“DELIVERY IN CHALLENGING TIMES”

SPEECH TO SCOTS TECHNICAL SEMINAR

APRIL 23rd 2010

1. Good morning ladies and gentlemen. I am delighted to be able to join you this morning to talk about the "Business Perspective Coming Out of Recession".

2. Businesses large and small are a key pillar of SCDI's wide membership, which also includes local and national government, trade unions, academia and the third sector. Our key role since we formed in 1931 has been to work on behalf of our members to influence government policy at all levels to create a stronger environment for economic growth here in Scotland.

3. We think that our wide membership across all sectors - including your own - gives SCDI a unique, joined-up overview of the economy, the challenges it is now facing and the opportunities we see in the future. Opportunity and challenge are the key themes of my talk today.

Coming Out of Recession

4. We are, as the title of your seminar says, in challenging times. Challenging and also uncertain. You have asked me to speak about "Business Perspective Coming Out of Recession". It was only on Wednesday that it was confirmed that the Scottish economy had emerged from recession in the fourth quarter of last year. So I should commend SCOTS' economic forecasting!

5. But it was - and it was always going to be - a close run thing and growth was 0.2%. And we know that the first quarter of 2010 was mixed for many of our member businesses. We have had a long and difficult winter, and, while it was boom time for our ski centres, the bad weather hit many hotels, service businesses and retailers.

6. **So where are we now? The recession in Scotland was shorter than in the whole UK. But it has also been deeper, with total GVA in the Scottish economy falling by -6.1% compared to a slightly smaller contraction of -5.7% in the UK, mainly due to the relative performance of the service sector. And the Fraser of Allander Institute also forecast that recovery in the Scottish economy will be weaker than the rest of the UK because of our relatively larger public sector and greater impact from fiscal consolidation. It has raised its prediction for growth to 0.6% this year, but it is not expected to return to trend until 2012.**

7. **Business confidence is returning, but it is still weak. The labour market has been comparatively resilient, but unemployment is projected to rise further. Of particular concern to government and to SCDI is the 89% increase, in other words, a near doubling in youth unemployment over the two years to February.**

8. And the sector with which you work most closely – construction – has been especially badly hit. In Scotland, output has fallen by -15.5% since late 2006. UK construction has displayed a classic 'V' shape with a sharp and deep downturn followed by rapid recovery. But surveys of activity in the Scottish construction sector have shown that in the first three months of this year half of building firms, including three-quarters of those working on public-sector contracts, said new orders had fallen.

Public Spending

9. So that is a short summary of where the Scottish economy is at present. We have been through the credit crunch and then the recession, but we are now entering the recovery phase, which will also involve another big challenge: restoring the public finances.

10. Co-ordinated action by the Scottish and UK governments and the Bank of England has stabilised the economic position. But falling tax revenues, bank rescue packages and the fiscal stimulus mean that Government borrowing has hit £163.4bn or 11.6% of GDP, far higher than in previous peak deficits and the biggest annual borrowing figure for a UK government in peacetime. Total government debt now stands at £890bn, which is equivalent to 62% of UK GDP.

11. All the UK parties are committed to dealing with the deficit and we know some details. But it is fair to say that optimistic economic growth assumptions and unspecified spending cuts are involved, and we can expect a further sizeable fiscal squeeze post-election.

12. The implications for Scotland will then be clearer. But the latest analysis estimates that public sector funding in Scotland could decline in real terms by up to 14 per cent by 2014 and that there will be budget

constraints until 2018. In a report published yesterday the Scottish Government's Chief Economic Adviser Dr Andrew Goudie estimated that it will take a period of sustained adjustment lasting up to 12 to 15 years before 2009/10 levels of expenditure are reached once again. Over this period, Scottish expenditure could cumulatively forego £25 - £35 billion in real terms – a very significant and sustained reduction in demand in the economy.

13. This will obviously increase our challenge of raising Scotland's long-term economic growth rate and achieving Scottish Government economic targets.

14. So the UK and Scotland face interlinked challenges: rebalancing and growing the economy, managed restoration of the public finances, and investing in the economy and public services for the long-term. SCDI is arguing that public sector support for the economy should not be withdrawn too rapidly while the private

sector is weak and not ready to begin replacing lost demand.

15. The public sector plays an important role in driving sustainable economic development, for example stimulating innovation, regeneration and rural development, particularly where the private sector has less of a presence. But we agree that, once solid growth has been resumed, a managed restoration of the public finances should be an overriding priority. Replacement demand will need to be generated by higher private sector activity.

From Recession to Growth

16. And my central message today is that, from the business perspective, the challenge is not a lack of opportunities; it is how we realise our opportunities.

17. In the last decade the Scottish economy has become more of a service sector economy as the manufacturing share declined and the economy has become more dependent on domestic demand. This is likely to be weaker over the next ten years. So rebalancing the economy - with more resources devoted to business investment and net exports and fewer to consumption - will be our key challenge.

18. And, from SCDI's perspective, two opportunities stand out above all others: internationalisation of the Scottish economy and the low carbon sector.

19. Internationalisation has always been at the heart of SCDI's activities. We spearheaded the attraction of overseas manufacturing investment to Scotland in the late 1940s. Since our first trade visit in 1960, SCDI has organised and led 350 visits comprising over 5000 participants to 50 markets worldwide. Our 2009/10

programme targeted India, South Africa, the United Arab Emirates and China.

20. And the opportunities we see are huge. In the next 10 years emerging markets will grow faster than developed markets and global trade will grow three times faster than global GDP. Almost 60 per cent of companies expect to derive more than one fifth of their global revenues from emerging markets in 5 years' time - almost twice the current proportion.

21. SCDI has therefore recommended to the Scottish Government that a target should be set to double the value of Scotland's exports in the next decade to £40bn annually. This will be stretching so I want to briefly identify some of the ways we think it can be achieved.

22. Our annual survey of activity in the oil and gas supply chain has shown that overall sales have trebled in 10 years to £15.4bn and international activity now accounts for over 40% of the total. In SCDI's view, the

supply chain could be as important a wealth creator for Scotland over time as North Sea production.

23. Last year, in the midst of the global recession Scotch Whisky exports rose by 3% in value to a record £3.13bn. Scotland Food and Drink has recently announced a new higher target to grow Scotland's food and drink exports from £3.8bn to £5bn by 2017.

24. The number of life science companies in Scotland has doubled in the last five years and with more companies achieving scale and new developments in Edinburgh, Dundee, Aberdeen and Inverness, they will be ready to take advantage of threefold growth forecast for the global sector in the next five years.

25. Scottish tourism has performed resiliently in the global downturn and it is expected that international tourism will grow strongly in the next decade especially with the increasing size of the middle-classes in emerging markets. Research from Deloitte and Oxford Economics suggests that the industry's

added value contribution to the UK economy will grow at 3.5 per cent per annum over the next decade and another 250,000 jobs will be created. The report predicts that annual spending by foreign visitors in the UK will almost double from £16bn to £31bn. With the Commonwealth Games in Glasgow in 2014, we have a once-in-a-generation opportunity to showcase Scotland and capitalise on our national events programme.

26. Export opportunities are also enormous in the low carbon sector. SCDI's recent report on the "Future of Electricity Generation" in Scotland found that new wind power equivalent to more than twice the country's largest operational windfarm will be needed every year until 2020.

27. Initially, this will involve new and expanded onshore windfarms, but the licensing is now in place for offshore windfarms and marine and tidal farms in the Pentland Firth. Investment will also be necessary in port and near port infrastructure, manufacturing and

maintenance, renewable heat, energy from waste, insulation and infrastructure for low carbon vehicles. Investment of £60 to £70 billion in Scotland's green economy is anticipated over the next 10 to 15 years.

28. Billions of pounds of investment are also likely in the wider energy sector. The oil and gas industry projects major activity over the next five years. And Longannet is on track to deliver the UK's first full Carbon Capture and Storage demonstration project.

Re:Wiring Scotland

29. Realising these opportunities for Scotland will, as I have already said, be the great challenge of our times. We need to Re:Wire Scotland: economically, socially and environmentally. And if Scotland is to benefit from sustainable economic prosperity over the next 10 years, it needs to take advantage of the opportunities in Re:Wiring the world. This will be the

theme of SCDI's Blueprint for the Scottish economy which we will publish in the coming weeks, post election. Today, in the time that I have remaining, I want to touch on some key priorities of most relevance to your discussion today.

30. Specifically, improving Scotland's connectivity will be critical if our economy is to realise the opportunities in internationalisation and the low carbon sector. We need to be able to get our goods and services to market, attract more visitors to Scotland, and transmit the renewable power generated on our hills and around our coasts to markets in the UK and Europe.

31. SCDI is therefore particularly concerned that the most recent projections are that net investment intentions as a percentage of GDP in the UK will fall from 3.1% of GDP in 2009-10 to 1.3% in 2013-14.

32. In the private sector, banks will no longer provide upfront funding for infrastructure and are only

prepared to make financial contribution to infrastructure when a capital receipt has been generated or an income stream created. They will generally only support projects in prime locations not in sub-prime locations.

33. Developer contributions will need to be proportionate, potentially phased and not endanger project viability. And regeneration projects will need far higher public subsidy in the future.

34. Our investment in infrastructure needs to be able to match the global ambitions of Scotland's businesses. In our more peripheral location, we need connectivity which is at least as good if not better than our competitors if our Scottish companies are going to be able to grow and we are to attract inward investors.

35. We need to ask: how can we start the new high-speed rail line in Scotland or start at both ends or bring it here much sooner? This would deliver economic benefits, including wider impacts, of £19.8bn to Scotland, the highest figure for any region outside London. And we need to ask: how can we extend next generation broadband to all of Scotland by 2017 and not only the 90% suggested in Digital Britain?

36. We need to urge the Scottish Government to hold firm on major infrastructure projects and place a higher priority in its own resource allocation to capital spending than is projected by the UK Government.

37. But these challenging times also demand a new approach. We need innovation and collaboration.

38. With public spending under pressure, Government will also need to find new ways of securing additional

private capital to fund infrastructure around Scotland at a reasonable and defensible long-term cost. At present, the message from the Scottish Government on private sector involvement can be unclear.

39. We are encouraging local, Scottish and UK Governments to explore a range of private sector funding mechanisms to deliver essential projects across all sectors. It is vital that the Scottish Futures Trust can rapidly expand investment in projects. SCDI welcomes the exploration of Tax Increment Finance for projects which will deliver significant economic stimulus.

40. Continued investment in water infrastructure is also needed to promote economic growth and meet environmental standards. If the current model of funding proves unsustainable within tightening public expenditure limits and economically and socially

acceptable charges, SCDI has recommended that other external funding streams should be explored.

41. We need to join-up policy making. The next subject on your agenda is climate change. SCDI has supported the introduction of a variable UK-wide road pricing system to replace fuel duty. By charging at the point of use for the real costs of driving, this would encourage rational decision-making between transport modes for specific journeys. This would reduce congestion and carbon emissions, and benefit rural areas of Scotland and the UK where public transport is generally less available. Funding could be channeled back into maintenance and infrastructure.

42. We also need innovation and collaboration at a local level. SCDI has concerns that while local government has enhanced responsibilities for economic development, it does not have the funding, and that, with competing priorities, transport budgets will be

squeezed even further. A debate is needed on options for local authorities to raise more money locally in response to local needs and on incentives for local authorities to encourage start-up businesses.

<u>Conclusion</u>

43. **I am sure that none of us underestimates the challenges in this agenda. But in these challenging times, do we have a choice? I would suggest to you that we should draw confidence from the challenges which have already been faced in coming out of recession and from the opportunities for Scotland.**

44. **We are confident that by working together we can Re:Wire Scotland for growth and meet these challenges head on**

45. **. Thank you again for the opportunity to speak to you today and I hope that you enjoy the rest of your**

conference and we look forward to working with you all in addressing the challenges and opportunities ahead.