The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 15 December 2010

Session 3

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Wednesday 15 December 2010

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ECONOMY, ENERGY AND TOURISM COMMITTEE
35th Meeting 2010, 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)

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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:

Professor Andrew Hughes Hallett (Council of Economic Advisers)
Sir George Mathewson (Council of Economic Advisers)

CLERK TO THE COMMITTEE

Stephen Imrie

LOCATION

Committee Room 2

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 15 December 2010

[The Convener *opened the meeting in private at 09:38*]

11:03

Meeting continued in public.

Council of Economic Advisers (Annual Report)

The Convener (Iain Smith): I welcome everyone to the public part of the 35th meeting in 2010 of the Economy, Energy and Tourism Committee. Agenda item 3 is consideration of the annual report of the Council of Economic Advisers. I am very pleased to welcome back to committee the chairman of the council, Sir George Mathewson. He is joined by Professor Andrew Hughes Hallett, a council member. Sir George, do you wish to make any opening remarks before we move to questions?

Sir George Mathewson (Council of Economic Advisers): I have very few opening remarks to make, convener. I believe that the committee has been subjected to most of them before. I have found it extremely rewarding to work with the people on the council over the last period. Interesting work has been done. Individuals on the council, including Professor Hughes Hallett on my right, have been extremely generous in the time and intellectual effort that they have made on behalf of us all.

The Convener: Thank you for that. I will open with a fairly general question. Given that this is the council's third annual report and that we are coming to the end of this third session of Parliament, what are the council's three most significant achievements in its first three years?

Sir George Mathewson: Achievement is a difficult word to use, because what is actually done and achieved is up to Government; our role is to advise Government. The Government has taken steps on planning—although in my view, that has not been totally successful in as much as the local authorities, I believe, have not quite cottoned on to what the modern world requires. The thinking on fiscal independence has gone a considerable way. I believe that the council's views on several other matters have triggered a lot of good thinking within Government.

The Convener: Has the Government adopted sufficient of the recommendations that you have made over the past three years and sufficiently changed policies to reflect them?

Sir George Mathewson: "Sufficient" is a hard word to use in that regard. I do think that the Government has been influenced. What we recommend from an economic viewpoint is as good as we can muster, but it is politicians who judge what can be achieved or not within the political environment in which they work. Our job is merely to advise on what our beliefs are, and their job is to decide what can be done within the context.

The Convener: Chapter 2 of your report is entitled "Progress Against Purpose Targets". With the benefit of hindsight, which as politicians we are all very good at having, if you were starting today with a clean sheet of paper would you use the same purpose targets as were used four years ago, when they probably seemed reasonably valuable?

Sir George Mathewson: Probably.

Andrew, would you like to speak on that?

Professor Andrew Hughes Hallett (Council of Economic Advisers): Yes. The targets are all long-distance targets, so they are kind of fundamental. I do not think that you would want to depart terribly far from that. It is a bit difficult to talk about, because circumstances engulfed us, which tends to make people look shorter term, but if you are looking at the long term, you want to go for growth, jobs and other priorities that follow from that. If I was doing the targets again, I do not think that I would change them.

The Convener: Given that they are long-term targets, is there any inconsistency between any of them—for example, between the one on growth and those on environmental sustainability, carbon reduction and so on? Are they mutually achievable, or are they contradictory, as some politicians would certainly suggest?

Professor Hughes Hallett: They are mutually achievable and will have to be achieved if we want to survive. Life is full of trade-offs. If you set ridiculous numerical targets, they might conflict, but getting a good balance is achievable.

Rob Gibson (Highlands and Islands) (SNP): Chapter 4 of the report looks at the potential for increasing the rate of long-term economic growth. You make it clear that there are evidence bases for different ways of raising taxes and so on. The Scotland Bill allows very little borrowing of any kind. The view of the Council of Economic Advisers is that borrowing would be helpful under devolved taxation. Does that mean that the Calman proposals and the Scotland Bill proposal could introduce a degree of instability into tax-raising?

Professor Hughes Hallett: Yes. There are two things: our report; and what went on in the Calman commission, or rather the expert group that underlay it—there are lots of stories to be told out of school about that. The bottom line on the borrowing question—and I was involved, so I will answer the question in this way to start with—is that the borrowing arrangements in the Scotland Bill, both on the capital and the revenue side, are a bit pathetic. The reason why that is important is that during the Calman process, the argument was that you would not want to devolve because that risks too much volatility in the revenue streams. That was why the commission—against the advice, I think, of the person on the expert group who handled the issue—would not entertain letting the North Sea oil revenues be devolved. The inconsistency is that at the same time they wanted to devolve income tax, or at least part of it. However, the income tax stream is just as volatile. So, there is an inconsistency there, but if you want to do what the bill proposes you have to have some form of borrowing.

The borrowing that they have introduced in the Scotland Bill is for borrowing against forecast mistakes, not borrowing against volatility in the income stream from which income tax is paid. In a private conversation yesterday, someone put it to me that that is interesting because if the Office of Budget Responsibility was to get its forecast exactly right, they would inject instability into the budget that would not have been there before. That is why the matter is of considerable concern. The borrowing on the revenue side is now much smaller than it was; for the purposes of conversation—this is obviously numerically not quite correct—it is not there.

If I was talking to anybody on the outside, I could say, “What would have happened with this arrangement in 2007?” In 2007, we were making forecasts of the future revenues from the income tax component, which would have been relatively rosy because that was a boom time until halfway through the year, when we then got a collapse in revenues. As I understand it, the proposed structure involves a three-year process of deciding on the tax rates, actually implementing the tax rates, then getting a reconciliation at the end of that year. If that process had been used in 2007, taxes would have been forecast at a generous rate in 2007 and the payback would have been in 2010, when we are at the bottom of the cycle and hoping to recover, which would have driven the cycle further down. The situation could be reversed—things could have boomed and gone the other way—but I put it the way I did because that is in everybody’s minds. The process is going to create extra instability.

I will put this in much more graphic language because it is much more fun to talk about it in graphic language. I am sorry to be boring about this, but in lecture 4 at the beginning of an economics course you would come across an accounting identity that says savings minus investment has got to equal Government spending minus tax revenues plus the trade balance. The trade balance is on costs, so in the short term it is not going to vary a great deal. Just looking at the other two components, what would have happened in 2007? Because of the generous forecasts, Government spending would have been higher than the tax revenues, which means that the savings are higher than investment. So where are the savings going to go? They will go into assets, and you get an asset bubble. Then in 2010, when the reconciliation comes in, you are going to be hit with the payback. The Government spending is going to go down, which means that G is less than T, which means that savings are less than investment. So, you create the kind of credit freeze that we see at the moment. The banks are not going to lend, so individuals, small businesses and so on are going to have a hell of a time trying to borrow money. That is what is being generated by the mechanics of the process, which has nothing to do with the politics. I do not talk about the politics; this is the mechanics.

That was a very long answer, but I wanted to give you several ideas of why there is a great deal of potential instability. If you want to get round that, what do you normally do? What would any businessman do when faced with a great deal of uncertainty? He would look for insurance policies. The insurance policy is to diversify, and you would diversify over different tax revenues—but you cannot do that here. Therefore, you can see why the logic would lead you to consider a more varied scheme, which is what we talked and wrote about.

Rob Gibson: As Sir George said earlier, the developed views about these things are valuable and have fed into the Scottish Government. The committee is looking at the legislative consent motion on the Scotland Bill from our point of view in Scotland. Should we take on board this financial conundrum and try to find an answer to it?

Professor Hughes Hallett: Indeed. I would have thought that any legislation needs to have beneath it an evaluation of the consequences. You have to understand that the Scotland Bill is actually considerably different from the original Calman proposals. It has some extra mechanical differences, but it also took some problems out and put some other problems in. It is like Peter with his finger in the dyke: every time you stick your finger in, the water spouts out somewhere else—that is what is happening with the bill. Therefore, it needs proper evaluation, which as far as I know has not been done. It is no good saying that it was done by the Calman commission, because I was in the Calman commission expert group and I know that it was not done. There was a survey of different tax-raising regimes that could be introduced, but no analysis of what the effects on the economy would be—that is missing.

11:15

Rob Gibson: Thank you for that.

The Convener: Does Wendy Alexander want to follow up on that?

Ms Wendy Alexander (Paisley North) (Lab): Yes, I have a few questions on this area for the chairman, Sir George Mathewson.

Sir George, in recommendation 8 of your report you say that the Scottish Government should seek

“to obtain ... tax powers outlined above”.

Did the Council of Economic Advisers request or consider any modelling of the impact of fiscal responsibility on Scotland in the recent past?

Sir George Mathewson: I believe that we did, but I will again hand over the question to my resident expert, Professor Hughes Hallett.

Ms Alexander: I really want to ask the chairman this, because you stressed in your opening remarks the importance of evidence but there is no evidence at all in the report of any modelling of what the impact of your recommendation would have been on the finances of Scotland over the past decade. It seems to me extraordinary that a council of economists that is based on evidence would recommend a transformation in national financing with no modelling of any kind provided. What I am asking is this: did the council request it? Did it look back at all at any of the evidence? Is it willing to share with us that evidence of recent history on which the recommendation is based? Chairman, did the council examine any recent study of how fiscal autonomy would have impacted on Scotland’s finances in the past decade?

Sir George Mathewson: I think that the answer is yes, actually.

Ms Alexander: Will you publish it? You recommend a transformation in national financing for which you say you undertook some modelling against the status quo. Will you publish it?

Professor Hughes Hallett: Sorry for just passing pieces of paper back and forth, but the same question applies to the Scotland Bill.

Ms Alexander: I am well aware of that, and the Scottish Government has published the counterfactual to the Scotland Bill. I am asking whether the Council of Economic Advisers modelled how recommendation 8 would have impacted on national finances in the past decade. If it did, will it publish that modelling?

Professor Hughes Hallett: Yes. I have a PowerPoint presentation on my laptop that will show you some of those calculations. They are based on, for example—you will know this because you have heard it before—the evidence that we have from the academic literature that a devolved system has a certain systematic effect on the growth rate and so on, and on that basis you can calculate through what you would expect to occur. If you want more than that, you had better vote the Council of Economic Advisers a little bit of money to go and employ a modelling team; I can do it, but it would take me a wee while and would be done in my personal time.

Ms Alexander: Let me ask Sir George Mathewson another question. We know that the Scottish Government has had 16 meetings with the Treasury suggesting that we should have full fiscal autonomy, and the Scottish Government has not published any of the modelling whatsoever. I am aware of the many eminent positions that the chairman of the Council of Economic Advisers has held in banking. It therefore seems to me extraordinary, Sir George, that you would suggest a transformation in national financing without undertaking a detailed comparative study of your recommended new model against the status quo, particularly when you state that it will give

“the capacity ... to raise and spend those sums of money”

that

“would most improve the performance of the”

Scottish economy. Was any evidence examined collectively by the Council of Economic Advisers before it recommended obtaining all these tax powers? I cannot imagine that in your banking career you would make a recommendation to transform any aspect of banking without looking at the numbers. I am saying: please let us see the numbers that the council collectively examined before it reached the assumption that this would improve the performance of the Scottish economy.

Sir George Mathewson: I believe that that work was done by Andrew Hughes Hallett and corroborated by his economist colleagues on the council, to support the conclusions.

Ms Alexander: But did anybody on the council say, “Let’s collectively look at the evidence of the numbers”? If not, why have the numbers not been published? We are talking about the most fundamental transformation in the financing of Scotland and there are no numbers.

Sir George Mathewson: I believe that that work was done. Your idea of the depth to which it was done is perhaps different from ours. We can only work within the constricts within which we work, but I am satisfied that the experts on the council were satisfied with the work that was done.

Ms Alexander: But the council did not collectively look back at recent history, the numbers and your recommendations.

Sir George Mathewson: I do not know what you mean by "collectively". We had people on the council who spend their lives doing just that, and we were prepared to believe their recommendations.

Ms Alexander: But there are no numbers.

Professor Hughes Hallett: You do not have the numbers, but you were not at the meeting in St Andrews when we talked about them.

Ms Alexander: So why have they not been published?

Professor Hughes Hallett: Because we do not publish advice to the Government.

Sir George Mathewson: Yes. We advise the Government; we do not produce research papers for general analysis.

Ms Alexander: But you assert that, by obtaining the tax powers, we will obtain the powers necessary to grow the Scottish economy. Let me share just one number with you and invite observations on it. From 1999 to 2009—the period includes peak oil revenues so far in the past year, of course—total tax receipts in Scotland rose by 47 per cent, but total spending in Scotland rose by 94 per cent. That is why the numbers are so interesting. If we moved to full fiscal responsibility, we would have had 47 per cent more tax receipts over the past decade, whereas our spending rose by 94 per cent. I am interested in how that gap might be filled. Are there any numbers? Is there any modelling? Was that issue discussed? Do you recognise the figure? Do you dispute it? It comes from "Government Expenditure and Revenue in Scotland". That is one simple comparison of the status quo with the system that the council has recommended.

Professor Hughes Hallett: There is a difference between the quantity of taxes raised in the geographical area of Scotland—we get into trouble with the North Sea, but if we had fiscal responsibility, we would have control of that—and—

Ms Alexander: I have included the figure for that in the 47 per cent figure.

Professor Hughes Hallett: You have?

Ms Alexander: Yes. The geographic share of oil is 70 or 80 per cent. Tax receipts rose by 47 per cent over a decade and our spending rose by 94 per cent. It seems to me that the council might have reflected on that number in reaching its recommendation. Were such numbers considered? Were any numbers considered?

Professor Hughes Hallett: The Treasury paper from January 2010 has similar numbers. It says that £38 billion and something taxes were raised and £32 billion and something taxes were spent. You can do all sorts of things with the numbers.

Ms Alexander: But we have done.

Professor Hughes Hallett: That possibly means that there was a surplus. There is a distinction between what is raised in Scotland by Scotland and what is raised in Scotland, goes to London and comes back. I will give specific numbers on defence, for example. Scotland's contribution towards defence is £2.8 billion, and the money that is spent on defence in Scotland is £2 billion. That is a particular example, but the figures can be looked at more generally. On the GERS numbers and autonomy, you will find that more taxes are being raised than are being spent in Scotland. That is distinct from what is spent elsewhere on Scotland's behalf.

Ms Alexander: Sir George, we are left with the impression that no numbers were considered by the council in full. Is that correct?

Sir George Mathewson: May I ask you a question? Has the Scotland Bill been put through analysis that is similar to the analysis that you are suggesting?

Ms Alexander: Indeed. One of the difficulties that we are in at the moment is that the Scottish Government has had 16 meetings with the Treasury and has not modelled its own option but is modelling the option that is in the Scotland Bill. I have asked both Governments to help our deliberations by providing us with their numbers, and it is wholly fair for me to ask you to provide me with your numbers. You make a recommendation, and it appears that there was no modelling of any kind.

Sir George Mathewson: No, that is not true.

Ms Alexander: Where is the evidence?

Professor Hughes Hallett: It is in my bag, I think.

Ms Alexander: We are talking about a recommendation by the council as a whole, which has many distinguished economists and other individuals sitting on it. I am trying to probe whether, in advance of reaching that conclusion, the council looked collectively at any modelling of the impact of its recommendation on the financing of Scotland in the past 10 years.

Sir George Mathewson: We were satisfied with the level of analysis that the experts on the council did.

Ms Alexander: Did the analysis that the council considered collectively in reaching its recommendation involve any modelling of its preferred option against the status quo over the past decade?

Sir George Mathewson: Yes, I believe that it did.

Ms Alexander: Will you publish it? We will have to check with other members of the council whether it was presented with modelling of the status quo against its preferred option. We will invite other members of the council to give evidence. Why did you not publish the evidence?

Sir George Mathewson: We never considered that it was to be published. Neither was it considered the council's role to produce published research papers. Its role was to provide advice to the First Minister.

Ms Alexander: I thank the chairman and will leave it at that. I simply say that we are looking not for research papers but for evidence from the Council of Economic Advisers to support its recommendations.

I will ask a final question on a different issue. Economic debate at the moment is dominated by a discussion about how we align a monetary union with a fiscal union, so I am interested in the proposals in the report, which appear to suggest that we should have a fiscal union in Scotland but remain part of a European or, perhaps, United Kingdom monetary union. If we divorced a fiscal union from a monetary union, the entire adjustment burden would fall on the citizens of the fiscal union.

What consideration did the council give to that issue and would the adjustment burden under full fiscal autonomy rest on the citizenry of that fiscal union rather than on the citizens of the monetary union? That seems to me to be the fundamental economic debate at the moment and it would be of great interest to hear what the council's conclusion on that was.

Professor Hughes Hallett: Am I allowed to answer that or is it for the chairman to answer?

Sir George Mathewson: You can answer it.

Professor Hughes Hallett: We did not go into whether it should be the UK or European monetary union. You are perfectly right, Ms Alexander, that, if we continue, the discussion will be about whether to remain part of one monetary union or the other. You are also perfectly right that, in that case, more adjustment has to fall on the fiscal side in each of the component parts of that union.

That is true whether we have the new system or the old. The adjustment used to be done with the Barnett formula. If Scotland moves away from that, it can move to some intermediate position, such as in the Scotland Bill, under which the adjustment—as I explained before you came on to your questions—has to go through the income tax component. Alternatively, Scotland can go to a so-called fiscal autonomy regime, under which the adjustment can happen through any of the taxes that are involved in that scheme. That is why I made the point about diversifying across taxes. It would give Scotland far more opportunity to adjust than it would have under a much more restricted system in which only one tax is available to the Scottish Parliament to operate.

It is true that the European model requires that adjustment. That model lies behind your question on the interactions between fiscal policy, monetary policy and the adjustment on the residual region. I have spent 10 years arguing with the European policy makers that their system is screwed up because they do not have the opportunity to have those interactions. By way of anecdote, about 10 years ago, when Mr Issing was the chief economist at the European Central Bank, I had an hour's private, one-on-one interview with him. He understood the point exactly, and then shook hands on the way out, saying, "I understand what you say, but I couldn't possibly agree because I am a European." It is not that these things are not known but that they do not have any mechanism for dealing with them. It took 10 years for the system to get into trouble.

11:30

There is a whole section in the annual report on the institutional support that is required for greater fiscal responsibility and, among many other things, it includes a grants commission, which would include an economic policy forum in which such problems are discussed. It also includes a cohesion fund and various other ideas that will put back into the system the automatic stabilisers that are going to be missing because, under the proposed legislation, the adjustment possibilities that you want will no longer be there. In the old days under Barnett, London could fix it in any way to make sure that the stabilisers were there. Under the new regime, with 20 per cent income tax up here and 80 per cent down there—or whatever the numbers might be—the 80 per cent will continue to operate as before. However, because Scotland will focus on only one tax, there will be no stabilising opportunities. We do not want to get into numbers at this meeting but, logically, you would need to have a better opportunity to have adjustment and stabilisation. The point is that stabilisation reduces the amount of adjustment that has to be made by fiddling with the tax rates. That regime is a much better bet.

Ms Alexander: I have a final question for the chairman. What was the council's policy intention? Under its proposals for full fiscal autonomy, who would have financed the rescue of the banks in Scotland? What was the policy intention of full fiscal autonomy as proposed in the report?

Sir George Mathewson: Your question is based on a misunderstanding. Where a bank's head office is or ownership lies is not relevant to the discussion of where any supposed bailing out of its creditors must happen. What is relevant is where it is operating and where its business is. Lloyds and the Royal Bank of Scotland had to have Government financing because, without it, the UK economy would have got into unimaginable problems. Basically, the concept of a bank being characterised by where its head office is is an irrelevance.

Ms Alexander: I am asking you about the policy intention of the council on who finances—

Sir George Mathewson: The financing of such an exercise would be done by the UK.

Ms Alexander: So all the tax revenues in Scotland would go to a Scottish exchequer, but the UK Exchequer should pay for the bank rescues.

Sir George Mathewson: No, no.

Ms Alexander: That is what you have just said.

Sir George Mathewson: No.

Ms Alexander: Okay. Explain.

Sir George Mathewson: It would not matter if it was the UK. For example, RBS has a large bank in the United States—

Ms Alexander: I am asking about the UK bank rescue.

Sir George Mathewson: Well, I am choosing to answer the question in this way.

Ms Alexander: Or not.

Sir George Mathewson: I am going to answer this question because I have very clear views.

The bank in the US is regulated in the US and its systemic importance is a US issue. If it has to be "bailed out"—that is not an expression that I like, actually—that should, to my mind, be a matter for the United States. In the case of RBS, 95 per cent of its business is in London. What you are talking about is a bank with a Scottish name with its headquarters in Scotland that is owned globally but whose systemic importance is to what is nowadays known as the UK—to both Scotland and England. As such, it must be recapitalised by the jurisdiction that is systemically affected. Do you understand what I am saying?

Ms Alexander: I do.

Sir George Mathewson: That is very important. Indeed, everyone should be thinking about this issue with regard to the future of banking organisation globally.

Ms Alexander: In that case, who do you think would have been responsible for the bank bailout under the proposals for full fiscal autonomy? After all, it happened less than two years ago. I just want to understand the policy intentions behind the very different system that you are proposing.

Sir George Mathewson: It would depend on the regulation of banks. If, for example, you still had the Financial Services Authority and the Bank of England, the monetary unit for which they are responsible would recapitalise the banks.

Ms Alexander: So your policy intention with fiscal autonomy—

Sir George Mathewson: No, no—we have no policy intention.

Ms Alexander: —is to remain within the UK monetary union with the fiscal burden also remaining with the UK Treasury.

Sir George Mathewson: No. I do not know what the system of regulation or, indeed, what the banking system will be under fiscal autonomy. The same differences arise in Europe. However, there is a contingent liability on the balance sheet of any country or jurisdiction when the banks reach a size at which they pose a systemic risk. It does not matter where a bank is based.

Ms Alexander: I have one final question. Is there any risk—

Sir George Mathewson: I just want to stress that that is a very important issue.

Ms Alexander: Indeed. In light of recent experience in Scotland and more generally, do you think that the proposals for full fiscal autonomy pose any risk to Scotland or pose a risk that too much fiscal adjustment might fall narrowly on the shoulders of just 5 million Scots? Given the scale of Scotland's banking sector, do you see any risk associated with these fiscal responsibility proposals?

Sir George Mathewson: No.

Ms Alexander: Do you see any risk at all?

Sir George Mathewson: No. I really do not think that the scale of the banking sector is relevant.

Ms Alexander: In moving to full fiscal autonomy, you see no risk with regard to the adjustment burdens that might fall on 5 million Scots.

Sir George Mathewson: No, I really do not. It just cannot happen that way.

Professor Hughes Hallett: Perhaps I might interject at this point. You asked for evidence; I point out that there is an international understanding of these things. As Sir George has said, when banks go wrong, bailouts depend on the jurisdictions where they carry out their activities. In that respect and given the distinction that has been drawn between solvency and liquidity, I point out that, on the liquidity side, the bailout for Dexia was shared between Holland and Belgium and for Fortis between Belgium and France. Furthermore, under new legislation in the US, the Federal Bank's liquidity bailouts for RBS and HBOS have just been published and, depending on who you talk to, the figure for RBS is somewhere between $400 billion and $117 billion and the figure for HBOS is $181 billion.

In response to your question about how would this work under the full fiscal autonomy regime if operations were shared between Scotland and the rest of the UK, I think that it would be negotiated through the economic policy forum mentioned in the report. That is precisely why it is there. There would be negotiations between the UK and Scottish authorities and, if a bank elsewhere happened to be involved, the authorities in that country as well. It would not be difficult to arrange such negotiations, although it might be more difficult to arrange the deal.

I also point out that, if all this were to go through, the Bank of England's monetary policy committee, which is about to get the powers of supervision back again, would have a Scottish representative, which would provide an opening in that respect. As a result, evidence exists. However, at the point of writing the report, it was not possible to publish the numbers, because they were not available. They came out only 10 days ago.

Sir George Mathewson: I would like to make something clear to Wendy Alexander. We should understand clearly that it is not a question of Scotland under fiscal independence having to bail out a bank the size of RBS.

The Convener: I have checked the minutes of the ninth meeting of the Council of Economic Advisers, at which the issue of fiscal responsibility was discussed. The discussion appears to have been based on a paper by Professor Hughes Hallett and Drew Scott that was published by Reform Scotland. Is that correct?

Professor Hughes Hallett: Yes, that was the background paper.

The Convener: Was that the paper on which the discussion and the recommendations were based?

Professor Hughes Hallett: Yes. You will find the missing modelling there. It shows that 10 per cent more devolution would lead to an increase of between 0.5 and 1.3 per cent in gross domestic product.

The Convener: It might have been easier if that had been referred to right at the start. It would have saved our asking some questions.

Christopher Harvie (Mid Scotland and Fife) (SNP): I want to deal in general with section B of chapter 3 of your report, which deals with the fundamental transformation that we experienced in mid-2008. Reference has been made to the value of oil production. In the decade to which Wendy Alexander referred, the price of oil rose from $10 per barrel in 1999 to $150 in 2008. It is now heading north of $80, towards $90 a barrel. There is a fluidity that seems, by and large, to be in Scotland's favour, as a producer.

I want to look at your analysis of the present condition of the banks in relation to investment. I will concentrate not on your case study of life sciences, although that highlights various aspects of the issue, but on how the small to medium-sized enterprise element of renewables, by which I mean measures such as retrofitting housing and passive housing, can be developed. The evidence that I have received from people in my constituency—builders, passive house specialists and so on—echoes your reservations about the way in which the banking system has supported that level of enterprise. In the immediate future, what do you see as the optimal situation for a revival of Scottish banking at local level, especially through the putative emergence of a green investment bank in Scotland?

Sir George Mathewson: Competition is always a good idea, but it has suffered over the past several years. The Lloyds-HBOS merger was unfortunate at the time and is still unfortunate; it was not the right deal then and is still not the right deal now. At the moment, there is a low level of banking competition throughout the UK. Because of my past, I have some hesitation in commenting on current banks, as one can imagine, but I seem to see a decline in service levels over the past two or three years. However, I think that those will recover.

I have no doubt that, for medium-sized and quite substantial companies, borrowing is difficult and competition is reduced. We do not always see the ways in which competition can be reduced. When multibank facilities are being discussed, the company sometimes has little choice about where it can go. When loans are being refinanced, fees and new interest rates are higher than those that I have experienced historically.

11:45

We would like an increase in competition. In practical terms in the corporate world, that would not come from creating new banks. It is a long haul and the task is difficult. In the existing structures, I was pleased to see Santander buying RBS branches, because that should provide a strong competitor—although mainly in England—in the medium-sized corporate business, which can only be to everybody's good.

As for funding emerging green industries, that is the same issue as every technology has had since I ever knew anything about business. The issue is probably magnified at the moment because of the risk-averse culture in banks and because banks are under pressure from the Government and themselves to repair their balance sheets.

I cannot see any magical solution. However, in all our various functions, we should attempt to encourage the establishment of different banks in Scotland, by which I mean perhaps Lloyds TSB. I would like a separation of the HBOS and Lloyds merger, purely from a commercial viewpoint. That would benefit Scotland. I do not see the situation being all that easy in the next few years.

Christopher Harvie: I will put to you two observations. I had lunch in the members' restaurant with John Kay, with whom I was at school and university. His view was that, in the existing banking establishment, the banks' immediate finances would be sorted out to maintain their share value and sell them on, but he forecast tears later. We seem to be close to the tearful stage, given the stuff in today's *Financial Times* about the internal politics of RBS, its dependence on the American Federal Reserve and its investments in Ireland. That suggests that we are moving in the direction not so much of competition as of establishment consolidation, with the notion of getting out at a profit.

That is a concern when we consider the other side of the renewables question, which is large-scale capital investment for grids, generation, experiment and so on. I spent a day with Voith in Heidenheim, which is the biggest turbine manufacturer in the world and which still depends on its local banking system. I was struck that Germany's much-maligned local banking system is still a considerable player, because its eyes were focused on the northern North Sea as the place that it wanted to develop. What partnership can one envisage between banking in this country and industrial banking in Europe on that aspect of renewables development?

Sir George Mathewson: I am not optimistic in that area. I am not optimistic about the banks in the UK making new developments in the coming period, because they have so much on their plates to recover from where they are. We are in a genuinely difficult situation, although they will emerge at the end of the day.

Marilyn Livingstone (Kirkcaldy) (Lab): I want to follow on from Chris Harvie's question. As you know, Burntisland Fabrications, which is based in the constituency that I represent, is a world leader on renewables. At our recent business in the Parliament conference, it raised the issue of the gap in Scotland for capital for projects 10 years in advance. That is an issue for that company and, I am sure, for companies throughout Scotland. If we want to keep Scotland's share in the renewables market, such companies need funding 10 years in advance, but it was suggested that there is a gap on that. Has the council discussed that issue and, if so, what recommendations have you made to the Government? The issue was raised with John Swinney on the day of the conference, but what are your thoughts on it?

Sir George Mathewson: We agree that there is a gap, but there has been one ever since I have been in investment, although it has varied in size over those decades. There is perhaps scope for looking to develop other sources for longer-term finance. Lord Smith, who is also a member of the council, is in favour of re-establishing the old Industrial and Commercial Finance Corporation, which was a long-term investor in medium-sized companies—I worked for it at one stage in my career. Such an organisation does not exist today. It evolved into a high-value private equity business, 3i, because the skills were all there and it meant that the people made a lot of money but, previously, it had a mission outwith that of merely making money. Robert Smith might have a point that the UK, and Scotland in particular, could do with the re-establishment of a 3i—or ICFC, as it was in those days—type organisation, to supply long-term funds. However, the ICFC was established from the banks and I wonder whether, in today's world, you would get them to co-operate in that sort of exercise.

I do not know whether Andrew Hughes Hallett has anything to add.

Professor Hughes Hallett: Not really, because you have much more expertise than I have on that, other than to say that it is a generic problem—although perhaps I should not use the word "generic". The issue comes up in the life sciences, too, on which I have made another of my little contributions. In that sense, it is a generic issue. Anything that we could do—in another life, anyway—to review that problem, to suggest ways to get finance, or possibly to get into areas in which finance is not so critical so that you do not fall down so easily, would be useful.

Marilyn Livingstone: I am interested in being kept up to date with anything that happens on that, because it is of interest to the committee. If there is a gap in the renewables sector, that is certainly a worry for us. I used BiFab as an example, but companies throughout Scotland are leading on the technology at the moment. If, as Chris Harvie alluded to, companies in countries such as Germany can get better access to funding than those here, that is a concern for us.

Sir George Mathewson: You have to be a wee bit careful when you make comparisons with other countries. When people make such comparisons, they are, correctly, selective, but if you go to a place such as Germany, you will find people complaining that they do not get the right kind of finance for projects. It is certainly a UK issue and probably a global one.

Marilyn Livingstone: I will move on slightly. We have talked about the restrictions on finance, which I believe are hitting the construction industry hardest. I chair the cross-party group on construction and we are very concerned about the lack of finance, particularly to the SME sector. An issue that the construction industry has raised with me—this has been raised in evidence to the committee—is that the problem for the industry, which is vital to reflating the economy, is pipeline projects. The industry is telling us that it is in crisis now, because the projects that were carried out before under public-private partnerships are now drying up. The industry is very worried about pipeline projects. There are not the projects coming through the Scottish Futures Trust that we or the industry expected. If we use the capital budget for the new Forth crossing, which, obviously, I totally support, and the Borders rail link, and the Scottish Futures Trust does not deliver, the construction industry believes that it will be in serious trouble. What are your views on the Scottish Futures Trust and how we can provide finance to get the pipeline projects, so that we do not lose more and more of our skilled workforce in that industry, because that is what is happening?

Sir George Mathewson: I am encouraged by the Scottish Futures Trust. Things have started to seriously happen there. In my time, I was a supporter of the private finance initiative, but I am afraid that it was to some extent abused on both sides of the contract. It is certainly a very expensive way of doing things. I cannot be specific in answering your question, because it is outwith my knowledge.

Marilyn Livingstone: The problem is that, even if the Scottish Futures Trust was miraculously to get its act together tomorrow and provide funding, there is still a two-year gap by the time things get through planning and companies get projects in. We have a construction industry in crisis, with no pipeline projects. What discussions have you had with the Government on that crucial issue?

Sir George Mathewson: Our discussions on capital projects were pretty well limited to supporting the Government's intentions to accelerate capital projects as much as possible. Part of that was to centralise the planning decisions for large projects. There is evidence that the decision-making process for large projects has improved and is faster than it was.

Marilyn Livingstone: I have to say that I am still very concerned about that issue and I ask you to raise it again with the Government.

I refer to your recommendations in chapter 5, which I have concerns about. There is very little mention—I think that there is only one mention—of Scotland's colleges. The report talks about higher education as if it is the university sector that is delivering higher education in Scotland. In 2008-09, Scotland's colleges had 500,000 students. They deliver a quarter of Scotland's higher education. My college in Fife had 30,000 students in 2008-09, which is crucial to our economy. Anyone reading the report would think that colleges do not play a role. The report is all about the university sector, which I agree is very important. However, if it was not for two plus two in my constituency many people from less well-off backgrounds would not have the opportunity to enter university. Surely if we are looking at the skills pipeline, we have to look at Scotland's colleges. I am quite concerned that anyone reading the report would think that you had not looked at them at all.

Sir George Mathewson: You have a valid point. Obviously, the colleges are extremely important and perhaps will be more important in future. Perhaps we should have spent more time thinking about that.

Marilyn Livingstone: As I say, anyone reading the report would think that colleges were not valued. A different message has to come out of the committee about that today. I just do not understand those recommendations, which ignore 500,000 students and a quarter of Scotland's higher education.

12:00

Sir George Mathewson: Perhaps it is felt that you are doing things right—perhaps the colleges are doing a good job, so we are not recommending any major changes there.

Marilyn Livingstone: It would have been nice if you had said so.

Sir George Mathewson: Okay.

Gavin Brown (Lothians) (Con): The Scottish Government's draft budget for next year proposes a new Scottish tax for large retailers. Was that issue discussed or raised with the council?

Sir George Mathewson: No.

Professor Hughes Hallett: Not specifically, no.

Gavin Brown: Is that something on which you have a view that you are prepared to share?

Sir George Mathewson: We have never discussed it.

Gavin Brown: Fair enough.

Turning to page 28 of your report, I see that your first recommendation is:

> "that the Scottish Government ... asks the OFT to review competition in the Scottish banking market."

The committee had that as one of its primary recommendations, about a year and a half ago. At the time, the Scottish Government did not think that that was the right thing to do and said that it would not do that. My understanding is that Mr Mather, in a debate three or four months ago, suggested that the Scottish Government was now going to request it. I am trying to establish the facts. When you had your meeting to discuss the matter, did the Government tell you that it had already pursued it? Did it tell you that it thought that it was a good idea?

Sir George Mathewson: We discussed that, but as something separate from Government policy and what the Government has done. However, we believe that such a review is what should happen.

Gavin Brown: I thought that ministers attended your meetings. Are any ministers present at your meetings?

Sir George Mathewson: Yes. The First Minister and John Swinney are normally there.

Gavin Brown: So when you were discussing the matter and making that recommendation, did Mr Swinney not—

Sir George Mathewson: I am trying to remember the dates. We recommend something and then ministers come back to us. To be fair to the Scottish Government side, I think that ministers always felt that representations should be made to the UK Government about increasing the level of competition in Scotland, and they were probably wishing to handle the timing delicately, given the principles involved. I do not see any reason why the ministers would differ from us in that view. I think that all of us sitting round this table would agree with the recommendation.

Gavin Brown: That is what the committee thought at the time, so we were surprised when the matter was not mentioned.

Sir George Mathewson: I think that that was a timing issue, but I do not know.

Gavin Brown: On the same page, the report refers to the divestment that will be done by Lloyds Banking Group. You state:

> "This offers the opportunity to create a stand-alone Scottish headquartered bank, should a purchaser wish to do so."

The committee also wanted something like that to happen but, given the size of the divestment, is it likely that there will be a "stand-alone Scottish headquartered bank"?

Sir George Mathewson: You are asking me to comment on something that I perhaps should not comment on. Clearly, I hear both positive and negative things in relation to that world. I have no real idea whether that will happen.

Gavin Brown: Fair enough.

Marilyn Livingstone asked you about PFI. I think you said that your view now was that PFI was an expensive way to do infrastructure. In your view, and from your experience, in what way is the non-profit-distributing model, which is the Government's preferred model, less expensive for the procurement of infrastructure? I think that it has suggested a sum of £2.5 billion over the next few years.

Sir George Mathewson: Fundamentally, the implied interest rates will be less. When I was on the other side of the equation, the deals that were done certainly tended to favour the private sector over the public sector.

Gavin Brown: There is certainly the perception that the initial deals were as you suggest, but do you think that PFI still favoured the private sector in its latter years?

Sir George Mathewson: PFI covers such a wide field, and there are so many different ways of using it, that a general statement cannot be fair or true. Every deal must be looked at on its own value.

Gavin Brown: Okay.

Lewis Macdonald (Aberdeen Central) (Lab): I will take Sir George back to his parting comment to Wendy Alexander, when he said, "Let me make it clear: fiscal independence is not about Scotland bailing out banks the size of RBS." I want to probe that a little further. Clearly, Scottish taxpayers will have paid their due share of bailing out RBS with many millions of pounds. Under your proposals for fiscal independence, as you describe it, would that responsibility be transferred lock, stock and barrel to the UK taxpayer?

Sir George Mathewson: Professor Hughes Hallett explained it. What would happen is that the investment required would be negotiated between the two jurisdictions and would probably be something like 4 per cent from the Scottish taxpayers and 96 per cent from the English taxpayers.

Lewis Macdonald: At the moment, it might be more like 91:9.

Sir George Mathewson: I do not know.

Lewis Macdonald: In essence, you envisage a situation in which fiscal independence halves the liability of Scottish taxpayers for an institution such as the Royal Bank of Scotland. In other words, you envisage a negotiation linked to market share rather than population share.

Sir George Mathewson: That is what it would be like in practice—it would be based on market share.

Lewis Macdonald: So the idea—

Sir George Mathewson: Market share is a difficult concept to grasp. It is a question of whether you are talking about the asset size, the retail base or the deals that are done in London or elsewhere. That issue exists everywhere at the moment—it is difficult.

Lewis Macdonald: In other words, it becomes a matter of horse trading between different Administrations rather than a matter that can be dealt with in a clear, coherent way and as urgently as had to happen at the UK level two years ago.

Sir George Mathewson: No. I do not see why it could not happen quickly and simply.

Lewis Macdonald: In a sense, it sounds more like fiscal irresponsibility. You are saying that we will leave the responsibility for dealing with the macro economy with the UK Government, but we will take responsibility for the tax revenues that we would like, thank you very much.

Sir George Mathewson: I disagree. The important thing to understand from this discussion is that the key is not where the head office and ownership are but where the business is done—where the systemic problem would arise.

Lewis Macdonald: Clearly, you have personal experience and insight but, in that sense, the idea that the Royal Bank of Scotland is a Scottish institution is simply delusional.

Sir George Mathewson: Yes.

Lewis Macdonald: That is very interesting, considering your perspective.

Sir George Mathewson: RBS has a long history of being a Scotland-based institution. It has a value because a disproportionate number of staff are in Scotland compared with the spread over the UK as a whole, but it is owned and now functions globally. In today's world, characterising any institution by where the head office is located is misleading at best.

Lewis Macdonald: That is interesting. We had a discussion earlier during which Wendy Alexander tried to find out the numbers on which you based your recommendations. I was interested, perhaps in a technical sense, to understand where the number that Professor Hughes Hallett mentioned as being Scotland's contribution to defence—I think he said that it was £2.8 billion—came from. Could you explain briefly how that sum is reached?

Professor Hughes Hallett: It is from the Government economic service. If you ask what the numbers are—

Lewis Macdonald: It is the GES's analysis of the tax take.

Professor Hughes Hallett: It is the GES's analysis of the tax take that goes down to London for those services, plus its analysis of what is spent in Scotland.

Lewis Macdonald: Those are the same raw material numbers that you would use for all the calculations that have informed your judgments on these matters.

Professor Hughes Hallett: Up to a point, yes, but if you want to go further into what was earlier called the modelling, that is not done by the Government economic service. It is in academic exercises that trace through what has happened in other countries that have been through this kind of system.

Lewis Macdonald: But one starts from the basis of Government economic service figures such as those that have been provided on defence spending and revenue—

Professor Hughes Hallett: In principle, yes.

Lewis Macdonald: And one uses the GERS figures.

Professor Hughes Hallett: Yes. That is what you would have to do in this case, if you were going to do it with each individual item.

Lewis Macdonald: Do you accept Chris Harvie's point, which seemed to question something that was said in your introduction, that North Sea oil revenues over the past, say, 12 years have been far more volatile in real terms than income tax revenues for the UK Exchequer?

Professor Hughes Hallett: The variability is high, but the numbers are smaller, so the impact on the budget is not quite what you say it is. The risk has principally been on the upside, not on the downside. That is to say that it has clicked up and what goes up has to come down. The oil price is around—correct me if I am wrong—$90 a barrel, and most people will tell you that the production costs are somewhere around $80 a barrel plus, so the capacity for the price to go down is very small, whereas there is capacity for the price to go whizzing up, especially if there is a problem somewhere in the world. From Scotland's perspective, the risk is therefore a risk that you might get a windfall gain; there is not a risk that you will get a loss. Income tax, as you can see, is dropping, so the risk there is on the downside.

Lewis Macdonald: As a representative of Aberdeen, I have to say that the notion that you can safely predict that the oil price will never go down is a bit reminiscent of what has happened in the banking sector in recent years.

Professor Hughes Hallett: If you want to predict that these oil companies are going to go out of business, that is fine.

Lewis Macdonald: I think that it is an important point, though, because oil revenues in 1999-2000 were a good deal less than they are today. Such volatility can, as we have seen in other sectors, go in both directions.

Professor Hughes Hallett: By the same token, income tax revenues were a good deal less in 1999 than they are today.

Lewis Macdonald: But they are not volatile.

Professor Hughes Hallett: Oh yes they are.

Lewis Macdonald: Not to the same degree, surely.

Professor Hughes Hallett: In pounds terms, they are pretty volatile, and they go both ways. The problem is on the downside each time.

Sir George Mathewson: Professor Hughes Hallett's point is that production costs have gone up, which in effect reduces the downside volatility.

Lewis Macdonald: There is a quite simple outcome. As we know from 1999, if production costs exceed revenue costs for an oil company, it stops producing oil in the North Sea. The oil companies can all do that, because they are all global companies, so there is no certainty at all about future increases.

Professor Hughes Hallett: But you seem to think that the price is not determined in the market. It is a global market, so the prices are in the market. It is not that the price goes down and I go out of business. The point is that if the price threatens to go down, I reduce supply and that means that the price goes back up, so we do not get into the problem that you describe.

Lewis Macdonald: I am interested in your analysis. My analysis is that if I am an oil operator and the price goes down, I produce from cheaper oil fields in Africa and I leave the North Sea well alone until the price goes up again.

Professor Hughes Hallett: The point that I am making is that the oil fields in Africa are not cheaper, because they are deepwater oil fields.

Lewis Macdonald: Some of them are, as I am sure you know.

Professor Hughes Hallett: That is right, so that is half the market. There you go.

Lewis Macdonald: The point here, though, is whether you accept that oil prices are volatile and that oil revenues are therefore volatile and cannot be predicted with certainty. Income taxes can clearly be predicted with a degree of certainty in the sense that we can predict the trend, but oil is surely much more volatile.

12:15

Professor Hughes Hallett: I can predict the trend, or rather, I can see what has happened in the past. Over the past 10 years, the forecast errors on average have been 1.1 per cent of the revenues, with a variation of +7 per cent to -4 per cent. That is a sufficiently bad record that people have to think about how to do it. The variation may have a considerable effect on the forecasted revenues and hence the expenditure side. If you are forecasting income taxes with an upward bias, which this one has had, that means that too much is being taken off the grant element in the brave new world. There are big problems there. On average, you cannot borrow against that.

Lewis Macdonald: It is interesting, and I guess there will be much discussion around that going forward.

Professor Hughes Hallett: The capacity for uncertainty in this sort of thing is practically infinite.

Lewis Macdonald: My point is that the capacity for uncertainty is very marked in the oil sector, particularly in a mature and high-cost province such as the North Sea.

Professor Hughes Hallett: But in the context in which the question comes up, one can diversify across different revenue sources.

Lewis Macdonald: Okay. I will move on. Like Marilyn Livingstone, I was taken by a few points on education in chapter 5 of the report, and I want to ask you about two in particular.

Paragraph 5.30 states:

"One possible policy suggested by the Council would build on the strengths of the standard four-year honours degree ... by considering a two-tier approach ... with the first two years resulting in a broad, stand-alone qualification and the second two years providing an additional, specialised qualification."

That is an interesting concept. Could you expand on it a little in terms of what the two different qualifications might look like for people who graduate at those two stages in their higher education?

Sir George Mathewson: In my view, the first two years would be sufficient to give a general education, and the next two years would focus in. Some people would say that four years for a general education is too much, and the first two years might be more equivalent to an American BSc degree. Four years is perhaps not right for everybody who goes to university.

Lewis Macdonald: Again, I will refer to an oil industry example. Somebody might qualify with a degree in maths or physics and want to acquire an additional competence in some form of engineering—petroleum engineering or petroleum geology, for example. Would the proposal be relevant to that? Does the person who completes the two-year general education qualify with a degree? Will that degree be taken seriously by employers, or would the course simply be a generalised two years, after which people would require an additional specialised qualification in order to make it meaningful in the labour market?

Sir George Mathewson: We have to recognise that many graduates do not have a specialised qualification after four years. If someone wants to do an honours degree in engineering, that is one thing. If they want to gain a general technological background, after which they have the option of specialising in oil engineering or whatever, that is something else. The concept is about offering additional flexibility in the system, and I feel that it is worth looking into further.

Lewis Macdonald: It is an interesting proposition. I am just slightly unclear as to whether a person who completes their education with only that two-year qualification would have something that was of any value in the market.

Sir George Mathewson: Yes.

Lewis Macdonald: What would it be? Would it be a university degree?

Sir George Mathewson: Yes, it would be a degree. The final two years would be an honours degree; the first two years would be a pass degree.

Lewis Macdonald: My concern is that you might unintentionally create a lower-value, lower-status two-year degree. Where would that stand?

Sir George Mathewson: But the person would always have the option of going on, if he was up to it.

Lewis Macdonald: Thanks for that. My final question is on recommendation 15, which is overleaf in the same chapter. You recommend that the Scottish Government should give

"fresh thought to involving university students and their families directly in carrying the costs of Higher Education, preferably through a system of deferred payments. The alternative ... is likely to be unsustainable financial pressures".

I would be interested to hear you expand on both the kind of deferred payments system that you have recommended to ministers and on your concern if they do not follow that advice.

Sir George Mathewson: As we know, the Scottish Government will produce a paper on Thursday.

Lewis Macdonald: I am not asking you to reveal what will be in the Government's green paper.

Sir George Mathewson: I do not know. It is important for you to realise that we do not know. We do not take part in designing policy.

Lewis Macdonald: No. Absolutely.

Sir George Mathewson: The feeling within the council was, first, there is a financial problem; and, secondly, if everybody got everything free, that might result in a devaluing of further education and people might not appreciate further education. It was felt that some level of commitment—not even necessarily financial—is a good idea. We did not go through all the different methods that can be envisaged to provide that commitment; we will have to wait and see what the Scottish Government comes up with.

Lewis Macdonald: You do, however, state your preference for a system of deferred payments. Can you say a little more about the system of deferred payments that you have in mind?

Sir George Mathewson: Deferred payments could mean anything from graduate tax to all sorts of different mechanisms. I really do not know what methods the Scottish Government will come up with but, one way or another, the financial problem must be solved. We all agree on that.

Lewis Macdonald: I understand that you do not know what will be in the green paper. If you did, I would not ask you to tell us in advance of the minister's announcement of it. However, I am interested in what the council—

Sir George Mathewson: We did not recommend specific ways of doing it.

Lewis Macdonald: Okay, but you discussed the matter and came to the view—

Sir George Mathewson: We discussed the matter, but there was not tremendous unanimity around the table at the council about it. It was felt that some evidence of commitment and contribution was sensible.

Lewis Macdonald: I would like to understand it a bit better, as I am sure that you would not have stated in a published report that you would prefer a system of deferred payments unless you had had some discussion about what that might look like.

Sir George Mathewson: We would prefer a system of deferred payments in as much as we do not believe that it is practical to have a system without deferral. We were certainly not recommending that all students should have to pay up front.

Lewis Macdonald: You considered the option of up-front tuition fees as against some form of deferred payment and came to the collective view, after discussion, that a system of deferred payments was the preferred option.

Sir George Mathewson: Yes.

Lewis Macdonald: That is helpful. You have spoken about the person's individual commitment but, in your recommendation, you also speak about the "unsustainable financial pressures" that might follow if there is no such contribution. How important is that to Scotland's economy?

Sir George Mathewson: We believe that the universities are enormously important to Scotland economically, intellectually and in every way. Any mechanisms that are found for the future should not only fund the universities but do so in a way that allows them to improve their status globally. Certain ways of funding certain things could have the opposite effect. We believe in the importance of the universities.

Lewis Macdonald: You are clearly concerned about what will happen if no proposition comes forward. What are the "unsustainable financial pressures"?

Sir George Mathewson: We are concerned about what will happen if there is no way of financing the future. That is slightly different from no proposition coming forward for students.

Lewis Macdonald: Which implies that perhaps the status quo—

Sir George Mathewson: We recognise that there is a financial issue. We are saying that it must be solved one way or another.

Lewis Macdonald: It is implicit in what you have just said that the status quo is not a solution. Is that correct?

Sir George Mathewson: It would seem not to be a solution because of the financial position that has arisen over the last period.

Lewis Macdonald: Thanks very much.

Stuart McMillan (West of Scotland) (SNP): I have a few quick questions, the first of which is for Professor Hughes Hallett.

At the beginning of your comments, you made the statement—if I am correct—that, if the OBR projections were correct, that would have a negative effect on budgets.

Professor Hughes Hallett: It would not have a negative effect. Whether they are correct on average is not the issue. Volatility is the issue that we talked about earlier. Without the ability to borrow, there are no stabilisers in the system at all, if the projections are correct. If they contain some mistakes, it depends on which side those mistakes are made, but if they are correct on average, that means that every time revenues go down because of the economic situation, spending has to go down—full stop; and vice versa if revenues go up. You can see that that would inject some volatility into the system that would not necessarily otherwise be there.

Stuart McMillan: You have clarified that point.

The Scottish Government has provided some analysis that says that the measures in the Scotland Bill would have meant cuts to the Scottish budget of some £8 billion since devolution. Do you recognise that figure? Do you think that it is accurate? What effect do you think that the proposals in your report would have had over the past 10 years?

Professor Hughes Hallett: That figure is probably about right. I have not done the calculations—they were done by the Government economic service. I have the relevant piece of paper, which I took from the website. You have to realise that the £8 billion is a cumulative figure; it is not for a single year. There is a deflationary bias because the income tax component would have grown more slowly over the relevant period—that is why there must be a deflation in the amount of revenues that would have been available. If you accumulate that over the time, that is what would happen. I do not know whether the figure would be £7 billion, £8 billion, £9 billion or whatever. It is possible to obtain figures for individual years. If you look closely at the information, you will find an individual year in which the situation was the other way round. If you think about it, that is bound to happen any time that a country comes out of a recession because, when that happens, incomes are the first thing to recover, whereas Government cuts that are made at the start of a recession will continue for longer. The situation will reverse for a single year, but systems are not planned on the basis of a single year. It is necessary to see what the accumulated effects over a period of time would be. That is where the £8 billion figure comes from.

If I go home and get my pocket calculator out and do the same calculations over, say, a 10-year period, I will come up with the same sort of argument but a different number. The figure will be larger if I do the calculations for 10 years into the future rather than for the past 10 years. The argument is not about the size of the number; it is about the mechanics of what is going on.

The Convener: I have a few concluding points. An issue that has come up quite a lot is the fact that the discussion that the council had was based on the paper by Professor Hughes Hallett and Drew Scott, but if there were any additional background papers for that, would it be possible for those to be made available to the committee? Any modelling that was done on the status quo compared with what the council proposed or, indeed, with the Calman commission proposals, which were also referred to in the discussion, would obviously be helpful.

Sir George Mathewson: We will have to discuss that. I do not quite know what the protocol is.

Professor Hughes Hallett: Personally, I do not mind, but what the council thinks is another matter. You can have all my papers on the subject, which are legion.

The Convener: Basically, the committee is interested in knowing the basis on which the council reached the conclusions that it did. It would be helpful if you could let us know whether it did so on the basis of Professor Hughes Hallett's paper alone or on the basis of Professor Hughes Hallett's paper plus additional background modelling.

Professor Hughes Hallett: It would also be a good idea to put out what happened in the Calman expert group, which was a precursor to all that, but that is not possible.

Sir George Mathewson: Why is that not possible?

Professor Hughes Hallett: Because I am not allowed to say anything. I have the e-mails.

The Convener: That is outwith our remit. We are looking at the report that you have produced, the recommendations that you have made to the Government and the basis on which they have been made. That is what we are trying to get clarity on.

Finally, just out of interest, what do you consider to be the council's long-term role, given that the First Minister has appointed Joseph Stiglitz as his special adviser on economics and that he already has Dr Andrew Goudie as his chief economic adviser and the Cabinet Secretary for Finance and Sustainable Growth, who has responsibility for the economy. What are the roles of all those people who are involved in giving advice to the First Minister?

Sir George Mathewson: The council has stood down. This is our last appearance as members of the council. There is an election in May and it is up to the First Minister, whoever that may be, to decide whether he wishes to formulate a council or something equivalent or similar. We have no understanding of what the future will hold in that regard.

The Convener: I thank Sir George Mathewson and Professor Hughes Hallett for coming along and answering our questions. We wish you luck in the future.

Meeting closed at 12:31.

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