we have any clue as to the budget implications for the construction industry?

Dr Goudie: I am not sure that we have information in quite that form. We have clear information on what, precisely, the capital budget is going on, and on the nature of the projects that are being supported, but I am not sure that it is broken down in quite the way that you seek. However, I would be happy to have a look to see whether we can say any more about that.

You are asking for quite a strong sectoral impact analysis. The answer is that I am not sure. Part of the answer lies in the extent to which the construction projects that are financed through the capital expenditure programme are run within Scotland or by companies outwith Scotland; another consideration is what the differential effect on the Scottish economy would be. It is certainly an important question, and I would be interested to see whether we can do more to identify that information.

The Deputy Convener: That draws this part of our business to a close. Given the various requests that have been made, it would be useful if, during our inquiry, you could share with us any information that you get about the state of the economy and other details about the ways in which businesses are being affected by the current situation.

Thank you for bringing together some useful statistics. I see that you have a lot of access to the Bank of England’s facts and figures, which is very helpful. Given that the Financial Services Authority and the Treasury are prepared to give us evidence, it would be nice to think that the Bank of England might also do so.

I thank the witnesses very much.

10:30

Meeting suspended.

10:35

On resuming—

Subordinate Legislation

Criminal Jurisdiction (Application to Offshore Renewable Energy Installations etc) Order 2009 (SI/2009/1739)

Civil Jurisdiction (Application to Offshore Renewable Energy Installations etc) Order 2009 (SI/2009/1743)

The Deputy Convener: Item 3 is subordinate legislation. We are considering two statutory instruments. The clerks have produced short papers on both the orders, which are being considered under the negative resolution procedure, meaning that they enter into force unless Parliament decides otherwise. Do members have any points or concerns to raise?

Lewis Macdonald: Sorry, but what was the proposition?

The Deputy Convener: We have two negative instruments. Do you have any comments on them?

Lewis Macdonald: I support the principle behind them. Will the minister come to the committee to address them at some point?

The Deputy Convener: They are negative instruments.

Lewis Macdonald: So there is no requirement for that.

The Deputy Convener: Indeed.

Lewis Macdonald: That is fine. My only comment on the orders is to recognise the benefits that they bring. They are derived from the Scottish Adjacent Waters Boundaries Order 1999, which was one of the first items that the Scottish Parliament debated 10 years ago. I am happy to support these orders, given that Alex Salmond moved a motion against that order 10 years ago. Clearly, there is room for a learning process on the part of all members of the Scottish Parliament. I am glad that, 10 years on, Mr Salmond is now founding new legislation on the 1999 order.

The Deputy Convener: As you raise the issue, I draw attention to the explanatory note that is attached to SI/2009/1739. Clearly, it was not one of Alex Salmond's friends who wrote in paragraph 7.4 that

"Second, for the reasons set out … the Scottish border in this Order is based on boundaries in the Scottish Adjacent Waters Boundaries Order 1999",

as Lewis Macdonald pointed out. It continues:

"This is a different (and indeed more southerly) border than that provided for in the 1987 Order. We considered that, absent a precise definition of the Scottish border, there was real risk of confusion as to the correct boundary to be applied."

Although the SI contains latitude and longitude in figures, there is no map in the explanatory notes. Any map would show that that 1987 order had a more southerly boundary and that the 1999 order had a more northerly one, so the explanatory note is incorrect. I ask members what we might want to do about that. The issue is not with the order—the explanation is wrong.

Lewis Macdonald: I, too, was struck by the phraseology, which is slightly surprising. I recall that, when the Scottish Adjacent Waters Boundaries Order 1999 was debated in Parliament 10 years ago, a map was provided as part of the accompanying documents. I was surprised that that was not repeated in this case. However, I suspect that we might have a consensus on the 1999 line, so it might be as well to endorse the proposals without further comment.

The Deputy Convener: I wonder whether it is worth commenting on the need for the provision of a map with any such explanatory notes. I have certainly seen maps with other statutory instruments. Do members agree that it would be useful to write to the Government about that?

Members *indicated agreement*.

The Deputy Convener: Do members agree that we have no recommendations to make on the orders?

Members *indicated agreement*.

The Deputy Convener: That brings the public part of our meeting to an end. We will now go into private. The committee's next meeting will be on 30 September, when Robert Peston, business editor with the BBC, is to give evidence on banking issues and we will take evidence as part of our scrutiny of the budget.

10:40

Meeting continued in private until 11:33.

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