The Committee will meet at 10.00 am in Committee Room 1 to consider the following agenda items:

1. **Cross Cutting Expenditure Review on Economic Development:** The Committee will take evidence from—
   - George Kerevan, Comments Editor, The Scotsman; and Alf Young, Policy Editor, The Herald; and
   - John Downie, Scottish Press and Parliamentary Officer, Federation of Small Businesses Scotland; and Donald MacRae, Strategy and Finance Director, Lloyds TSB.

2. **Efficient Government:** The Committee will take evidence on the Scottish Executive’s publication Building a Better Scotland - Efficient Government Securing Efficiency, Effectiveness and Productivity from—
   - Tom McCabe, MSP, Minister for Finance and Public Service Reform; and
   - Colin McKay, Head of Efficient Government Team; and Richard Dennis, Finance Co-ordination Team Leader, Scottish Executive Finance and Central Services Department.

3. **Budget Process 2005-06 (in private):** The Committee will consider its draft report.

4. **Gaelic Language (Scotland) Bill (in private):** The Committee will consider its draft report.
The papers for this meeting are:

**Agenda Item 1**

*Research by Peter Wood, Committee Adviser, dated 31 March 2004*

Written submissions

PRIVATE PAPER

**Agenda Item 2**

*Building a Better Scotland – Efficient Government*

**Agenda Item 3**

PRIVATE PAPER

**Agenda Item 4**

PRIVATE PAPER
Finance Committee

32nd Meeting 2004 – Tuesday 30 November 2004

Cross Cutting Expenditure Review on Economic Development – Written Evidence

1. The Committee has received submissions from the following organisations as part of its Cross Cutting Expenditure Review on Economic Development:
   - The Federation of Small Businesses in Scotland
   - Lloyds TSB Scotland

2. The Committee is invited to note these submissions.

Terry Shevlin
Finance Committee
SUBMISSION FROM THE FEDERATION OF SMALL BUSINESSES IN SCOTLAND

The Federation of Small Businesses is Scotland’s largest direct-member business organisation, representing 18,000 members. The FSB campaigns for an economic and social environment which allows small businesses to prosper. We therefore take a strong interest in all government investment decisions relevant to meeting the needs of business and welcome this opportunity to contribute to the Finance Committee’s review.

In our evidence we make some general points on the report before considering some more specific points and the questions posed by the Committee in relation to the report from Tribal HCH.

Introduction

This research is an interesting first stage in trying to come to a better understanding of what level of economic support may be appropriate in Scotland and of which types of support are most effective and efficient. The FSB has been continually calling for the Executive to improve its analysis of spending, outputs and outcomes, and the report is a welcome step to providing more focus on this issue. However, on its own, the report tells us little and further work is needed to look at different areas of expenditure (e.g. Business Gateway) and whether these are delivering their intended outcomes (e.g. increased business starts).

If this is the first phase of analysis, it would be useful to know what the Committee intends to consider in later stages. We would agree with the research (para 2.7) that gathering “evidence on the outputs and impacts of these elements of spending” would be a “logical further step”, although the difficulty of achieving it should not be under-estimated, especially in relation to secondary or support spend.

Indeed, given the methodological difficulties and the importance to business of investment in areas like education and transport, it is questionable whether looking at direct business support spending in isolation of indirect spending really furthers our understanding of the spending priorities for boosting enterprise.

It must also be remembered that direct and indirect expenditure on economic development is only part of a comprehensive strategy to promote enterprise. Political will to reform the regulatory framework within which Scottish businesses operate is also required, with reform of the planning system being an obvious first step. Similarly, cutting business overheads, for example by extending the small business rates relief or cutting water charges, would give an undoubted boost to the SME sector.

Committee questions

1. Do you think the overall level and growth of what the research terms ‘primary spending’ on economic development has been appropriate?

It is difficult to answer this first question unless we define what is meant by appropriate. However, some observations do seem reasonable given the data, but
first we should be clear that the following refers to industry assistance only and not to agricultural assistance which generally has non-economic aims and is outwith the control of the Scottish Executive and UK government. In addition, we look only at the Executive spend as the other spending has no trend data or comparators available (see comments below on this).

- From table 3 of Appendix 2 it can be calculated that non-agriculture, forestry and fishing (AFF) primary spend has **fallen** over the period 1999-00 to 2004-05, at a time when the Executive budget has risen overall.
- If demand driven grants are also excluded from the analysis there has been a six per cent increase in direct economic development spending, well below the overall increase in the Executive budget over this period. This indicates a declining share of the Budget.

At present all that can really be implied is that the fall in direct economic support spending as a percentage of the overall Budget, at a time when we are emerging from a period of difficult trading conditions and with Scottish growth continuing to trail that of the UK as a whole, this could be seen to be inconsistent with the Executive’s claim to have the economy as its top priority. However, the FSB would not necessarily argue for greater funds for the enterprise networks or VisitScotland, as we believe there are other areas which would be classified as ‘secondary’ economic spending in the present report where investment would have a greater economic impact (see below).

2. **To what degree do you think economic development considerations and priorities are reflected in decisions concerning the level and nature of “support spending” (e.g. expenditure on transport and higher and further education)?**

Unfortunately, it is not clear to us what the Executive’s overall “economic development considerations and priorities” are, so it is difficult to answer this question. The Executive’s “primary spend” priorities are largely set out in ‘Smart Successful Scotland’, and their wider economic strategy is set out in Framework for Economic Development Scotland (FEDS) but the latter document does not give priorities for wider spending. It is unclear how FEDS is used, however in terms of informing spending priorities across the Executive budget. This implies that “economic development considerations and priorities” have little impact on spending but are used as a further justification for it once allocations have been made. Hopefully, this will be addressed in the updated FEDS which is expected to be published in September.

Given the importance of the education system and our national infrastructure, the FSB is concerned to see that the share of the Scottish Budget accounted for by activities supportive of economic development has fallen from 16.4% in 1999 to 12.2% this year. This is hardly indicative of the economy being the Executive’s top priority. Further, it should be borne in mind that investment in areas supportive of economic development lead to a return to the public purse in the form of higher tax takes and lower benefit spend due to higher levels of economic activity and productivity.
There are a number of areas where the FSB feels that indirect expenditure could be increased to benefit enterprise and the economy, and some specific examples are outlined below:

- **Water and Waste Water Infrastructure** – The Committee members are well aware that one of the biggest barriers to economic development in Scotland today is the capacity of our existing water and waste water infrastructure. The current Scottish Executive consultation ‘Investing in Water Services 2006-2014’ estimates the cost of ending these development constraints to be in the region of £1billion. Scottish Water is currently required to recover the costs of infrastructure investment through customer charges but this has rendered development in many parts of Scotland economically unviable. If promoting enterprise is the Executive’s number one priority then surely there is a case for direct public investment to unlock this barrier to growth.

- **Small Business Rates Relief Scheme** – Research has been published illustrating the disproportionate burden that the rates system places on smaller businesses and the Scottish Executive has introduced a small business rates relief scheme to reduce the rates burden on businesses with a rateable value of less than £10,000. However, not all businesses claim the relief they are entitled to and the current scheme is based upon the aggregate rateable value of a business’s property. Making the relief automatic and basing it upon the value of individual properties would extend take-up of the scheme, delivering greater benefits Scottish businesses.

- **Waste Management Infrastructure** – SEPA estimates that the cost of landfill will rise by four to eight times in the coming years as landfill space becomes scarcer. Significant investment is necessary to ensure that alternative waste management options (e.g. recycling, CHP, composting) are put in place if increased landfill charges are not to harm business competitiveness.

- **Pre-school Education** – The education system is obviously crucial to economic development. Research shows that the first seven or eight years of life are the most important in establishing patterns of learning, IQ and social skills, so government should target the majority of its resources at this stage of the life cycle. Investment at this early stage has the greatest impact, and pays dividends throughout life, providing the best return on government's limited resources, and removing the need for remedial aid later on. By getting the schooling and living environment right, we will equip our children with the basic skills - such as literacy, numeracy and problem-solving - that they need to take advantage of the opportunities to learn and work later in life, and to contribute to a vibrant national economy.

3. *Do you believe that the economic development impact of spending on items such as higher education and public transport has been adequately assessed – for example in the appraisal of such projects?*

We are not aware of any such assessments or evaluations having been made. We note that such assessments are notoriously difficult to make but that does not mean that they should not be attempted.
In addition, we would also observe that insufficient assessments or evaluations have been made of projects and initiatives covered by ‘primary spending’.

A further suggestion for future work in this area would be to make greater use of comparative data, both within the UK and from other countries. As the report suggests, it is very difficult to prove which spend is the most effective or which even works at all. However, some indication of success might be garnered from looking at funding patterns elsewhere and how they match up with economic performance.

4. “What is your opinion of the available evidence on the output and impact of the budgets of Scottish Enterprise and Highlands and Islands Enterprise and of the scale of those outputs and impacts?”

The FSB has been supportive of the ‘Smart Successful Scotland’ strategy for the enterprise networks and of the enterprise agencies’ role in skills development, delivery of the Business Gateway and the development of the Intermediate Technology Institutes, for example.

However, there is currently little detailed research available on the output and impact of the budgets of Scottish Enterprise and Highlands and Islands Enterprise and this is an obvious topic for further investigation by the Committee.

We would stress here the importance of sticking with policies over time, (a) so that they are given time to work, and (b) so that they can be properly evaluated. Emphasis should also be put on evaluating the impact of specific projects rather than the ability of Scottish Enterprise as a whole to increase the relative level of GDP per capita and the like.

5. Do you think the balance of expenditure between primary and support spending has matched economic needs and priorities?

Given the difficulties measuring financial inputs and relating these to outputs and outcomes, it is almost impossible to answer this question. It is only in times of serious disequilibrium that it is obvious where under-investment is occurring. For example, in Ireland in the 1950s and 1960s there was significant under-investment in education. There are a number of areas where greater investment is now needed to address past under-investment, most notably water infrastructure but also transport and communications infrastructure and housing.

Wider Observations

The FSB has consistently argued that the best way to promote economic development is to develop FEDS in such a way akin to the successful Irish National Development Plans (see Annex 1). In other words a coherent, co-ordinated, attempt at prioritising spending across services with the goal of stronger economic development. (Note - this should not be mis-characterised as a return to some sort of central planning with greater public sector involvement, but rather seen as a way of improving strategic planning and offering greater vision and leadership in those areas that the public sector is inevitably involved in.) In order to achieve this it seems essential that the Finance Department is given greater powers of central control and
co-ordination of budget funds and the budget process. An enhanced ability to 
evaluate, to carry out cost-benefit analysis and to allocate according to agreed 
priorities should lead to a more efficient and effective government, especially in 
cross-cutting areas like economic development which currently tend to lose out to 
Departmental silos like health and education.

**Technical Comment on Tribal HCH Report**

In general we find the document a little ill-focused. It seems obvious that AFF 
spending is an interesting, but largely separate, issue and should have been 
considered in a separate section. Its inclusion in most tables and charts makes it 
more difficult to interpret the underlying trends.

- Given that local authority spending on education and transport dwarfs central 
  spending, this should have been included in the analysis reported in section 3 
  of the report
- The inclusion of UK government data is half hearted at best, yet this 
  information is readily available from GERS
- No attempt is made to look at the data over time
- The PESA 2003 data referred to is available on a consistent basis from 1997- 
  98 to 2001-02
- There is no support spending included under the UK government and yet 
  PESA 2003, table 8.7, shows figures for ‘roads and transport’ and for ‘culture 
  media and sport’
- In para 2.18 it states that PESA 2003 figures “do not indicate how the total 
  spending is divided between Executive spending and Whitehall spending”. 
  This is untrue; the figures are given in table 8.7 (this table is actually cited as 
  the source in GERS).
- PESA 2003 figures include similar ‘primary’ and ‘support’ data for England, 
  Wales and Northern Ireland. Some comparison of shifts in such spending over 
  time would be interesting. In addition, PESA also includes a breakdown by 
  English regions, which again might show some interesting comparisons. All 
  this data is also given in per capita terms
- PESA 2004 data was published on 19 April 2004 and the research should be 
  revised in light of this. There have been considerable improvements in 
  regional data (Chapter 8), in line with the recommendations of the McLean 
  Report. In particular, for 2003-04 data is split between: Scottish Executive; 
  Scotland Office; Local Authorities; and UK government Departments, for a 
  wider selection of spending functions, including ‘enterprise and economic 
  development’, science and technology etc (see table 8.14). Also tables 8.9 (a) 
  and (b) split spending by function between current and capital spending.
- In general, it might have been more useful to start from the PESA data, which 
  should be consistent, and break this down to its elements (the data must be 
  built up in this way and the Executive/HMT/ONS between them must have this 
  data available).

**Specific Points**

Proceeding through the document in order:
Para 2.10 and table 2.2, does education spend include preschool spend (nurseries, childcare etc)? It is also unclear why culture heritage and sport is included here (as opposed to some elements of health or environment or social inclusion, for example).

Para 3.1, it would have been interesting to start prior to 1999-2000, if the data were readily available, to observe the transitional impact of devolution.

Para 3.18, again this ‘analysis’ is pretty half hearted. Either it is of relevance and should be considered properly or it should be omitted.

Para 5.1, as stated above PESA has total spend data from 1997-98 to 2001-02, so that more than 1 year could be presented, and for support as well as primary spend (which is also omitted from section 4).

ANNEX 1

FSB Proposal for National Development Plan to improve Scotland's economic performance

The most powerful agent for change is a nationally shared vision of where we are now, where we want to be in the future, and how we intend to get there.

The 'Framework for Economic Development in Scotland' and 'A Smart, Successful Scotland' set out elements of such a vision, but were far from a complete solution. However, both served to demonstrate the benefits of a well-researched and focused long-term strategy.

The improvements to economic growth would be maximised by the development of an over-arching plan for economic development, based on robust academic research and analysis, drawn up with all key stakeholders, and setting out the benefits that greater economic growth would bring in terms of jobs, raised living standards and falling unemployment.

A successful model would bring greater focus and understanding to economic development policies, and would act as a route map for Scotland's economy. Around the world, from London to Ireland to Silicon Valley, there are examples of such plans acting as an aid to turning 'change' into 'wealth'.

A plan would have the aims of:

- Identifying the positive changes needed to improve growth
- Stopping the negative changes that restrict business growth
- Setting out government's vision, objectives and priorities for the Scottish economy
- Assessing the potential outcome of policy options and clarifying their implications for growth
- Identifying future threats and opportunities
- Prioritising limited funds for public infrastructure investments

Plan would set out an ambitious target for national growth, and every government department, and agency's role in contributing to this
• Plan would be drawn up by the new Office for Business and Work (see Government section) in partnership with all key stakeholders, drawing on the expertise of the widest possible selection of the business community, academia and wider civic Scotland

• Plan would be informed by four-yearly Holyrood small business summit, hosted jointly by the Parliament and Executive

OUTCOMES:

• National consensus on the challenges to increased economic growth, and how we can overcome these

• Focus on, and understanding of, economic development policies, leading to better and more sustainable businesses

• Wider understanding of the benefits of economic growth - more jobs, higher wages, increased standards of living

SUBMISSION FROM DONALD J R MACRAE, LLOYDS TSB

1. The Scottish Economy
The Scottish economy has performed weakly over the last few decades. GDP per head is 94.6% of the UK average and is only in the third quartile of 31 international comparators coming in at 20th out of 31. On twelve indicators of economic progress, from GDP per head to the proportion of the workforce in employment undertaking training, Scotland is in the third international quartile position for eight of those indicators, in the second quartile position for two and in the first quartile position for two.

The long term economic growth rate of 1.6% per annum over the last three decades compares poorly to the UK at 2.1%, Norway at 3.3% and Ireland at 5.2%. Within the UK, sub-national differences in economic wealth are the most disparate amongst the OECD countries. Scotland's performance against the UK has slipped in the last few years.

2. Opportunities
Scotland is part of the UK macroeconomic area and is in the EU. It benefits from a stable macroeconomic background with access to one of the largest consumer markets in the world. The transition from a heavy industry economy has taken place with now one of the lowest unemployment rates (claimant count) in the EU. Scotland's academics are the third most quoted per head in the world for refereed publications while the history of Scotland in invention (but not innovation) is second to none.

Scotland has a well developed record in education, is politically stable, speaks English and has a mature framework of economic development infrastructure in place. As the economy becomes more global, Scotland's geographical position on the edge of the EU is less of a disadvantage. Quality of life in Scotland can be argued as genuinely superior to many other competing countries. If any small nation seems equipped to compete in the knowledge economy then it is Scotland.
3. **Theory of Economic Development**

It is very difficult to establish clear causal relationships between economic development expenditure and subsequent growth of an economy. However, high growth economies are associated with a number of discernible trends. A growing population in an economy may be an indicator of economic growth or may indeed cause economic growth. What is clear is that people make a choice and the ultimate test of success of an economy is whether people choose to live in it. On this basis, Scotland has a challenge.

The level of business R&D is another indicator of the degree of effort applied to invention, subsequently applied to innovation and then applied to business. Therefore, a high level of R&D is seen as a pre-cursor of innovation and eventually higher productivity and higher economic growth.

There are often "clusters" of industries which emerge together in a particular location which, once established, can create a platform for further growth.

The level of new business starts in an economy is an indicator of other factors such as entrepreneurial attitudes, the ease of starting a business including access to finance. The supply of true risk or equity capital can influence the number of new business starts.

Clearly, the state of physical infrastructure of an economy such as transport links and its degree of "connection" to the global economy can influence development.

Given the experience of various other countries, particularly Ireland, the corporate environment for taxation seems a contributory and important, but not strictly essential, factor in producing high growth companies and therefore higher economic growth.

Finally productivity and therefore growth can be influenced by the quality and availability of education to the quality and availability of health care. There may well be a link between poor or low productivity and poor health.

The connection or causal link between all these factors in economic growth is not clear. It is impossible to produce an analysis which says if business R&D is increased by x% then the increase in economic growth will be y%. Further, it may not be necessary for all of the above factors to be increased to have a positive effect on economic growth. However, high levels of these above factors are associated with high levels of economic growth.

The timescale of response to economic development initiatives can vary. An award of Regional Selective Assistance (RSA) may have a quick, discernible effect in the short term but the effects of most of the policies in Smart, Successful, Scotland may only start to be felt in five years time.

4. **Effectiveness of Expenditure**

For all the reasons listed above, it is difficult to be precise about the effectiveness of expenditure on economic development. There has been a tendency in the past to measure "outputs" rather than "outcome". Concentration has often been on quantity
of outputs as opposed to quality of outcomes. It must be also recognised that the widespread and increasing use of indicators of performance do, in fact, have some effect upon how expenditure is made. I recommend focus on a smaller number of indicators and outcomes as opposed to either inputs or outputs.

5. **The Tribal HCH Review**

I commend the Tribal HCH review for focussing on all the expenditure associated with economic development. The inclusion of Common Agricultural Policy (CAP) money is debatable, as is the subsequent division of expenditure into urban and rural areas. The division of expenditure into rural or urban depends largely on whether the CAP spend is included.

I note with interest that the total spend by the enterprise networks has declined relative to total public spending. This seems incompatible with having economic development as the number one policy priority. However, public spending as a percentage of GDP, according to my own estimates, reached 54% in Scotland in 2002 and has probably increased since then. This level is too high and may be inhibiting the growth of the private sector.

The report concludes that over the period since the creation of the Parliament, primary expenditure on economic development has fallen from 7.4% to 5.5% of spending (from 5% to 4% if CAP spending is excluded). Over the period 1999 to 2005, the Scottish budget has grown by 41% compared to a growth in primary economic development spend of 10% and 22% for support spending. This seems at odds with the objective of increasing the economy’s growth rate.

6. **Recommendations**

I have a few recommendations:

1. In all major policy formulation and in public spending ask the question: "What is the effect on economic growth and the economy?"

2. Concentrate on fewer indicators and make those outcomes rather than quantities of outputs.

3. Tackle productivity both in the public and private sectors.

4. Identify expenditure of a capital nature i.e. investment in the physical assets of Scotland, which will be in place over a number of years and will not recur annually.

5. Limit economic development activities of enterprise networks to increasing value added in the private sector of the economy.

6. Embed economic development into all areas of policy and expenditure.

7. Shorten the planning process.