



The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

FINANCE COMMITTEE

Wednesday 24 October 2012

Session 4

© Parliamentary copyright. Scottish Parliamentary Corporate Body

Information on the Scottish Parliament's copyright policy can be found on the website - www.scottish.parliament.uk or by contacting Public Information on 0131 348 5000

Wednesday 24 October 2012

CONTENTS

	Col.
DECISION ON TAKING BUSINESS IN PRIVATE	1699
DRAFT BUDGET SCRUTINY 2013-14	1700

FINANCE COMMITTEE
26th Meeting 2012, Session 4

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Gavin Brown (Lothian) (Con)

*Bruce Crawford (Stirling) (SNP)

*Michael McMahon (Uddingston and Bellshill) (Lab)

*Elaine Murray (Dumfriesshire) (Lab)

Jean Urquhart (Highlands and Islands) (Ind)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Professor John Kay

CLERK TO THE COMMITTEE

James Johnston

LOCATION

Committee Room 3

Scottish Parliament

Finance Committee

Wednesday 24 October 2012

[The Convener *opened the meeting at 10:00*]

Decision on Taking Business in Private

The Convener (Kenneth Gibson): Good morning everyone, and welcome to the 26th meeting in 2012 of the Finance Committee of the Scottish Parliament. I remind everyone to turn off BlackBerrys, mobile phones, pagers and so on.

We have received apologies from Jean Urquhart.

Agenda item 1 is to decide whether to take items 3, 4 and 5 in private. Do members agree?

Members *indicated agreement.*

Draft Budget Scrutiny 2013-14

10:00

The Convener: Our next item is further consideration of the draft 2013-14 budget. I welcome to the meeting Professor John Kay. I thank him for his paper, and invite him to make an opening statement before I open up the meeting for questions.

Professor John Kay: Thank you, convener. I begin with an apology to the effect that, as my excellent secretary was on holiday for part of last week, the committee received a document that was edited only by me, and not very well. It contains a number of typos, for which I apologise. I hope that those will be self-explanatory as we go through. We have, with the clerk, posted a proper version of the document on the Parliament website.

I think that I will be most useful to you not by expressing opinions—the committee seems to have plenty of people coming along to do that—but by setting out a framework for the type of issues that, if I was in the committee's position and asking the type of questions that you are asking, I would address and examine in the budget, and on which I would quiz the Government.

My starting point is that if we ask what contributes to growth in Scotland, the answer is that growth in Scotland is basically created from Scottish businesses, and we are therefore asking what the Government can do to help businesses.

Broadly speaking, I think that the Government can do that in three ways. First, it can provide infrastructure—by which I mean both physical infrastructure such as transport and utilities, which are preconditions of commercial life, and social infrastructure, which covers the education and skills of the people who work in Scottish businesses, the houses in which those people live and the like.

Secondly, Government can provide sector-specific initiatives of various types. I have a very firm view on that. In the 20th century, globalisation made it much more possible for small states to prosper economically than had previously been the case. To stylise a little—but not too much—the 19th century involved the expansion, growth and development of large states and empires. That happened in large part for economic reasons, because getting control of larger quantities of resources was seen as being the key to both military strength and economic prosperity.

In the 20th century, that trend essentially reversed itself. A large part of the reason for that was that it became possible, as a result of the

freeing of global trade and capital movements, for small countries to operate in a global environment without having to have within their own borders all the resources—either physical or skill resources—that are needed to create a prosperous society.

The corollary is that the small state operates in a global world through particular specialisms that are developed on an international scale. If we look at the successful small states of Europe—for example, Denmark, Finland and Switzerland—we can identify particular specialisms in all those countries that are reflected in various groups of their firms and which are rooted in the history and culture of their societies.

That operates in the same way as the success of individual businesses, which—as I have stressed in a great deal that I have written—is based on distinctive capabilities. We need to ask ourselves not only what can we do well, but what can we do that other people find difficult to do as well as we do it. There are usually not many such things, but it is key for us to think about what they are and to work on developing them. That is, in my view, what an industrial strategy for Scotland ought to look like, if one identifies—as I think the Scottish Government has done in the past few years—the areas in which it is possible to say that Scotland has such advantages.

We have the same advantage as the United Kingdom in being an English-speaking country, which is a real advantage in business services and in aspects of the media. That advantage has been reflected historically in Scotland's strength in financial services. We also have strengths in the energy services that flow from development in the North Sea and our proximity to it. We have a position in premium food and drink: around Europe, a lot of high-quality produce at the top of the market comes from Scotland.

We have, historically, strength in medicine, and people have talked about translating that into a modern strength in life sciences. That is plausible, but I am not sure that we have yet been very successful in commercialising our capabilities in that area. It is obvious that our landscape and scenery also give us a potential competitive advantage in tourism.

The focus that I am describing is on asking about our particular strengths as a country, and how we can focus an industrial policy around those. That takes me on to the challenge that I think the committee should be throwing at the Government: you should ask how it is focusing on the strengths, what it is doing to develop skills and capabilities in those industries and what it can do to contribute to success.

As the paper that I prepared for the committee points out, when people talk about industrial

strategy, they talk about picking winners in a rather disparaging way. What I have said so far is exactly about picking winners. The reason why that has such a bad reputation is that people have tended to pick sectors that were not winners, but which they would have liked to be winners, or sectors that were losers that people wanted to turn into winners. The winners that I am talking about are real winners, in which there are good reasons for believing that we have a competitive advantage.

The third area is to do with macroeconomic policy. As we all know, the Scottish Government has relatively limited leverage in macroeconomic policy, but it has some ability to set priorities and to make allocations in the budget. That raises issues about capital versus current expenditure, the directions of expenditure and the possibilities of emphasising—for reasons of recovery—sectors that are both particularly cyclical and employment intensive. Construction is a sector that most obviously jumps out in that regard, because it is employment intensive and has been particularly severely hit by the recession. It also fits in with some of our other requirements with regard to infrastructure.

I have raised those issues simply to open up questions about some of the areas in relation to infrastructure on which the committee should be asking questions.

In my submission I mentioned transport, telecommunications and other utilities. For example, on transport, how much activity is directed towards helping business rather than towards doing things for consumers? I asked challenging questions about broadband strategy, because for the foreseeable future there will be severe pressure on public expenditure and there must be priorities. We can no longer just do things because they are nice to do; we must do things because they are more important than other things. That applies to everything that we do.

I am conscious that in Scotland in the first few years after devolution we had—to be blunt—too much money. I think that other witnesses have made the same point. As a result, it has taken us a long time to get into the right frame of mind and to realise that budgeting and finance are about deciding priorities rather than deciding what it would be nice to do. Perhaps I should end on that point. I might have said enough to provoke discussion.

The Convener: You have left that idea hanging. Thank you for your opening remarks and for your brief briefing note. In your note and in your remarks, you gave us many questions to put to the Scottish Government. John Swinney will appear before the committee at our meeting in Hawick a week on Monday, and we will no doubt ask a

number of those questions. However, I am sure that I speak for most—if not all—committee members when I say that we are keen to hear your views on the questions that you have posed. I will put you in the hot seat and I hope that you will not be too coy in giving answers.

The committee wants to ascertain whether the Scottish Government is on the right track in the context of its priorities in these difficult times. I will ask about three issues before I bring in other members. You asked:

“to what extent is transport expenditure directed towards improvements which promote growth”,

as opposed to

“those that offer direct consumer benefit?”

What do you think? Is the balance right, or is there too much or not enough emphasis on consumers?

Professor Kay: I will not entirely duck your request for me to express my views.

The Convener: Good.

Professor Kay: However, much of what the committee and people like me should be doing is about asking questions of and teasing information out of the Government. In some areas we might not have the information that we need in order to take a view.

I flagged up transport as I did because I had two concerns in mind. One is that our transport concerns might be rather more consumer friendly than they are business friendly. We have been spending quite a lot on rail, and such spending is mainly directed at consumers, rather than at business. I am also slightly concerned by the inclination to promote flagship projects. I have been looking at the issue mainly in an English context and I do not have examples of specific instances in Scotland, but in relation to transport priorities I have been struck by the extent to which people have focused on large improvements and large projects, where we can easily see the difference, although larger returns could be had from piecemeal improvements.

10:15

In some of the work that I have done on that in the English context, I focused on one or two particular areas where there are spectacular returns to be gained from improvements that have been postponed for 20 years because, every time there is budgetary pressure, people knock back those projects. There is a mile of the A21 between London and Hastings that has needed to be dualled for more than 20 years, and there have been dualling plans for 20 years, but every morning and evening there are still long tailbacks on that mile of road, which is bad for business and

consumers. In transport, there is a lot of mileage in looking at little items rather than the big ones that tend to attract more political attention.

The Convener: I understand that. You talked about businesses versus consumers and you mentioned rail. Should more emphasis be put on road maintenance or new road building?

Professor Kay: Yes.

The Convener: Obviously, most freight now goes by road.

Professor Kay: As you know, a certain volume of freight goes by rail, but it is generally low-value traffic.

The Convener: That is right. It tends to be things such as coal, rather than finished goods.

Professor Kay: Yes.

The Convener: You also touched on broadband, which is a fairly high-profile issue. Certainly in my constituency, many businesses and consumers want superfast broadband to be rolled out as soon as possible. From your briefing and statement, I take it that you might not be so supportive of that, although I could be wrong. Will you say a little more about that?

Professor Kay: It is an interesting issue. Other people have done more work on the subject and I have been impressed by some of the things that I have learned from them. The cost of providing widespread very fast broadband is high, but the business benefits are not clear or substantial. There are benefits to a small number of firms that use large quantities of data, but those firms are mainly in financial services and are concentrated in areas where it is relatively cheap to provide such broadband. Bluntly, much of the benefit of very fast broadband is about the rapid download of movies—that is the really data-intensive thing that consumers use. To my mind, that definitely falls into the “nice to have” category.

On priorities, I am impressed by the argument that it is a lot more important to get the people who are digitally excluded—because they do not know how to use computers or do not have easy access to them—online so that Government services can be delivered to them online and so that they can get other benefits from being connected to the world. To caricature for a moment, I say that that is a lot more important than enabling people in remote areas to download movies quickly.

The Convener: This is starting to develop into an interesting discussion. I am tempted to hog it, but I will not, because I know that my colleagues are desperate to leap in and ask questions. Therefore, I will restrict myself to asking about one other issue that you touch on in your briefing.

Bruce Crawford (Stirling) (SNP): Convener, may I ask a question about broadband before we move off that, or can we come back to it?

The Convener: Do not worry—we can come back to it.

Professor Kay: I did not think that I would get away with that one unchallenged.

The Convener: I thought that I would give members a few minutes to reflect on the professor's comments.

Bruce Crawford: Very good.

The Convener: You talked about picking winners. In your briefing and opening statement, you have mentioned areas where Scotland has competitive advantages, such as food and drink, financial services and life sciences. Do you feel that the budget will help to advance those industries?

Professor Kay: I do not see much that is relevant to that agenda, if I am honest.

The Convener: That is fine—we are trying to find out your views on such issues. How could the budget be tweaked to emphasise those areas?

Professor Kay: It is difficult for me to make specific suggestions. If I was determining expenditure priorities for the Government, I would have in my discussions champions for the sectors who would constantly challenge me to answer the question, "How does this help the industries that are important to Scottish development?"

The state of the industries varies widely. A lot of large firms in Scotland are engaged in financial services and we have a lot of collective activity by people in that sector. On the other hand, the food and drink industry and the tourism industry are fragmented. We have some strength in them in aggregate and we have a potential competitive advantage in them, but I do not feel that we have strong Scottish firms or a strong collective Scottish identity in those two industries. We have a lot more potential in both those industries than we have succeeded in realising.

I have not come to the committee with, and I do not have, specific suggestions on how we might address the situation. We need to have in those sectors Scottish firms that are globally identified as leaders. I mentioned Denmark, Finland and Switzerland: we all recognise globally leading firms from those countries in the areas in which they are strong. That is not true of the sectors in Scotland that I just talked about.

The Convener: I know what you mean—Finland has Nokia, Denmark has DONG Energy, Switzerland has Nestlé and all the rest of it.

Professor Kay: There is Novo Nordisk, and so on.

The Convener: Surely the food and drink sector in Scotland is doing really well—growth in that sector's value is high. A recognised firm might not exist, but Scottish products such as salmon are well recognised overseas. The Scottish tourism brand—which is the image of the Highlands, whether we like it or not—is a tremendous brand that is recognised worldwide, even if individual firms in the sector are not recognised.

Professor Kay: The brand is tremendous, but is it all that successful in economic terms? When I looked at the number of visitors to Scotland, it struck me that we ought to be doing a lot better. If one compares Scotland with other small European countries that are less accessible than Scotland and which might have less appeal to tourists than Scotland has—we have a combination of spectacular historical monuments and amazing scenery; we are a great tourist story—I think that we could do better in the numbers that we attract. As you say, we do not have recognisable Scottish firms that are leaders in the sector.

Elaine Murray (Dumfriesshire) (Lab): I have found your paper and the discussion to be extremely thought provoking. I am not sure whether I agree with everything that you have said, but I agree with some things.

Professor Kay: There would be no point in my being here if you agreed with everything.

Elaine Murray: I agree about the importance of investment in some smaller projects that can make a big difference locally to businesses and consumers. You seem to separate the interests of consumers and businesses. Are you saying, for example, that we should not undertake certain rail projects now? Public transport gets people to work, which supports business, and it gets visitors around the country to view tourist attractions and so on. Are there certain public transport projects that you think are not worth while?

Professor Kay: I shall explain what I mean. In the end everything is for consumers—or at least for citizens. Predictably, in a sense, the sense that you get from the Confederation of British Industry Scotland submission is that there is a business interest, which is different from the citizen interest. Of course there is not, because business exists to serve citizens. If we impose taxes on or give help to business, in the end the taxes are taxes on people and the help to business makes sense only if—directly or indirectly—it helps Scottish people. The transport infrastructure that gets people to work is clearly just as important as the transport infrastructure that gets goods into shops or away from factories. There is not an issue there.

I have a sense from some of the priorities in Scotland in the era since devolution that there has been more interest in pursuing things that would be immediately popular with voters than things that would contribute to the long-term development of the Scottish economy.

Elaine Murray: Can you give us an illustration or two of that?

The Convener: Go on—you know you want to. [Laughter.]

Professor Kay: I know that I do not want to. [Laughter.]

I cannot help but be sceptical about what one or two commentators have described as the “culture of ‘free’”, which is concerned with prescription charges, bridge tolls, tuition fees and personal care. In my view, all those are aimed at what are—I am choosing my words carefully—known to be popular policies among affected groups but which may not properly reflect underlying Scottish Government priorities in terms of using public expenditure either to promote equity in Scotland or to promote economic development. I have chosen my words as carefully as I can.

Elaine Murray: I appreciate that your comments are very carefully worded.

I will briefly raise two other issues. The first is broadband. You made the point that very fast broadband is attractive to consumers if they want to download films and so on, but is perhaps not necessary for business. Should broadband investment be skewed towards providing everybody—all businesses in Scotland—with a sufficiently fast system to enable them to compete rather than concentrating on very fast delivery in certain areas?

Professor Kay: The underlying message in all of this is that we must look at the cost versus the benefit.

In a sense, Scotland is a rather strange country, because it has a rather densely packed central belt where it is not terribly expensive to provide such connections for a lot of people, but it also has a very large land area where it becomes more and more expensive to provide such connections. Because of that, I am sceptical about what I think is the slogan-driven approach to thinking about such things, when we state that we need to become number 1 in some aspect of digital development. Getting such connections to very wide areas of the country may prove to be terribly expensive relative to the benefits.

We can discriminate between business and consumers for these purposes only in our choice of the areas in which the connections are provided. In a rural area it is not cheaper to

provide broadband to businesses but not to consumers; we provide it to the area or not at all.

We just need to look sceptically at all the choices. For me, the benefits need to be demonstrated in relatively specific terms. We cannot frame the issue as people saying, “We need to be number 1,” or “X per cent of the population of South Korea have superfast broadband, therefore we need to do the same in Scotland.” I do not think that that is a very strong argument.

10:30

Elaine Murray: I was intrigued by your statement:

“The ideal business tax is one whose impact is largely exported”.

That sounds like the mythical beast of a popular tax. Can you give me any examples of the type of taxation that you were thinking of when you made that statement?

Professor Kay: Yes, I could. What is Scotland’s iconic product?

Elaine Murray: I would say whisky, but that is maybe just me.

Professor Kay: Yes, of course it is whisky. It is a product in which we have a competitive advantage because it is probably the only product anywhere that takes the name of a country when people are talking about it. That would be a business tax that would be substantially exported.

Elaine Murray: Do you mean putting a taxation on whisky before it is exported?

Professor Kay: We are talking about a tax on the production of whisky, not a tax on its consumption.

Elaine Murray: Yes, I mean a tax on its production.

Professor Kay: That illustrates the point that who a tax on business is a tax on depends on the structure of the tax. That kind of tax, which might be exported, contrasts with a tax on a competitive industrial product, which might simply damage Scottish business to nobody’s benefit. For example, the tax on large retailers in Scotland is, in effect, a tax on Scottish consumers.

John Mason (Glasgow Shettleston) (SNP): The discussion has been very interesting so far. I want to touch on the infrastructure issue—rail, broadband and such things. You have said that we sometimes make decisions for the short term rather than the long term. I suppose that that is one of the disadvantages of being a democracy. Over the years, we have struggled to keep populations in the more rural areas of Scotland.

Therefore, in the long term, is it not a good idea to develop the infrastructure even if, in the short term, that does not produce quite as big a result?

Professor Kay: Yes, we have to ask such questions. It is possible that the only way in which we will keep people in rural Scotland is by enabling them to download movies very quickly, but I would try other things first.

John Mason: On rail, I wonder whether it is possible to disentangle the benefits for the consumer from the benefits for business. We are trying to improve the Glasgow to Edinburgh rail links, and business is enthusiastic about that. The feeling among businesses seems to be that, if those two cities were joined up better, that would provide a boost to business. It would help individuals who live in Glasgow to work in Edinburgh and vice versa, which might not be a great advantage but might mean that an individual business might have a bigger pool of people from which to draw. Do you think that we can disentangle those things?

Professor Kay: We can disentangle them to some degree. A faster rail link between Glasgow and Edinburgh would have substantial benefits both for consumers and for business. Do we want high-speed rail links between other Scottish cities? I have not done or seen any specific cost benefit analysis of such proposals, but from what I have seen of other cost benefit analyses of high-speed rail it seems very unlikely that it would be a sensible transport priority.

The Borders rail link raises rather different issues and was one of the projects that I had in mind when I raised the question in my written submission. We need to be very careful when we think about claimed benefits for a particular transport link and to examine whether they are simply attracting activity from one area of Scotland to another or are actually generating new activity that would not take place anywhere in Scotland if the rail link did not exist. That is the question that needs to be posed. I use that example because, in my view, the distinction was not made in the discussion about the claimed benefits of that particular proposal.

John Mason: That again is quite difficult to disentangle. Is the Glasgow to Edinburgh link, which we are probably all quite familiar with, really boosting business in the two cities or is it simply making it more convenient for people to travel back and forth and giving them more of a choice about where to live, which, in itself, might not benefit business? Can we disentangle that?

Professor Kay: It will benefit business if people spend less time travelling between the two cities and if businesses in one city or the other find it easier to attract people who work in other parts.

John Mason: But will people not simply live further and further away? After all, is that not what happened in London? When the rail links were improved, people started to live in Peterborough and wherever.

Professor Kay: That is true, but such improvements have produced benefits to consumers and to businesses in London in their ability to attract good and skilled workforces. Of course, it also means that people do not arrive at work flaked out from travelling an hour and a half.

John Mason: On the issue of education, can you expand on the comment in your submission that we have to consider

“different components of education expenditure, especially between higher education and the rest”?

Should we be putting more into further education rather than higher education? Indeed, within higher education, should we be concentrating more on, say, engineering, food and drink and hospitality, which, as you have suggested, are the success areas, and have fewer people studying politics, history and so on?

Professor Kay: On the second part of your question, the education systems of the successful small economies of western Europe that I mentioned earlier are significantly biased towards the industries in which those countries have competitive advantages. I do not think that we have thought about Scottish education in those terms very much. It is a key issue that is directly relevant to the Scottish Government's priorities and budget, and holds true at further and higher education level.

The balance of priorities issue was raised in my mind because in this and the previous budget there has been an attempt to respond to worries that the Scottish higher education system might suffer from its very differential treatment relative to the English higher education system by shifting resources within the education budget towards that sector. That might be the right thing to do, but I have queries in my mind that it is and I would certainly want to examine the matter carefully before I believed as much.

Bruce Crawford: Professor Kay, you have opened up many areas that I want to ask about. However, I will need to concentrate on only a couple of them or the convener will not let me ask any more questions.

First of all, with regard to broadband, you highlighted some of Scotland's natural advantages or unique selling points. I think that the Scottish Government has already recognised many of those, although we need to ask whether it is putting enough money into them. You also said that we are an English-speaking nation and made

it clear that that is one of our great strengths. If that is the case, do you agree that it is economically important to get as many of our people as possible connected to the rest of the world in the best way possible and that broadband is one of the ways of doing that? We might need to work on how broadband is used to find out the skills, the opportunities and the growth that can be achieved from connectivity but surely, in principle, it would be a good thing and a great strength to have as many people in our country as we can connected to the system that the rest of the world uses through broadband. I realise that that is a big question.

Professor Kay: That sounds good when expressed in general terms. However, when we try to turn it round to specifics and discover that being connected to superfast broadband primarily means being able to download a movie in five minutes rather than half an hour, the arguments sound much less convincing. Equally, if the main need for superfast broadband in business is to download very large data sets for financial services firms, it will be absolutely essential to the competitive position of those firms based in Glasgow or Edinburgh, but it will not be essential—or even important—to the bulk of Scottish businesses, far less Scottish businesses and consumers located in rural areas.

Perhaps I can make a suggestion, convener. My thinking on this has been very much influenced by Professor Patrick Barwise at London Business School, who has done a good deal of work on the matter and is very convinced of the argument that we really need to spend our money and resources on bringing basic internet access to the whole population instead of providing superfast access to the minority of people who will actually make very effective use of it. As that argument is clearly important in a Scottish context, I suggest that you get his advice on what the right things might be for Scotland.

Bruce Crawford: Of course, the other associated issue is the structure of the Scottish economy. Despite our incredible history of producing entrepreneurs, we now have low entrepreneurial growth; moreover, instead of being based in large firms, most of the economy is based in smaller firms, many of which are, by their very nature, in more rural areas. This is not just about our competitive advantage and the fact that we are an English-speaking nation; we also need to think about the structure of the Scottish economy itself. The central belt will get connected to superfast broadband but in order to grow entrepreneurs throughout the whole of Scotland and to support the smaller business units that make up the structure of the Scottish economy we need a more disparate system of connectivity and

broadband than perhaps other parts of the UK, such as the midlands.

Professor Kay: Umm—

Bruce Crawford: I am arguing on my feet here—I am curious about the issue and am finding the discussion fascinating.

Professor Kay: I am not sure how many businesses regard the speed of their internet connection beyond a certain level as being an issue of critical business importance, but we can certainly get those facts. I certainly think that one has to pose the question in that way.

Your comments raise two fascinating questions beyond the issue of connectivity, the first of which relates to the kind of Scottish entrepreneurship that we have had over the past few decades. I sometimes describe the situation by saying that we have not had much entrepreneurship from the Scottish middle class. If one thinks of the successful Scottish companies that have been grown over the past few decades, one thinks of the transport businesses that were developed, essentially, by smart people who emerged from local bus garages. We are talking about people such as Jim McColl at Clyde Blowers, Tom Farmer and so on. They are not people who came out of our rather good Scottish universities. The people who have been our entrepreneurs have not had that kind of training from the Scottish educational system. We have had some entrepreneurial successes, but they have been of a particular kind. I would very much like to work through why that is so.

Closely related to that is the fact that the Scottish businesses that exist today are widely dispersed across Scotland. You are right about that, but a large part of the reason for that has been the steady drain of corporate headquarters out of Edinburgh and Glasgow, which is one of the extremely damaging things that has happened to the Scottish economy over the past few decades.

10:45

Bruce Crawford: I would like to move on to another area, if the convener does not mind—that of food and drink, which is one of those areas in which you thought that we could do better.

The convener mentioned the salmon industry, but I want to mention the Scottish whisky industry, whose exports seem to grow exponentially year on year. Maybe I am blinded by the numbers. The salmon and whisky industries are the two iconic ones, but our exports in beef, lamb and fish goods are increasing significantly—not that some of those areas are not experiencing difficulties; I could go on about that for ever. Those industries are closely linked to the branding issue of clean

highland spring water. We might not have iconic brand names—although Diageo in the whisky industry must come pretty close to that—but we have a branding system that we have emphasised for a considerable length of time that does not concentrate on specific firms, but which uses the brand of Scotland to push products from a wider section of businesses than just those that are iconic.

Professor Kay: Let me take whisky—

The Convener: Should we have a short break and break out the glasses?

Professor Kay: That is an excellent idea.

I think that the contribution that whisky makes to the Scottish economy is quite disappointing. People are impressed by the export figures, which have very little meaning as far as contribution to the Scottish economy is concerned. The whisky industry employs about 10,000 people in Scotland—that is the main contribution that it makes to the Scottish economy. As you know, the two largest whisky firms in Scotland are Diageo and Pernod Ricard, neither of which is a Scottish-owned business. I could go on.

I think that people are bemused by the export figures and that the contribution that the whisky industry makes to the Scottish economy is significantly overestimated. The growth of the Scottish whisky industry is not that impressive, given the extent of global growth in spirits consumption. There are a lot of questions that we should be asking about the whisky industry and its contribution to Scotland.

Turning to food and drink more broadly, you described Scotland as having a premium brand in food and drink. Potentially, it does, but I am not sure that that branding is realised.

When I talk to people outside Scotland and say that Scotland has a premium position in food and drink they think, “What?” but I talk about salmon, lobster, Aberdeen Angus beef and so on, and they say, “Yes, I see what you mean.” The issue is also tied up to the by no means irrelevant fact that the diet in large parts of Scotland is notoriously bad. When I was a child, we spent most of our summer holidays in Crail, in Fife, which you will know is a lobster port. However, I never ate a lobster and barely saw a lobster until I was an adult, and the first lobster that I ate was in London. For me, that is symbolic of the issue that we have in this area.

The Convener: I know what you mean. Sometimes, the self-deprecating image that Scots—particularly Scots comedians and people in the public eye—put forward of the mythical deep-fried Mars bar does not help.

Professor Kay: It is very unhelpful in branding Scotland.

The Convener: Yes, it is.

Gavin Brown (Lothian) (Con): Professor Kay, you have talked about the provision of infrastructure as a key issue. There are various types of infrastructure that we can invest in, such as transport and housing. Some of the money also goes to local government and some is invested in health and so on. When the budget is tight and there are priorities that will help economic growth, how do you compare investment in housing with investment in transport and other areas? Do you have any thoughts on how we can get the biggest economic impact when we invest in infrastructure?

Professor Kay: That is a large question. Across the UK as a whole, we have not spent enough on infrastructure for a couple of decades, and we all know the reasons for that. Every time that there is pressure on public expenditure, it is easier to identify items to postpone and to reduce capital spending of various kinds than to cut current spending. We must recognise that as a problem both in Scotland and in the UK as a whole at the moment.

There are no simple criteria to identify what one should be spending money on. The area that has been most neglected over a couple of decades is probably affordable and social housing. At the beginning of the Thatcher era, the construction of new public housing across the UK fell to almost zero and the amount of public housing that was lost was not replaced. In Scotland, where the contribution of public housing had been particularly large, there was significant growth in private sector housing but the overall levels of housing provision were far lower than in the eras when there were large public housing programmes and they are still far lower than they need to be in the long run to maintain an adequate and well-balanced housing stock. In that sense, housing would be close to the top of my list of priorities. However, for reasons that we have been describing it is difficult to make housing a priority because it is one of the most easily postponed of all items of Government expenditure.

The other area, which we talked about earlier, is the large projects versus the incremental ones. Two things have happened there—one, which we were describing earlier, is that large projects tend to be prioritised because they have more political appeal. The other thing is that for reasons that I find quite difficult to understand, the cost of constructing large projects seems to have risen a lot more than the cost of constructing smaller projects.

One example that stuck in my mind was the Forth bridges. The first Forth bridge, the great Victorian rail bridge, which is an extraordinarily overengineered structure—you just have to look at it to see that—cost £3 million in the early 1890s.

The new Forth road bridge, which was built in the 1960s, cost £25 million. That is about right given general inflation between the 1890s and the 1960s. We probably built that one a bit on the cheap, but nevertheless the order of magnitude was there. The right factor to use for inflation from the early 1960s to now is 10 for general inflation. We are talking about a lot more money than that for the bridge that we are building now and I do not know why. That means that the large flagship projects tend to run away with a disproportionate share of the overall budget—much more so than was true historically.

Gavin Brown: You also talked about the idea of focusing specifically on what we do well as a country, such as financial services, energy services and premium food and drink. Outside the industries in which we do well in terms of the whole industry, we have companies that do well in industries that are not favoured or which are not necessarily those in which we have an advantage. How do you strike the right balance between looking after the industries where we have a natural advantage without ignoring companies in other industries? That is one of the debates that always takes place regarding Scottish Enterprise. Do you completely ignore anyone who is not in your favoured group? How do you strike the right balance?

Professor Kay: I do not have a problem with companies that are doing well outside the favoured group, but as a small country—given the world that I have described—we cannot afford to be spreading our favours around in this area. It may be more difficult for you as politicians, but I would be ready to be very robust about this and say that in order to survive, there are certain sectors that we have to favour and that is what we are going to do.

We all know that that is what we have to do as individuals. We take for granted the idea that as individuals we focus on the things that we are good at. I try to be quite good at economics; there are a lot of things that I am very bad at, such as putting up the bookshelves at home. I realise that it is better for me to stick to economics and get someone else to put up the bookshelves. That is the nature of competitive advantage in the global economy as well as the household economy.

Gavin Brown: I am still searching for something to be good at.

Members: Aw.

Gavin Brown: I have one more question, if I may, convener.

When you look at the draft budget for 2013-14 as a whole and the actual numbers and decisions taken—as opposed to what might be said publicly about the draft budget on either side of the

debate—what are the Government's priorities in terms of the decisions that it has taken and how the numbers stack up?

Professor Kay: That is an interesting and provocative question. I will duck answering it, because I have set my research assistant the exercise of looking at the story. If we consider the pattern of Scottish public expenditure since 1999, how has it differed, as a result of devolution, from the pattern of public expenditure that we would have had if we had simply stuck with UK policies in the devolved areas? That is a question about the impact of devolution to which I would like the answer. The answer might or might not prove to be interesting, but we need it if we are to be able to give a good answer to your question, which is, "Forget about the political rhetoric; how do Scottish Government decisions reveal Scottish Government priorities?" I do not know the answer.

11:00

Michael McMahon (Uddingston and Bellshill)

(Lab): You suggested today and in your briefing note that we have focused too much on what is desirable as opposed to what we need. We have heard from many people who are involved in academia and the economy that we must think about how to get our priorities right. The phrase "preventative spend" keeps coming up—"preventative" is a buzzword. We need to focus what we spend now to ensure that we do not have to firefight or pay more in the longer term. The example of free personal care is usually given—it would be more accurately described as publicly provided personal care, because it is not free.

You talked about spending money that will benefit private business and the wider economy, but are there other areas of spending that we should prioritise, which will have a benefit in the context of public spending in the long term?

Professor Kay: "Preventative" is quite a good buzzword, although the area in which there is potentially the biggest impact—health, broadly, which is the issue that you raised in the context of personal care—is the most difficult area. To be blunt, we would make the Scottish population a lot healthier if we spent more on things that would make them healthier and less on treating them when they get ill. However, as I think that we probably all know and recognise from our own lives, that is not what the population wants to hear. People want someone to make them better when they get ill; they do not want to be told to eat less, drink less, stop smoking and take more exercise, even though that is the best way to improve health outcomes.

We have such difficulties in many areas of preventative spend. A striking example is offender

management and crime. Activities that might stop people committing crimes in the first place can be very cost effective relative to the cost of locking a person up when they have done something that we did not want them to do. The cost benefits of tagging people and letting them out into the community are also attractive.

We need constantly to ask those kinds of questions. In times of public expenditure pressure such approaches are difficult to take, because they are almost all about intangible investment in the future. They involve spending more money now so that we spend quite a lot less in future.

Michael McMahon: We have repeatedly heard concerns about evidence-based spending—that is, showing that the outcome gives value for money. On a number of occasions when we have talked about the amount of public investment in the private sector, the evidence has not appeared to be there. The example that I keep referring to is the small business bonus scheme. Organisations such as the Scottish Chambers of Commerce and the Federation of Small Businesses say that it is great that small businesses are getting assistance, and that they can show that there has been an improvement in some of the areas that have received it. However, other people have told us that, at best, one in 10 small businesses has the capacity to grow and that the assistance that a lot of companies receive from the small business bonus scheme might be to their detriment. That seems counterintuitive, but there is no incentive for them to be entrepreneurial and move forward when they like to be in the comfort zone where they receive the bonus and they do not want to move out of it. Do you have any comments or observations on that?

In your written submission, and again this morning, you talked about focusing on sectors. A lot of those sectors are dependent on those same small businesses. Would it be better to focus on small businesses and target investment to maximise growth, rather than to have a blanket approach under which small businesses of a certain size qualify for a grant without having to show what they do with it or actually having to grow?

Professor Kay: I cannot comment on the effects of the small business bonus scheme, because I do not have evidence to make that kind of comment. From what you said, no one has the evidence to do that. That obviously limits what I have to say.

More generally, I have spent my life believing in and advocating evidence-based policy. I have actually seen more and more of what I call policy-based evidence, where people think up a policy and tell people to go away and find the evidence to support it. Discussion on evidence-based policy

has unfortunately led to more and more of that. In some of the areas that you described, largely spurious calculations are generated to support the alleged benefits of policies. A lot of the work that is currently done on providing impact assessments and so on would be better not done, because they are superficial exercises that fall into the policy-based evidence category. We have persuaded ourselves that that is a process of rational decision making, when in reality it is the opposite.

In your specific final observations, you made the point that we would be better to be selective in our assistance to business. Everything that I have said is designed to encourage you to go down that direction. It is in the nature of economic growth in a small country that we decide that there are certain things that we are good at, and those are the things that we will focus on. That should be firmly in our mind. We are trying to be successful rather than to be fair between businesses.

John Mason: In a couple of answers you have mentioned ownership of business, especially the point that two main whisky producers are not locally owned. Do you believe that that is negative? Some people would say that it does not matter, as long as it is efficient—bigger is better. Business tends to be quite keen on being allowed to have mergers and acquisitions quite freely. That is clearly not something that Scotland or the UK has complete control over, although I believe that it is perhaps more difficult to take over or merge a company in other countries that we have mentioned such as Finland and Denmark. Should we be worried about that, or doing something about it?

Professor Kay: Yes, we should be very worried about it. As I said in an earlier answer, one of the most damaging things that has happened to the Scottish economy over the past two or three decades has been the steady migration of corporate headquarters out of Scotland.

One of the many bad aspects of the collapse of the two Scottish banks in 2008 was that, effectively, we lost a large part of the residual headquarters, which had become Scotland's two largest businesses. We should be worried about that, but it is almost too late for us to do much about it—even if we in Scotland had the power to do very much—because almost all the horses have left the stables.

John Mason: Those are the traditional businesses, but one would hope that a new brewing company or something similar would grow.

Professor Kay: We would hope so, and we would really like to keep those companies in Scotland.

John Mason: Is there an attitude problem on Scotland's part? Do we not want that enough? Do entrepreneurs not want to carry on doing that?

Professor Kay: It is perhaps an attitude problem. We have suffered in two ways, one of which involves the centripetal pull of the UK. A fair question is whether that would be different if Scotland was an independent country, and I do not know the answer. It might be a bit different, but the pull of London would exist whether or not Scotland was a separate country.

There is also the fact that the UK has had a policy on mergers and acquisitions that is probably the most accommodating of any of the major economies in the western world. That has not been a good policy for the UK, and Scotland has suffered from it.

The Convener: Your last comment about the pull of London is quite intriguing. We have talked about Switzerland being successful, but would Switzerland have the strong economy and high standard of living that it has if it was just the eastern periphery of France, a northern outpost of Italy or the southern fringe of Germany? Surely the fact that Switzerland has been able to set its own political and economic course over the past two centuries has had a significant impact on a country that, geographically, is half the size of Scotland but has no natural resources by allowing it to develop such a relatively strong economy.

Professor Kay: We are in danger of getting into a political argument in which I do not want to engage. I make the observation that, for many economic purposes, one would regard Switzerland as part of the economy of southern Germany. You can make of that what you will.

The Convener: I do not think that the Swiss would necessarily agree with that.

Professor Kay: I do not think that they would.

The Convener: Switzerland certainly has a higher standard of living than Germany in terms of purchasing power parity.

Professor Kay: One might also say that Holland and Denmark are to a very substantial degree part of the German economy, which goes back to what I said at the beginning about the role of small countries. That is a very sustainable and economically manageable situation to be in. Those countries are heavily economically integrated with their larger partners. That severely limits the degree of economic autonomy that they have, which everyone ought to recognise, but it does not prevent them from functioning as independent states.

The Convener: Nor does it prevent them from focusing on their own priorities. I know what you are saying about Switzerland, but I would have

thought that it would just be a mountainous rural area from which folk moved to find work in larger German cities if it was not structured in the way that it currently is. It has certainly avoided two world wars by being an independent state, has it not?

Professor Kay: One strange thing about Switzerland is how scattered its population is. The two major cities, Geneva and Zürich, are small relative even to the size of Switzerland.

Bruce Crawford: And they have broadband connectivity.

11:15

The Convener: Aye, indeed. They are also able to take decisions such as—anyway, I will not get into that.

I will return to the Scottish budget. I am sorry to digress, but it was after I visited Switzerland—once I had looked at their country and compared it to ours—that I decided to join the Scottish National Party, so it is very dear to my heart.

You state in your briefing that

"The Scottish government has limited levers in fiscal policy",

which we all acknowledge, and that

"Its macroeconomic influence is essentially confined to the effects of allocate and reallocate with an overall budget total".

Where would you reallocate—if you would do so at all—resources within the Scottish budget in order to fulfil the Scottish Government's set objective of sustainable economic growth?

Professor Kay: The broadest answer that I can give is that I would attempt—and I could do so only over a period of years—to exert much more serious pressure on current expenditure, which we know is overwhelmingly dominated by the two areas of health and education, in order to fund more capital expenditure not only in relation to health and education but rather more in relation to infrastructure, economic development and the like, which we have spent most of our time talking about this morning.

In a sense, one of the striking things about this morning's discussion, if we were to step back from it, is that we have not spent very much of our time talking about the main items on which the Scottish Government spends its money, which are health and education.

The Convener: I am keen for you to give your views on one or both of those areas of expenditure. Basically, I am asking whether we have got the balance right. If we have not, where should the balance be?

Professor Kay: In the first seven to 10 years of devolution, the Scottish Government had too much money. The result was a substantial increase in current expenditure on health and education services without any commensurate improvement in outcomes.

The difficult problem that we now face—which is the central budgeting issue in Scotland in the medium term—is how we gradually recoup some of that expenditure without doing too much damage to the level of service provision in those sectors. That will involve reducing relative pay and numbers in some areas. It is not the case that there was never any benefit from the additional expenditure, but there was not enough relative to the amount that was spent.

The Convener: I want to touch on the issue of broadband, which has been discussed quite a lot this morning. We have talked about download speeds and that type of stuff. If I was deciding to go on holiday to Orkney or Fort William for a week and tried to get in touch with a wee bed-and-breakfast or a hotel, and it took me half an hour to download information about whether they had any vacancies, I would probably decide to go somewhere else.

Tourism is integral to, and the basis of, a lot of those economies, so things such as having fast broadband connections make a difference even to very small one or two-person businesses, as well as to the wider business community that depends on them and to the whole structure of some of our rural areas. Those people should not be at a competitive disadvantage, and it is important that we connect them.

Professor Kay: I am not a person who gets into techno-geek discussions, but one would not need a very fast broadband speed to download emails for a B and B. One would certainly not need a superfast fibre optic cable to ask whether people have a room free on Thursday night.

The Convener: That is of course the case, but the difficulty is that some of those rural areas do not even have much connectivity at all. Part of my constituency effectively has dial-up internet. There is no real incentive to take steps to get an effective broadband connection unless we are going to go the whole hog and have a superfast broadband connection that would allow businesses the opportunity to expand in the locale.

I am talking about the Isle of Arran, which has businesses with 90 or 100 employees on an island of 5,000 people. Even rural areas have relatively large businesses in relation to their communities, and yet in some parts of the islands there are very basic connections that often do not seem to work. The level of frustration is high, and no one would expand or set up a business in places like that.

Highlands and Islands Enterprise and the Scottish Government are working to try to expand broadband in those areas so that we do not ultimately focus the whole Scottish economy on urban Scotland. We are trying to give rural areas an advantage.

Professor Kay: Right—I am in favour of that objective. All I am doing is trying to signal that we ought to be framing those issues in terms of costs and benefits, not in terms of trying to make Scotland number 1 in this, that and the other. It is easy for us to sit in the Scottish Parliament and make ringing declarations, but we have to ask whether each objective represents the best use of limited public money.

I do not want to say more than that, but I have read the Scottish Government's digital strategy and it does not seem to be asking questions about costs and benefits. It seems to be providing slogans about how exciting broadband is. That is not the way that the Scottish Government should be making expenditure decisions, nor is it the way that the committee should be reviewing them. I am stopping a long way short of saying that I am offering an alternative policy; I am just saying that there ought to be a lot more questioning of those objectives than there has been.

The Convener: Okay. We seem to have exhausted questions from members of the committee. I thank Professor Kay for his very—as Elaine Murray described it—thought-provoking submission, his answers to our questions and his opening statement.

As the committee agreed earlier, we will take the remaining agenda items in private.

11:22

Meeting continued in private until 12:09.

Members who would like a printed copy of the *Official Report* to be forwarded to them should give notice to SPICe.

Available in e-format only. Printed Scottish Parliament documentation is published in Edinburgh by APS Group Scotland.

All documents are available on
the Scottish Parliament website at:

www.scottish.parliament.uk

For details of documents available to
order in hard copy format, please contact:
APS Scottish Parliament Publications on 0131 629 9941.

For information on the Scottish Parliament contact
Public Information on:

Telephone: 0131 348 5000
Textphone: 0800 092 7100
Email: sp.info@scottish.parliament.uk

e-format first available
ISBN 978-1-4061-9769-3

Revised e-format available
ISBN 978-1-4061-9786-0

Printed in Scotland by APS Group Scotland
