



The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 12 January 2011

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Wednesday 12 January 2011

CONTENTS

	Col.
UNITED KINGDOM ENERGY POLICY	4567
ENTERPRISE NETWORK INQUIRY	4585

ECONOMY, ENERGY AND TOURISM COMMITTEE

1st Meeting 2011, 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 Robert Crawford

Rt Hon Chris Huhne MP (Secretary of State for Energy and Climate Change)

Professor Donald MacRae

Phil Wynn Owen (Department of Energy and Climate Change)

Steve Thomson (Highlands and Islands Enterprise)

CLERK TO THE COMMITTEE

Stephen Imrie

LOCATION

Committee Room 1

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 12 January 2011

[The Convener opened the meeting at 09:52]

United Kingdom Energy Policy

The Convener (Iain Smith): I welcome everyone to the first meeting of the Economy, Energy and Tourism Committee in 2011, and I wish you all a happy new year. It is the final term before the election, but I am sure that the committee will continue to work in the co-operative way that it has worked throughout the past three and a half years.

We have two items on today's agenda. For the first item, I am pleased to welcome the Rt Hon Chris Huhne MP, who is the United Kingdom Secretary of State for Energy and Climate Change. He is running a little late thanks to the vagaries of British Airways or BAA.

We are a little short of time as the secretary of state has to leave by about 10.40, so I ask members to keep questions brief to give all members an equal opportunity to ask questions. I invite Chris Huhne to introduce his supporting cast and to make brief opening remarks before we move to questions.

Rt Hon Chris Huhne MP (Secretary of State for Energy and Climate Change): Thank you very much. I am here with Phil Wynn Owen, who is the senior director general in charge of our flagship programme on the green deal and many other parts of the department. I offer many apologies for starting late—I am afraid British Airways seems to have it in for me at the moment. Fortunately, I am not quite as late as I was in getting to Cancún, when it managed to delay the flight for a whole day. Nevertheless today's delay has meant that I am late for you.

I will, if I may, cut my opening remarks as short as possible to give you more time for questions. I am delighted to be here—Scotland is a key part of our ability as the United Kingdom to deliver on our energy ambitions.

We have four key pillars to our energy strategy. The first, and perhaps the newest and in many ways most important, is to put energy saving in pride of place as part of our energy policy. All the evidence shows that the cheapest and quickest way to cut the gap between energy demand and energy supply is not to use energy in the first place.

We have—Phil Wynn Owen is responsible for it—the most ambitious and comprehensive programme of energy saving of any of the G20 leading industrial nations. We have been working closely with the Scottish Government on that, because it is a devolved responsibility. We have been delighted with the amount of co-operation, and I am pleased that we have had a good relationship with John Swinney on the matter. We have managed—I hope—to reach a situation in which we can have a genuinely UK-wide set of changes that will make a dramatic difference.

The other three elements of our energy strategy all involve energy production. We believe that there could be a substantial increase in electricity demand in the period to 2050, as we move to a vision of an economy that is increasingly fuelled by electricity—including, for example, our vehicles and the residual heating in our homes. There could easily be a doubling in our electricity demand, so ensuring that the electricity is coming from low-carbon sources is a key priority.

We have three pillars to the overall strategy, one of which—the nuclear element—does not apply in Scotland. We have a clear commitment to a dramatic increase in renewables, to new nuclear and to what is perhaps the most important and exciting potential development: carbon capture and storage. That last commitment has enormous implications for Scotland, as Scottish Power at Longannet is the remaining bidder for the £1 billion of UK funding for carbon capture and storage.

I attribute an enormous part of the success that our department has had in ensuring that we got the funding for carbon capture and storage out of the public expenditure round to the fact that we were able to demonstrate the clear lead in the science that the UK has by looking at the publications on CCS in peer-reviewed journals. I pay tribute in particular to the researchers at the University of Edinburgh, which is the leading institution in research on CCS. That is a very significant matter for Scotland.

At this point I will shut up and let you get on with questions.

The Convener: Thank you for those opening remarks. I will begin by asking you about the energy saving side, because I have raised that—as members of the committee will be aware—as being one of the key issues in energy, which is as much about reducing demand as it is about how much we produce. I refer to heat in particular, because it is sometimes forgotten that while we talk a lot about electricity reduction, heat accounts for 50 per cent of our energy use. Perhaps you can explain a bit more about what the UK Government is doing and how it is working with the Scottish Government to promote the reduction of energy use, particularly in terms of heating.

Chris Huhne: The renewable heat incentive was a key priority for our department in the comprehensive spending review. We got a good settlement, and we will come forward with details on the incentive through the course of the year. We agree with your analysis, convener, that heat must be a key part of meeting our renewables targets, including the target of a 15 per cent reduction in emissions by 2020 and our greater ambitions further on.

As you said, nearly 50 per cent of carbon emissions come from heat. In many cases there are technologies for providing renewable heat that completely bypass the electricity generation process—well, not completely, as we need electricity to run them. The obvious ones are air-source heat pumps, ground-source heat pumps and solar thermal energy, which will be available for support under the renewable heat incentive.

We have worked closely with the Scottish Government on that and look forward to having a scheme that is as joined up as possible.

10:00

The Convener: The green deal relates to home insulation, in particular. Can you expand on what is proposed and the timescales for developing the green deal?

Chris Huhne: In the green deal we want to focus on insulation, because in many ways that should be the sine qua non of everything else. It is a bit crazy to slap a solar panel on a house or to put in a ground-source heat pump if you have not done the basics of energy insulation. In many ways, the green deal is the foundation of what we need to do.

I characterise the green deal as having two elements. The first is to ensure that the energy savings that flow from a major and holistic energy-saving package that is installed and retrofitted in a home can be paid for not just by the existing homeowner or tenant but by the next one. That will allow the private sector to provide most of the funding for the improvements, as it will be able to recoup its investment not just over the period of the existing tenancy or the existing owner-occupier's time in the property but over the life of the improvements. There was a broad measure of cross-party support for that approach. Although my party, the Liberal Democrats, was the first to come up with the idea, I am delighted that it was one of those that were pinched pretty rapidly by the Labour Party and the Conservative party. In this area, there is a substantial degree of cross-party consensus, which includes the Scottish National Party.

The other side of the green deal, which is different from what has gone before and has not

really been recognised, is the level of ambition. We are trying not merely to do energy saving in the way in which it has been done before, with a bit of extra loft insulation here and a bit of cavity wall insulation there, but to conduct a survey of each home that is likely to be with us in 2050, to ensure that we come up with a specification for energy insulation that will make that home fit for purpose and consistent with our clear statutory obligations to bring about an 80 per cent reduction in carbon emissions nationally by 2050. Inevitably, that means that we are looking to go into each home once; we do not want to have to go back in in 10 or 20 years, especially given the amount of hassle that is involved for householders. We really want there to be a one-off retrofit for each home.

The consequences of that level of ambition, which I do not believe has been matched in any other leading industrial country, is that we will create a very substantial new industry. At the moment, the energy insulation industry employs about 27,000 people. We calculate that, as it ramps up to provide the green deal and to retrofit our existing housing stock, it will eventually employ about 250,000 people. What is really significant about the industry is that it will be active everywhere in the UK. It will have no national or regional bias, because our homes exist everywhere in the UK. The green deal will be a significant programme that will support small businesses in particular, and the construction industry. It will have a dramatic effect, as it will absorb a substantial number of people who might otherwise be unemployed. There will be substantial economic implications as well as the obvious implications for energy saving, climate change and our energy security.

One of the interesting things about the green deal is the question of who is paying for it. Under the ECO, or energy company obligation, substantial subsidy is going first and foremost to those in fuel poverty, and also to those with hard-to-treat homes, such as homes with solid walls where we would need either external or internal solid-wall insulation. To the extent that the overwhelming majority of that is being paid for by private sector funding, what is actually happening is that it is being funded from energy savings that are being made by cutting our import bill. You could argue that the green deal is actually being funded by the gulf oil and gas producers that would otherwise be sending us oil and gas. It is a pretty good programme for boosting the UK economy.

Phil Wynn Owen (Department of Energy and Climate Change): You asked about the timetable. Perhaps it would be helpful if I laid out a few of the key milestones for this Parliament and the UK Parliament.

We have primary legislation in train in the UK Parliament at the moment. The Energy Bill has at its heart the green deal clauses. I think that this Parliament will shortly be considering a legislative consent motion from the Scottish Government, on which we have worked closely with Scottish Government officials. We hope to get royal assent for the bill by next summer, subject to the vagaries of Parliament. We will then proceed to secondary legislation, which will fill in a number of the details of the scheme. We plan to introduce the green deal, which will be private sector led, with suppliers from autumn 2012. As Chris Huhne said, a new energy company obligation will be introduced at the start of 2013, which will be designed to underpin and support the green deal.

We plan to review the workings of the green deal after a year, not least in order for the secretary of state to decide whether to trigger the powers on the private rented sector within the bill, where again we have worked carefully with Scottish Government officials to ensure that we respect the existing powers relating to Scottish property law and so on, so that the Scottish Parliament can choose which way to go on that issue.

Chris Huhne: I will add something on that. In Scotland you have greater powers than will be the case under our legislation to prod the green deal into action. I hope that we could set up a friendly competition to see who can get there first. That would be good news for all of us.

Rob Gibson (Highlands and Islands) (SNP): Good morning, secretary of state. Your ambition is welcome. Our particular ambition for the development of renewables helps Scotland, Britain and Europe in our strategic needs. Key to getting that money early is the release of the fossil fuel levy, which has become tied up by Treasury rules. Is there any way that it could be released early, given that it is clear from the discussions in the Treasury that it is prepared to release it in three years in a different form?

Chris Huhne: Having been through the spending review, I can sympathise with Rob Gibson's implicit comment on Treasury rules.

As you know, that is a matter for the Treasury, I am afraid, and not for the Department of Energy and Climate Change. We were very clearly committed in the coalition agreement to making available the fossil fuel levy. As I understand it, the Chief Secretary to the Treasury, Danny Alexander, has stated that a quarter of the money that has been allocated for the green investment bank in 2013-14—in other words about £250 million—will be ring fenced and earmarked for Scottish use. Clearly, the full amount that will be available will depend on the exact structure and form of the green investment bank. I would like it to be very

clearly a bank, my common-or-garden definition of which is something that borrows and lends.

If the £1 billion of capital that has been allocated to the green investment bank is taken together with the capital that we hope to find from the asset sales that we are considering—for example, sale of the URENCO company, which is in DECC—we could have capital of £2 billion, which, in extremis, could support lending to green projects of up to £100 billion. In other words, we would be looking at a multiple of the capital figure as far as its impact on Scotland was concerned.

The design and phasing of the green investment bank must meet Treasury concerns about our fiscal credibility and contingent liabilities for the British taxpayer and so forth but, as I understand it, the commitment that Danny Alexander has made—with the approval of the Treasury, obviously—to ring fence that money is clear. In effect, that is how we will meet the coalition commitment on the fossil fuel levy.

Rob Gibson: I understand that, and I welcome the partial help that those arrangements will provide, but because of the financial structures and strictures under which we work in Scotland, the development of renewables will be stalled for three or four years, which cannot be good for our overall carbon reduction targets. I suggest that we need to receive better news on that from London, because the present arrangements will not help at all in the interim period.

Chris Huhne: The way I think about the financing constraints and the green investment bank is that it is clear that we can provide substantial incentives for renewables through existing mechanisms such as the renewables obligation certificates or through our proposals on electricity market reform and the contracts for difference. The way I think about the green investment bank, in particular, is that it is a way of releasing particular blockages in the private commercial financing system for low-carbon projects.

As an economist by background, my view is that the argument is about what is the most effective and cheapest way for the British taxpayer and energy consumer to get the level of investment in low-carbon electricity generation that we need. In my view, if we were to go down the route of incentivising that only through our means—whether through ROCs or contracts for difference—we might have to pay a substantial extra subsidy to get around the blockages in private financing. The argument for the green investment bank is that there are market failures in private financing that we can release.

However, I think that it is more important that we get the green investment bank right than that we

get it quickly. If we can get it quickly and get it right, that would be the best of all possible worlds, but we are looking at financing a transition that will take place over decades. I do not think that many people realise not just the scale of the investment, but the timescale that we are talking about. If we are to decarbonise the power sector, that will go on well into the 2030s. An awful lot of other major projects, such as high-speed rail to Scotland, might benefit from the green investment bank, so I want to get the institution right. If that means getting it there in 2013-14 rather than getting it there this year, that is what I would prefer to do, because we are talking about a process that will be a long haul.

10:15

Phil Wynn Owen: Again, it might help if I chip in on the timetables. Government-published business plans aim for completion of the design and testing of the green investment bank concept by May of this year. Vince Cable's department—the Department for Business, Innovation and Skills—has in its business plan a target date of September 2012 for the green investment bank to be operational. If that happens, it could be investing much earlier than 2013-14, for instance from the potential proceeds of Government asset sales. We may not need to wait the full two and a bit years until 2013-14 to see the green investment bank going live.

We are keen to see Treasury and Scottish Government officials sit down together to discuss the fossil fuel levy and the potential investment in Scottish renewables, which are important to our and your plans. The Treasury has offered such discussions; it is the lead on that.

Rob Gibson: So, ultimately, we have to wait and see. In the meantime, while we are talking about 2013 and so on, we are talking about attempting to meet carbon reduction goals by 2050—indeed, by 2020. Surely, the delay of two or three years means the kind of lack of early spending that Opposition parties here have criticised the Scottish Government for, because we do not have money to do it.

Chris Huhne: The green investment bank is not—

Rob Gibson: The fossil fuel levy is.

Chris Huhne: The fossil fuel levy and the green investment bank are not the only tools that we have available to us. Obviously, it would be nice if we could get the green investment bank operating this year, but we have a lot of other mechanisms, including ROCs. We are determined to be the fastest-improving country in Europe on renewables, for the simple reason that we start so far back. We are 25th out of 27 European Union

member states—that is the legacy that we have inherited as a Government—and there is only one way to go. The only two European Union member states that have a worse record than us are Malta and Luxembourg, which is pretty shocking.

Rob Gibson: It is indeed.

Lewis Macdonald (Aberdeen Central) (Lab):

To start on the topic that Rob Gibson finished with, can you confirm that the current proposal is that, when the fossil fuel levy is released to the green investment bank, it will be offset by a reduction in the Scottish consolidated fund?

Chris Huhne: I think that you need to talk to the Treasury on the details of how everything will work, because it is not my departmental responsibility. However, as I understand it, the proposal is that a quarter of the money that the Treasury has earmarked for the capital of the green investment bank will be ring fenced for Scotland. In effect, that is the Treasury's way of fulfilling the commitment to ensure that there is money to match the fossil fuel levy. As I understand it, under Treasury rules, the Treasury regards fossil fuel levy money not as money that can be spent—the spending totals are determined separately—but as a means of financing the money that can be spent.

Lewis Macdonald: In other words, under the current Treasury rules an offsetting provision would be required on the other side of the budget.

Chris Huhne: With the solution, the Treasury appears to be benefiting enormously from the fungibility of money, which is something that I remember encountering as part of my banking studies a long time ago. The point is that you can find a pot of money from somewhere else and come to the same conclusion.

Lewis Macdonald: One concern has been alluded to in reference to the pace of development on ports infrastructure, which is critical this year and next year in order to exploit offshore wind opportunities in particular. The previous UK Government postulated in its last budget a £60 million fund for the UK, and I understand that your department's decision has been to focus that fund on England alone. Is that correct and, if so, what is your proposition on how Scotland can compensate for loss of access to that fund?

Chris Huhne: We obviously have to take legal advice on what our powers are and what we can actually do. There are two elements on the powers. First, the fund is industrial support, which is a devolved matter. We took the position from the point of view of our responsibilities that it would be trespassing on your terrain if we were to extend the scheme north of the border.

The second legal constraint under which the Scottish Government and Parliament and Westminster labour is, of course, the European state aid rules. However, I was delighted that the Scottish Government found £70 million for port development in Scotland, because that allows us jointly to go to potential foreign investors and show that there is even more than we originally hoped for in the joint pot, and we will be even more attractive than we would otherwise have been in seeking to get those investors in. As a result of that, we have had a lot of interest. We have had expressions of intent from GE Energy, Gamesa and Siemens so far, and when I was in Beijing recently with the Prime Minister I had expressions of interest from two Chinese offshore wind companies about the possibility of manufacturing in the UK.

I am firmly of the view that we will develop a substantial manufacturing capacity and that it will be a key industry for us, so I very much welcome what the Scottish Government has done on that.

Lewis Macdonald: That is helpful.

What about the electricity market reform that you have proposed in recent weeks?

Chris Huhne: It is a consultation; it is not a firm proposal. We will consult on the consultation document that we have published, and we aim to come forward with a white paper that sets out our firm proposals. In talking to the First Minister about the matter, I was clear that we really are consulting. We want the Scottish Government's views and we will very much welcome the views of the committee as well.

Lewis Macdonald: Thank you for that. My understanding of the principal model on which you are consulting is that it involves the abolition of ROCs, which you mentioned in a couple of previous answers. As the existing mechanism for stimulating renewables development, ROCs have been effective throughout the UK, but in Scotland we have had the additional benefit that we have been able—on a cross-party basis—to vary ROCs for different technologies where that has been helpful. I presume that, before proposing the abolition of ROCs, you talked to the renewables sector about the issue. What was its response to the proposal?

Chris Huhne: The main trade body in renewables has expressed concerns about a change in the system, but my soundings suggest that, among those who are in favour of and are pushing renewables, there is a substantial amount of support, the more they look at the potential proposals.

I should clarify that we are consulting on whether there should be a parallel system, so ROCs might not be abolished. I suppose our

preferred proposal is for ROCs to be grandfathered and then phased out by 2017, but an important part of the consultation document, as you will no doubt have seen, is our determination to ensure that there is no gap for people to fall through between any change of regime.

Perhaps I can explain why we think that contracts for difference—in particular, the feed-in tariff with contracts for difference—will be an advantage for renewables compared with ROCs. Speaking as an economist, I argue that what contracts for difference give an investor in renewables that ROCs do not give is security of price. Contracts for difference effectively guarantee a price for the electricity that is produced by an offshore wind farm, for example, whereas with ROCs, we cannot guarantee that. We can make an assessment and a forecast, but it is not as certain as guaranteeing a price. As we move forward into the major expansion of our low-carbon generation, in order to ensure that the British energy consumer and taxpayer have the best possible deal, we will want to run a Dutch auction so that we get the contracts for difference guaranteed price as low as we can in delivering what we want to deliver.

However, the point remains that the move will assure investors by removing an existing risk in the ROCs regime. As a result, it should have two effects: first, it will encourage investment simply because there will be less uncertainty about pricing; and secondly, it should reduce the cost of capital. After all, if there is less uncertainty, commercial lenders ought to be prepared to lend at a cheaper rate to investors than they would otherwise. We believe that there are potentially substantial economic advantages for renewables in having the extra certainty that is implied by the feed-in tariff and contracts for difference compared with the ROCs regime, and I very much hope that in my meeting later with one of Britain's best energy economists—who, I gather, is doubling up as the First Minister at the moment—I can persuade him that this is good news for Scotland. I certainly have a lot of respect for Alex Salmond's energy economics expertise.

Lewis Macdonald: Should this guaranteed minimum or intervention price apply in the same way to renewables, carbon capture and nuclear, or are you actively consulting on having three separate and parallel systems of support for each of those industries?

Chris Huhne: We are suggesting that the low-carbon contracts for difference be available to all low-carbon sources. However, to pick up the point that quite rightly was made about the necessity to flex and indeed increase support for early-stage technologies, I point out that in the consultation document we made it explicit that there could be a

premium for different technologies that are at an early stage. For example, offshore wind will clearly attract a premium over the overall low-carbon price, and I would expect the premium for tidal stream to be greater and for wave power, which is even further away from commercial exploitation, to be even greater.

As an economist, I feel that the economic literature provides a very sound basis for providing subsidy to early-stage pioneer technologies and no basis at all for providing any extra subsidy to mature technologies, which should be able to wash their face. With contracts for difference—or, indeed, with ROCs—we would, as technologies were developed and started to be produced on a commercial scale, reduce the level of extra support so that, by the time they became mature, they received no extra support at all. That would be more transparent with feed-in tariffs and contracts for difference than it would be with ROCs.

Lewis Macdonald: But they would all receive initial public support through the guaranteed price system.

Chris Huhne: Absolutely.

Stuart McMillan (West of Scotland) (SNP): Good morning, secretary of state. I have a couple of questions. First of all, although there is widespread political support for the green investment bank, I am not sure that the public have fully bought into the idea or even understand what it will do. What can you and the UK coalition Government do to get across what the green investment bank is actually about and the contribution that it can make to the energy debate?

I am also keen to find out how independent the GIB will be. This morning, you suggested that you want it to be a bank and to be considered as a bank, and said that, instead of being a short-term operation, it should be in place for the long haul. If that is the case, how can you ensure that if the GIB needs additional funds in the future—obviously, we have been through banking bailouts in recent years—it will not need to go to whichever party is in power in London to get them? Also, how can you ensure that bankers' bonuses for the GIB, which will be funded by the public sector initially, will be limited or nil in order to instil more public confidence in the institution?

10:30

Chris Huhne: That was a lot of questions. Speaking as a Liberal, I wish that we could enthuse people more about process issues and not merely outcomes. In my view, the way in which we decide and do things is often key to what the outcomes are. However, you probably share my

experience on the doorstep that it is often quite difficult to concentrate people's minds on what they regard as secondary issues about how to reach objectives rather than on the objectives themselves. That is one of the problems that we have with the green investment bank. It is a means of reaching the low-carbon economy that we want, but it is—frankly—difficult enough getting public buy-in to the vision of a low-carbon economy, which is crucial to our future prosperity, let alone getting them to understand that the green investment bank is an important leg in the argument, because of the market failures and everything else. However, we will keep working on that and I hope that we will have some success.

On your point about additional funding, if the green investment bank is set up as a proper bank it will obviously have its own capital. We envisage that, first, £1 billion will be allocated for 2013-14 and that extra capital will be brought in from asset sales so that it has, say, a £2 billion capital base. That will allow the green investment bank to access the interbank market, the capital markets and the syndicated credit market. It will therefore have all the access to funding that a normal bank has, providing obviously that it has the normal credit ratings and that the markets perceive it to be soundly run with a good governance structure, which is why it is important that it is run on sound principles and is independent. On that basis, it will regularly be able to secure on-going funding.

If, at any point, more capital was required as opposed to the on-going funding of the liabilities side of its balance sheet, it would obviously have to go back to its shareholders. If they were a mixture of private and public shareholders, there could be a rights issue or any of the normal means of finding more capital. I do not think that I am letting anybody into any secrets by saying that the first and opening position, and probably the last and closing position, of HM Treasury is that it wants to scamper as far away as possible from any contingent liabilities, which means that it will want to ensure that under no circumstances does it pick up potential contingent liabilities. The capital base, the lending practices of the bank and the governance structure will therefore be key from the point of view of not only market credibility but the Treasury.

Bonuses will obviously be part of the Government's arrangements, but we will have to allow the management team some flexibility to determine what they are going to do in that respect. We certainly have not even considered the issue. The important thing at this stage is to determine the remit of the institution and its broad structure, make announcements and get under way in setting it up. Do you want to add anything, Phil?

Phil Wynn Owen: I have just a few compatible process points that may help to answer Mr McMillan's question. Subject to the work that I mentioned that BIS is leading to determine key design parameters by May, it is likely that there will need to be legislation to establish the bank and to formulate its degree of independence and its on-going relationship—if any—with Government and other stakeholders. It is also likely that an application for a banking licence will have to be made to the responsible authorities, and that to form the bank the Government will need to be party to appointing fit and proper persons, otherwise it will be quite hard to get a banking licence to run the bank. I would be surprised if the legislative process and/or the appointments and contractual negotiations with fit and proper persons—usually people who have run a bank before—to run the institution did not answer a number of Mr McMillan's questions, including those about the contractual terms and whether they include any bonuses.

Stuart McMillan: I thank both of you for your comprehensive responses, but you probably understand that, on public buy-in, the public might not be convinced if an institution that receives public money to help the green economy and the economy as a whole pays out large bonuses to bankers. A lot of public support could be lost at the outset.

Chris Huhne: Obviously, we are in danger of trespassing on the general public debate about bankers' bonuses, but the institution will need to ensure that it has the expertise to perform, particularly in the energy area. It will take a view on what it needs to pay under the contractual arrangements.

To digress slightly, one reason why Edinburgh has a particular claim as the potential site for the green investment bank is the substantial expertise on the energy lending side that exists here. I have no doubt that, when we are determining where the bank should be located, other places in the UK with a financial locus, such as Leeds and London, will bid for it as well. It was when I was in the financial sector and when I was an economic and financial journalist that I first became acquainted with the expertise of one of Britain's best energy economists, who now doubles up as the First Minister. Edinburgh has a substantial advantage in that respect.

The Convener: We are short of time and one or two members need to get in, so please be brief, Stuart.

Stuart McMillan: I want to ask about the secretary of state's statement to the House of Commons on electricity market reform on 16 December. Towards the end of it, he said:

"by 2030 consumer bills will be lower than they would have been if we had not reformed the market."—[*Official Report, House of Commons*, 16 December 2010; Vol 520, c 1065.]

That argument was put some years ago in discussing the creation of nuclear power stations. How can you guarantee that, with more renewables technology, more nuclear power stations and more fossil fuel stations, consumer bills will be lower by 2030?

Chris Huhne: Two elements have to be distinguished with respect to consumer bills. One element is comparing what we propose in the consultation document on electricity market reform with what would happen if we continued with the current regime, which is a patchwork quilt of different measures that have accumulated over time like barnacles on a ship's hull. They do not necessarily fit together terribly well. By moving to feed-in tariffs with contracts for difference, we will provide substantial extra certainty to investors, and thereby reduce the cost of capital. Our proposals are likely to be cheaper than continuing with the existing policy because the cost of capital will be reduced, which will feed through to benefits to consumers.

A separate set of issues that many people think about involves the consumer costs of having a low-carbon system rather than a free market in which we do not take into account the enormous costs of carbon emissions—as Lord Stern has said, that is the biggest market failure of all time. If we took the advice of, say, Lord Lawson and ignored all that, we would probably have a system that relied on fossil fuels. Even then, people often say that that would be cheaper, but I do not accept that. Such a system would be cheaper only if fossil fuel prices stayed in their current range. If their prices went up substantially, the low-carbon alternative would be cheaper.

In the annual energy statement that was issued last summer, we provided a calculation, which I intend to update annually, that showed that moving to low-carbon generation and energy saving with the total package that we have set out would cost about 1 per cent on consumer bills throughout the UK in 2020, if oil cost \$80 a barrel and gas prices stayed broadly in line. The break-even point with oil prices is about \$100 a barrel. The US Administration projects the oil price in 2020 to be \$108 a barrel. If it is right, our consumers will save money by going down the route of energy saving, renewables, nuclear and carbon capture and storage in comparison with a completely free market that ignores all those measures—the Lord Lawson option—and relies on gas and oil. We must think about consumer costs in a contingent way in the world post-Macondo—post-Gulf of Mexico—where the costs

of extracting oil and gas will increase and where oil and gas prices could be substantially volatile.

The Convener: The secretary of state is very short of time, so I ask the other members to ask their questions briefly.

Chris Huhne: I have probably been giving answers that are too long—I am sorry.

The Convener: I call Gavin Brown, then Wendy Alexander, Christopher Harvie and Marilyn Livingstone—Marilyn has just arrived; she had to attend another committee meeting.

Gavin Brown (Lothians) (Con): On the green investment bank, at what stage is the plan for asset sales? Could that be accelerated to guarantee that the bank is operational before the departmental expenditure limit moneys are provided in 2013-14?

The Convener: I will take all the other members' questions, after which Chris Huhne can answer. That will save time.

Ms Wendy Alexander (Paisley North) (Lab): It is clear that achieving the emissions reduction targets in Scotland and the UK would be easier if the EU scheme moved to 30 per cent. Where are we in ensuring that the EU moves in that direction?

I concur with everything that Chris Huhne has said about the advantages of electricity market reform in bringing certainty to investors and having premiums for technologies depending on their distance from commercial development. However, one anxiety is whether the UK remains committed to decarbonising its power sector by 2030. Concern is felt that the electricity market reform process seems to downplay the reduction in overall energy demand. A word on that might help.

On the green deal, it is clear that the pace of Government action is much slower than Opposition politicians wish. It is important for governmental resources not to subsidise unnecessarily such work, but it is also important to get the incentives right. Are you moving towards setting targets for the number of households that you hope to reach in each of the next three years? If the incentives prove inadequate to reach those targets, will you revisit the incentives?

10:45

Christopher Harvie (Mid Scotland and Fife) (SNP): Have you factored into your forward projections the notion that we are entering a period in which there will be many more climatic events, notably, with the melting of the Arctic ice cap, inundation? The Thames barrier has been used more in the past couple of years than it has in its entire career, and our remedies for

inundation, from Aggreko machines through to sandbags, are almost totally dominated by high-carbon measures. If we have inundation on the scale that, say, the Severn valley has experienced, will that not in a single year put us back even more than we might gain in the same year through energy conservation?

Marilyn Livingstone (Kirkcaldy) (Lab): First, I apologise. I had to attend this morning's meeting of the Rural Affairs and Environment Committee.

I do not know whether this question has already been asked, but I wanted to hear your views on support for the offshore wind manufacturing industry, incentives and access to long-term funding for companies at the leading edge of innovation and, importantly, the ability of those companies to expand to compete in the marketplace.

The Convener: That was a wide range of questions—I hope that you can pick them all up, secretary of state.

Chris Huhne: First of all, I can certainly tell the committee what the department is trying to do about asset sales, which is a BIS lead. We are trying to find a way of selling our remaining share in URENCO, the enriched uranium company. There are security sensitivities to take into account, but we are aiming to get over those, and if we can go as quickly as we can, we will do so. We are also looking at other asset sales across Government and in other departments and an interministerial committee, on which my esteemed and very capable colleague Lord Marland of Odstock is our representative, is working hard on the matter. I would love to go quicker if we could with asset sales, but it is a bit of a holy grail.

Turning to Wendy Alexander's questions, I hope to get the debate about moving the EU scheme to 30 per cent going in the first part of the year and to reach a conclusion in the European council in the spring. A number of leading countries now back our position; we started the ball rolling with the French and the Germans, which was a good start. However, the French minister has changed and we have to ensure that the whole French Government has signed up to the proposal. Since we came up with the joint position on the move to 30 per cent, we have secured the backing of the Danes, the Swedes and the Spanish. We now have quite a substantial group, which is important, although the Poles and certain other central and eastern European countries face real problems that we need to address.

The cross-party ambition to decarbonise is as clear as it ever was. We are governed entirely by the Climate Change Act 2008, the 80 per cent reduction goal and the advice of the UK Committee on Climate Change. That structure,

which the 2008 act put in place, is a very important way of keeping us on track, and I would not want to be the Secretary of State for Energy and Climate Change at the receiving end of any criticism.

The formulation of exact targets for the green deal is particularly difficult, given that we are relying on getting big private sector companies such as B&Q and Marks and Spencer involved in the process. We will be able to be clearer about that in due course, but it is always difficult to make firm projections at an early stage. The Energy Bill contains a number of incentives that we already talked about to regulate the private rental sector—of course, there are even more powers in that respect north of the border. For example, we want to ensure that tenants can get a green deal and that landlords cannot unreasonably refuse any such request. Those measures will come in from 2015, and we are considering other incentives. We are acutely aware that we will not get the private investment that we need to make the green deal work unless we put in place a very clear structure of incentives.

On the next point—*[Interruption.]* I am sorry—my handwriting is so awful—

Phil Wynn Owen: It was about climatic events.

Chris Huhne: Indeed. I am entirely sympathetic to that point. In my recent discussions with insurers, I was very much struck by the fact that in the past 10 years flood damage claims in the UK amounted to £4.5 billion compared with £1.5 billion in the previous 10 years. I am, of course, talking in rough numbers—I am sure that the Association of British Insurers will provide you with the exact figures. Contrary to some press reporting, that enormous increase in claims cannot be attributed to only one event. We have experienced an increasing series of particularly extreme flooding events, and I am very worried about the situation. I should point out, though, that adaptation and the flood defences budget are the responsibility of Caroline Spelman, the UK Secretary of State for Environment, Food and Rural Affairs, and that the issue is, in any case, devolved to Scotland.

Nevertheless, Mr Harvie is absolutely right to say that the adaptation agenda will be increasingly important not only in flood areas but, over time, to the vast amount of our activity. I am not sure that people actually appreciate that. After all, if wind speeds increase, we will need to look again at how we fix our roof tiles, and if we have hotter summers, we will have to look at the specification of road tarmac to stop it melting. I very much agree that it is all going to have a profound effect.

I should say to Marilyn Livingstone that I answered a number of questions earlier about support for manufacturing in the ports, and I very

much welcome the Scottish Government's initiative in that respect. The industry is going to be vastly important—after all, the UK is already the world's largest offshore wind power country and we are only in the foothills of what the industry will be able to do—and I very much hope that we will have substantial manufacturing capacity. We have already had a number of announcements. I hope that that situation will continue and, as I say, I very much welcome the Scottish Government's initiative.

Thank you very much. I am very sorry for having to rush off and, indeed, for arriving late.

The Convener: Thank you for taking the time to come along this morning. The session has been very helpful, but I am sure that further questions will arise and that you will be happy to take them in writing in due course. Please pass on to the Cabinet Secretary for Environment and Rural Affairs our apologies for delaying your meeting with him.

10:53

Meeting suspended.

10:57

On resuming—

Enterprise Network Inquiry

The Convener: Item 2 is evidence as part of our enterprise network inquiry. Today we have a panel of witnesses comprising previous and current enterprise agency board members. I invite them to introduce themselves briefly and to make brief opening remarks; then I will open the meeting to questions.

Steve Thomson (Highlands and Islands Enterprise): I have been on the board of Highlands and Islands Enterprise since October 2008. I currently operate a small business on the isle of Tiree.

Professor Donald MacRae: Good morning. I am appearing as an immediate past board member of Scottish Enterprise. I am chief economist in the Lloyds Banking Group Scotland, and a director of Lloyds TSB Scotland plc. I am on the board of Interface, a hub that is designed to promote interaction between universities and business. I am also a member of the rural development council, a trustee of the David Hume Institute, a member of the Scottish Government's economic statistics group, and a member of the skills committee of Skills Development Scotland and the Scottish Further and Higher Education Funding Council.

Dr Robert Crawford: I imagine that I am here as a past chief executive of Scottish Enterprise. I have been around, for good or ill, economic development in Scotland, the UK and elsewhere for rather longer than I care to remember. I am also chair of the Clyde Gateway, which is the urban regeneration company for the east of Glasgow and South Lanarkshire.

11:00

The Convener: Thank you, gentlemen, and thank you for coming along this morning. I will start by referring to the written submission that we received from Dr Crawford. You seem to suggest that the enterprise agencies as they currently exist are not really making any significant impact, so perhaps they should not exist at all. Is that a reasonable summary?

Dr Crawford: No, that is not what I was trying to say. I was trying to move the question away from the structure of the enterprise agencies to a different set of questions. In fact, given what they have been charged with doing, the enterprise agencies do a very good job. Obviously, I know Scottish Enterprise best. What I was trying to ask in my pretty modest submission was whether what the agencies are doing is the appropriate job. If we

are to meet most people's—if not everyone's—aspirations for growth rates in Scotland, which have for many decades been a plague in comparison with those of the best in the world, is what the enterprise agencies are doing going to make any material difference? I am pretty sure that it will not, but that does not mean that I think that they are doing a bad job. I do not. They are doing a good job, but we need to be asking a different set of questions.

I say this with the greatest respect to the committee and indeed the Parliament, but I think that the questions that have been posed, although interesting, are the wrong questions. If we are to achieve the material breakthroughs of the kind that we have seen in other European countries, never mind the Asian countries, we need to change the game significantly.

I was going to stop at that point, but I have an interesting quote from the latest annual report of Tekes, which is an influential and successful innovation agency. I know the difference between an innovation agency and an investment bank, by the way. It is such an interesting and aspirational quote for Scotland that I will read it out. The director general of Tekes said:

"A key conclusion of the international evaluation of our innovation system is that the system has worked well and that Finland has reached a pioneering position in terms of indicators such as average private sector productivity. The evaluation panel concluded that because Finland no longer needs to catch up with global leaders and will be among the pioneers in the future, the focus of the national innovation policy needs to be shifted increasingly towards encouraging creative destruction".

I cannot imagine a more remarkable and aspirational statement of intent and achievement from a country whose gross domestic product performance 25 years ago was significantly poorer than ours.

I will stop there, but I am saying that we need to be asking a different set of questions—which is not a criticism of the enterprise agencies.

The Convener: My apologies if I misrepresented you. You are essentially saying that the enterprise agencies are doing a good job but it is not necessarily the job that they need to be doing to grow Scotland's economy.

Dr Crawford: Yes, that is what I have concluded. My fingerprints are all over some of this stuff as well, including some of the programmes that are referred to in the Scottish Enterprise submission, which I support. The enterprise agencies are fine; there is nothing wrong with them, and the businesses that receive support from them will doubtless benefit from that. They are certainly staffed by good, professional people.

However, if we are to achieve a material breakthrough along Finnish lines, what the enterprise agencies are doing by way of resource and intent will not achieve that. We need to be honest with ourselves. If the Parliament, or any Government of whatever colour, decides that those are the resources and vehicles that we should be directing, we had better realise that we will not achieve the growth rates that the Finns have achieved, and that we will not equalise our growth rates—even though they are modest—with those that the other parts of the UK have achieved. It is worth remembering that London and the south-east are slipping in international competitiveness terms against the best of breed, and we are slipping further behind them.

The Convener: Do Professor MacRae or Mr Thomson want to comment on those issues?

Professor MacRae: There is a continuing gap of around 0.6 per cent per year between Scotland's performance and that of what I would call the small European countries. That is down to two major factors. The first is that our population growth has been minimal for the past few years, although it is improving through net migration. The second reason is that our business base, or the number of businesses per head of population, is substantially lower than that of our European competitors. Those are the two main reasons why our growth rate is behind that in the small European countries that make up the peer group with which we are often compared.

How do we go about changing that? It is quite obvious that the Scottish Government, Scottish Enterprise and Highlands and Islands Enterprise do not have their hands on all the economic levers. That is the first point. They work with what they have.

The next question—I think that this is the question being posed by Robert Crawford when he talks about an investment bank—is whether there is sufficient funding for Scottish businesses. The total bank debt of Scottish businesses is between about £30 billion and £40 billion. There are no recorded Scottish statistics on this, which is something that I would like to try to rectify. The total amount of risk capital going into Scottish business was about £118 million in 2008, and just over £100 million in 2009. To me, there is not enough risk capital going in.

The Scottish Investment Bank, which has not yet been formally launched, but which will be soon, is an attempt to close that gap and improve the supply of capital to Scottish businesses. The figures that are being discussed for the Scottish loan fund indicate that it will be in excess of, I hope, £100 million. Scottish Enterprise is therefore actively trying both to continue the development policies, some of which Robert Crawford started,

of course, and which I believe have been shown to be effective, and to improve the funding of Scottish businesses in total.

Steve Thomson: Being a relatively new member of the HIE board, I feel somewhat outgunned in terms of experience. I returned to Scotland only about eight years ago and I do not have any experience of Scottish Enterprise, so I cannot comment on it.

Over 45 years, the HIE function has become an integral part of the fabric of the Highlands and Islands. It is a high-profile agency in local communities, so some of the changes that have occurred over the past two or three years have been felt quite heavily by people at the grass-roots level. HIE is now moving towards a situation in which it sees itself as assisting businesses to operate in environments that are very different from those that operate in the Lowlands, by virtue of geography, market opportunity and so forth.

Although some of the macro arguments obviously have some impact on the Highlands and Islands, a lot of what we undertake basically involves taking a leadership role for local communities and giving them the support and guidance that they need to make decisions for themselves. I certainly see it as a significantly more grass-roots role, perhaps particularly outside the Moray Firth area. For me, over the past two years we have worked much harder on giving communities leadership and support.

I have been involved in a couple of very large—by Tìree standards—community projects, in relation to which HIE has been crucial to achieving our goals, empowering a community and turning around many years of population and economic decline. That is how I see the role of HIE in the Highlands and Islands.

Rob Gibson: I would like to pursue the population question. Donald MacRae mentioned the problem of a very low growth rate. Many parts of the country have been denuded of people, and that affects the ability of, for example, the south-west of Scotland and the Borders to feed into Scottish Enterprise's overall message.

HIE has had a slightly better impact in respect of stabilising the population in some areas and addressing the opportunities that exist on islands such as Tìree, which seem very much on the periphery. We have not yet been able to deal with the same problem properly through the enterprise networks, because HIE's social remit, which has been behind its ability to deal with place and community, has not been replicated in the south. I fear that we have missed a trick in looking to the major centres in the Lowlands rather than having a forward policy that would keep people in places, which could then form the basis for a much

healthier economy. Your comments on that lower-level issue would be useful, because I want to come on to the national issue on the back of it.

Professor MacRae: I will kick off on that. First, I am a Highlander—I am from the Black Isle—so I have a lot of sympathy with the issue of rural development and the performance of the rural economy. However, the rural economy in Scotland has been performing quite well. If you look at the overall published figures, you will find that it is growing faster than the urban economy. If you divide Scottish Enterprise funding by the number of people in the areas in which it operates, you will see that it is considerably less per head than Highlands and Islands Enterprise funding. In addition, it does not have some of the more social objectives that HIE funding has. The figures do not tell me that the rural economy of Scotland has been disadvantaged by that.

Rob Gibson: The rural economy contains opportunities for some of the most cutting-edge economic activities—renewables, for example, which is the clear leader in that debate. Is it not, therefore, wrong to talk about rural and urban economies? In a modern economy, it does not matter where the activity takes place. Finland is on the edge of Europe, in an area that does not have the major resources that Scotland has. Scotland is not addressing the potential for modern development in areas that are not urban centres of population.

Professor MacRae: I will respond to that briefly. There are two issues of particular importance for the rural economy. One is the need for high-speed broadband connection. I draw attention to the recent Royal Society of Edinburgh report on that. The other is the fact that the challenges that are faced by businesses in rural Scotland are almost identical to the challenges that are faced by businesses in other parts of Scotland—there is not that much difference. My personal view is that in many areas we do not need a separate rural policy that is distinct from a Scotland-wide policy.

Dr Crawford: I endorse that. This is a profoundly complex subject. As we all know, population is not necessarily a proxy for anything. I remember working in Egypt, where the rate of population growth was among the highest anywhere in the world. It was outstripping Egypt's ability to grow its economy, so it became a drain.

It is a complicated matter and I endorse pretty much everything that Donald MacRae has said. I do not think that we should bifurcate the economy into the rural economy and the urban economy. This year marks the first time in recorded human history when more of the population live in urban centres than live in rural centres. I also take the view that broadband is a necessary comparative

indicator, regardless of whether it is used in an urban centre or in the middle of the Highlands.

The key issues are the mechanisms that help to grow business; people will determine whether they want to migrate to those opportunities. Throughout human history, people have been migrating to opportunity or fleeing from problems. We see both going on at present. My worry, to which I refer in my written submission, is that we will lose significant talent. The best and brightest leave early because they can—usually because they can find jobs somewhere else—whether they live in Glasgow or in a Highland village. We should, therefore, focus on the mechanisms that support growth.

I recognise that there is a strong social mandate behind HIE. I have no comment to make on that—I am sure that it is appropriate. It did not exist when I was at Scottish Enterprise and I do not think that it exists there now; nor do I think that it should. The issue is the need to support economic growth and to increase growth for all our people, regardless of where they are located. Some of the fastest-growing parts of England are rural or semi-rural areas.

Rob Gibson: We are talking about the enterprise network. My point is that the enterprise agencies seem to be overwhelmed at the moment by the size of the investment that is required for some of the very large individual projects, such as renewables projects. Should we just say, "Okay, the game's up. We've got a small pot at the moment and it's not enough"? Are we just going to have to find other levers—which you have both talked about—to get the money for investment?

11:15

Dr Crawford: I do not want to bang on about this at length, but I am concerned that I am being caricatured as being critical of the work of people whom I respect. I am not. We need to start asking a different set of questions. In an era of declining real resources, are these the best approximations for funds investment? I do not think that they are. As I was involved in the creation of some of them, that is a pretty significant comment.

I will give you an example from Scottish Enterprise's written submission. It states:

"Last year ... Scottish Enterprise invested £32m in 106 of Scotland's most promising companies alongside private sector investment of £68m for a total investment of £100m."

That is a rounding error. Those businesses undoubtedly benefited; I am sure that the vast majority would say that they are better off as a result. However, if it is national transformation that we are speaking about—indeed, the SE submission properly does that—and if that is what

all political parties want, that approach is not going to do it.

The question is then whether we should examine how we are using the resources and ask whether there are better ways of using them. It is not that how we are using them is wrong or that they are badly managed; they are not. Nevertheless, it is my view that there must be a better way of using them if we are facing a continuing decline in real resources over the cycle. You can draw your own conclusions about what the growth rate is going to be like in two or three years' time, regardless of what is about to happen over the next two to three years, which is a fall-off in public investment of pretty dramatic proportions that will have implications for the supply chain.

Some of the countries that faced the problem took that approach. The Irish did so through the judicious use of corporation tax—I am not going to get into the politics of that. Other countries, such as Finland and Singapore, did it by asking, "What is the size of the challenge that we face and how do we use scarce resources to approximate to that challenge?" With the greatest respect, I do not think that we are asking that question.

Lewis Macdonald: I would like to pursue that a little bit. Some of the priorities that have been set by Scottish Enterprise and Highlands and Islands Enterprise are about identifying areas of market failure, in which the free market or the private banking sector is not providing the support that is required for economic development. Every witness this morning has mentioned broadband as an example of that, and renewable energy has been mentioned as well. What is your vision of the kind of interventions that are appropriate to address those areas of market failure or those areas of comparative disadvantage that impact on either Scotland as a whole or specific parts of Scotland? What is the appropriate role for enterprise agencies of whatever sort in dealing with those?

Professor MacRae: That is a very broad question. First, there is a limited pot. Everyone knows that there is not an unlimited funding budget for Scottish Enterprise or Highlands and Islands Enterprise. That means that decisions must be made about how to allocate resources. When I was on the board of Scottish Enterprise, I chaired the economic policy committee, which undertook a lot of analysis to work out where we could get the best return on our spending. All the analyses of the past investments by Scottish Enterprise are available for you to look at. They have been done by outside agencies. We also applied that methodology in looking forward.

It is obvious that there are different returns on different kinds of investment as well as different time profiles. A grant could be made on day one that would have an instant effect, whereas a

research and development tax cut might take 10 years to take effect. We need to be aware of all that. I suggest that the single biggest, most important objective for Scottish Enterprise is to increase the number of high-growth businesses in Scotland. In my opinion, that is its number 1 objective. A recent study of high-growth firms in Scotland suggested that, of the 825 that were identified, Scottish Enterprise was and had been in touch with 20 per cent. That is very impressive and encouraging.

There are about 22,000 businesses in Scotland with 10 or more employees. Scottish Enterprise is actively involved with about half of those so, again, that is impressive. Could it be involved with more? Yes, but it would require more funding. On the available evidence on how effective they have been, Scottish Enterprise's interventions have been fairly impressive. I hope that the committee has had access to all those analyses.

Would I be in favour of increasing the supply of risk capital? Absolutely. That is why I am very much in favour of the Scottish Investment Bank. I would be even more in favour of further funding for Scottish Enterprise's co-investment activities, which have been highly successful. We should do more on that.

We can ask how transformational all those activities have been in raising Scotland's growth rate in comparison with that of our competitors. As I said a few minutes ago, there is still a gap. The question that I put to you is this: what would Scotland's growth rate have been if we had not had Scottish Enterprise's activities? I accept Robert Crawford's point that the Scottish economy has not been transformed, but that would be too much to expect from Scottish Enterprise and Highlands and Islands Enterprise alone.

Steve Thomson: To return to the commitment to development from the agencies and the Government, as a relative newcomer I have been struck by issues to do with broadband. Obviously, we recognise the importance of broadband, which has been a subject of deep discussion in the past three or four years, but I am surprised by the low level of action on the ground. Even the UK broadband development funding to extend the points of presence to give high-speed fibre connections is a relatively small investment in the region of £10 million or £15 million. I still find it strange that we talk a lot about development but seem reluctant to commit the funding that is required, even when it comes to moneys that are actually just rounding errors, as was said earlier.

There is no doubt that the Highlands and Islands economy is different from the core of the Scottish economy, in the Lowlands. Basically, we need to sustain the existing economy and to grow and to get growth companies. In a sense, we need

to make economic-disadvantage decisions to go to areas that are remote and have a range of costs. Running a business on a remote Scottish island is, to be frank, a bit of a challenge. The things that really help with that are things such as access to broadband.

If agencies are to intervene, they must spend the limited resources that they have in particular ways to get maximum benefit. Certainly in the Highlands and Islands, broadband is a key issue on which we can see material benefit, not only in bringing in new growth businesses but in retaining the population. I say this with some hesitation, but there are issues such as 18-year-olds having access to Facebook. That might sound trivial, but it has become an integral part of our society. In communities that do not have broadband access, there is a perception of deprivation. Ultimately, since the introduction of broadband in the outer isles and in some of the inner Hebrides, we have seen a change in the demographic process. Young people have started to come back to the islands. I do not argue that broadband has been the answer in itself, but it has definitely contributed to a sense of change and a sense that, ultimately, things are getting better.

A lot of the activity is about sustaining where we are and, we hope, once we have stabilised the situation, building on it. Taking an outright growth model, which is important in the Lowlands, would almost be throwing the baby out with the bath water in the Highlands and Islands. We talk about keeping things stable so that we can build on that, and we are just about getting to that point.

Population growth can be a double-edged sword. Undoubtedly, in the Highlands and Islands, we have many retired economically inactive people moving into retirement homes, which causes a range of problems. It has an impact on house prices and on what local communities want to undertake. HIE needs to act in that leadership role to try to find consensus, bring the parties together and build communities that are socially and economically stronger.

Dr Crawford: Donald MacRae is entirely correct, because Scottish Enterprise, Highlands and Islands Enterprise and the other agencies cannot be expected to make the kind of transformational difference that all of us would like to see. I, too, have made that point. My concern is that there is—and probably always has been—a set of expectations out there that they should be able to make such a difference.

The issue of island economies is interesting. For example, the Isle of Wight has probably the densest concentration of manufacturing excellence anywhere in these islands. Admittedly, it is rather closer to the mainland than some of the Scottish islands are, but we should not assume

that an island is incapable of achieving remarkable things because of its location; it depends on what you do with the island and how you support it. Some of the most advanced composite technologies on the planet are being pioneered on the Isle of Wight. I gained some knowledge of that recently.

The fundamental problem is a failure of risk capital provision, which I am trying to get us to address in some way because it is restricting growth. Absenting my own bias towards fiscal independence, I believe that the two key problems confronting the Scottish economy are the scarcity of skill sets and the scarcity of capital. I would put those ahead of Donald MacRae's concerns, although he is a substantial economist and I am an insubstantial economist. I believe that those two problems are far more important than the issue of demographics. At the moment, if we create a successful economy, we will attract the kind of people who create the fusion that creates a successful economy. If you go and look at the parts of the world that are the most dynamic, you will quickly get the point. Skill sets and capital are the two key deficiencies. If there is one of them that we could and should address, it is the difficulty in accessing risk capital in whatever form—debt or equity. That is why I believe that—although I do not for a moment think that it is the silver bullet or a solution by itself—we should have an investment bank that is larger in scale and more commercial in orientation than the one that we are proposing.

Some of the schemes that are run across the UK prohibit certain things, such as market gardening and horticulture, from qualifying for investment by Government through grant, equity or anything else. One of the most dynamic industries anywhere in western Europe happens to be flower growing in the Netherlands. The Dutch horticulture industry is massively international and incredibly competitive and has created an extraordinary science and technology supply chain from the universities all the way through to bankers who are expert in that subject matter. We need to take the blinkers off and ask whether we really care whether a business is a service business. The Finnish do not care about that; 25 per cent of their investment in technology went into service businesses last year. Do we care if it is a horticultural business? I do not care, so long as it is growing rapidly and internationalising, which is a far more important proxy than innovation per se.

I would like to open up our collective mindset so that we ask searching questions about why we stick on prohibitions, courtesy of the EU and the Treasury, and decide that we do not need them any longer. What we would like is a bunch of people who are much more skilled and

experienced than I am to make investment decisions that are based on opportunity, whether in the Highlands or the Lowlands—I do not care, because Scotland is Scotland to me.

Professor MacRae: I have a comment on the interesting issue of high-growth sectors and firms. You will all be aware, of course, that the Scottish Government's economic strategy, and that of Scottish Enterprise and Highlands and Islands Enterprise, has key sectors. The high-growth study showed very clearly that high-growth firms are not exclusively found in the high-growth sectors. That does not mean that you instantly change the policy on having high-growth sectors; what it means is that you should not rule out any business from being part of the account-managed programme of Scottish Enterprise or Highlands and Islands Enterprise, for example, because it is not in a key sector. It is quite feasible to have low-growth firms in a key sector, but the sector itself may have a high potential for growth. That was a key lesson that we learned from the high-growth study. By the way, the percentage of high-growth firms was higher in Scotland than in the UK, which is very encouraging. The trouble is that it is a slightly higher percentage of a smaller base—that is the big issue.

Lewis Macdonald: I hope that it is fair to characterise those responses as offering three slightly different versions of the kind of enterprise support that should be provided or that is currently being provided: one where you intervene to support the social and economic fabric of communities, particularly disadvantaged ones; another where the focus is on working with high-growth companies and making their further growth possible; and the third where the focus should be on providing risk capital and seeking a return on that. Would it be fair to say that the enterprise agencies have up to now tried to do all three of those things to differing degrees and that the difficulty that they now face is that they simply no longer have the resource to attempt all those things at the same time?

11:30

Steve Thomson: I have been in my position for only two years but, looking back, it strikes me that risk capital was not a great part of the process as far as HIE was concerned in relation to extending money. There was an element of it becoming a dispersal fund for Government largesse. Because there are more limited resources now, there is definitely greater focus on ensuring that there is a better bang for its buck.

As one of the hated former investment bankers, I have to say that, in a commercial environment, you are looking for a return. That is the driving element of any kind of commercial activity. When

you start getting into the slightly social element, the question is how you control that process. Globally, some state-owned development banks/investments banks have a good track record and some have a much poorer track record, because they become vehicles for political largesse. We should move towards much more proactive investment. However, that runs contrary to the current situation on funding. The funding is being steadily reduced, so the activities that might have a risk capital element within the activities of SE or HIE are being diminished over time. We are being forced into concentrating our limited resources on ever-decreasing numbers of projects. Our capacity to meet any demand is being severely diminished, regardless of the structure of funding.

Professor MacRae: Lewis Macdonald summarised our responses by saying that there were three solutions on offer. There are social interventions, on which Highlands and Islands Enterprise has done well over the years.

The supply of risk capital has been a problem for as long as I can remember in both the UK economy and the Scottish economy. I was very interested to look at the Business Development Bank of Canada, which has been going since the war. It operates alongside commercial banks. It is not a substitute; it is complementary to the activities of commercial banks. It also has a venture capital division, which, if you look at its accounts, you will see has made a loss for the past five years. The bank as a whole made a very small profit in the past year. It has lending of about 12 billion Canadian dollars. To me, it is acting like a commercial bank, but it also has a venture capital division. The problems with venture capital in Canada seem to be even worse than they are in Scotland and the UK.

I would be greatly in favour of increasing the supply of risk capital if at all possible. The Scottish Investment Bank and the loan fund within it are an attempt to improve that situation. I wish that the figures were larger.

I think that it is absolutely right to pursue economic development by developing companies. However, there is one aspect of that that you should be aware of. We in Scotland are very good at what I would call the supply side; there are many schemes, grants and incentives and so on. However, we have to ask what the demand is from our business base. What is the demand for R and D? Business R and D is extremely low. There needs to be an increase in ambition, as well as in the supply of risk capital.

You can also comment on the demand for debt. People have often been critical in the past few years of what banks supply to businesses, but it is a two-way process. We must ask for a greater

degree of ambition from Scottish business as regards exporting, R and D spend and product development. That must be factored into our overall approach to economic development.

Dr Crawford: I believe that. I would again like to quote my friends in Tekes, who said:

“Public agencies can play an active role in the promotion of user-driven innovation.”

The experience of not all but many transformed economies over the past 30 years is that the state and its agencies have a significant role to play in promoting the possibilities of innovation, which is the point that Donald MacRae has made, although, typically, great businesses do not need that to occur and manage without intervention by anyone. The evidence from all over the place is that the state and its agencies have a serious role to play in stimulating an understanding of how innovation and internationalisation improve profitability, which, frankly, is what businesses are interested in. Most of them do not carry a social mandate, and they probably should not.

Alongside that—these are not enemies; in my view, they are brethren—capital should be made available in whatever form businesses require, subject to commercial judgments being made by people who are more able to make them than I, for example, would be. If we put those two things together, several things come out.

I am going to make a statement that is too bald or too generalised, but I think that it is important to get it on the table: in the long run, grants do not work. I used to chair the Scottish Industrial Development Advisory Board, and I certainly attended it many times when I ran the inward investment agencies and later. The fact that great businesses, typically, do not need grants does not mean that at certain points in time they do not come in handy—and, by the way, if you offer them, businesses will take them; who would not?

I think that a much more effective mechanism is a market assessment of whether the investment—whether it is in debt or equity—will drive that business to a higher level of performance than a grant. If I were looking round for money to put into whatever form the investment bank takes, I know what I would look at first. There is not a lot of it out there these days—scarce capital is scarce capital. There will probably be horror at a former Scottish Enterprise chief executive saying that grants do not work. I am generalising but, over the piece, if I were to choose between investing in debt, equity or grant, I know what I would do with scarce capital.

Lewis Macdonald: Thanks very much. For me, the question that that leaves hanging is this: if people like you who lead the enterprise agencies are not well placed to make judgments about the

kind of investments that are required in future, who is?

Dr Crawford: My view on that is that those are commercial judgments that should be made by people who run businesses, people who have been effective and successful bankers—that is a dirty word these days, but they do matter—and people who are successful venture capitalists of repute. I have undertaken a pretty long journey in my life. I repeat what I said: I believe that economic development agencies and state agencies have a significant role to play in doing a variety of things but, when it comes to making commercial judgments about investments in businesses, that should be left to people who have done that effectively in businesses that they have run and people who have been successful venture capitalists. What Donald MacRae said about the Canadian venture capital industry is true, but that situation is not peculiar to Canada—venture capital businesses have failed all over the place in recent years.

Such decisions need to be taken by people who have made commercial judgments about whether a business plan is a good one and whether the business has the ability to grow on the back of that plan and to repay the debt or to generate revenue through equity. Economic development agencies have a serious role to play, but difficult commercial decisions should be made by people who have direct experience of doing so and a track record, to boot.

Professor MacRae: I really do believe that we need to increase the supply of risk capital in Scotland—that is fundamental—but we should not do so at the expense of doing away with all the infrastructure of Scottish Enterprise and Highlands and Islands Enterprise. It is not a case of having one or the other; it is a case of adding on investment. The Scottish Investment Bank will go some way towards that, but it is not a case of having one or the other; the two can exist together.

Steve Thomson: In general, I accept the argument about the need for more risk capital to be made available, but I make the point that, particularly in markets that have relatively small larger businesses, especially in remoter locations—including in the Lowlands—it is necessary to provide more general support.

HIE has had a joint scheme with the Massachusetts Institute of Technology, and I have been surprised by the level of take-up of that scheme. For many businesses in the Highlands and Islands, it has almost been a badge of recognition that they are a go-ahead enterprise. It has yielded a lot of rewards because it has taken people out of their existing position and said to them, “Look, this is what you might be able to do.”

The scheme is a relatively small commitment financially, but many of the non-financial commitments from the agencies help to put businesses ahead.

A number of other things have made a difference. For example, we have had a scheme to put graduates into businesses that have traditionally not employed graduates. Robert Crawford made the point that this is a complex area, and principally there is a portfolio approach, but we should not lose sight of the fact that the agencies provide a large and increasing amount of non-financial support through the account-managed system. That has been particularly important to many businesses.

Lewis Macdonald: Thank you.

Christopher Harvie: Did you mention “creative destruction” in relation to Finland?

Dr Crawford: Yes.

Christopher Harvie: It is just that I think that one ought to handle any of the legacy of Joseph Schumpeter with a lot of care. He was the same man who lauded the British way of industry and politics in “Capitalism, Socialism and Democracy” as an impressive method of managing the transition from empire to Europe, if you like. That is just an aside, but the point is that we sometimes tend to use the wrong bits of defunct economists, as Keynes would have said.

I want to look in particular at one big driver. I think that it is a huge driver. It is as big as North Sea oil, about which I think I am qualified to talk, having written the only book that has so far been produced about it, although I will say that Alex Kemp ought to have been a lot faster off the mark with getting in his official history. An official history is like a military history. It tells you why you lost the last battle. I got mine out in six months. I will not claim anything great for it, but it came out in six months. Sixteen years have passed since Alex Kemp began. The whole point about official histories is that they are a sketch to future action. That is a general point.

We have got renewables, which in many respects are similar to North Sea oil. I approach this from the position of having gone abroad in 1980, after Mrs Thatcher came in—as the *News of the World* would say, I made my excuses and left—to serve for 26 years as a servant of the Government of Baden-Württemberg, which is the most impressive complex of regional industry in Europe. As professor of regional studies at the University of Tübingen, I was also joint chair of the international economics diploma that we awarded, and several of my students have come across and helped me here, so I think that I have some experience of coming from that particular type of structure.

If we go on to renewables, the Germans are undoubtedly fixated by us because we are the largest supplier of natural power. The German coast does not come into it at all, because it is necessary to go well north of the North Sea. That is why Voith, Bosch and Siemens are so interested in us. Now, I have made contrasts with Scotland, about which I have written about 10 books, some of which are even read by some Scots and some Germans. It is interesting that, when I go around German firms, I am asked to sign copies of “Fool’s Gold”. I went to a meeting with Scottish Engineering where people confessed that they had never heard of the book.

The Convener: Chris, can you—

Christopher Harvie: I just mention that because I think that we have to start off by looking at where we are.

“If way to the better there be, it exacts a full look at the worst”,

as Hardy said, and the situation in Scotland is not very promising.

Where can we get a structure of small and medium-sized enterprise development that is comparable with that in Württemberg? Is it necessary for us to have big outfits like Siemens, Bosch and Daimler-Benz to supply the infrastructure and training? When I went to the education ministry in Stuttgart recently, they said that it is 50:50 in the German system of industrial training, and in that state it is actually 75 per cent in the shop and 25 per cent in the technical college. If you do not have that industrial back-up you are in trouble. That is roughly where Scotland is.

11:45

There are various questions to ask. How do we compensate for the absence of an effective SME system since the first world war? How do we update our training to get people out for renewables? Our experimental work is good, but the back-up is almost non-existent. It costs £5,000 to train a call centre operative and £55,000 to train an Elektromechaniker—that is roughly the Siemens or Voith experience. These people are eager to co-operate with us, but they see all sorts of problems in doing so. How do we reassure them? How do we involve them in a type of bilateral operation? How do we keep enough of the initiative for ourselves in order that we can make the innovations that pay really well and keep the cash for ourselves?

Scotland made the greatest breakthrough in offshore drilling when we invented positioning of rigs. If you ask any politician in this room what positioning is, they could not tell you. Could you?

Lewis Macdonald: I would dispute that.

Professor MacRae: I am not sure how many questions were in there. I will give the other two time to think up some answers.

I have been to Finland and it is a delightful country. Six feet of snow was not uncommon when I visited. When you think of that country and its population and position, you realise that it is the most innovative economy in the world. It is amazing. However, after many years studying parts of the world that we would like to emulate—such as bits of Germany, as Christopher Harvie said, and other bits of Europe—I have concluded that we must be careful about trying to copy something entirely from another country, because it does not work. That is my first warning.

By the way, Finland had a cathartic shock that some would argue was instrumental in its economic record over the past few years, which was the break-up of the Soviet Union. Other countries—

Dr Crawford: New Zealand.

Professor MacRae: Robert Crawford describes them in his submission. The cathartic shock came from various sources.

I agree with you about renewables in Scotland. We must not let this opportunity go, as some might suggest we did with North Sea oil. We must grab the renewables opportunity as vigorously as we can. We could look at it another way, which is that Scotland is in the biggest single market in the world. We have a stable political system. We have a highly educated workforce. Our skill levels are remarkably good. The absence of skills is not the reason for Scotland's underperformance. There are certain pockets where we need to improve, but that does not really explain why our growth record has been comparatively poor. We have many advantages. We have an extremely good university sector. Our challenges are the rate of business formation, the levels of business and the supply of risk capital. Those are the key areas that we need to work on.

Christopher Harvie: There are qualifications to that. One is that Finland had a tremendous cathartic experience before the one you mentioned. It was an agricultural country in the 1930s and became an industrial country to supply reparations to the Russians. It remained thereafter the sort of Hong Kong of Russia. I know the historian of one of the banks in Finland very well, so I have a fairly good background in Finnish economic history. That is one point.

The other issue is that we should remember that Baden-Württemberg starts off with 35 per cent in manufacture, up from 30 per cent a decade ago—that is largely high-tech manufacture. Our

commitment to manufacturing is around 12 per cent, in capital terms and in terms of labour. Although our labour might be skilled, there is a lot less of it.

Dr Crawford: I agree that you cannot simply take the experiences of another country and impose them on your own—that is clearly inappropriate and would fail. Lessons can be learned and conclusions drawn, but the strategic challenge must be understood and whatever mechanisms are available applied to doing something about it. All of us believe that the strategic challenge is an inadequate growth rate against the best in the world, which is likely to get worse unless we address the problem. The question is, are we applying the appropriate instruments to do something about it? I repeat that I do not think that we are.

Renewables are a great opportunity. The Germans may not have wind, but they have investment. Renewables manufacturing is a highly mobile industry. Right now, five international businesses are looking at investing in the UK, but they could go anywhere else. They are being driven by a series of considerations, not the least of which is—contrary to what I told you earlier about grant—the amount of financial support that they will get. Tax, too, is a driver of where they will end up, as are skill sets.

Christopher Harvie knows more than I do about the Mittelstand, which is a tradition that goes back a century and a half and is an extraordinary supply chain. Although it is true that, in the long run, SMEs produce more jobs than large businesses, it is often forgotten that they do so because many of them operate in markets in which there are very large employers and they are part of the supply chain for those employers, which increasingly outsource activities that the SMEs undertake. One of Scotland's grave weaknesses—apart from simply our deficiency in manufacturing—is the fact that we have too few large employers in manufacturing and other sectors to create a supply chain of SMEs. That is the strategic challenge. One is not the enemy of the other: you need both—healthy economies have both. A criticism that could be made of Finland is that it is overdependent on one very large employer—Nokia—that has an enormous supply chain. That is also true of other markets.

We need both large businesses and SMEs. The question is, how do we get them? I am sorry to keep coming back to that point. We cannot recreate the German experience; we will not have a profusion of Mittelstand enterprises, with all the great benefits that they bring to the economy as a whole. However, we can do more to support our fast-growing businesses and others. I support what Scottish Enterprise and HIE—if it is doing it—

are doing in that respect. I am more interested in the internationalisation proxy than in the innovation proxy. That is a very arcane question, but it is worth looking at in due course.

We may not agree on the skills question—I do not agree with what Donald MacRae said about skills in Scotland at the moment—but I think that provision of risk capital will be an extraordinarily important driver of performance. We seem to have unity of purpose on that point.

Christopher Harvie: I spent a day with Voith, as some of my graduates work for it. Voith is the biggest supplier of water turbines in the world and is very interested in our advance, because its principles of construction include locating construction nearest to the point of use. Indeed, it has bought into Scottish firms. The problem is infrastructural. We have a lousy railway system between the Channel tunnel and Scotland, and we have just lost one of our connections—the ferry. Voith needs to be able to load into a truck in Germany stuff that will go by train to the position of manufacture, but we have a railway system that closes down every weekend for repairs. We must get it up to date. The sort of partnership that we require may involve German concerns taking on a much greater chunk of the Scottish infrastructure, notably our transportation infrastructure.

The Convener: I will take that as a comment rather than a question. I put on record the fact that there is still a ferry service, but it is now for freight only, not passengers. It is important to remember that we have a freight ferry service.

Ms Alexander: It has been an interesting and timely debate. I agree that the strategic challenge is how to drive growth in Scotland. The game changer that Robert Crawford proposes in his paper is innovation. We cannot pursue the issue here, but I simply note that there are other views on the key drivers of growth. In its recent work, McKinsey & Company argues that improving our service-sector productivity and dealing with our infrastructure would have the fastest impact on productivity and growth.

I simply say that we should ask the big questions. What is the driver of growth? There are other solutions, but let us take the paradigm that you have offered, which I think is innovation. SE has an honourable record in driving innovation and high-growth companies.

The danger is that the phrase “Scottish Investment Bank” obscures, in exactly the same way as the phrase “development agencies” obscures, what we are trying to do. The problem is that the mandate that is being given to the Scottish Investment Bank is—in the minds of the Scottish Government and much of the business community—to deal with the issue of patient

capital investment in decent businesses that are struggling to get access to capital because of what has happened in the financial crisis.

It seems to me that you are saying that the mandate of the Scottish Investment Bank should be closer to that of an innovation agency; that it should involve support for innovative companies. We need to resolve that issue, because the phrase “Scottish Investment Bank” does not resolve the dilemma for us.

If we use the target that you have set of return on investment for the taxpayer, we will be putting patient capital into well-established businesses and not supporting the range of high-growth innovative companies that may fail. That is the very reason why Calum Paterson and Scottish Equity Partners are not investing in those companies, and Canada’s venture capital industry is making losses.

The danger is that we are subsuming into the Scottish Investment Bank SMART: Scotland, support for products under research, the proof-of-concept fund and the co-investment fund, which are needed at the pre-risk capital stage.

I would like comments, please, to enable us to get to the core of the issue. Let us not debate what the driver of growth is—we can just acknowledge that there are different views on that. We must ask, within the innovation paradigm, whether we are trying to fix the innovation issue in how we support high-growth companies or to deal with the problem of access to capital.

The tragedy of the Scottish Investment Bank is that it is being posited as an answer to the access-to-capital problem, which I do not think you are identifying as being the problem that we need to solve. The views of Scottish Enterprise on what the Scottish Investment Bank’s mandate will be, the difference between the rhetoric from politicians at the Scottish Trades Union Congress, the nature of the risk capital gap that we are trying to fund and whether it is appropriate that a return on investment for the taxpayer is the mandate for the Scottish Investment Bank are the discussions that everyone should be having in the next six months.

Dr Crawford: I will maybe have a go at that. There is a danger—in fact, it is more than a danger; it is going to happen—that we will subsume existing schemes, which is a mistake. A lot of those schemes are already available across the United Kingdom—in fact, some of what is on offer is more than what we are offering.

I do not mean that we should subsume those schemes. They probably have a role and purpose—I hope so, because if they do not, they should not exist. I am talking about the provision of risk capital that offers disproportionate growth opportunity to solve that problem and does not

offer simply access to capital, which is a different problem. An investment bank should not be limited to businesses; you are right in that it is probably closer to the innovation agency model.

It could—I have spoken about this elsewhere—include investments in things other than businesses. It could, for example, and provided that there will be a return, invest in some form of critical capital infrastructure, such as provision for an advanced factory that could not be funded by other means.

Wendy Alexander was right to issue those qualifications. I should have been more detailed in what I said in my submission, but she was correct that there is a danger that the bank will end up being too narrowly focused.

Professor MacRae: First, I will comment on innovation. The traditional measure of innovation is business R and D as a percentage of GDP. There is also the number of patents, and the EU community innovation survey. All of those measures have, looking back, shown Scotland—and the UK, in fact—to be quite poor in comparison with competitors.

However, part of that is down to the structure of the economy, the types of businesses and the sectors in which those are operating. The latest innovation survey, which has an expanded Scottish sample of a robust size, shows that our level of innovation is a lot better than we had thought, although it is still lower than I would like it to be. We have to define innovation quite widely. It is not just the registration of a patent, for example; it is much broader than that.

Secondly, the SIB will supply mezzanine finance—it will not supply finance to small businesses. As Wendy Alexander said, it is not designed to close what some perceive as being a gap in access to finance in general for SMEs. The SIB will operate by targeting businesses that have growth ambition and can make a significant economic impact, which I think is correct.

12:00

Is there is actually a problem with access to finance? We must bear it in mind that there are no distinctly Scottish data, but a few years ago, before the credit crunch, lending to UK businesses was increasing at an annual rate of 19 per cent, which was not sustainable. It is unsurprising that the figures show that lending to UK businesses is still declining, although I point members to the results of the latest survey of 400-plus businesses in Scotland, which show that their assessment is that the availability and cost of credit are improving.

I realise that many people will always say that not enough bank credit is available, but I cannot believe that anyone in the room would suggest that banks should say yes to every credit request that they get. The percentage of approval across all banks is widely quoted as not having changed over the past few years, but I expect that, as we go on, the figures will show an improvement in the total amount of lending to UK businesses.

Finally, the Scottish Investment Bank will be targeted, at least in my view, not at closing the perceived gap in access to finance, but at growth companies. I am adamant that the other successful schemes that were mentioned, such as the co-investment fund and proof-of-concept fund, will not be negatively affected by the loan fund.

Steve Thomson: I am always slightly bemused by the idea that if an investment bank or investors are presented with a good idea they will somehow miraculously stand back from it. My business experience has largely been in Russia where, to be frank, it is like the wild west. People there have made what I would describe as substantial risk commitments on the possibility of return. In the end, I do not think that the dynamics of Scotland and Russia differ very much. If I have a good idea and I present it to investors, the aim for me is the diminution of risk. The co-investment and supporting aspect reduces that initial risk, and there is certainly some merit in that. The idea that the Scottish Investment Bank is the answer to all problems is a bit far-fetched, but it probably has a role in sharing the burden.

Ms Alexander: In the interests of time, convener, I will leave it at that.

Gavin Brown: I have just one question. In your paper, Dr Crawford, you suggest that economic development bodies are probably doing the wrong thing. With your experience of Scottish Enterprise—I will probably restrict this question to Scottish Enterprise—and considering what it currently does, what do you think it should continue to do and what should it cease doing?

Dr Crawford: When I say that it is doing the wrong thing, I mean that it is being asked to do things or it is projecting programmes that may be important to the businesses that will be affected, but which will have only a modest impact at the aggregate level.

I support the focus on fast-growing businesses, but we need to be careful about that because, by their very nature, a lot of those businesses will be dead weight. Contact with fast-growing businesses is a proxy that is widely used by economic development agencies. It is not unimportant, but we have to be careful because it can mean a lot of things. Many businesses will tell you, if you probe them, that the initial contact was fine, but beyond

that there was no great impact on the business—there is tons of evidence of that. I will not include HIE in that, because I simply have no expertise and it would be inappropriate to comment.

To be frank, I regret some of the things that have happened. I regret the dissolution of the link between skills and economic development because the link is pretty innate, but I think that I understand why it occurred. However, given the scarcity of resources, I would like there to be a much keener focus on businesses that are absolutely capable of benefiting from that interaction.

That applies on two levels. An innovative business could be Starbucks or an advanced engineering business. I would be happy to see Starbucks headquartered in Scotland rather than half a dozen small businesses—however innovative they were—that employed far fewer people. We should fixate not on the sector but on the business's possibility to internationalise.

Internationalisation capacity is my final proxy. You really need to understand that the intervention matters. If it releases capital to do other things, such as provide risk capital to businesses that will take on that responsibility—I am encouraged by Donald MacRae's comments of a moment ago about what the Scottish Investment Bank will do—I would rather see the capital diverted to there.

I repeat that, given what Scottish Enterprise is being asked to do and is measuring itself on, it is probably doing a fine job. I am rusty; I have been gone from the board for more than seven years, so I am very much yesterday's man. However, I would like there to be a keener relationship between innovation support and investment support for fast-growing international businesses, and the programmes should reflect that.

Stuart McMillan: Earlier, someone commented that population growth is a double-edged sword. However, population decline is certainly an issue for some communities in Scotland.

I am a West of Scotland representative. I stay in Inverclyde, which has lost some 20,000 people over the past 20 years. A number of times in the past, I have raised my concern about the amount of work that has gone into improving urban areas that are on the periphery of cities. My question will be predicated on the situation of Inverclyde, but is not about Inverclyde only; it applies to Dumbarton, Clydebank and Paisley, to name a few places in the west alone.

I understand why a lot of effort has been focused on the cities, and we heard this morning that there was a lack of focus on rural areas in the past, which has come up throughout the evidence-taking sessions. However, I am concerned that there has not been as much focus on driving

forward urban areas on the periphery of cities to improve their economies, improve their job prospects and—certainly in Inverclyde's case—keep the good people there, instead of watching them leave at the first opportunity.

Dr Crawford: Again, I am rusty on this, but there used to be an arc of accelerated depopulation that ran from Dumfries and Galloway, increasingly up through pretty much all of Ayrshire and continuing up through East Renfrewshire, parts of Renfrewshire and Dunbartonshire. It also included large parts of Glasgow. Businesses fell off, people moved out and were not replaced. I know Inverclyde well. North Ayrshire, where I live, continues to be plagued by that problem, although there is some inward migration as new houses are developed.

The fundamental problem is the lack of businesses in the area. Although the local enterprise companies and, before them, the Scottish Development Agency intervened in different ways—there was an intervention in Inverclyde specifically and there was intervention elsewhere—they did not reverse the decline. I think that the reason for that was not that they were not staffed by good and committed people—they certainly were—but because there were no mechanisms to persuade businesses to invest in those areas or to grow the businesses that existed there.

One situation is an outcome of the other. I would love more people to live in Scotland—all of Scotland, although I am sure that that would cause some difficulties—but, unless we have a fast-growing business base that employs people, it will not happen. Unless we solve that problem, we will not address the difficult demographics about which you are talking.

I live in the village of West Kilbride, which is expanding because there is land around it and it is a pretty decent place to live. People are moving in as the result of the availability of housing. However, there is not the jobs base in West Kilbride or North Ayrshire—although things are better in Inverclyde than they were five years ago, say. That jobs base is further up the country, or even beyond. The challenge for North Ayrshire and Inverclyde is to support businesses that hire people. That is what we have failed to do over several decades—and I include myself in that.

ICI in Stevenston closed, and IBM ran down in Inverclyde—I used to work there—and they were not replaced with the same kind of high-value businesses that allowed people to stay locally, at least in an approximate sense. I have my views about why we did not replace them, although it could get me into controversial territory, but the fact is that we did not do that. Although there are some excellent businesses in Inverclyde—some of

which are run by friends of mine—and there are some fine businesses in Ayrshire, they are far fewer than they used to be and they do not scale up.

Steve Thomson: I do not think that I can comment on the periphery of Glasgow.

Professor MacRae: I have mentioned that some rural parts of Scotland had been enjoying a population increase. If we dig down into the data for the Highlands, we find that parts of the area have shown growth, whereas other parts show negative figures. Inverness has grown remarkably but, to be frank, that has happened at the expense of some of the areas around it. If we dig into the age structure, however, we find that it is people of my age who are coming to the Highlands, rather than the area keeping the younger ones. It is a complex issue.

That illustrates two things. The first of those is the importance of businesses, as Robert Crawford has been saying, and that reinforces my view that the prime function of Scottish Enterprise should be to help create more businesses, especially high-growth businesses. Secondly, we need to concentrate on infrastructure. I am not just talking about roads, bridges and air links, but about broadband and so on. Those are two crucial areas on which we need to concentrate. There is a very good argument for so-called intervention on broadband and the expenditure of public monies on solving that issue.

Steve Thomson: I come back to the demographics of declining areas and the community remit of HIE. I cannot comment on the urban areas on the outside of Glasgow, but one of the key elements of the social focus of HIE has involved going into communities. I mentioned its leadership role earlier—its ability to bring communities together, to give them an expectation and to foster their aspirations. That role should not be underestimated. In many communities that we deal with, that sense of local confidence had completely disappeared, with a sense of being on a never-ending downward slope.

For some places, we can pat ourselves on the back and say that the situation has been reversed, although that requires time, money and effort. There are examples of places where that has happened in the Highlands and Islands, in different circumstances compared with the west of Scotland. It can be done, and agencies such as Highlands and Islands Enterprise and Scottish Enterprise are needed to lead such initiatives. It is often very difficult to bring all the parties together, but once we do so there can be great success.

Dr Crawford: There is a real problem here, and it is something that we perhaps do not talk about openly and honestly enough. Urbanisation is a

global trend. I remember that, when Wendy Alexander was enterprise minister, we brought Richard Florida to Glasgow to discuss the rise of the creative class. Much of what he said then still applies. Creative people tend to congregate in urban centres. That does not mean at all that there are no creative people in rural parts of the world—of course there are—but the great urban centres are increasingly attracting certain categories of people, for a variety of reasons, and they reinforce each other. That will bring in good restaurants, boutique cinemas, galleries and so on.

The problem is perhaps so large that we will not arrest the population decline that you are understandably concerned about. I share that concern. I think that we should eat the elephant one bite at a time. We should focus on trying to grow highly competitive, internationalised businesses using scarce resources, allowing the businesses themselves to determine where they locate and why they locate there. Many of them will choose, for a whole variety of reasons, to move from Glasgow to North Ayrshire—I hope—or somewhere else, because of the good broadband connectivity and because they prefer the lifestyle there.

However, if we start to agonise over the justifiable concerns that you have, we will probably never solve the problem and never get past it. Historically, parts of the Highlands have apparently been the exception.

12:15

If we face having increasingly scarce resources, we need to ask ourselves—as any business would—where we will make the greatest impact using those scarce resources. I know that you are doing that. I would like to see more jobs in North Ayrshire, but I fear that, for the foreseeable future, most of the jobs that will be created in that part of the world will be in Glasgow and its hinterland, and people will migrate to those jobs. I think that that will happen, as such things are happening everywhere else in the world.

I mentioned rural growth rates in parts of England. It is true that there have been significant growth rates in some rural parts of the south of England, but overall, the great growth surge in England in the past 10 years—if I may call it that—has been in the urban centres, notably Manchester, Leeds, Bristol and two or three other areas. Nottingham is doing very well on the back of life sciences. There are compelling reasons for what has happened which we will never overcome, I think, however well intentioned we may be.

Stuart McMillan: I want to follow up on an earlier comment that you made about grants not

working in the long run, Dr Crawford. You referred to going for more debt and equity. In light of how the whole enterprise structure is currently structured and the moneys that it has, would it be wise or useful to suggest putting an element of the funding aside for urban areas outside cities so that they will not fall too far behind when other international companies want to come to Scotland or more people want to migrate to the cities? When or if a company decided at some point in the future to relocate from a city to somewhere else, it could then go to somewhere with good infrastructure rather somewhere with very little because nothing had been invested there for a considerable period.

Dr Crawford: I wish that I could answer your question as directly as you require. I chair the urban regeneration company for the Clyde gateway area, which has suffered appalling demographic difficulties, losses of jobs and people and all the things that go with that over many decades. However, I believe that the area is full of opportunity—I would say that anyway, would I not?—because of the M74 extension, its proximity to central Glasgow and beyond, and, of course, the imminence of the Commonwealth games. In doing what Scottish Enterprise and the Scottish Government are strongly supporting us in doing, we are investing in opportunity, which is a good and sensible thing to do, even in an area of deprivation. Over the longer term, that will yield benefits for the taxpayer and, I hope, reverse the awful population decline that the area has suffered from.

The key phrase is “investing in opportunity”. There are other parts of the country where the ask is too great. The more we deal with scarce resources, the greater the ask becomes. I suspect that that is not the response that you would like, but I would not do what you suggest. I would invest in businesses, let them determine where and why they will grow their business, and let the responsible authorities in council areas respond to those businesses’ needs where they are able to do so. I know that that is not the response that you want, and I probably would not have given such a response 10 years ago, but that is my view now, to be honest.

Marilyn Livingstone: You have said that the two issues that we should focus on are access to finance and skill sets. I want to ask the panel questions about both of those issues.

On access to finance, I know that you do not want to get caught up in structures, but how has support for SMEs in particular benefited or suffered with the removal of functions from Scottish Enterprise to local government? What effect has that had? It is not just about funding; it is also about the removal of what was perhaps

seen as expertise in local areas. Obviously, Robert Crawford knows my area of Fife very well. I refer to the removal of Scottish Enterprise Fife and its expertise, as well as the removal of funding. I think that Steve Thomson talked about bringing people together in partnership working and how that has been affected.

My second point on access to funding concerns venture capital. John Robertson, the managing director of a company in my constituency called Burntisland Fabrications—BiFab—which is at the leading edge of offshore wind technology, has told this committee that it cannot get access to long-term funding. How do we support such companies to secure investment that might not bring rewards until 10 years down the line?

Dr Crawford: I have been out of Scotland for the best part of seven years—some would say that that is not long enough. It would, therefore, be dishonest of me to comment on your first question. I have read the responses that the committee has received on the relocation of the small business advisory services. Many seem to be supportive and others seem to be less so. I will leave it for others who are closer to the issues to comment. My honest answer would be that I do not know the answer to your question.

I am appalled and surprised to hear what you say about BiFab. That is exactly the issue that we need to address because BiFab is exactly the kind of business that we should be investing in over the long term, as it is an innovative and internationalised business. That is the fit and proper role of an investment bank.

Marilyn Livingstone: BiFab was raising the general issue that there will be no reward for 10 years on some of the investment that is currently needed. How does the country support such a company to ensure that it remains a world leader? BiFab is not facing issues at the moment. The question is, how do we enable companies to grow over that longer period?

Dr Crawford: There are a number of ways in which research and development investment support can be provided. Earlier, Donald MacRae mentioned tax breaks, which are appropriate in that regard. I strongly favour the use of tax as an instrument to incentivise and support R and D. We are currently underperforming on research and development against the UK average, and the UK is significantly far down the Organisation for Economic Co-operation and Development league table. Our performance in that regard has not improved very much over the past 10 years or so.

I would encourage an investment bank, subject to the commercial sense of the investment, to take a longer-term view about whether investment will pay off.

I sound one word of caution about R and D. I hesitate to get into this issue, but there is an assumption that R and D is always a proxy for economic competitiveness. However, it is not. Innovation is not necessarily dependent on R and D. Some of the most innovative companies in the world do not do much R and D. I endorse the idea that we should support R and D, but we need to be careful about assuming that R and D always leads to superior performance because, economically, that is not true. The best example of that is Japan, which always comes top of the R and D league table but of which it could hardly be said that it has been one of the stellar economic performers over the past 20 years. A country that, until recently, has done badly in terms of R and D spend is China, for obvious reasons—it is now addressing that issue. It was an importer of other people's ideas and technology, and did that effectively.

Professor MacRae: I will comment on the business gateway, which I think is what you were talking about.

Marilyn Livingstone: No; I was talking about the removal of the responsibility for local economic development from Scottish Enterprise and the demise of the local enterprise network in Fife and across the country. Those functions were given to local government. What effect has that had on economic development?

Professor MacRae: The business gateway is relevant in that regard, and I would like to comment on it. As you know, the functions of the business gateway were transferred to local authorities in 2007. I understand that all the operators that were in place before the transfer are still there.

Marilyn Livingstone: That was not what I asked. I was asking about—

Professor MacRae: I understand. I will come on to that in a moment, if I may.

Dr Crawford: I am sorry for interrupting, convener, but I must beg permission to leave. I have to get back. I thank members for their questions and for listening to my answers.

The Convener: Thank you for attending, Dr Crawford. I am sorry that we have been running a little behind schedule.

Professor MacRae: I will return to the question about LECs and their successors but, to finish on the business gateway, I point out that the figures suggest that since the transfer there has been little change in the numbers of businesses that have opened, been created and so on. However, if we look behind the figures at the types of businesses that have been created and their potential for growth, we will find that those targets have not

been met, although I should add that that situation is the same as it was before the transfer. The jury is still out on how well the transfer has worked. Of course, these contracts will be awarded in 2012—or next year—and there will have to be a review of how well they have worked. As I have said, though, there is no evidence to suggest that there has been either a huge increase or a fall in performance, except for the fact that the targets for creating businesses capable of high growth have not been met.

As for the LECs, I hope that the committee supports the establishment of the regional boards. Again, I see no evidence that removing the LECs has had a very negative effect; in fact, when I joined the Scottish Enterprise board, I was very much in favour of streamlining the organisation into its current structure and of maintaining local delivery, which is really quite critical. I see no conflict between those two elements, but regional boards need to be strong and there must be a vehicle to ensure that their voices are heard and their presence felt.

As for Robert Crawford's point about innovation, I should say that if our record on innovation was that poor we would not have been able to maintain our level of GDP per head. Innovation is taking place that has not actually been captured in some of the R and D statistics, but it is certainly true that our businesses and our economy as a whole are still not investing as much in R and D as I think they should.

Steve Thomson: Picking up on a couple of themes, I believe that, as far as innovation is concerned, the tax system is a good way of incentivising companies to commit. As an ex-banker, I would observe that most companies think that money is too expensive, that there is not enough of it and that it is not given readily enough. However, that is simply a standard response. Obviously they think that they have a great idea but that it is always someone else who assesses the risk, which is one of the classic struggles between business and finance. Again, that tends to blur things and some of the issues can get lost.

BiFab is a good example. Even though, with my former banker hat on, I think that it is a good long-term play, I am still concerned that it will find it difficult to access long-term capital, particularly given the outlook for renewables. If that long-term finance is not available, the case made by Robert Crawford might well have some justification. Despite what people might think, bankers are in the business of managing risk and a good fundamental macro-situation is a good underpinning for a company that is principally involved in subsea connectors and structures.

BiFab is, in fact, a good example of what HIE has been trying to support; indeed, it has

supported the company's activities at Arnish in Stornoway. That is part and parcel of what our agency has been doing. Like the person who I think said the same thing earlier, we see renewables almost as a revolutionary change for the Highlands and Islands, bringing large-scale employment and substantive investment well beyond any of our previous expectations. Argyll array alone has a capital cost of £7.5 billion, but there is no doubt about the issue of the Scottish Government's commitment to exploiting all that. Our major concern, which is probably at a very much lower level than that of Scottish Enterprise, is that many communities in the upper parts of the west coast will simply get skipped over. At a presentation that I attended recently on Thanet, which is the offshore wind farm off the coast of Essex, I learned that only 10 per cent of the content actually came from the UK. We must be very careful not to reproduce that scenario.

12:30

The LECs went in the Highlands and Islands, which undoubtedly caused some unhappiness. In the past couple of years, we have taken various measures to try to resolve the local connection issue. Our local panels, of which I have attended quite a few meetings, have become good forums for businesses to discuss what they think of HIE and what they see as major issues. Most of the sessions that I have attended have been animated and have had a good flow of views. The partnership between the two sides has been strong.

The business gateway system had a difficult birth. A major transformation undoubtedly took place. Local authorities had trouble in starting up and a major gap existed. However, we have been keen to maintain a single door of entry—for example, many Skills Development Scotland and business gateway staff are co-located in HIE offices. The people have remained largely the same and they are in the same locations. We might have changed some people's hats, but we have not fragmented the system, and people still work as a coherent whole. The passage between each of the organisations is developing and is improving all the time.

Marilyn Livingstone: My point was that BiFab is successful and innovative and is already a world leader. For it to keep that position, it must look 10 years down the line. The Government's role is to support successful companies such as BiFab through the next 10 years; otherwise, it is argued that those companies will lose their position and companies from other countries, where industry is being supported, will take over their market share. We must be careful about that. I tried to ask about that issue; I was asking not about R and D, but

about how we support successful companies that are world leaders in new technologies to keep their position. We heard Chris Harvie going on about how Germany is jealous of where we are on wind power. BiFab says that no support from the Government is in place. The Government's role is to support such industries; that is what I asked about.

Steve Thomson: The point is fair. We have talked slightly at arm's length about Nokia, with which I was quite heavily involved about 20 years ago, when it started to break into international markets. From my contact with that company, I have no doubt that the Finnish Government's role in supporting its activities was big—that applied to everything from higher education to research grants. Such companies do not emerge without any assistance—governmental commitment is a key element of success.

The Convener: I will ask about governance. To what extent is it the role of enterprise agency board members and boards to challenge the policies that are put to them and how much is it their role just to implement those policies?

Professor MacRae: I am delighted to be asked that question because, in my experience of Scottish Enterprise's board for the past six-plus years, it has operated to a high governance standard. The minister sets the objectives, but how they are delivered is up to the board. We and I used to—and still do—challenge the executive manager many times to justify their policies. I assure members that that happens to a high degree. I am also a board member in the private sector and I assure members that one of the most positive aspects of the development agencies—although I have not been involved with HIE to the same extent as Scottish Enterprise—is that they operate to a very high governance standard and that challenge takes place frequently and continually.

I make no apology for lobbying for change in one area. Scottish Enterprise's budget should be bigger than it is at the moment. I realise that adjustment must be made among all the competing items in the Scottish Government's budget, but a good case can be made for increasing the budget from the current level.

Steve Thomson: There is a surprising amount of challenge. Having had no involvement in the public sector, I definitely came to the post with the expectation that it would be somewhat sleepier than it has been. There have been interesting discussions around the board table about strategy and HIE's approach to certain problems. That has been a constructive process for both officers and board members. There has been a very positive and dynamic relationship that I would like to continue.

I am with Donald MacRae on the funding issue. We have talked a great deal about renewable energy, which will be a major development opportunity for the Highlands and Islands. At present, with the amount of available funding constantly slipping and calls on that money becoming larger, we may not be able to meet and to answer the demands of companies such as BiFab, which can address the issue on both a national and an international basis. I sound only one warning. Renewable energy is the biggest opportunity that we have had in the past three or four decades. We should be careful not to let it slip simply because there is insufficient funding and commitment to support it.

The Convener: Thank you for your comments. Steve Thomson's final remark is interesting. Over the past few years, the committee has raised the issue of the decline in real terms in the enterprise agencies' budgets, even at a time when Scottish Government resources were still increasing, but neither the Highlands and Islands Enterprise board nor the Scottish Enterprise board raised concerns with us about those reductions. I make that point for information.

I thank Professor MacRae, Steve Thomson and Dr Crawford, who had to leave a little early, for coming along. Their evidence has been helpful in our inquiry. I ask members to stay behind for a couple of minutes after I have closed the meeting for a quick chat on progress. At our next meeting, we will take evidence from the senior management of the two enterprise agencies.

We have a fairly busy couple of weeks in the chamber. This afternoon, we will contribute to the debate on the draft report on proposals and policies. Tomorrow, there will be a debate on the energy market review. Next Wednesday afternoon, subject to the Parliament's approving the Parliamentary Bureau's recommendations today, there will be a debate on the report on our inquiry into internationalisation.

Meeting closed at 12:37.

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