ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 30 September 2009

Session 3

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ECONOMY, ENERGY AND TOURISM COMMITTEE
25th 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)
*Stuart McMillan (West of Scotland) (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:

Dr Peter Hughes (Scottish Engineering)
Bill Jamieson (Scotsman Publications Ltd)
Michael Levack (Scottish Building Federation)
Robert Peston (BBC)
Peter Taylor (Town House Collection and Scottish Tourism Forum)
Alf Young (Riverside Inverclyde)

CLERK TO THE COMMITTEE

Stephen Imrie

SENIOR ASSISTANT CLERK

Katy Orr

ASSISTANT CLERK

Gail Grant

LOCATION

Committee Room 4

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 30 September 2009

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

Budget Process 2010-11

The Convener (Iain Smith): Good morning, colleagues. Welcome to the 25th meeting of the Economy, Energy and Tourism Committee in 2009. David Whitton is here this morning as a substitute for Marilyn Livingstone, whose mother has sadly passed away. I am sure that the committee will join me in offering our sympathies to Marilyn. Our thoughts are with her at this difficult time.

I remind all those present to turn off mobile phones and BlackBerry-type devices, as they can interfere with the sound system even when they are in silent mode.

The first item on our agenda is scrutiny of the draft budget for 2010-11. This is our first evidence-taking session on the draft budget. I am pleased to welcome to the meeting our adviser, Peter Wood, who is here to assist the committee, and our panel of witnesses. I will ask the witnesses to introduce themselves briefly and make some brief opening remarks before I open the floor to questions.

This year, the committee has agreed to focus on two key questions. First, given that the recession is still under way in Scotland, is the proposed budget the right one to help the economy to return to growth and is it consistent with the Scottish Government's economic recovery plan? Secondly, did the various measures that were agreed last year, such as accelerated capital expenditure and increased spending on, for example, modern apprenticeships and energy efficiency, make any substantial difference?

Dr Peter Hughes (Scottish Engineering): Good morning. I am from Scottish Engineering, which is the employer body for the engineering manufacturing sector in Scotland. We represent 400 member companies in all sectors of manufacturing and engineering. Seventy-three per cent of our members fall into the category of small and medium-sized enterprises, with fewer than 250 employees, and the rest include big companies such as Scottish Power and Weir Group.

Michael Levack (Scottish Building Federation): Good morning. I am chief executive of the Scottish Building Federation. As an organisation, we are 114 years young and we have 700 members from Orkney to the Borders and from major contractors down to sole traders. I am also the employer secretary of the Scottish Building Apprenticeship and Training Council.

Alf Young (Riverside Inverclyde): Technically, I am still a member of staff of *The Herald*, although I am on holiday and will be retired from *The Herald* as of 19 October. I should declare an interest, because I am about to draw a teacher's pension from many decades ago. I see that the Scottish Public Pensions Agency accounts for the biggest block of the budget for the directorate that the committee oversees.

The Convener: Fortunately, we do not oversee that part of it.

Bill Jamieson (Scotsman Publications Ltd): I work as the executive editor of *The Scotsman* and I am Alf Young's long-time sparring partner on "Newsnight Scotland". My remit at *The Scotsman* is to have oversight of business, economic and finance matters.

Peter Taylor (Town House Collection and Scottish Tourism Forum): I am founder and chairman of the Town House Collection, which has four hotels in Edinburgh and is about to open Blythswood Square in Glasgow, a 100-bedroom five-star hotel. I am also the immediate past chairman of the Scottish Tourism Forum. At the moment, the forum represents, directly or indirectly, 19,000 tourism businesses in Scotland.

The Convener: I thank the panel for their introductory remarks. I will direct my first question at Michael Levack, but others can chip in if they feel like it.

Has the accelerated capital programme that was announced for this year's budget found its way through to assist the building trade? If not, do you expect that it will at some point during this year?

Michael Levack: Of course the industry welcomed the accelerated capital expenditure that was announced during the past year, and one would not want to appear ungrateful, but it was never going to be enough, given the drastic times that the construction sector is facing. It has not worked its way through the system quickly enough, which the Scottish Government could take action on, particularly in relation to public sector procurement. The procurement process is very slow and is a drain, not only on the bidders—the people who tender to win the work—but on the parties that put the jobs out to tender.

We are willing to undertake some simple measures to assist the process. I will not go into details here, but we have offered to discuss them with the Scottish Government. It is important that we are efficient—we hear words such as "efficiency" and "greater effectiveness", and we see that the proposed budget has put the squeeze on every department. There is currently a dreadful waste of resource in the procurement process.

With regard to affordable housing, we have found that a lot of the money has been used to buy land and some existing stock, rather than to start new projects, which would protect employment and capacity in the industry. Our fear about the budget proposals is that there might not be the necessary level of expenditure to maintain some assistance for the industry. One important area, on which I would be delighted to give more details later in today's session, is the need to back up the Government's promises on reducing carbon emissions with some hard cash to make a start on the retrofit programme, not only for housing but for all buildings.

The Convener: I will press you on that slightly. Is your primary concern that the money in the budget is not making its way through because the planning and procurement timescales mean that it cannot be spent quickly enough to make a difference?

Michael Levack: Yes. We announced last week that, given the latest findings from research among our members, we estimate that 8,500 jobs have been lost in Scotland this year, on top of the 20,000 that were lost last year. We cannot afford to continue to lose jobs and capacity at that rate.

The Convener: Before I invite other members to ask questions, I want to ask Peter Taylor about the tourism industry. Have you found the moneys that have supported homecoming Scotland 2009 to be beneficial? What are the implications for next year, when we will not have a homecoming?

Peter Taylor: There can be little doubt that homecoming Scotland has worked. It has been a brilliant collaboration between the public and private sectors. There are some 300 themed events, and many local people and action groups have been working together. I think that there will be a major legacy element to homecoming, but I have some concerns about a real-terms reduction in the budget—although in the same breath I appreciate that all budgets are being stretched.

This perhaps follows on from Michael Levack's comments: we all need to think and act differently. The public and private sectors need to work together and collaborate more, and try to strip out duplication. The public sector needs to be light-footed and ready to switch its strategies, and it needs to demonstrate added value. In general, if it were not for homecoming Scotland, I am not sure where we would be this year.

Rob Gibson (Highlands and Islands) (SNP): I will follow up on the points about public procurement. A lot of civil engineering takes place because of Scottish Water, which undertakes a wide range of projects and is the biggest procurer for the public good in the country. Large parts of the construction industry are involved in that work, which includes renewable energy developments. Are most of your members smaller members of the trade, and are they having difficulty in getting money from the banks to help them to get on with the job?

Michael Levack: Our membership covers a cross-section of the construction sector but not civil engineering—I leave that to my colleagues at the Civil Engineering Contractors Association (Scotland).

The great benefit in contractors working for Scottish Water is that, although it goes down the framework procurement route, its funding is allocated over several years and it is constantly trying to improve the process, as it realises that it has not yet got the perfect model. That gives a degree of certainty to businesses.

You also raised the issue of the banks. How does a business in the construction sector—whether a small to medium-sized enterprise or a large contractor—go to the bank with a business plan in the current environment? There is a lack of visibility of projects coming forward, and businesses have to take a stab at what they will succeed in winning.

The banking sector impacts on construction through cash flow, which is essential in the construction industry. We hear the same about many sectors, but even in good times the construction industry operates on profits of 2 to 3 per cent. The word that we are getting—not anecdotal comments, but the real experience of our members—is that cash is not available and banks are trimming overdraft facilities, telling businesses that they will just have to be a bit slower in paying their suppliers. If they do that, however, the problem just goes elsewhere in the economy until it comes full circle, which is not good. We constantly hear that the United Kingdom Government is listening, but we could do with some action on that. Who is responsible for tackling the banks and ensuring that credit is provided in a sensible way?

Rob Gibson: I am aware that we are dealing with the matter in our banking inquiry as well. The Scottish Government survey that Andrew Goudie presented to us last week showed that small to medium-sized enterprises are having huge problems with the banks. There are particular difficulties in Scotland because of the virtual duopoly in lending to such enterprises. Have those things had a major impact on the problems that we have experienced in getting projects under way or are you saying that it is all down to the Government rather than other things?

Michael Levack: No. The impact of the lack of credit in the banking system has been to dry up private sector development. Many of the larger contractors rely on private sector work, public sector work and work that is funded through public-private partnership projects. The latter have just about disappeared at the moment and there is virtually no private sector development, so the contractors are all chasing the public sector work. That is distorting the whole marketplace and it is becoming increasingly difficult for the smaller companies to win work. They have to submit lengthy pre-qualification questionnaires when they may have trimmed their staff back, so they do not have the staff to do that. It is not uncommon for more than 40 companies to submit PQQs and for the client authority to allow 20-plus contractors to bid for the work.

Rob Gibson: I would like to follow that up with some other members of the panel. Peter Hughes nodded. Perhaps others wish to say something on the subject.

Dr Hughes: Michael Levack's comments about the banks are extremely valid. A significant number of our member companies are having great difficulties with the banks. They are being charged anything between 4 and 11 per cent on overdrafts, and arrangement fees are suddenly being doubled or trebled. They are being called in for a meeting with the bank manager to be told that their terms and conditions are changing—and that, by the way, the meeting is costing them £3,000. "But you called the meeting," says the businessman. "Tough," says the banker, "Pay it." That is what is happening. The banks are not being particularly clever at the moment. The result is that cash is king and folk are holding on to cash to ensure that they can get by, as Michael Levack has suggested. The situation is extremely difficult and is holding back development significantly.

Alf Young: I want to say something on the original point about the acceleration of programmes and the stimulus. In my spare time, I chair the board of Riverside Inverclyde, which is one of the Government's pathfinder urban regeneration companies, down on the lower Clyde. The challenges for us are significant. Regeneration, as part of economic intervention, is a long-term business. We have, supposedly, 10 years to do what we are doing on the lower Clyde, but we do not know what the budget is going to be a year from now, let alone 10 years from now.

09:45

Some of the things that have been done as a stimulus cause their own problems. For example, we were a beneficiary of the town centre regeneration initiative that flowed out of last year's budget. We were chosen as a beneficiary only in July, and the money is just flowing now, so we have five months in which to spend £1.3 million on a town centre regeneration programme, because it is limited to this year. I suspect that you will find that people across Scotland will do very quick interventions and clean up town centres, but the long-term impact on what town centres will look like through the next decade will be limited. That is part of the problem.

Another problem is that if we take capital out of future years and put it into this year or last year, it will not be available to spend next year. That also skews long-term regeneration efforts.

I realise that regeneration is not even part of the enterprise directorate's responsibilities; it is part of health and wellbeing, which I find curious. Bits of economic intervention seem to be scattered across all the directorates, which is another part of the problem: we do not know who we are talking to half the time.

Bill Jamieson: Alf Young made a point about the gamble that is taken when capital spending is accelerated from future years into current years, and the debate about whether we are going to have an L-shaped, W-shaped, or V-shaped recovery. The worry is that we are heading for a double dip, or a bit of slow recovery and then back into recession, and that accelerating capital programmes means that we are stealing from future years for the current year. That causes a problem with sustainable growth, which I believe is the current Government's main purpose.

I also echo Alf Young's concern about what is and is not part of economic development and regeneration. Elements are scattered throughout the draft budget. I looked through the finance and sustainable growth portfolio, and believe that to get clarity and to enable us to drill down to what is economic regeneration and enterprise, it might be helpful to divide the portfolio into two. Items such as the Scottish Public Pensions Agency work could be attached to the finance minister, and a second category could be more focused on what the Government is doing specifically on sustainable growth and promoting enterprise in business.

Rob Gibson: I want to pin down that point. There has been accelerated spending because of the crisis that we are in, but is this the time to stop it? Should we continue with it? When accelerated spending is the message across the world, why should Scotland suddenly stop having the injection of cash that has been of some help?

Bill Jamieson: I am sure that it has been of help, although quite how we measure that at the macro level is difficult, and we might not be able to measure it for a good year or 18 months.

We are caught between two enormous forces. On one side is the pressure to sustain the economy and the little growth that we have, and on the other is the enormous pressure to bear down on a fiscal deficit that we know is heading for £175 billion gross Government debt this year, and £1.4 trillion by 2014. Now there is a proposal to have an act of Parliament that requires bearing down on the budget deficit.

The Convener: We can always repeal a law.

Ms Wendy Alexander (Paisley North) (Lab): Tempting as it is to enter into the debate that Rob Gibson has started about whether it is appropriate or inappropriate at a UK level to bring forward more capital spend next year—I think that there is a powerful case to be made, but I digress—it is clear that we should take the opportunity to focus on the opportunities in the budget.

The intervention of the September weekend, which appears to be a Glasgow-only holiday, may mean that panellists have not had the opportunity to see the work done by the Centre for Public Policy for Regions on the long-term trends in the budget. I invite the panel to comment on the following as we think about budget amendments.

Unarguably, after bringing forward capital spend, the budget changed by a shade under 1 per cent—there was a 0.9 per cent decline. The top-level decision about capital spend and resource spend leads to a proposal to cut capital spending by 17 per cent next year over this year—departmental expenditure limit capital is down 17 per cent. The CPPR paper suggests that the finance and sustainable growth portfolio is to be cut in real terms by 7 per cent. A table in the paper on the largest winners and losers indicates—this alludes to the point that Alf Young made—that expenditure on water quality is down 70 per cent; regeneration spending is down 72 per cent; other transport agency programmes are down 31 per cent; housing is down 30 per cent; other Scottish Government transport directorate programmes are down 18 per cent; enterprise, energy and tourism spending is down 13.6 per cent; and education and training spending is down 6.5 per cent.

That picture does not suggest that the budget in its current form is about putting sustainable economic growth at the centre of everything that we do. I realise that panel members do not have the advantage of having the CPPR work in front of them, but I ask them to reflect on some of the big choices that we face, given that there is uncertainty about whether further capital spending will be brought forward on a UK basis. A 17 per cent cut in DEL capital is being proposed this year along with major cuts in the housing, transport, innovation and enterprise budgets. We would like some input on those matters as we focus our budget amendments.

Michael Levack: As I said, it is important for the business community—certainly for construction businesses—that it can plan its business and investment. We hear a lot about apprenticeships from many political parties. An apprenticeship in the construction sector is a commitment to a young person for four years. How can someone possibly make that commitment in the current climate, when there is uncertainty about funding programmes?

Long before the recession started, I maintained that the Scottish construction sector was ready, willing and able to tackle the challenges of reducing CO_2 emissions, and that remains the case. That work will keep a generation of people active, whether it be the experienced tradesman or the young apprentice. The Sullivan report, which made recommendations to ministers on tackling building regulation, referred to the cost and to the experiences of other European countries: significant public sector funding is required. The issue is constantly on the agenda and we hear the claim that the legislation recently passed in Scotland is world leading—we must now put the cash against that.

Some tough decisions have to be made. The business community is well aware that public sector finance is restrained and that we cannot please everybody, but we keep having political announcements about carbon reduction, so let us put some cash into front-line action to protect the capacity of the industry and make a difference on energy efficiency rather than spend it on the bureaucracy and administration that goes with that.

Dr Hughes: I have a couple of points. Obviously, the levels of decrease in some of the areas that Wendy Alexander mentioned are very significant. There is comment in papers about support for infrastructure, yet we have still not sorted out the energy infrastructure. The Beauly to Denny line has been under discussion for eight and a bit years and we are still waiting for an answer. We must sort out such things.

I wonder if politicians have the will or the desire to look at things such as the Scottish Public Pensions Agency—welcome to the real world. In the private business sector, we stopped entrance to our pension fund five years ago. We are dumping our entire final salary pension fund in April next year. Why? Because we cannot afford it. The same thing applies in many ways to the public sector. Frankly, that issue should be looked at very seriously.

Bill Jamieson: The CPPR paper provides a very good analysis. It drew my attention to the reduction in the finance and sustainable growth budget—at the DEL level rather than the overall level—and gives a measure of how badly that portfolio is doing relative to other Government portfolios.

The paper also makes the good point that the office of the finance secretary should be detached from a spending department. In other words, there are some dangers in having someone act as both centre forward and referee.

Alf Young: I have not seen the CPPR report—I have been in transition, as it were—but Wendy Alexander's point about where things are going highlights the kind of longer-term challenges that we face. Politicians of all parties have a huge responsibility to attempt to address the longer term. In the 10 years of the Parliament's existence, responsibility for skills has been transferred into Scottish Enterprise and transferred out again. I have no idea how much that cost, but the gossip circulating suggests that it was significant. Numbers as high as £100 million have been suggested for the cost associated with merging Careers Scotland and Scottish Enterprise. As a consequence of the merger, leases had to be abandoned and people were made redundant. The same things happened again when the two organisations were taken apart. Such significant sums of money flow from the choices that politicians make.

For people like me and my colleagues on the board of the URC who try to do our little bit on the fringes for a community, there is absolutely no certainty about where we will be in two years' time. We are entering into legal obligations, but we have no idea whether we will have a continued flow of money from either the Government or Scottish Enterprise or the local authority to support us. I cannot stress hard enough—having written about the Scottish economy and its constituent parts for 30 years, I have spent a lot of time and shoe leather going in and out of companies all over Scotland—that all companies crave long-term certainty. Many of our competitors have delivered a degree of consistency of approach that simply does not exist either here or in the rest of the United Kingdom. We jump from fashion to fashion and from concept to concept.

Consequences flow from putting an agency into one body and then taking it back out. That just does not work. We need to realise that problems cannot be solved simply by accelerating from year B to year A, as if that was the story over. We need to look at horizons of at least a decade to get the fundamental and sustainable change—sustainable growth is what the budget is supposed to be all about—that we can all sign up to.

The Convener: I think that Peter Hughes wants to respond, so I will let him do so.

Dr Hughes: Further to Alf Young's concern about how the handling of skills and training has been transferred back and forth, Skills Development Scotland has existed for more than a year but we are still getting plenty of navel gazing. We are waiting to see the outcome, which I hope will be positive, because business is ready to get in there and support it. One thing that is for sure is that the recession will end, and when it does we will need skills, which are vital. Skilled folk cannot just be taken off the peg and used immediately when they are required; gaining skills takes time. As Michael Levack said, an apprenticeship can take four years, and a degree can take longer, but we will need those highly skilled people. We need to upskill, because that is how we will be successful in manufacturing and exports. That is very important indeed.

10:00

Ms Alexander: As some of the witnesses will be aware, we will look at Scottish Enterprise next spring. We have left it until then because we felt that the changes that the Government has made should be given two years to bed in—although, in the time horizon that Alf Young has given us, that is a remarkably short period.

The witnesses have not had the benefit of seeing the data that have been put in front of us today. We asked the Scottish Parliament information centre to do a bit of work for us on what had happened to the enterprise agency budget in real terms. In 1997-98, it was spending a shade less than £600 million in real terms; as of next year, it will have considerably less than £200 million. That obviously includes the changes in relation to skills—like the witnesses, I have an interest in that area, having been the minister with responsibility for skills. However, leaving that aside, it seems to me extraordinary that we have had no meaningful public debate about the transformation in the agency's budget. Over 10 years, our national economic development agency has arguably gone from having a national economic development mission to a role in supporting medium-sized companies. That may be good or bad, but it is extraordinary to have such a real-terms change to the budget without any meaningful public policy discussion about the organisation's mission.

We will come back to that in the spring, but it would be helpful to have some thoughts on the matter from the witnesses.

Bill Jamieson: It is baffling and confusing to go back into the history of Scottish Enterprise and try to do a timeline of its budget and core function. However, let us not forget that the divestment of the skills agency was approved and desired by the agency's executives. They felt that they did not have the expertise or competence to manage a skills agency as well as it deserved to be managed, and the Scottish Enterprise board fully approved of hiving it off.

The board equally endorsed the hiving off of the local enterprise companies to local authorities. It felt that the LECs were not the priority that they were under Crawford Beveridge. Things change. I have rather lost sight of how effective local authorities are in handling local enterprise companies; I have totally lost the picture and do not know whether we have any assessment of how well or badly we are doing in helping small firms at that level.

Having reduced Scottish Enterprise and Highlands and Islands Enterprise down to a core area of competence—helping middle-sized companies and providing investment in targeted industries and sectors—there might be a case for bringing the two organisations together. Does the rationale for keeping them separate still exist?

Dr Hughes: The reduction in the budget is significant but, as Bill Jamieson rightly said, it relates to the removal of much of the skills element in particular. We certainly welcome the continuing support for the Scottish manufacturing advisory service and the commitment to double its budget. I am hopeful that that commitment still holds—I gather that the additional staff are being recruited. The return from the Scottish manufacturing advisory service over the past 18 months has been very good. Every £1 of public money that has been spent has generated more than £5 of real benefit. That commitment and support are a positive and welcome aspect of the Scottish Enterprise budget. We look forward to the service succeeding in the future as well.

Alf Young: What has been missing from the recent changes and transitions in Highlands and Islands Enterprise and Scottish Enterprise is, as Wendy Alexander said, any clear public debate about what the agencies are for.

I have been throwing out a lot of stuff from my office, including great runs of Scottish Development Agency annual reports, although I was half tempted to keep them and write something about the long sweep from where we came from in 1975 to where we are now. It seems that any commitment to place making has disappeared from Scottish Enterprise. The agency is now focused not even on small businesses but on medium-sized and large businesses with exceptional growth potential.

The breakdown in its costs in the SPICe paper shows that Scottish Enterprise is now talking about enterprise, innovation and investment. However, Highlands and Islands Enterprise is still talking about strengthening communities. We ought to have had a public, political debate about what these agencies are for. Do they still have a place-making function? Scottish Enterprise still finances my little URC to the tune of £10 million a year. I suspect that it does so rather reluctantly at times, because the budget is ring fenced—the Government has told Scottish Enterprise that that funding must continue. Its general commitment to place making throughout Scotland is almost zilch now, which is a big change that has happened without any public debate or sanction.

Peter Taylor: I just want to follow up Bill Jamieson's point about the two agencies. From a tourism perspective, although both HIE and Scottish Enterprise have been supportive, they have supported different initiatives, so one has had to present things in a different way. We are a small country. I realise that there are different issues in the north, but I would support there being more coming together, so that we can agree on the same issues, such as skills and training. I would support our having another look at that.

Michael Levack: Scottish Enterprise has had very limited positive impact on the construction sector over the past five years. We are almost invisible to Scottish Enterprise at times. Until recently, we were not even listed on its website as a sector. Obviously, construction is not seen as a sector with the potential for high growth—we do not have appeal, because the export opportunities are virtually nil. Scottish Enterprise has had virtually no positive impact on the sector.

The move to transfer skills and learning to Skills Development Scotland has probably not happened at the best time, given that the industry needs assistance. Our members in the Highlands and Islands have concerns about whether their particular needs are being taken into account in that transfer.

Dr Hughes: People have asked why we still have HIE and Scottish Enterprise. A couple of years ago we had the very successful make it in Scotland programme, which we took around the whole of Scotland. However, Highlands and Islands Enterprise decided that it would not take it and that we should have it only in the Scottish Enterprise region. We are a country of only 5.5 million people for goodness' sake; can we not get together and sort it out? There must be a lot of duplication.

Gavin Brown (Lothians) (Con): I will start by asking about tourism, so I will focus my questions on Peter Taylor. You said in your opening remarks that you understand that budgets get squeezed and that tourism might not be immune to that. Last year's budget for tourism was £49 million. Next year, the proposed budget is £44 million. That is quite a big cut for tourism. Do you have a feel for what the implications might be for the industry if that were to be the eventual budget in April next year?

Peter Taylor: I would never support regions spending money to compete with one another, which has started to happen around Scotland. VisitEngland has a major campaign to promote staycations and, given that 63 per cent of our business comes from the south, I am concerned to protect that business.

It is difficult to say what the implications of the budget are, but I am concerned. We are not seeking special treatment for the industry, because we are only as good as the economy generally. I urge that we have another look at the budget and at least have a standstill situation.

Gavin Brown: Is your concern about staycations the fact that the 63 per cent of our tourists who come from south of the border will simply stay there next year instead of coming up to Scotland?

Peter Taylor: Yes.

Gavin Brown: Do you know how much VisitEngland is spending on that campaign?

Peter Taylor: I do not have the figures with me, but I can supply them to the committee.

Gavin Brown: Thank you.

Going back to Scottish Enterprise, I would be interested to hear, in particular, Bill Jamieson and Alf Young's views on the following questions. Wendy Alexander talked about the long-term trend of reduction in the Scottish Enterprise budget from about £600 million to £200 million. Of course, some of that can be rationally explained by the fact that Skills Development Scotland is getting £200 million and that local authorities have been given money for the business gateway and local regeneration.

I want to drill down into this year's change, which I think is pretty savage. Perhaps I should say "stark", as someone got into trouble for using the word "savage" a couple of weeks ago. In last year's budget, the planned figure for 2010-11 for Scottish Enterprise was £295 million. However, in this year's draft budget, the agency is to receive £201 million. Last year, the planned figure for 2010-11 for HIE was £73 million, whereas in this year's draft budget it is to receive £54 million. About £35 million of those changes can be explained by the acceleration of capital spend, but that still leaves a gap of about £60 million or £70 million. From April this year to next April, no structural changes have been or are going to be made to the organisations; after all, everything that was going to be given to local authorities has already been given, and Skills Development Scotland has been created. What will a change of that magnitude do to the Scottish economy?

Alf Young: As Bill Jamieson said, we do not have any hard, objective evidence on what a great many of these interventions have achieved. Scottish Enterprise has retreated into territory where it deals with a panel of companies that fit its criteria for growth and for making a significant individual and cumulative impact on Scottish gross domestic product. All the things that it and its predecessor body the SDA used to do are either not done any more or done by local authorities.

Of course, that raises its own difficulties. In a world of single outcome agreements, how do we know that local authorities are doing anything much about economic development? When these announcements were originally made, I actually thought that our little initiative on the lower Clyde was going to be sent back into the local authority that had desperately wanted us to take on the job in the first place because nothing had happened for the past 25 years. It took us a lot of beavering about and asking questions about what local regeneration meant to find out that we were actually of regional, not local, significance and would therefore continue to be funded by Scottish Enterprise. As I say, we are an orphan wean of Scottish Enterprise, because I suspect that in its heart of hearts it does not want us to be part of it because it just does not do place anymore. We have a ring-fenced commitment at least for the next few years, but that does not go beyond the planning phase.

As I say, we simply do not know what effect many of these interventions have had. For example, great effort, energy and resources were poured into the business birth rate, Scottish Enterprise's great initiative of the 1990s, to try to upgrade the number of companies that were being formed in Scotland. However, if you look at the numbers over a long run—since 1991, say, or 1990 when the initiative was launched—you will find it hard to prove that the trend rate of growth in enterprise formation is any greater than it was before Scottish Enterprise started to intervene.

Bill Jamieson: I want to make two points, about the top and the bottom of the enterprise brief. Starting at the bottom, I am concerned that we have lost sight of the big picture of what the Scottish Government is doing—and could do—for the small companies sector. The sector is very significant, certainly as an employer; small firms account for about 52 per cent of jobs in the private sector. Therefore, the support that small firms are given is important. However, I detect among business contacts that there has been an inconsistency of address by local authorities. Some local authorities have been very good—I have heard good reports from business contacts about the positive manner in which Glasgow City Council has responded—but other local authorities seem to be a bit hesitant about whether they have real competence in the area and about how best to help small businesses and small business projects of the type that Alf Young has described. A problem exists that the Government can address.

10:15

I miss an economic brainbox function at the top of the enterprise brief. I think that Scottish Enterprise once fulfilled that function, but it does not do so now. We need an economic brainbox at the top of the enterprise agency if we are looking for advice and guidance on achieving long-term sustainable growth for Scotland. I would not necessarily simply leave things to the Government. Somebody independent and slightly apart from the Government is needed to give disinterested, objective advice on how best we can advance an economic programme that looks beyond the immediate crisis over the next three, five and seven years. We do not have that, which is a huge omission. It is also wrong that we have a Council of Economic Advisers attached to the First Minister that somehow seems to ostracise and totally ignore Scottish Enterprise. What are we up to?

Christopher Harvie (Mid Scotland and Fife) (SNP): We have discussed at length public and semi-state organisations, but we have not discussed the private organisations that are responsible for putting us in the state that we are in. We have not discussed the annexation of what was the Scottish independent banking system. A large number of people have said that, although they had a reasonable relationship with HBOS or the Royal Bank of Scotland for short-term funding, for example, they have suddenly found that the person whom they have phoned has turned out to be not in Reading—that is a rather sensitive place for these matters—but in some other place well to the south and that they have no interest whatsoever in them. Such people have wanted them to put up their houses as security against anything that they might get. I am not talking about anecdotal evidence; I am talking about what is said in letters that turn up in my constituency office.

That element co-exists with Sir Tom Hunter's magnificent orations about rearranging deckchairs on the Titanic. When one looks at the accounts of his various concerns, one realises that he must have had a fairly close acquaintance with icebergs in the past few months. What has happened has carried away a lot of the lending potential of the Scottish banks. There is a difference between what happened when Gordon met Victor and they decided to take over HBOS—I will come to the point in a moment, convener—and what they then discovered after doing so. What are the implications? We are talking about hundreds of billions of pounds for a country whose budget is around a quarter of HBOS's deficit.

The Convener: Rather than discussing the budget, we seem to have got to our next agenda item, which is on banking.

Alf Young: I will make just one point. There is a view in Scotland, which I do not share, that the fate of at least one of its banks was down to others. I have studied the Bank of Scotland closely and I knew all its leaders for the past 30 years, and I propose to write a book about the decline and fall of the Scottish banks. Therefore, I have a vested interest in the matter. My view is that the Bank of Scotland was largely the author of its own downfall.

Christopher Harvie: I am not denying that.

Alf Young: I wanted to make that absolutely clear. In the 1990s, Bruce Pattullo would regularly say to me in our frequent encounters, "We are not in the risk business, Alf." His successors took the Bank of Scotland heavily into the risk business. They threw themselves at the Halifax, having failed to get NatWest. By that time, they had embarked on a high-risk level and style of corporate lending, which must make Bruce Pattullo tear his hair out if he is still watching events. That largely led to the bank's downfall.

We in Scotland do ourselves no favours when we allege that our ills are other people's fault, and that phenomenon is currently very obvious in the banking sector.

Bill Jamieson: The central concern of the Scottish Government and everyone who is involved in Scottish economic matters is to ensure that competition is restored throughout banking and financial services. We rather lost sight of that with the mergers, which resulted in our having a duopoly. One bank has a 30 per cent share of the small business lending market in Scotland and an equally large share of the mortgage market. That is a worrying outcome of the emergency events of last year. For the customers of the banks, the sooner we start to unwind that, the better.

Christopher Harvie: I remind Alf Young that I was not alleging that there was any kind of kidnap. The banks were the authors of their misfortune.

The RBS's board of directors had a great representation from the high heid yins of the British state—Sir Steven Robson and so on—yet it went down the tubes. HBOS was allied to the biggest mortgage company in England, but it did likewise. In trying to reconstruct banking concerns, should we not go back to the origins of the Scottish banks and think about mutuals, which are comparable, let us say, to a German Kreissparkasse? Should we not go back to having some form of quasi-state bank as a control?

The Convener: We really are moving away from consideration of the draft budget. I ask Michael Levack to respond very briefly before we move on.

Michael Levack: Perhaps I can assist in bringing us back. We keep hearing about the need to be more efficient, effective and innovative in relation to future funding for capital projects. It is clear that the private sector will be looked on to fund developments. We have never been interested in getting embroiled in the politics of the Scottish Futures Trust as opposed to PPP, but we believe that the SFT now has a golden opportunity. We note the significant increase in funding for staffing that organisation and we are desperate for it to get up a real head of steam. Clearly, its success as a facilitator of major infrastructure investment will rely on the availability of funding, wherever it comes from. We heard earlier this week about funding for housing through the European Investment Bank. The question that has not been answered is whether the UK banks are going to be interested in participating in the Scottish Futures Trust. That is a matter of concern to the construction sector.

Lewis Macdonald (Aberdeen Central) (Lab): I have a specific question on the banking sector, while we are on that topic. Following our tourism inquiry, we recommended that a tourism investment bank should be established in Scotland. That call was supported by VisitScotland at the time, but we see VisitScotland's budget continuing to go downwards and, as we heard, the enterprise agencies are in the same position. Do Peter Taylor and the other witnesses have views on whether a tourism investment bank would be a useful approach? Michael Levack mentioned potential uses for the Scottish Futures Trust. Is an appropriate mechanism available? Should the Government resource some sort of tourism investment bank as part of the recovery from recession rather than simply postponing it until economic times are better?

Peter Taylor: My personal view is that I am not sure it is right or fair for us to ask specifically for a tourism bank. It would be helpful if a way could be found for Scottish Enterprise to have more funding that could be made available—not just on the equity front but on actual debt—to assist where there are projects that can move forward.

I was at a hotel investment conference in London the other day and I heard a senior person in the RBS say that she had on her desk 33 projects that were being actively considered. She was not promising that they would all be funded, but they had got to her desk because they had some real possibility. I do not know whether much is happening with construction and tourism in Scotland, but my sense is that it is not. To be honest, I am not up to speed enough to comment on whether it is right for us to push for a tourism bank or how that would work.

Alf Young: There is an enormous danger in rushing into bespoke banks for this, that or the next function. There is a proposal for a Scottish investment bank, but we have been there before. There is a body in Scotland called Scottish Equity Partners, which was a Scottish investment bank—it was a function of the old SDA and then Scottish Enterprise. It was run by the remarkable Donald Patience, who made more money for the state than any other public servant in many years because a lot of his investments came good. At that time, Scottish Enterprise was ordered to divest itself of the function and it went off as Scottish Equity Partners. It still exists and invests in venture capital projects, yet here we are inventing it again, presumably to float it off again at some future date. I just wonder about that. We have a rich, although rather damaged, banking infrastructure and we can make decisions to ensure that some of the lending priorities that are not being met are met without creating new banks to do that.

Lewis Macdonald: That raises a related question. The other body that provided significant capital funding for new technologies in a number of sectors was ITI Scotland, which was wound up earlier this year—again, with no public debate and with significant impacts on energy, information technology and life sciences. Do the panel members have a view on that? Is there a risk, as Alf Young has hinted, that the decline of Scottish Enterprise as a funded organisation has had significant funding implications for private sector businesses that have previously looked to the public sector for support?

Alf Young: The issue is partly to do with the shrinkage of Scottish Enterprise's function back to the core. Successive Governments of all colours have ordered it to get rid of its property portfolio, its investment function and so on. There is a long history of either forced divestment or shrinkage to the core, all of which has had a considerable impact.

You mention the intermediary technology institutes. I was never terribly persuaded by the original initiative. I have a friend who works at a senior level in the IT industry in California, who is an expatriate Scot. He came back full of determination to do something to help over here—a kind of commercial homecoming. He went to the intermediary technology institute to make linkages and do things, but he came away shaking his head and sent me volumes of e-mails saying, "How does this organisation ever deliver anything?" That is only one anecdotal story, but I was never terribly convinced by the model and I am not sorry that it has gone.

Bill Jamieson: I have received mixed reports about the achievements and performance of ITI Scotland; the case for it is not proven. However, I hear a lot of positive signals from the business sector on the work of the Scottish co-investment fund, which seems to be doing relatively well. Although the proposal to establish a Scottish investment bank is mentioned in the draft budget, it seems to be still in the water—it is not advancing at any great pace. I would be concerned if it advanced at the cost of a reduction in the Scottish co-investment fund. That would be another case of one part of Government devouring another part for no good purpose.

10:30

Stuart McMillan (West of Scotland) (SNP): Alf Young spoke about the lack of medium to longer-term thinking. At present, public spending rounds last for three years. Is there an argument for longer spending rounds, to try to plan for the medium to longer term?

Alf Young: It is desirable that a mechanism be introduced into financial planning in the public realm that allows for a longer perspective. I do not suggest that all budgets should be projected over 10 years rather than three or that we should scrap the short-term approach. I am conscious of the political pressures and that a Parliament will not last more than five years. Naturally, changes of control take place organically over time, and new parties in power have new priorities and want to change things. I am comfortable with that, but Government and politicians in general must think seriously about how to give an assurance or some comfort to agencies that are charged with a longer perspective that they can continue to plan.

Stuart McMillan knows what is happening in the lower Clyde area better than most, because he represents the area. I have a board of volunteers. We are all volunteers and we do not get paid—we do the job because we love the area. We sometimes talk about what we are letting ourselves in for because, technically, we are directors of a business, although it is a charitable business and there is not a straight commercial exposure. However, as Stuart McMillan knows, we are taking on a joint venture with the landowner in James Watt dock. We have a limited liability partnership agreement to redevelop the sugar sheds and the wider James Watt dock area. That will not happen in one, two or three years. With a fair wind, it will happen over perhaps a 10-year period.

We must begin a debate about how the elements of political initiative that span far beyond normal spending rounds can be given an assurance or commitment that will outlast Parliaments and Governments because they are in the interests of the economy and people of Scotland.

Stuart McMillan: Riverside Inverclyde is a good example. In 2007, the Government changed and measures were taken such as the altering of Scottish Enterprise. If the election result in 2007 had been different and the previous Executive was still in power, would that have changed what you have said, or would the issues still exist?

Alf Young: I do not know what a Government of the same colour as the previous Executive would have done. We were a pathfinder URC, so a different Government might have decided that the path was stony, that it did not want to follow it any further and that it wanted to go somewhere else instead. When people do the kind of thing that we are doing, they have to buy into a degree of political uncertainty about what will happen next, whatever Government is in power.

I must say that I found the initial change in the responsibility for regeneration and the way in which it was announced utterly confusing, because we had no advance warning. No one told us about the decision—it was just put to us that the local regeneration responsibility was to be handed to local authorities. We have a stretch of 10 miles of the waterfront and that is all we do, so we are local in that sense. We thought that we would be handed to a council that, as the committee will know, wanted us to take on not only the waterfront but all economic regeneration in the three-town area.

Being at the end of the feeding chain, we struggled to understand what was going on. I saw, like everyone else, that the budget line for regeneration in the draft budget—which is not in finance and sustainable growth but in health and wellbeing—was going down by almost a half in the next year. Of course, that was because the accelerated spending on the Clyde gateway project was dropping out of the budget, but that was not explained, and we were not told anything in advance. My chief executive and I had to make urgent representations to civil servants to find out what would happen to us—whether we would still have our budget for the next year or whether it would be halved.

That is a simple, short-term problem to solve. To be honest, it happens with whoever is in power, because we are so far away from the centre and so far down the feeding chain. However, the long-term issue is harder to solve. There must be serious debate in Government and the civil service about how to give comfort to initiatives such as ours that cannot be delivered over a year or even two or three.

Stuart McMillan: My final question is on tourism, but it ties in with what is going on at RI and at the Southbank marina development in Kirkintilloch.

I set up a parliamentary cross-party group on recreational boating and marine tourism, which is an area with great potential. The group was informed at its meeting last week that VisitScotland has provided £65,000 to Sail Scotland, which is the first funding that it has received in more than three years, to promote Scotland as a sailing destination. The cross-party group has found that sailing has not had a downturn in the number of customers. In fact, the position is the opposite: despite the recession, sailing businesses are sold out and cannot take any more business. It is wonderful that there are positive stories to tell about some areas of Scottish industry. Is there potential for further development of marinas or sailing activities, particularly on the Clyde and the Scottish canal networks? Would it be viable and worth while in terms of economic benefit for local communities to maintain and expand them?

Peter Taylor: Absolutely. I am a sailing man, so you are talking to the converted. I think that brilliant things have been happening on the sailing front, and I have a bit of knowledge of Sail Scotland and on where it is going—it faltered a bit in how it was being run a few years ago.

One of the biggest interventions that could work would be to lay down more mooring buoys. Way back when HIE invested money in that, it had a significant impact. Villages and ports that have adopted and maintained those buoys are in a win-win situation. There is therefore real potential. I have not managed any sailing this year, but I have seen, when sailing over the past few years, that people come over from Sweden and Norway to spend the whole summer—or six weeks, let us say—sailing up and down the Clyde and the west coast, all the way to the outer isles. There are great opportunities for developing that. I am not so sure about the canal network, but there are opportunities there as well.

Alf Young: I am not a sailor, but what we do down in Inverclyde is very water focused, because we are in a marine area. The potential is enormous: we have a couple of marina developments planned, and all the advance analysis suggests that the demand is certainly there. We are also bringing the tall ships back to Inverclyde in 2011—the last time that happened, around 150,000 people turned out to see them. There is a great deal of potential for such events; we held a small-scale event a few weeks ago as a forerunner, which brought in significant numbers of people.

Stuart McMillan: The majority of the marinas on the east coast and in the north-east are run by local authorities in some shape or form, whereas on the west coast they are private developments. Considering the budgets for local authorities and the public spend in general, could there be challenges in other parts of the country in comparison with the west?

Alf Young: In terms of our budget for developing the concepts that we are already running with, we have very limited resource to invest permanently in a marina development in Victoria harbour, for example. We have gone out and tested the market, and there is certainly commercial interest. As you point out, places such as Largs and Inverkip, and some others on the west coast, are commercial marinas.

I was speaking at an event at Inverkip marina only a few weeks ago, and there were boats as far as the eye could see—it was extraordinary. One of the extraordinary things is that many of the boats just sit there and are not used very often. I know that Peter Taylor is an active sailor, but there is often a degree of trophy ostentation that surrounds boats. Inverkip and Largs are certainly jam-packed; people come from the midlands of England to sail and moor their boats up here, and more people from overseas are discovering the marinas. Sailing has enormous potential as a leisure activity in Scotland and we could do much more to promote it, whoever it is delivered by.

Dr Hughes: This is the Economy, Energy and Tourism Committee. We have spent a lot of time on banks, Scottish Enterprise and tourism, but one area that we have not really touched on is energy.

It would be remiss of me not to say that the members of Scottish Engineering are very concerned that we are not having an appropriate public debate on energy and on-going energy supply. It is a contentious issue in many areas, but we firmly believe that we need a balanced, sustainable, affordable and—most important—secure supply of energy that incorporates all the appropriate technologies as we go forward.

There is a great deal of technological wizardry in Scotland that we do not use to its full potential. That includes renewables—some of our members make onshore and offshore wind turbines, and clean coal technology—but the sustainable energy supply should incorporate all the technology, including nuclear. We need to debate that issue, which we are not currently doing, and the danger is that we will lose the skills and abilities in our nuclear engineering sector unless we address it. Although it is starting to happen now, we are also being very slow in adopting the clean coal technology that has been developed by Doosan Babcock in Renfrew, and elsewhere.

Energy is important to us, and we are concerned—given the current demise of fossil fuel power stations as a result of regulation from the

European Union and beyond—that if we do not tackle the problem in the longer term, the lights will go out at some stage. One cannot build a new nuclear power station in 12 months—it does not happen.

The Convener: Thank you for your comments. I point out that this committee spent a year on its energy inquiry and published a report in July, which is being debated this very afternoon. You are welcome to come along to the chamber at 10 minutes to 3 to hear the debate.

10:45

David Whitton (Strathkelvin and Bearsden) (Lab): It is nice to be back at the Economy, Energy and Tourism Committee, but normally I attend meetings of the Finance Committee. Yesterday we received a report from the committee's adviser, David Bell, which is now available in the Scottish Parliament information centre, so I am not breaking any confidences by talking about it. When he presented us with his paper, I asked him whether the Government's budget was in line with its stated purpose of sustainable economic growth. I did so because the budgets for enterprise, energy and tourism are all going down. He replied that he had raised his eyebrows at that and would like to see the argument for it. Were your eyebrows raised as well?

Michael Levack: Yes. We have heard and read in the draft budget that there will be severe reductions in many of the areas that concern our members. We appreciate that there was accelerated expenditure last year, but we will now pay for that. I hope that I have stated clearly my concerns about capacity. If we do not have the required capacity, we will not be ready for recovery. I touched on the need to apply greater funding so that we can meet the targets that the Scottish Government, along with many other Governments, has set. Some people may say that a little lagging and insulation will not keep the whole construction industry busy, but we must make a start. We are not addressing the significant cost to the private sector, the public sector and every household or member of the public of achieving the targets that have been set for 2050 and the years leading up to that. There should be a significant shift of funding towards such measures.

Dr Hughes: Figures of 30 per cent for housing, 18 per cent for transport and 17 per cent for regeneration have been quoted. Those are significant reductions.

We would like more effort to be put into retaining our skilled workforce. The Germans subsidise labour up to a point to avoid redundancies, which are expensive for everyone, especially the person who is made redundant and the family that suffers as a result. The cost of getting folk back into work is high. I would rather that we concentrated on finding ways and means of keeping them in work, which is preferable to losing them and having to re-recruit them later. The recession will end at some stage and we will have to recruit folk back. The danger is that, if folk leave certain sectors, they will not want to come back to them or will persuade their youngsters not to go into them. That is an alarming thought.

David Whitton: I believe that the Welsh Government has a scheme for subsidising labour.

Dr Hughes: It has.

David Whitton: Would you like that to be repeated here?

Dr Hughes: I would like it to be tried, at least.

Michael Levack: It is said that we cannot consider wage subsidies. To me, the partnership action for continuing employment funding that Skills Development Scotland administers comes too late in the day, as does the adopt a redundant apprentice scheme. As Peter Hughes said, the construction sector is liable to lose such apprentices. In recent years, we have become a career of choice, and we need to maintain that.

We need to provide support to small businesses in particular, possibly in the form of wage subsidies, when times are tough. The Scottish Government is doing that in another sector, as it has announced funding of £3 million for 100 apprentices in life sciences. The deal, I believe, is that if a life science company takes on one apprentice it gets the wages of a second apprentice paid.

David Whitton: Before I come to the two economic gurus, I ask Mr Taylor to comment.

Peter Taylor: As you would expect, I will speak in support of tourism, which is the one industry that will be around for many hundreds of years to come.

David Whitton: You mentioned that homecoming Scotland has been a relative success, despite our misgivings about the size of the budget that was allocated to it. What will it mean for your industry if that budget is not there next year and the tourism budget is cut?

Peter Taylor: One way forward would be to allocate more significant match funding. In the past year, the private sector has put its hands in its pockets quite significantly to support initiatives, and there could be an additional fund that is specifically ring fenced for matched funding, whether it be from individual organisations or a collaboration of three or four businesses. That is already in place, but more could be put into it.

There is a concern. I see what is happening in all the other sectors, and I guess that until we resolve the banking issues we are not going to move forward significantly.

David Whitton: You are just about to open a new large hotel in Glasgow, creating how many jobs?

Peter Taylor: One hundred and fifty.

David Whitton: How much help have you had to do that?

Peter Taylor: We had a lot of help from Scottish Enterprise; we were very pleased with that. VisitScotland was also supportive.

The building's CO_2 emissions will be 43 per cent less than they would otherwise have been because we are investing approximately £1.5 million in alternative technologies. That was my decision; I made it a long time ago and I have no regrets. We are investing £25 million, and we are confident that it will work.

In the wider industry, there needs to be more collaboration between all parties involved in the public and private sectors.

David Whitton: Mr Jamieson, the headline on your column yesterday was "John Swinney's amazing shrinking draft 'Budget for Growth'". Will you elaborate on that? I guess that you are not convinced that the budget is for sustainable economic growth.

Bill Jamieson: No, I am not convinced. The problem that I referred to earlier was in going through the finance and sustainable growth portfolio in the draft budget and trying to single out the items that are specifically to do with economic growth, enterprise and supporting the economy. It is difficult to arrive at clear conclusions when the portfolio includes the Scottish Public Pensions Agency, the General Register Office for Scotland expenses, the Registers of Scotland expenses and concessionary bus fares, which, at £191 million, are almost as much as we are now itemising for Scottish Enterprise. We really have to separate the office of the finance minister from what is being done for enterprise.

When I did that, I got a residual figure of £2.3 billion, which is down 8 per cent in real terms. That is a terrific whack when it is compared with other Scottish Government departments. That is my concern for 2010-11, and I have to tell you that, looking beyond that, it is going to be much tougher.

David Whitton: I think that we all accept that it is going to be much tougher.

The witnesses will be interested to know that, when Mr Swinney gave evidence to the Finance Committee, he was asked about separating his portfolio into one finance ministry and one spending ministry. He seemed to think that things were okay because his deputy ministers could argue the case for the spending with him and he could still mastermind it all. There we go; that is up for debate as well.

Alf Young: I do not disagree with what the other witnesses have said. When the objective of increasing Scotland's sustainable growth rate year-on-year is set against the numbers that we have talked about this morning, there is a question mark. I would be tempted to go further and ask whether the sustainable growth rate growth is within the gift of the Parliament, given its powers, or indeed whether it should be a desirable, overarching objective of politics.

There is a lot of talk about getting back to normal after the banking crisis, and I think that it will be a new normal rather than the old normal. There will be a lot of debate in that new normal about whether the entire overarching purpose of politics is about increasing the GDP growth rate. GDP measures something—although even economists are not quite sure what it measures—but there are a lot of things that it does not measure, many of which are of great significance to families and others in society. I just wonder whether it is the right objective for the right Parliament.

David Whitton: Others have touched on last year's capital reprofiling decision to bring forward spending by a year. Is there any evidence of where that money has been spent?

Michael Levack: There were significant sums of accelerated expenditure on housing. However, as I said earlier, from speaking to our members—who include major contractors through to sole traders and second or third-generation local businesses, and who have always been active in the affordable housing market—it is clear that they are finding that a lot of the money has been given to registered social landlords to buy sites and completed stock rather than to start new projects.

There is another source of continuing frustration. It has taken a member company that is trying to provide 18 affordable units 18 months to get a section 75 agreement in place. The development now spans three financial years and still the company does not have certainty of funding. That is a major disincentive for a local business that employs local people to invest in housing, which is a big concern. Against that should be balanced the Scottish Government's desire to move to a three-year funding programme for affordable housing, which I think is desperately needed.

Dr Hughes: Although there is evidence that some of the accelerated funding has found its way through to the areas that Michael Levack referred to, we have a number of member companies that make mechanical equipment for the construction industry and it has certainly not reached them. They are in deep trouble as far as orders for the next six months and beyond are concerned. A few years ago, they were doing extremely well, but orders for mechanical equipment are just not being made because folk are deciding to hang on to what they have and not to replace it. That is what is happening.

David Whitton: If Dr Hughes wants to give me the name of the bank that is holding a gun to the head of the business owner that he mentioned and saying that it costs £3,000 for a meeting, I will be happy to raise the issue with the convener of the Finance Committee.

The Convener: We would be happy to get information on that for our banking inquiry. We will raise the matter directly with the banks.

Dr Hughes: I had great difficulty in getting member companies to agree to say things on camera. When I did a piece for "Newsnight Scotland" on the same subject recently, we ended up using a Bob the Builder character and putting figures in a balloon coming out of its mouth because the managing director in question did not want to provide the information in public.

The Convener: I understand that. We would be happy to discuss with you and other organisations how we can best get direct rather than anecdotal information.

I am afraid that time is against us. Will each of you say, in just one sentence, what changes to the draft budget the committee should recommend to the Government?

Dr Hughes: As I said, I would welcome continuing support for things such as the Scottish manufacturing advisory service. I would also welcome some real discussion about where we are going on energy. It is all very well to talk about Scotland being the Saudi Arabia of marine energy, but the technology is not there yet and will not generate any electricity for the grid for at least 10 years. We must plan ahead and invest in the areas that we need for the next 10 years.

Michael Levack: I repeat that the Government should put its money where its mouth is on the carbon reduction targets. We are talking about long-term financing, and we have set a target for 2050. Everyone recognises that, if we are to get there, we face a serious, challenging profile. Let us make a start.

Alf Young: The Government should take on the issue of longer-term funding for infrastructure and regeneration.

Bill Jamieson: It should have a much sharper definition of what the budget is doing in the area of promoting growth, enterprise and business.

Peter Taylor: It should reconsider putting the £4 million or £5 million back into the budget to balance it up, given that, as far as we can understand, there was a £44 million bonus from homecoming Scotland.

The Convener: I thank the panel very much indeed for its valuable evidence. The committee has a lot to reflect on and to take forward to the next stage of its budget inquiry. I suspend the meeting for five minutes.

10:59

Meeting suspended.

11:06

On resuming—

Financial Services Inquiry

The Convener: The next item of business is our banking and financial services inquiry. This is the third of the three scene-setting sessions that we agreed to have at the start of our inquiry to enable us to understand the main issues better before we take detailed evidence from November onwards.

There is probably no one who personifies the banking crisis more than our next witness, Robert Peston, the BBC's business editor. The committee welcomes the opportunity to hear his perspective on the causes of the crisis, the challenges that we face and the future regulation of the financial sector. I invite him to make some opening remarks, after which we will ask questions.

Robert Peston (BBC): Thank you for inviting me to talk to you about this. There are few issues that are more important in the world than the need to draw the right lessons from the economic and financial crisis that we have experienced recently. One of my slight fears has been that issues to do with, for example, the structure of the banking industry are normally regarded as dull stuff for professional economists and what one thinks of as the financial priesthood—the regulators and the central bankers—rather than stuff that will make the front pages of popular newspapers or be seen enough of in the broadcast media. My view is that this stuff matters to all of us. In the past, we trusted the financial priests rather too much to get it right and they patently did not get it right. It seems to me that, before we draw the conclusion that we are somehow over the worst and that we can tolerate a patching-up of the status quo, a proper national debate is required, so the fact that the committee is considering the issues in such detail is fantastic.

The Convener: The focus of the inquiry is largely on looking ahead at where the sector needs to go, at how we can protect jobs in the financial sector in Scotland and at how competition issues can be dealt with. The Scottish Parliament does not deal with the regulation, but any changes to the regulation of the financial sector will have an impact in Scotland. Where do you see the banking sector, particularly in Scotland, going over the next year, two years or three years?

Robert Peston: The banking sector in Scotland cannot be divorced from banking globally, as banking is now one of the more globalised industries. There are issues that are particularly pertinent to Scotland, to which I am sure we will return, but one needs to start with the broader question of where banking in general is going. There are some obvious and simple points to make. One is that, for as far ahead as one can see, some of what the banks did wrong over the previous few years will be corrected. They are lending less relative to their capital resources, mostly as a result of being forced to do so by regulators and Governments, but partly as a result of having woken up and smelled the coffee. In other words, banks globally are managing themselves slightly more prudently. They have woken up to the notion that liquidity matters and that they need to take seriously the quality of assets that are available for sale. They have realised that, in simple terms, they can no longer ignore, as they did previously, the amount of cash that they have available to meet demands.

I am sure that members will know that one great criticism of banks in the preceding few years was that they were reasonably focused on the asset side of the balance sheet and the quality of the loans that they made but hopeless at managing the liability side of the balance sheet, which is about where the money was coming from. Among the many striking statistics that show what went wrong is that, for the Royal Bank of Scotland and, in particular, Lloyds, because of its purchase of HBOS, the ratio of their loans to customer deposits was well over 150 per cent, which was a manifestation of how dependent they had become on wholesale markets. They treated the wholesale markets as permanent sources of funding that could not possibly dry up but, as we know, in the summer of 2007, that turned out to be an utterly misplaced and reckless assumption. They are now in the process of managing down their exposure to wholesale markets. They can do that thanks only to the munificence of all of us taxpayers. When the wholesale markets dried up, we had no alternative—we had to bail them out by lending to them directly or they would have gone bust.

A statistic that I regard as one of the defining characteristics of the crisis is that, through loans, guarantees, investments and the creation of new money in Europe and the US, taxpayer support for banks is, at the last count, $15 trillion, which is more than $2,000 for every person on the planet. In the United Kingdom, we have provided about £1.3 trillion of support. Barely a bank would be alive today without that support, much of which was in the form of funding. The issues that will define much of what happens in the next few years are how the banks correct their excessive reliance on the wholesale markets and how we as taxpayers manage down our support for the banks. Plainly, for the long term, it does not sound like a good idea for us to support the banking system indefinitely to the tune of $15 trillion. However, how we withdraw that support in a way that does not put enormous pressure on banks, at a vulnerable time, to stop lending or to reduce the amount that they lend is a tricky issue. We therefore face massive challenges.

11:15

It is a little early to make cast-iron predictions about the future structure of the banking industry, partly because there is still a debate in train about whether it makes sense to break up the banks, for example. Breaking up the banks raises two issues. The first is competition, which Neelie Kroes is looking into. The second is whether the banks have become dangerously large relative to the size of their respective economies, putting them in a position of always holding taxpayers to ransom, and whether their mix of businesses—the notorious conjoining of the so-called casino of investment banking with retail banking—is a dangerous combination. We are only at the beginning of the debate on whether the so-called universal banks, such as the Royal Bank of Scotland, Barclays, UBS of Switzerland and Citigroup, are, in a sense, intrinsically weapons of mass destruction.

The Convener: Thank you. You have answered my next question. It is often said that the banks became too big to be allowed to fail. Is that what happened? Should we now break up the banks so that failure is a possibility for them and they are a bit more conservative in their management to ensure that they do not fail?

Robert Peston: It is plainly crazy that the banks want to be left alone to compete in the market, to look for business and to generate profits, yet they are permanently in receipt of 100 per cent insurance from taxpayers, as we have found out. Unlike in other sectors of the economy, when it came to it, we could not take the risk of allowing any of the banks to fail. Common sense dictates that if someone is allowed to go out and do what he or she likes to make profits, when he or she gets it wrong he or she should pay the price. Plainly, those institutions did not pay the normal price of failure because, if they had failed, the cost to all of us would have been immense in terms of the damage to the economy.

None of us can escape the conclusion that the status quo was completely unacceptable, partly because of the size of the institutions. When the Royal Bank of Scotland got to the stage at which its balance sheet was greater than £2 trillion—which is a significantly bigger amount than the value of everything that we produce in this country—it was unthinkable that it should be allowed to fail, given the repercussions for the availability of credit, for moving money round the economy and all the rest of it. If a bank of that scale had been allowed to fail, the recession would have become a depression.

The tricky question to answer is whether the problem was the size of the institutions, the combination of their activities or a bit of both. If it was both their size and the fact that some of their activities that were vital to the functioning of the economy—taking deposits and lending to small and medium-sized enterprises and other businesses that could not be allowed to collapse because of the damage that that would do to all of us—were conjoined to the more speculative activities of the investment bank, two separate questions arise. First, how can we limit the size of the banks? Secondly, is it conceivable that we could put in place arrangements whereby there would be an internal separation between the so-called casino and what one might call the utility bank—the bit that matters to us? That is something that the Bank of England and the Financial Services Authority are currently working on. The authorities in London are working on what are termed living wills. That is code for putting the different activities into wholly separate legal structures and trying to ensure that there is little overlap or contagion between the two, so that, if the bank were to fail, the bit that matters could be lifted out and saved, and the bit that we regard as less vital to the functioning of the economy could be left to take its chances and, in effect, to fail.

At this stage, it is unclear to me whether the ambition of making these conglomerates—the universal banks—safe without breaking them up can succeed. Distinguishing between the two parts of banks is tricky. Banking is complex, and there would have to be a lot of regulatory intrusion all the time to ensure that the two—or more—bits of a bank were being kept separate. There is a commonsense argument that, if we think that for public policy reasons the two types of activities need to be kept separate in a legal sense within one organisation, it might make life simpler for everyone if we broke up the organisation, so that the activities were not connected in any way. Arguably, that would make life a lot easier for regulators.

The solutions that we are seeking at the moment tend to put an enormous emphasis on the quality of regulators. Basically, we are saying that we want much better regulation and regulators. There is no doubt in my mind that the FSA's game has improved. The FSA has admitted that it did a lamentable job in the previous few years. My impression is that things have improved, but would it not be better for us to be less reliant on the human frailty of regulators by having an institutional structure for banks that was intrinsically less dangerous?

The Convener: Do you agree that there was a regulatory failure in the system? If so, was it limited to management of the UK-based banks, or was there a worldwide failure to regulate some of the financial instruments that are one of the causes of the problem?

Robert Peston: Do we have another couple of days to talk about the issue? An extraordinary amount went wrong. When we look back at the preceding few years, it is astonishing how much went wrong. As you know, part of the background to the crisis consists of what are known as great global imbalances. There was an excess of saving in places such as China and Japan, which was recycled, in effect, into cheap credit in the UK, the US and other parts of the west. Many economists, politicians and central bankers said for years that that was unsustainable, but we went on and on accumulating debt in the UK and the US and accumulating surpluses in many other parts of the world—the middle east, China and Japan. The problem was not and has not yet been fixed. There is no doubt that it created instability and was a big contributor to the crisis that we experienced.

There were two kinds of regulatory failure, one of which was broadly lethal for the global economy and one of which was unfortunate. The unfortunate stuff stemmed from the fact that the supervision of individual banks was not good enough. The FSA has acknowledged as much; it has admitted that it did not boss the likes of HBOS, Northern Rock and the RBS around enough when they were doing reckless things. Northern Rock should not have been allowed to have become so incredibly dependent on wholesale markets, because that made it a very risky bank, and it should almost certainly not have been allowed to lend all those billions in the form of 100 per cent plus mortgages or, indeed, the 95 per cent mortgage and personal loan package that meant that it was lending up to 125 per cent of a property's value. That sort of bonkers behaviour would have had any sensible regulator saying, "Hang on a second—this does not sound like prudent banking." It is also amazing that HBOS was allowed to become so extraordinarily focused on particular sectors and that regulators simply did not stop all its corporate lending to property and construction.

My own view is that inadequate supervision has been costly to us all because it caused problems at individual banks to be worse than they would otherwise have been. The massive systemic failure, however, was to allow almost all banks to lend far too much relative to their capital requirements and to become far too dependent on wholesale finance and lend far more than was altogether prudent relative to their deposit bases. That failure happened in the UK and the US and was induced by too many years of things going well and people failing, for a whole variety of reasons, to measure risk in a sensible way.

The failure was also a result of the Basel I and Basel II accords, which set global standards for banks' capital and liquidity requirements but also encouraged banks to game the system and do all sorts of silly things to get round the rules. They were an attempt to micromanage banks but, on the whole, banks are smarter than regulators and were able to get round the rules to an horrific extent. Of course, it turned out that they were not as smart as they thought they were. I will not go on more about this now—you might want to ask questions about it later—but I think that the global rules were part of the problem, and they certainly need fixing.

Rob Gibson: I am tempted to draw lessons here.

With regard to the regulatory failures that you mentioned, do you think that the system of regulation that the UK Government has now put in place will effectively tackle the current problem? The corresponding question, of course, is whether the various elements of the original tripartite system that Gordon Brown set up actually talked to one another and whether any regulatory activity could have been carried out under it that might have helped us to avoid the current situation.

Robert Peston: You will have to forgive me but, as I work for the BBC and am supposed to remain politically neutral, I will not be able to answer one part of your question directly.

However, you have hit the nail on the head. What matters is that the central bank talks to the regulator and the Treasury and that relevant information is shared. Plainly, for a period, part of what was going wrong was that the different bits of the tripartite system were operating too much in their own silos. As a result, the right kind of market intelligence was not being shared across the piece. It may also have led to a more cumbersome approach to the bank rescues initially, although the shock has meant that the three authorities have been working together much better more recently.

11:30

It plainly matters that central bankers talk a lot to supervisors if they are to understand what is going on. In good times and bad, there is a tremendous connection between ensuring that banks have the right amount of capital and the sort of stuff that the Bank of England is interested in, such as credit conditions. One thing that went wrong over a period of years was the complete disconnect between monetary policy, which is the Bank of England's role in ensuring sufficient liquidity in the economy, and prudential supervision. The two are inextricably connected, yet the two parts of the system operated as though there was no connection. For example—to tell you stuff that I am sure you know—if a bank is required to hold X per cent of its loans and investments in the form of regulatory capital, that requirement has a significant impact on its ability to lend and, therefore, on credit conditions in the wider economy. However, those decisions on capital adequacy were taken completely separately from the Bank of England's decisions about monetary conditions in the economy, such as whether interest rates should rise or fall and all the rest of it. Plainly—just as a definitional point—quite apart from what led to the crisis, the fact that those two activities were so separate was not a good thing. When people talk about the need for macro-prudential supervision, they are in part capturing that need to bring those two functions rather closer together.

Another point is simply that the lender of last resort, which must be the central bank, cannot operate independently from the organisation—in this case, the FSA—that, in theory, oversees what goes on in the market. It is plain that the two organisations were too disconnected. They have acknowledged that they need to work much better together.

It is for others to decide whether the appropriate partnership can be forged by keeping that separation between banking supervision and monetary policy, as is the Labour Government's policy, or whether the Conservative party is correct that it would make sense to transfer banking supervision to the Bank of England. What matters is not the institutional arrangements in a theological sense but what works.

Rob Gibson: Given that the Bank of England is currently arguing for more powers and given its debate with the FSA on the structure of banks, will the forthcoming banking bill—which your blog describes as a short bill "of perhaps 50 clauses", according to your sources—lead to root-and-branch change, or will it just tweak the system in the hope that things will get better?

Robert Peston: Are you talking about the regulatory system or the tripartite system?

Rob Gibson: I am talking about the tripartite system.

Robert Peston: The Government's position is that it believes that the tripartite system can be fixed. The Government intends to give new powers to the FSA and is trying to create a framework in which the Bank of England and the FSA work more closely together.

I will be honest with you. I think that there are risks on both sides. The risk of doing what the Tories want to do and transferring banking supervision to the Bank of England is that it would create an enormous institution. The Bank of England would be the most powerful non-elected institution in the country by a mile, and also a huge and complex institution. There would be a management challenge and also a democratic accountability challenge. One should be under no illusion about what would be created in those circumstances. In many ways, the Bank of England would be much more powerful than the London Treasury because it would have absolute control over all aspects of macro policy other than fiscal policy, and even then it would have some indirect influence on fiscal policy. There are democratic questions about whether that is the right direction to take, and there are questions about whether it would be manageable.

On the other side, if banking supervision is not transferred to the Bank of England, is it possible to put in place a genuine partnership approach? If we look around the world, there is no perfect model. Every country, more or less, is agonising about those things. Although one or two countries have come through the banking crisis better than others—Canada and Australia have come through it all right—they have different regulatory models. We cannot say that their experience tells us that there is an optimum structure. As always, these things are to do with history and culture.

In the end, we have to consider the need not to make the system too cumbersome—some would say that the tripartite system was a bit cumbersome—versus the democratic and management issues that will arise if banking supervision is moved across. It is definitely a tricky one.

Rob Gibson: You say that although the tripartite system is cumbersome, it has benefits for the country. We are thinking about our banks and the need for finance. Do you think that the proposals for banking reform that are to be discussed in the House of Commons and the House of Lords in the next six months will effectively deal with the problems that have occurred and create a playing field that is much clearer in future?

Robert Peston: Sorry, I am being a bit thick. What do you mean by that?

Rob Gibson: Will the short bill just tweak at the edges or will there be root-and-branch reform that makes it clear where discussions take place between the FSA, the Bank of England, the Treasury and so on. Will we be able to see a lot more transparency of regulation?

Robert Peston: It is plainly not simply a question of tweaking, but one should not forget that since the crisis there has already been one quite big regulatory change: the Bank of England has been given the power to take over a failed bank. Indeed, it has now exercised that power. That is plainly an important step in the right direction. When the crisis with Northern Rock blew up, it was impossible—or very difficult, anyway—to put it into an administrative procedure that would not have caused significant harm to depositors. That was a terrible failing of the previous regulatory system. The fact that the Bank of England now has the ability to take over a failed bank's assets speedily in a crisis, which allows the deposits to be hived off and kept whole, is an important step in the right direction. Many would say that it was long overdue.

When it comes to the systemic issues, it is not 100 per cent clear to me who is in charge, or rather, who will be in charge when the bill becomes law. It is unsatisfactory that, at the moment, the systemic issue falls between the Bank of England and the FSA. There must be oversight of the system as a whole. When excessive risks are being taken, it is hugely important that that is monitored and that judgments are made and acted on. However, it is unclear to me whether, after the legislation has been passed, we will be clear enough about precisely where the buck stops.

The FSA and the Bank of England are trying to forge a partnership. John McFall MP, who is a member of a committee that you might regard as a competitor—

Rob Gibson: No, no. It is complementary.

Robert Peston: John McFall asked the right question when he wanted to know who would get sacked when it all went wrong. That is a useful question to ask of any organisation in which there are proper lines of accountability. It is not 100 per cent clear to me who would get sacked in those circumstances, which may be a problem.

The Convener: Who should have been sacked the last time that it went wrong?

Robert Peston: A few bankers lost their jobs, but it is a weird thing. We have had a crisis the like of which we have never seen, yet because there were so many causes and because so much went wrong, more or less everybody was able to say, "It's partly my fault but it's also everybody else's fault, so I don't have to fall on my sword." Many people out there regard that as unsatisfactory.

Lewis Macdonald: The original coverage of the crisis is interesting. Although our remit is to look forward, it is useful to learn from past developments. When Alistair Darling told *The Guardian* that he foresaw a financial and economic threat to the global economy such as we had not seen since the 1930s, many commentators were sharply critical. I recall that you were one of those who said that he was perhaps right. What were the first danger signals and how well were they picked up and acted on in the early part of the crisis?

Robert Peston: There were two phases. The first was the creation of the bubble in the period before the summer of 2007. The awful truth is that, although many people such as I saw bits of what was going wrong, very few—I would argue almost nobody—saw quite the scale of the bubble that had been created. The lesson that we have learned is that we must somehow devise a system in which it is possible to view the financial system with slightly more acuity than we could before.

There were lots of warning signs that lots of people picked up in different ways. You will all remember the concerns that were widely raised about the fact that British households were borrowing far too much. It was no great secret that the indebtedness of households rose to more than 170 per cent of their disposable income—an all-time record by a mile. That was visible. Also, although it rarely got off the pages of specialist publications or outside the last page of the *Financial Times*, the $60 trillion notional size of the credit derivatives market—which turned out to be something of a problem—was well known within the central banking regulatory world, yet its explosive growth was simply allowed to continue. In fact, far from trying to limit that growth, people such as Alan Greenspan were on the record as saying that those innovations were good things.

11:45

A number of things happened. In 2006-07, it was perfectly clear to me that banks were reducing the normal standards that they applied when lending. There was a range of banks lending as if there were no tomorrow and reducing the stipulations for security that they normally ask for. You have probably come across the notorious covenant light—or cov-lite—loans in relation to leveraged buyouts or private equity, whereby banks lent colossal sums with no strings attached. That was plainly a warning sign that banks were out of control. There was a period of euphoria in which their judgment was plainly undermined by the massive profits that they were making and bonuses that were being given. Plainly, that was a warning sign.

There is also the issue of the sheer complexity of the instruments. The moment that I knew that there was a big problem came when I did a little piece for the "Today" programme in spring 2007, which was before markets froze up. I felt like torturing 5 million or so "Today" programme listeners, so I thought that I would get senior bankers to explain credit derivatives and collateralised debt obligations. I put a microphone in the face of a senior banker at Morgan Stanley and said, "Pretend you're talking to your grandmother and tell me what collateralised debt obligation is." A quarter of an hour later the sweat was pouring off him and it was plain that his grandmother would be able to understand what this chap did for a living, but only if she happened to be a hedge fund manager.

The serious point about that is that, if an individual who does that cannot explain it in language that we can understand, it makes me worried that he does not know what he is doing. Further, as you will all know, the people at the top of those organisations did not understand what those highly paid employees were up to either. The way the system worked was that they employed risk managers, who employed other risk managers who talked to the traders and collated and processed the information in a way that could be fed up to the top board. At the end of the day, the board got what you might call a sanitised version of what was going on, which did not give them a handle on the risks that were being taken. That was plainly a disaster.

There were all sorts of warning signs in the run-up to the 2007 meltdown, and there was of course a second phase. You referred earlier to the remarks that Alistair Darling made. That was in summer 2008, which was a full year after the extraordinary shock to the financial markets. There were two periods of delusion. There was a period of delusion in the run-up to summer 2007, when we effectively ignored all the debt and the leverage that had built up into an unsustainable bubble, and there was a period in the year after summer 2007, when most of the authorities failed to appreciate the significance of the credit crunch and the economic harm that was being done by the massive contraction in credit that had been caused by the freezing up of the markets in that summer. The collapse of Lehman Brothers was a totemic event. At that moment, the world woke up to the fact that we faced a major crisis. However, to be frank, that was only a wake-up call—the crisis had already arrived. All Governments, regulators and central bankers failed to understand the significance of what had been going on.

Lewis Macdonald: Once an understanding of that became clearer, was it communicated effectively? In other words, were people in your position and in the sectors themselves too slow to report and make the situation transparent to the wider public?

Robert Peston: Again, there were two phases. The media in general was pretty lousy at calling time on the bubble before the summer of 2007. Let us be clear. In some sense almost everyone was implicated in the bubble, whether it was people buying a house at the top of the market with a 100 per cent mortgage, or the Chancellor of the Exchequer loving all that tax revenue that was coming from the city and not looking under the bonnet at what the city was actually up to, or the newspaper groups getting lots of lovely advertising from estate agents and property supplements or television companies getting lots of lovely viewers for programmes telling them to go out and buy another house to do up. I am afraid that, as a society, we were all implicated in the bubble. My view is that the record of newspapers and television was marginally better in warning of some of the risks than the central bankers and finance ministers were but, as I said before, that is just saying that we were myopic rather than blind, not that we have a distinguished record. However, after the summer of 2007 the media captured more of the scale of what was going wrong and needed to be fixed than was true of the authorities.

Lewis Macdonald: It can be either feast or famine with the media. Another criticism that has been made of the media is that, when a sector depends on confidence, as finance does, the reporting of one collapse can promote another. Is there any truth in that?

Robert Peston: What Keynes calls “animal spirits”—confidence—is incredibly important, and the media have to think about that. However, we also have to think about our role in the good times as well as in the bad times. You could criticise the media as much for making people less aware than they should be about the risks of taking on debt. Maybe we should have been less complicit in saying that the rise in house prices was all for the best in the best of all possible worlds.

To say that it is better for the media to underwrite a bubble than to prick it is a slightly odd way of looking at things. We have to provide solid, neutral and impartial views through good times and bad. Obviously I have had to think long and hard about this because people have periodically accused me of damaging individual institutions or the economy. In the autumn of 2007, I got a huge amount of criticism, so I am acutely aware of the journalist’s responsibility to stick to the facts, not to put them in an alarmist context, not to speculate, and not to be sensational. It is terribly important that one provides balanced reporting.

I also take the view, however, that we have a public duty to tell it as it is. What to me is just straightforward news that people have to have is, to some people, horrible news that they would rather was not out there. I am afraid that, in the end, I and the BBC have to make a judgment about what the public has a right to know. Although I do not say that the confidence issue is trivial—it is important—what matters most is that the media should provide the information that people deserve, whether the news is good or bad. That is a particular challenge for us.

It is almost impossible—in fact, I would say that it is impossible—to prove that the media made the situation worse, for the simple reason that it is a global phenomenon that is rooted in massive structural problems in the banking industry and the surpluses and indebtedness of particular countries. One does not want to be trite, but there has been $15 trillion of global support for banks from taxpayers—it is inconceivable that you can lay the blame for that at the door of the media.

Lewis Macdonald: In our earlier evidence session, Alf Young—whom I am sure you know—suggested that the nature of the economic times that we have just been through is such that it casts a doubt on whether sustainable economic growth is an appropriate objective for Governments. That is a big picture question. Has the big picture of the economic world that you report—quite apart from the detail of the regulatory legislation—changed?

Robert Peston: All sorts of interesting questions are being asked about the right goals for the stewardship of the economy. I am stating the obvious; I am sure that you already know that.

The interesting spin-off benefit for many people—although few would say that it is worth it—is that CO_2 emissions have been reduced during the economic shock. Few would say that we would want to engineer an economic shock as a coherent policy on global warming. However, such a fall in emissions rather bolsters the case against those who say that aggregate growth that does not take account of some long-term costs is simply the only target that matters; that, for example, we must return to 2 or 3 per cent GDP growth, irrespective of the costs that are generated in the process. That is an important question, and it is probably a good thing that it is now being debated with a bit more urgency than it previously was.

When there is a bail-out of the scale that we have seen, it is appropriate to ask questions about the relationship between citizens and a particular big part—in this case, the financial part—of the private sector, and about whether those institutions understand that, since their dependency on us has been proved, they have more of a responsibility to think about their role in wider society. It is not obvious that that has happened, and we have not yet heard an interesting speech on the subject—except from Stephen Green of HSBC, who has tried to talk about the role of banks in a wider societal sense. Very few bank executives think of what they do in that way: they think of their role purely in terms of their balance sheet and profit growth. Many would say that this is the moment when executives ought to recognise that there are wider issues that they need to address head on.

Gavin Brown: Credit rating agencies were passing off certain bonds as triple A, when they were quite clearly junk. Have those agencies got off quite lightly so far?

12:00

Robert Peston: It is certainly striking that the structure of that industry has not changed very much at all, despite the fact that hundreds of billions of dollars of stuff that they said was solid gold turned out to be rather nearer to poison. It is odd that there has not yet been wholesale, enforced structural reform of that industry. The regulator is still looking at that, and there are various proposals out there.

Many people have pointed out that there is an inherent conflict of interest in credit rating agencies being paid by the vendors of the debt and not by the purchasers. It is odd that that system has not been reformed yet. It also seems to me to be slightly odd that the authorities themselves are, in a way, sustaining the credibility of the credit rating agencies. For example, in some of the schemes that the Bank of England operates to provide liquidity to banks, the only assets that it will take from the banks are those that are rated as triple A by the rating agencies that apparently made so many mistakes on collateralised debt obligations and on the ratings of institutions such as the monoline insurers. Some would say that it is paradoxical that an institution such as the Bank of England is, in a sense, providing a rather healthy business stream for institutions that are part of the problem. The whole area is certainly work in progress.

Gavin Brown: There is a slight conflict in what we are asking banks to do, given that we want them to shore up their balance sheets while maintaining or increasing lending. The Treasury has indicated that it wants lending back to 2007 levels, but the Bank of England has said that it could go back only to 2004 levels. The committee has to consider the lending situation, because businesses tell us that they are being squeezed. Individual banks say that they are lending just as much, if not slightly more, as they ever did. In addition, the British Bankers Association said in evidence that all its members are lending as much as they ever did. However, banks cannot shore up balance sheets and increase lending at the same time.

Do you have a view on lending policy? Are all the banks lending as much as they could, or is there a discrepancy between them in that regard? Are businesses right to say that they are being squeezed?

Robert Peston: The picture is complicated. The first thing to point out—you know this stuff—is that many lenders have withdrawn from the British market. For example, the Irish banks are not lending what they were, because they have problems of their own; the American banks have retrenched to a large extent; and the Icelandic banks have disappeared. Further, all sorts of special lending vehicles collapsed or were wound up, particularly in the mortgage market. The Treasury calculated that, simply as a result of the withdrawal of credit from overseas and the collapse of many specialist vehicles, something like 50 per cent of lending capacity was taken out of the UK market. That is astonishing, and it caused the mess that we are in. That massive withdrawal of credit was the big, fundamental cause of the economic downturn—that is why it is called the credit crunch.

We must now broadly rely on our indigenous banks, but we expect them to do a number of slightly contradictory things. We want them to lend less relative to their capital resources—we want them to take fewer risks, in that sense—to reduce their reliance on wholesale markets and to lend less relative to their customer deposits. At the same time, we want them to lend more to the economy, at a time when all the credit to which I referred has been taken out of the economy. It is therefore not all that surprising that individuals and institutions are saying that there is not enough credit around.

Given the enormous amount of capital that taxpayers have put into the big banks and the enormous amount of pressure that politicians have put on the banks, the RBS, Lloyds TSB, HSBC and Barclays are probably making a bit more credit available than they were a year ago. However, making credit available and getting people to borrow are two separate things. That raises the question whether banks are providing credit on reasonable terms to creditworthy borrowers, which is, of course, where the argy-bargy and disputes arise. Many companies think that they are very creditworthy, but the credit lending officer at the bank will take the view that times are hard and that to lend to them might well be a case of throwing good money after bad. In the end, I guess that few of us would want banks to lend to institutions or individuals who cannot repay the loan and in a sense there will always be an element of subjectivity in assessing creditworthiness.

My personal view is that, although companies are making quite a lot of noise about not getting enough credit, we would be hearing far more noise if the banks were behaving appallingly. Indeed, there was a hell of a lot more noise from companies during the previous recession than there has been this time round. I am not by any means giving the banks a clean bill of health, but I think that they are probably doing a little bit better than some are giving them—[*Interruption.*] I was about to say “giving them credit for”, but never mind.

Of course, the statistics can be read in two ways. According to the aggregate statistics, for example, banks are lending less to businesses at the moment. However, I know from my experience with business that there are a number of businesses that, for a variety of reasons, want to repay debt, and some of that reduction in credit is a result of companies voluntarily and rationally deciding that in this difficult period they have too much debt, they want less and they would rather finance themselves in other ways. Some are lucky to be big enough to raise capital from the bond market, equity and so on, while others have simply decided to retrench for a bit.

Obviously, if everyone did that, it would be bad for the economy, and we need to be acutely aware of that. In his rather excellent analysis of the 15 years in which there was no growth in the Japanese economy, a chap called Richard Koo locates the fundamental problem not in a shortage of credit but in the collective decision of companies to borrow and invest less. We must not get into that position in this country, because if businesses took a collective view that they wanted to reduce borrowing and investment it would be hugely damaging to the country’s economic prospects. As a result, we need to look at demand as much as supply. For perfectly sensible reasons, people have tended to focus more on supply, but we should not ignore the suggestion that our companies are simply being a bit too cautious.

I should highlight one final point. People seem to see me as the person to complain to; last autumn, I was inundated with complaints from companies that banks were not behaving properly. I am now receiving a much smaller number of such complaints and if my personal in-box has shrunk in that respect it probably means that the banks are behaving a bit better than they were.

Gavin Brown: Finally, I want to ask a question that I have put to previous witnesses. Do you think that the Federal Reserve should have saved Lehman Brothers?

Robert Peston: I absolutely understand why it did not. Banks that do the kind of things that Lehman Brothers did should be treated as normal commercial organisations are treated when they do stupid things, as Lehman Brothers did. It became far too exposed to commercial and residential property; it took a mad gamble. If the authorities do not allow banks in such circumstances to fail, they give people who earn in a year more than thousands of people collectively earn in a lifetime a blank cheque and enable them to take a bet with our money. That is obviously not healthy. The instinct of the Fed and the Treasury that they had to allow at least some bloody institution to fail was fundamentally right. Unfortunately, they picked the wrong bank at the wrong time.

As you probably know, for at least two years, I have been working 24 hours a day more or less every day. At the end of the week in which Lehman Brothers failed, it was obvious that it had a problem. We were getting messages from the Treasury that it was not going to prop up Lehman Brothers and, all through the weekend, as the bank careered towards collapse, I really could not believe what I was hearing and what was happening. On the Sunday night, when I was aware what was about to happen and reported it on the "Ten O'Clock News", it was obvious to me that it would be a cataclysmic event. It was astonishing that the Fed and the Treasury did not prop up the bank.

Ms Alexander: Thank you for coming. I think that you are the first non-Scottish commentator who has graced us with their presence.

Robert Peston: That is a privilege.

Ms Alexander: You will appreciate that we are trying to get a perspective on Scotland's place in the crisis, what happened and why it happened. Therefore, the committee finds it strange that, when Scottish Financial Enterprise—the body that represents financial services in Scotland—and the Scottish Government gave evidence, they talked exclusively about the global dimensions of the crisis and were unwilling to offer any comment on its Scotland-specific dimensions. You alluded to some of those when you talked about the ratio of loans to deposits that the RBS and HBOS had. I invite you to say a few words about the Scotland-specific dimensions of the crisis with respect to the management of Scottish banks.

Robert Peston: That sounds like an invitation to walk into a minefield so, if you will forgive me, I will be slightly delicate.

It seems reasonable to me to take what happened in Scotland broadly within a UK framework because the regulator is the FSA and the central bank is the central bank for the whole United Kingdom. That is a pretty relevant envelope. In a curious way, Scotland was a victim of success in that it has an extraordinarily strong financial services industry and a proud history in that industry. If there is a Scottish element to the crisis, it is to do with the deposit base.

Many banks throughout the world took the view that the finance available from wholesale markets was, in a sense, a permanent revolution—that that money would be available for ever. Selling mortgages in the form of bonds is the classic example. Plainly, if you are a bank with a regional deposit base and you have global ambitions and very talented people, you have an incentive to raise money from non-conventional means. That was true of Northern Rock, for example. Northern Rock had a relatively small deposit base from customers but huge ambitions in the British mortgage market, and it tapped into the asset-backed security market to an astonishing extent.

12:15

The Royal Bank of Scotland and HBOS, through the Halifax merger, had UK-wide franchises and deposit bases. However, their origins within the smaller Scottish economy possibly made them more emotionally open to the notion that there were ways of fuelling expansion other than tapping their domestic deposit base.

One is trying to rationalise why those banks became much more dependent on securitisation and wholesale markets than some other institutions did. However, that is just a function of having a lot of bright and ambitious people, although one has to ask oneself why the individuals at the top of the organisation were not acute enough with regard to seeing the risks.

The phenomenon is not peculiar to Scotland. What I am talking about is a dimension that is peculiar to a smaller economy with people in a particular industry who are particularly talented and have big ambitions. I hesitate to say that the issue is a particularly Scottish one, but I would say that there is an issue about the need to manage growth based on something other than the deposit base.

I hope that that sort of makes sense.

Ms Alexander: It does indeed.

You have mentioned the size of the bail-out and the $15 trillion stimulus that has gone into the banks. Can you itemise roughly what you think is the size of the taxpayer bail-out of HBOS and the RBS? Last week, we found that the Scottish Government is unable to do that.

Robert Peston: Part of the problem is that some of the statistics are available only in aggregate for the banks. I will not, therefore, be able to give you any highly accurate information.

At the moment, some of this is work in progress. As you know, earlier this year, the asset protection scheme was announced. However, Lloyds and the RBS are, at the moment, seeing whether they can raise a bit of capital from the markets, which would reduce the use that they make of the asset protection scheme. Between them, Lloyds and the RBS have just short of £600 billion of assets—I think that the figure is around £585 billion. As well as that, the direct injections of cash that have been made into both of them are worth another £36 billion or £38 billion. The difficulty is that we do not know how much they have placed in the Bank of England's mortgage-swap scheme.

Because the mortgage security market shut down and because banks were so dependent on raising money by selling mortgages to wholesale institutions but that was no longer available, the Bank of England established a scheme whereby it basically took the mortgages from the banks and gave them cash loans in return. One must assume that, in the case of HBOS, that sum of money is substantial. My memory—although you would have to get independent verification of this—is that something over a year ago HBOS alone faced a requirement to refinance around £100 billion to £160 billion of wholesale finance over the following year. One must assume that most of that money came from the Bank of England; it is difficult to imagine where else it could have come from. You would need to get the figures from HBOS, but the sums of money coming out of the Bank of England's mortgage scheme for the two banks together must inevitably run to £100 billion-plus.

There is then the question of how much cash from the purchase of gilts has ended up within the banks. That is impossible to know. We are talking about those two banks certainly being responsible for more than half of the £1.3 trillion. The figure may even be two thirds of that, but it is difficult to say.

Ms Alexander: There is a common misperception that the only guarantee that has been extended to the banks over the past year is the share capital. As you say, the figure that we used a couple of weeks ago—in so far as there is an estimate out there—was of the order of £100 billion, although it may be more.

Robert Peston: It may be more. The other thing, which I forgot to mention, is the credit guarantee scheme. That is the taxpayer-guaranteed sales of short-term debt. The banks are on a life-support machine that is provided by taxpayers—we should be under no illusion about that. If we asked for the money back tomorrow, they would not exist.

Ms Alexander: It seems highly significant in the Scottish context that in excess of £100 billion in public sector guarantees has been extended in the past year to keep those institutions going. That is more than three times the entire budget of the Scottish Government, but that is not really my point.

Let us return to your previous point. All the talk at the moment is about the need for regulation to be global, but the truth is that rescues have been largely national. In thinking about the future character of Scottish financial services, we must consider whether we are going to be a centre for headquarters functions or a centre for back-office processing. If we have major domiciled headquarters functions that are engaged in extensive financial innovation, will they be underwritten by a domestic central bank that is capable of covering the losses or extending the guarantees in a time of crisis? The other nearby country that was big in financial innovation was Iceland, and its central bank found itself unable to extend the guarantees. It seems to me that, if rescues are largely a national matter, when banks are deciding where to domicile themselves they may need to consider whether a country is of a scale and significance that would enable its central bank to support them.

Robert Peston: Another easy question. [*Laughter.*] Forgive me for not answering directly, but I will respond to your question.

Ireland provides an interesting example. In the autumn of 2008, the Irish Government made an extraordinary announcement when, without consulting any other members of the European Union, it said, "We will guarantee the liabilities of all Irish banks." If Ireland had not adopted the euro, the punt would have gone to nought, because the Government simply could not have afforded those liabilities. I think that you understand what the issue is; it is about wider arrangements than what you are alluding to.

Ms Alexander: May I ask a final question on a different topic?

The Convener: You must be brief. We are running short of time.

Christopher Harvie: Honestly!

The Convener: I am sorry, but I am in charge of the meeting, Chris, not you.

Ms Alexander: My final question is about competition. When the Office of Fair Trading considered the Lloyds-HBOS merger, it found that the small business banking market in Scotland was highly concentrated and void of any constraints. Together, Lloyds and the Royal Bank of Scotland have 75 per cent of the small business banking market, but the Scottish Government has not a word to say about that. Scottish small businesses appear to be entirely dependent on the European Commission saying that a 75 per cent concentration in small business banking is unsustainable. Is Neelie Kroes doing the right thing on behalf of small businesses while there is silence in Edinburgh on the matter?

Robert Peston: She is bound to recommend divestiture that she thinks will introduce more competition. It is clear that that is one of her aims, but that is technically quite hard to do. It is quite an experiment.

Competition in business banking is a hugely important issue. Given that the Royal Bank of

Scotland in particular has run a seamless business banking operation more or less for ever, it will, in effect, have to create a business and then sell or somehow offload that newly created business, which will not be easy. Technically, it will be quite challenging.

Let us be clear. The issue is not just one for Scotland. The OFT was more or less aghast that things were waved through for reasons of financial stability. It is a big issue.

The Convener: I hope that we can get through all our questions. Three other members still wish to ask questions.

Robert Peston: I am sorry—I talk for too long.

The Convener: We have about another 15 minutes before we proceed to the final item on the agenda.

Robert Peston: I will try not to be quite so wordy.

The Convener: I ask members to keep their questions brief.

Christopher Harvie: I will be brief and will not make any party-political points.

On 18 September 2008, after consulting the Prime Minister, the FSA and the OFT, Lloyds took over HBOS for £12 billion. I have been through the blogs that you produced at the time. Sir Victor Blank was unaware of the toxic assets—it has been speculated that there were up to £116 billion-worth of them—on HBOS's loan book, and of the stakes that were taken in top-of-the-boom property and retail companies by HBOS's head of corporate finance, Peter Cummings. Was Sir James Crosby also in that state of ignorance? He is a former chief executive officer of HBOS, and was a member of the Financial Services Authority after January 2004 and deputy director of the FSA after November 2007 when, as you have told us, you already thought that something very rum was up. Was the Prime Minister, who, when he was Chancellor of the Exchequer, appointed him to those positions, also in that state of ignorance?

12:30

Robert Peston: You will have to ask James Crosby that question. I will, however, make one point, which you are at liberty to interpret how you will.

I interviewed Victor Blank about three weeks ago. He, and all his minders—who went white when we started talking about it—insisted that they were aware of what was inside HBOS. They said that what surprised them—as I said, you can interpret this however you wish—was the speed with which the loans went bad, but they claimed that the quantum, or £20 billion of losses so far from HBOS, was at the upper end of what they feared but not outside the range of their expectations. Now, they are being sued by shareholders and are facing court cases almost everywhere, so you might want to interpret those remarks in that light.

The Convener: It might be worth reminding everyone that we do not have parliamentary privilege to the extent that Westminster has.

Christopher Harvie: You were very benign in February 2008 in "Who Runs Britain?" when you postulated a possible total global loss to the banks of £13 billion in aggregate. That was on page 32.

Robert Peston: Did I? That was a mistake.

Christopher Harvie: If my reading of a recent *Financial Times* and my poor arithmetic add up, the total losses in Britain came to—

Robert Peston: My figure was from autumn 2007. I will have to go back and look at that.

Christopher Harvie: The total losses were at least £480 billion, according to the *FT* of about a month ago.

Robert Peston: Oh, it will be miles more than that. The losses to the banking system will be something like £2 trillion.

Christopher Harvie: I am arguing the fact that we knew so little about the banking structure. I was talking to Tom Burns, an expert in banking law from the University of Aberdeen, who wanted to do a thesis on the law of securitisation but found that there is no such law and that securitisation is completely in computers. What worries me about that is that Sir Callum McCarthy, head of the FSA during its light-touch days—I think that is the first time the term "light-touch" has been used this morning—pointed out that criminal gangs were infiltrating the City of London structures. That was in *The Guardian* in June 2005 or thereabouts.

In 2005 and 2006, we as observers, and the then chancellor, were obsessed with potentially immense carousel frauds of VAT and the Inland Revenue. Brown himself admitted that the sums were as high as £2.75 billion, but said that he had the situation under control.

I had a letter from Bill Keegan, the economics commentator with *The Observer*, from Singapore in September of that year saying:

> "All I can say is that at Singapore last month, one needed several hands to count the number of people who were concerned about the possibility/probability of a great Regulatory Failure!"

Were those danger signals misinterpreted, ignored or suppressed?

Robert Peston: A huge number of investigations are going on all over the world; it is a case of stable doors and bolting horses, but regulators everywhere are digging inside banks to see whether there was fraud. I think that the suppression element would fall into that category.

It is clear from the conversation that we have been having today that warning signals were ignored, but it was slightly worse than that. Among some regulators and quite a few banks, there was a sort of religious fervour that what was happening was either benign or positive. The point is not that lots of people were shouting very loudly, “This is all very bad.” The point is that rather too many people were shouting very loudly, “This is great.” They were saying that the world was a safe place because all the risk had been taken off banks’ balance sheets, with little parcels being distributed to all the investors, and that therefore the risk of significant problems for any particular institution in a downturn was greatly reduced. That was just bonkers.

Christopher Harvie: Not if you read Eric Ambler back in the 1970s. He sussed it out in his final thrillers. The theory came from the University of Glasgow, where a sociologist called John Mack and a Tübingen criminologist, Hans-Jürgen Kerner, produced the thesis of the clever criminal who remained in a largely computerised, tax-havened and global framework. The theory was around as long ago as that.

The Convener: There will be an opportunity to continue that discussion over lunch.

Stuart McMillan: One question that the committee posed in announcing the inquiry was:

> “How can we ensure that the Scottish financial sector continues to retain a global perspective and does not retreat into a purely localised lending regime?”

With the RBS restructuring, it is expected that its operations will be reduced or sold in 36 of the 54 countries in which it operates, and that it will centre on the UK with tighter and more focused global operations. Might the RBS become inward looking and boundary oriented in the UK, give or take one or two exceptions elsewhere?

Robert Peston: That is certainly not the ambition of the current management—at least, not going by what they have said to me. Patently, the ABN AMRO deal was a deal too far. It is perfectly rational for the bank to shrink a bit as a result of that deal and other decisions that it took prior to the deal. It is not obvious that that is necessarily a bad thing. The RBS still thinks of itself as having global ambitions. It is retaining one bit of ABN AMRO—its global payments system–that more or less all banks say was good. In that sense, it is firmly committed to remaining an international bank, but one that is rather less thinly spread.

In a way, the more important point is about the fact that the RBS is one of the universal banks—a conglomerate that is big in investment and retail banking. To return to where I started, it is possible that after a long debate we will decide that such structures are inherently dangerous and that we want banks such as the RBS and Barclays to be broken up. At that point, depending on what role you think the RBS plays in the Scottish economy, there might be an interesting public policy issue. By definition—and like it or not—the investment bank part will gravitate to London. It already largely operates out of London, anyway, but there would be a wholesale divorce. At that stage, an issue would arise about whether you thought that was damaging for the economy.

Stuart McMillan: I have a question about European Union state intervention. With EU state aid, one aspect that must take place is the restructuring of organisations. Some EU nations tend to have a reputation—rightly or wrongly—for being protectionist of their industry. First, what is happening in terms of European restructuring? How are member states dealing with that? Secondly, what is the potential threat to inward investment in Scotland? Earlier this year, BNP Paribas announced that it is going to set up a facility in Glasgow, which will create 370 jobs. I am concerned about the potential impact of the situation in other European nations on Scottish jobs.

Robert Peston: You are taxing my knowledge base, to be frank. People forget that Neelie Kroes is looking at all banks in Europe that are in receipt of state aid, not just the British ones. It will be interesting to see what she does in other parts of Europe. She certainly does not think of herself as somehow discriminating against Britain or against doing a particular British thing. It just so happens that we had a particular problem in this country and the scale of the bail-out here was bigger than in other parts of Europe, so a big part of her work is based here.

It is not clear to me that there is any threat from Europe. Why do you think there is a threat from Europe to inward investment in Scotland? It is not on my radar at the moment. Why is it on yours?

Stuart McMillan: I do not want to mention particular countries or industries, but one sticks out in my mind. In the past, a particular EU nation has had a reputation for being extremely protectionist in terms of what it can provide and what it gives to its workers. With the restructuring that has to come with the provision of state aid, how would the Government of that particular EU nation try to deal with matters within its own boundaries? Could that have a knock-on effect on inward investment in Scotland or elsewhere within the UK or other EU nations?

Robert Peston: You will be a better judge of that than I am. A lot of people believe that the UK rolls over faster when Europe tells a particular company to do this or that. Whether that is true is for others to judge. Neelie Kroes is a pretty formidable individual and it seems unlikely that anything that she did would be seriously discriminatory against the UK or Scotland. We will just have to wait and see.

David Whitton: Thank you for your patience, Robert. You have been asked some taxing questions so far. Members have clearly been studying your blogs. Blogs must be the curse of BBC journalists now, because anything you write comes back to haunt you. I will finish with a couple of easy questions about bank bonuses.

We are looking forward towards the effect on the banking industry in Scotland. You said that you are the person to whom people complain. Have you received complaints from your friends in the banking fraternity about attempts to curb their bonuses?

Robert Peston: No. We have talked about the scale of the bail-out. Most people find it extremely odd that, in those circumstances, the banks have not made more of a voluntary—"gesture" is not quite the word that one wants to use in the circumstances. They find it odd that the banks have not simply stood up and said, "Until we're free of this kind of support, we will collectively change the way we pay people."

12:45

David Whitton: I am sorry to interrupt but, earlier, you mentioned that there is only one banker who is speaking about the role of those institutions in the wider society. Do you think that there is a collective failure on the part of senior bankers to understand that they have a role to play in the wider society and that now is perhaps not the time to be paying themselves mega-bonuses?

Robert Peston: For reasons of editorial impartiality I cannot put it quite as starkly as that, but the fact is that it seems to me that it is not unreasonable to draw that conclusion.

David Whitton: I am asking because when I met some financial people last week and the question of bonuses came up, as it always does, they got very irked about the fact that their bonuses were under attack. They also said that they believe that stopping bonuses could damage the financial services industry in Scotland. I do not agree with any of that, but you were saying that there is a possibility that investment banking could migrate south.

Robert Peston: I was making a separate point about what would happen if you broke the Bank of Scotland up into two parts.

This is quite a tricky issue. For many people, common sense suggests that, given that we rescued these banks from a failure of colossal proportions—if the taxpayer had not given a blank cheque to the banking system in that crucial autumn, not a bank would have been left standing—it is extraordinary that bankers should be receiving bonuses.

Further, if you look at the activity that is generating the profits that are generating the bonuses, you will see that a lot of it is to do with the extraordinary amount of activity that has resulted from central banks flooding the markets with liquidity, Governments borrowing bonds, companies trying to raise new capital to reduce their borrowing and so on. A lot of the activity is directly created either by Governments trying to protect the economy or by private companies trying to shore themselves up in the wake of the mess that many would say the banks caused. In a sense, a lot of that activity is a result of attempts to clean up the banks' mess. Some would say that it is inappropriate for bankers to receive enormous bonuses in those circumstances. Indeed, Adair Turner, the chairman of the FSA, said that just the other day.

The counter argument that you will hear from the bankers is that there is a global market and, if they do not pay these enormous bonuses, they will lose people to rivals who are prepared to pay the bonuses. That seems to be a perfectly legitimate thing to say. However, the thing that is slightly odd is that, given that this is an industry that, historically, has been among the most collusive in the world—although, admittedly, there has been a bit more competition in recent years—chairmen seem to be incapable of ringing each other up and saying, "Actually, if we wish to become marginally more popular than Atilla the Hun, we should collectively cease paying bonuses for a bit." It is a bit odd that they are incapable of acting collectively on this. There is little more that one can say.

David Whitton: In your blog, you said:

> "In the Netherlands, for example, a ceiling is being imposed on the absolute amount in bonuses that any particular banker can receive."

Is that something that we should consider?

Robert Peston: The problem with action by individual countries is that there is a genuine risk that people will go and work elsewhere. If, for example, the UK unilaterally imposed such a measure, it is possible that quite a lot of British bankers would go and work for American banks that do not have such a ceiling, which might do a bit of damage. My point is that Americans do not love American banks any more than Britons, at the moment, love British banks, and banking is global. The thing that I do not understand is why banks are not talking to each other across borders about this issue. Damage is being done not only to the reputation of British banks but to the reputation of banks everywhere. It is odd that banks refuse to grasp that particular nettle.

There is a fundamental question that we do not have time for today, which is the extent to which we should worry about a few bankers going off somewhere else. This is not so much a Scottish issue as it is a UK issue, but the heart of the matter involves the extent to which the UK took the view that the bigger the City, the better. It is plainly the case that we went far too far in thinking that everything that went on in the City was for the good. Broadly, over the past 10 years, every time there has been a tax issue or an issue to do with the costs of people in the City, we have immediately heard people saying, "If we tackle that issue, a load of hedge funds will go to Geneva and a load of private equity firms will move away." However, in the end, we must ask ourselves what sort of structure we want our economy to have and how many eggs we want to keep in the financial basket.

Whether we should be imposing ceilings on bonuses and so on plays into a much wider question about how big we want the financial industry to be in our economy. You cannot see the issue in isolation from that question.

The Convener: Thank you for a fascinating question-and-answer session. I am sure that we will get a lot out of it as we go on with our inquiry.

Before I briefly suspend the meeting to allow Robert Peston to depart and to allow the hundreds of people who want to hear our deliberation of the Arbitration (Scotland) Bill to come in, I put it on record that we have appointed Philip Augar as our adviser for the remainder of the inquiry. I remind members that, because we will be dealing with the budget during October, it will be November before we return to this inquiry.

I thank you again, Robert. Some of us will join you for lunch after the meeting.

Robert Peston: Thank you very much. I enjoyed today's meeting.

12:52

Meeting suspended.

12:55

On resuming—

Arbitration (Scotland) Bill

The Convener: Given that we all have a fairly busy day, and given that we will have the opportunity to have lunch with Robert Peston in the members' dining room shortly, we will resume the meeting. I want to give Gavin Brown time to sit down because he is the only person who knows about the next item of business.

The final item of business is the Arbitration (Scotland) Bill. We agreed to consider this week, before stage 2 starts next week, whether the committee wishes to consider any committee amendments to the bill. Of course, members will be free to lodge their own amendments.

I thank the Minister for Enterprise, Energy and Tourism for the information that he has provided to the committee and for lodging the Government amendments on Monday, which will give us time to consider them today, which is helpful. The amendments touch on most of the issues that we raised in our report. We have to consider whether we still wish to pursue any amendments. As I said, members are free to lodge amendments on specific areas if they are not happy with the way the Government has responded.

Does Gavin Brown want to comment?

Gavin Brown: Yes. We raised a couple of issues last time. One was in relation to our original recommendation 2, which referred to the retrospective transitional provisions, I suppose, of the bill. Jim Mather's amendment 60, which applies to after section 33, seems to take care of the issues that I had on that point.

Our recommendation 3 was about bringing in part of the UK Arbitration Act 1996, which relates to consumer protection. That has not been proposed, but there is a letter from the minister explaining that he is awaiting a response from Westminster on it.

Our recommendation 7 referred to section 13, on confidentiality. Amendment 52 would replace section 13. What is proposed is much cleaner and takes care of the issues that the Faculty of Advocates, in particular, raised. It seems satisfactory.

The Government has dealt with most of the issues that we raised. I am still a little bit unsure about the list of small-scale consumer arbitrations and the potential impact on them, but there is not a specific section in the bill on that, so it does not merit a committee amendment. I would not recommend any specific committee amendments.

Lewis Macdonald: My only thought was about the United Nations Commission on International Trade Law model law and amendment 51. I would be interested to hear whether members think it provides a safe protection for parties to resort to the model law, rather than use the bill as it is designed.

The Convener: We can explore that when we debate the amendments. There will also be an opportunity to return to the issue at stage 3 if members of the committee are not satisfied.

Lewis Macdonald: At first sight, the amendment looks to be cleaner and clearer than what was there before.

The Convener: On that basis, do we agree that we do not need to lodge any committee amendments at this stage, although we will have that opportunity at stage 3 if we feel that something has not been satisfactorily dealt with at stage 2?

Members *indicated agreement*.

The Convener: That concludes today's meeting. It has been a long meeting but a valuable one. I remind members that at our next meeting we will deal with stage 2 of the Arbitration (Scotland) Bill and take further evidence on the budget.

Meeting closed at 12:59.

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