OFFICIAL REPORT
AITHISG OIFIGEIL

Net Zero, Energy and Transport Committee

Tuesday 25 January 2022

Session 6

The Scottish Parliament
Pàrlamaid na h-Alba

Tuesday 25 January 2022

CONTENTS

NET ZERO, ENERGY AND TRANSPORT COMMITTEE
3rd Meeting 2022, Session 6

CONVENER

*Dean Lockhart (Mid Scotland and Fife) (Con)

DEPUTY CONVENER

*Fiona Hyslop (Linlithgow) (SNP)

COMMITTEE MEMBERS

*Natalie Don (Renfrewshire North and West) (SNP)
*Jackie Dunbar (Aberdeen Donside) (SNP)
*Liam Kerr (North East Scotland) (Con)
*Monica Lennon (Central Scotland) (Lab)
*Mark Ruskell (Mid Scotland and Fife) (Green)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Sandy Begbie (Scottish Financial Enterprise)
Tracy Black (CBI Scotland)
Maurice Golden (North East Scotland) (Con)
Charles Holmes (Scottish Government)
Jeremy Lawson (abrdn)
Tim Lord (Phoenix Group)
Barry McCulloch (Federation of Small Businesses Scotland)
Lorna Slater (Minister for Green Skills, Circular Economy and Biodiversity)

CLERK TO THE COMMITTEE

Peter McGrath

LOCATION

Virtual Meeting

Scottish Parliament

Net Zero, Energy and Transport Committee

Tuesday 25 January 2022

[The Convener opened the meeting at 09:45]

Decision on Taking Business in Private

The Convener (Dean Lockhart): Good morning, everyone. Welcome to the third meeting in 2022 of the Net Zero, Energy and Transport Committee. We are meeting remotely this week.

Item 1 is to ask the committee to agree to take in private item 5, which is consideration of today's evidence.

No member has objected, so item 5 will be taken in private.

Subordinate Legislation

Deposit and Return Scheme for Scotland Amendment Regulations 2022 [Draft]

The Convener: Item 2 is consideration of a draft statutory instrument. I welcome Lorna Slater, Minister for Green Skills, Circular Economy and Biodiversity, who is joined by officials online. I also welcome Maurice Golden, who is joining us for consideration of the instrument. Thank you all for joining the meeting.

The instrument was laid under the affirmative procedure, which means that the Parliament must approve it before it comes into force. Following the evidence session, the committee will be invited to consider a motion recommending the approval of the instrument.

We are tight for time, so I invite members to please keep questions, answers and contributions concise. I hand over to the minister for a short opening statement.

Minister for Green Skills, Circular Economy and Biodiversity (Lorna Slater): Thank you, convener.

In December, when I announced in Parliament the new implementation timetable for Scotland's deposit return scheme, I remarked that I was

"looking forward to engaging with members ... as we move into the scrutiny process."—[*Official Report*, 14 December 2021; c 84.]

I welcome the opportunity to do so today.

The draft regulations before the committee provide a date of 16 August 2023 for full implementation of the DRS. As you know, an independent review, which was commissioned as a result of the pandemic and the uncertainties that Brexit causes, concluded that the July 2022 implementation date was not achievable.

We have engaged with industry, stakeholders and partner organisations to agree a project plan that will deliver a successful scheme by August 2023, while retaining the original collection targets of 80 per cent in 2024 and 90 per cent in 2025.

I have already announced the milestones in 2022 and 2023 that we will use to monitor progress on delivery, which include the signing of key contracts by Circularity Scotland Ltd, the scheme administrator; the construction of counting and sorting centres; the roll-out of the return infrastructure by retailers; and the launch of a return scheme in Orkney so that we can ensure that our DRS works well in rural areas, which often have different needs compared with more populated parts of the country.

As well as amending the implementation date, we are taking this opportunity to make several smaller amendments to the regulations to support successful delivery and operation of the DRS. The first is to provide additional reassurance to retailers selling through distance sales, who must offer a take-back service. That vital obligation to the accessibility of the scheme will remain; however, distance retailers can now refuse to accept a return of a disproportionately large number of containers in a single transaction.

For products that are filled and sealed in a retail or hospitality setting, such as the kind of can that is known as a crowler, the person who fills and seals them—the pub, for example—will be the producer and will bear responsibility for their collection.

Businesses that qualify as producers only because they sell crowlers will be exempt from the annual fee to register with the Scottish Environment Protection Agency, which has been raised slightly from £360 to £365 to cover the cost of regulating those extra producers. The new regulations also make a small number of amendments to prevent fraud and support SEPA effectively to enforce compliance.

I thank members for their time. I truly believe that the proposed changes will help ensure that Scotland will have one of the most effective deposit return schemes in the world. I look forward to working with the committee to make it a success.

The Convener: Thank you, minister. We now move to questions.

Liam Kerr (North East Scotland) (Con): As requested, I will cut to the chase, minister. How much will setting up the scheme cost, and will local authorities be compensated for the potential revenue and job losses that some have theorised will happen?

Lorna Slater: In line with the principle of producer responsibility, the drinks producers will pay for the costs of setting up and operating the scheme. Our estimates of the costs of operating the scheme are set out in publications such as the full business case addendum. The FBC addendum estimates expenditure of £92.9 million per year for Circularity Scotland in a steady state. You can see that those costs are not being borne by local authorities; they are being borne by industry, under the principle of polluter pays.

Liam Kerr: I am not sure that that answers my question, minister, because there will obviously be a scheme cost to the public purse to set it up. Perhaps you can come back on that if you are aware of such costs and they have been sorted out.

Secondly, has the Government strategised any scheme to allow smaller businesses to attract and retain customers in a similar manner to the big supermarkets, which presumably can incentivise customers through their loyalty schemes?

Lorna Slater: I am not aware of any such schemes. My officials might have information on that.

Charles Holmes (Scottish Government): There is not a scheme as such. I suppose that we would agree with the member that there is a good opportunity here for small businesses to boost their footfall by operating a return point; we think that that should be an advantage for small businesses. We have taken steps to make it easier for retailers to operate return points, such as creating an exemption from non-domestic rates and from planning permission, subject to certain conditions, for having reverse vending machines. We have taken steps to make it easier for them to operate a return point, if that answers the question.

Liam Kerr: It does, up to a point.

I have one more question, minister. As you will be well aware, other jurisdictions are trialling a digital DRS system, which—certainly according to the research that I have done—would be cheaper, have a lower carbon footprint and be easier for people to get involved with. That begs a question: has the Scottish Government conducted, or will it conduct, a business case and feasibility study for a digital DRS? Will businesses that have set up your DRS be compensated—and if so, by whom—for what would presumably be an obsolete outlay if a digital DRS is ultimately introduced in Scotland?

Lorna Slater: The digital DRS is a very interesting technology, and Circularity Scotland and the Government have looked into it. It is not quite yet mature enough to be implemented on the timescale for our DRS. However, we are aware of it, and Circularity Scotland intends the reverse vending machines that it advises businesses to install to be compatible with future digital schemes, so that there should not be any problem with moving to such a thing in the future. It is an exciting technology, and when it is mature, we will look at implementing it. I am sure that that will be the case.

Liam Kerr: I hand back to you, convener.

The Convener: Mark Ruskell is next up, to be followed by Natalie Don.

Mark Ruskell (Mid Scotland and Fife) (Green): The gateway review that came out last summer identified some risks with going even for the August 2023 date for implementation. What work has been done to look at those risks? How are you mitigating some of them? Everybody wants a deposit return scheme as quickly as possible, but clearly it needs to be up and running with the full confidence of retailers and the public. Can you identify what risks around the August 2023 date remain and how they are being considered?

Lorna Slater: Despite the pressures over the past year, Circularity Scotland has taken some very important steps since it was established in March 2021. It has established itself as a limited company and secured approval as a scheme administrator. It is currently securing start-up funding and appointing key staff. I have been meeting the organisation monthly and will continue to do so throughout the implementation, to ensure that it is on track.

We have agreed some milestones. We expect to see significant progress in the coming months, including the signing of contracts with partners to deliver the logistics, operations and information technology systems—we expect those contracts to be signed by March 2022. We expect the launch of a public awareness campaign in August 2022, so that businesses know that they need to sign up to the scheme and the public know that it is coming. We will also begin to build counting and sorting centres in August 2022.

I am confident that we have the milestones and robust governance and oversight to make sure that the scheme will happen. It will be done in a transparent way. We will show the public pictures of the sorting centres being built, and people will be able to start to learn about the scheme.

Mark Ruskell: That transparency will be welcome. Our predecessor committee asked for milestones way back in 2019, and I do not think that it got them, so the fact that we have them now is good.

What would happen if the committee decides not to vote for the statutory instrument today? What would be the implications of that?

Lorna Slater: As you know, the independent gateway review concluded that it was not possible to meet the original date of July 2022, as that would not have given the 35,000 producers and retailers involved enough time to comply with the regulations. We want the scheme to be a success, and that means allowing the scheme administrator and businesses time to implement it properly. It involves setting up the IT system, building the sorting centres and working out all the logistics, particularly around online take-back. Those things take time.

Unfortunately, Brexit and the pandemic led to our getting started with the scheme a bit later than we all hoped but, now that we have a plan, milestones and a scheme administrator, we are going full steam ahead.

Natalie Don (Renfrewshire North and West) (SNP): Good morning, minister. My first question has just been answered, so I will move on to my two further questions.

One thing that makes Scotland’s deposit return scheme so ambitious compared with schemes in other countries is the inclusion of glass. That has been criticised by some, and there are concerns that, if the scheme leads to more glass being crushed, that might mean less glass recyclate available for the industry. Can the minister guarantee that that will not happen?

Lorna Slater: Absolutely. The deposit return scheme will significantly increase the quantity and quality of glass recyclate, creating an aggregated and high-quality feedstock for reprocessing. I understand that Circularity Scotland proposes that the glass be collected whole or naturally broken and absolutely not mechanically crushed, which is compatible with closed-loop recycling. Section 34 of the Environmental Protection Act 1990 requires those handling waste to ensure that it is handled in a fashion that “promotes high quality recycling”. Return points, producers and Circularity Scotland, when handling return scheme packaging, including glass, will therefore have an obligation to promote high-value recycling.

Scotland’s code of practice for managing controlled waste makes it clear that

“the use of recovered glass cullet in re-melt applications to create new glass products”

is considered an example of high-quality recycling and so should be prioritised. The current best practice is not to crush the glass, so that is not the intention.

Natalie Don: Thank you for confirming that.

We have also heard concerns from parts of the industry that have raised issues about legacy containers, by which I mean containers of products that were produced prior to the regulations coming into force. That seems to be a particular issue for producers and retailers of products such as whisky, which can sit on shelves for a long period. Can the minister clarify exactly how such containers will be covered by the scheme?

Lorna Slater: I absolutely understand the problem around legacy containers, particularly in the whisky industry and similar industries. Stock that is placed on the market before 16 August 2023 and that is therefore not deposit bearing will continue to be legal for sale after that date, with no end date set in the regulations. That is different from a number of other schemes, which set an end date. We had Scottish producers such as the whisky industry very much in mind when we made the decision to allow that.

Monica Lennon (Central Scotland) (Lab): Good morning. The Government is relying heavily on the gateway review, which has been mentioned. The committee has had a submission from the Association for the Protection of Rural Scotland, which says that the gateway review and assurance of action plan is weak and has “many shortcomings”, one of the most obvious of which is the

“skewed choice of organisations interviewed.”

The submission goes on:

“Fully 40% of those spoken to were either Scottish Government or under their direct oversight ... and another 40% were producers or retailers. No organisations interviewed were operators of deposit return schemes”.

The association is also concerned that domestic and international experts were not spoken to, and says that that is the equivalent of

“trying to work out whether a vehicle could be fixed without speaking to a single mechanic.”

Is the association wrong?

10:00

Lorna Slater: During the gateway review, a wide range of stakeholders from across the public, private and third sectors took part in the discussions with me, my officials and/or the gateway reviewers. We published a full list of participants in the business and regulatory impact assessment.

The gateway review gave a preparedness estimate of 12 to 24 months for individual stakeholders, including retailers. That informed its judgment that a full implementation date of July to September 2023 was possible, albeit with significant risk. That was reinforced by our wider stakeholder engagement.

While an individual business might be in a different position, I have considered the circumstances that face the industry as a whole. It is essential that the scheme is a success not just for the short term, but for decades to come.

The gateway review, which followed standard procedure, focused on what would be a deliverable timetable and made recommendations on the governance programme to improve the likelihood of success. We supplemented the review with meetings with a wide range of industry representatives and environmental non-governmental organisations, as well as drawing on wider intelligence, including evidence from other schemes.

Monica Lennon: Those were the highlights of what the Association for the Protection of Rural Scotland said. Concerns have also been expressed by the Marine Conservation Society, whose submission focuses on the environmental impact of your proposed delay. It reminds us that we are in

“the midst of an intertwined climate emergency and nature crisis”

and says that

“Scotland’s seas and beaches are bearing the brunt of the delays to DRS.”

What will be the environmental impact of your proposed delay?

Lorna Slater: I promise you that no one wishes more than I do that it would have been possible to implement the scheme in July 2022. The scheme that we have set out will be implemented as quickly as practicably possible. The independent gateway review concluded that July to September 2023 was the soonest that that could happen. We have worked with industry, Circularity Scotland and other stakeholders to narrow that down to the specific date of the middle of August 2023.

The risk of having a scheme that does not work on day 1, that is less ambitious and that, for some reason, does not get public support and momentum or get retailers and producers on board is much greater than the risk posed by the unfortunate but necessary delay that we are proposing, in order to make sure that the scheme works from day 1 and is ambitious, rather than watered down. The scheme will be with us for decades and will have a hugely positive overall effect on our environment.

The Convener: The next question comes from Fiona Hyslop.

Fiona Hyslop (Linlithgow) (SNP): Monica Lennon covered some of the area that I wanted to ask about. Does the minister have any final message to those who are concerned about the environmental impact of plastic pollution in particular?

Lorna Slater: We are all very concerned about not just the impact of the plastic waste that litters our seas, but the cost to our local authorities of having to process that excess waste. We can all look to work towards our waste targets, which will reduce the total amount of waste that is produced in Scotland. The deposit return scheme will do that. It will have a significant impact by taking tens of millions of pieces of plastic waste out of circulation and making sure that they are part of the high-value recycling chain.

The scheme also opens up the possibility of investment in Scotland in relation to the building of recycling centres and all the businesses that are required around the logistics. It represents a really exciting step forward in the circular economy and reducing waste.

The Convener: Maurice Golden is next.

Maurice Golden (North East Scotland) (Con): I have some short, simple questions. On what date were you aware that there would be a delay to the scheme?

Lorna Slater: As I said in my statement to Parliament on 17 November, at that point my officials and I were continuing to work hard with Circularity Scotland and the wider industry to agree a final timetable and clear milestones for delivery, including interpreting the impact of the United Kingdom Government's decision on VAT, which had just been communicated to me.

Having carried out further work after that first address to Parliament, we identified a date, which was the subject of continuing analysis and discussion between me and various stakeholders. I announced that date to Parliament on 14 December. It was very much the subject of continuing assessment and review as new information came in and as we listened to different stakeholders.

Maurice Golden: At the time of the November statement, were you aware that there would be a delay to the scheme—yes or no?

Lorna Slater: At the time of the November statement, the matter was under discussion between me and different stakeholders. It was being assessed, and I committed to doing that assessment by listening to environmental NGOs, business and industry and Circularity Scotland, and reading the result of the independent review. That decision was very much under full assessment. We needed to make sure that we had spoken to everyone who mattered, including all the stakeholders, and had taken a careful decision. That decision was finalised when I made my announcement to Parliament on 14 December.

Maurice Golden: Were you aware that, prior to the November statement, Circularity Scotland issued tenders that had a start date for Scotland's deposit and return scheme that was later than 2022?

Lorna Slater: In line with the principle of producer responsibility—the polluter pays principle—Circularity Scotland is a private company. It was established by the industry to lead on the delivery of the DRS. As an independent private company, its procurement decisions and processes are its business and not for Government intervention.

Maurice Golden: Circularity Scotland proposed a date in 2023—June 2023—in October. Were you aware of that or not?

Lorna Slater: The procurement procedures of Circularity Scotland, as a private company, are its business, not the business of the Scottish Government.

Maurice Golden: In the interests of transparency, which the minister has committed to, will the Scottish Government instruct Circularity Scotland to comply with freedom of information requests?

Lorna Slater: I would need to get my officials to confirm this, but it is a private company and, as far as I know, private companies are not subject to FOI requests. Such requests are about transparency within the Scottish Government.

Maurice Golden: Zero Waste Scotland has a policy of generally complying with FOI requests. Who created Circularity Scotland as a private company?

Charles Holmes: FOI legislation and environmental information regulations, to boot, do not apply to Circularity Scotland, as it is an independent private company. It was set up by a coalition of drinks producers, retailers and wholesalers back in February 2021. It was not set up by the Government, and the Government does not have a power of direction over it.

Maurice Golden: Thanks. I am aware of that.

This is my final question. How many staff worked for the scheme administrator in 2016, 2017, 2018, 2019 and 2020?

Lorna Slater: The scheme administrator was brought into being in 2021. As far as I know, the business started up in 2021, and it has since been hiring staff and doing all the usual things that a start-up business does.

Maurice Golden: No staff. Thank you, minister.

The Convener: Minister, one of the key questions in this area is where the DRS vending machines will be sourced from. Given the further delay in implementing the scheme, can you guarantee that all the DRS vending machines will be built in Scotland, thereby avoiding highly paid jobs in manufacturing and technology being offshored?

Lorna Slater: There is definitely an interest in where the DRS vending machines are made. There is a problem with sourcing them, due to Brexit and other challenges. I am not able to provide a guarantee, because it is for Circularity Scotland and the industry to decide on their own procurement procedures, but of course we all very much hope and intend that as much of this as possible is done in Scotland.

The Convener: Thank you. As far as I can see, there are no more questions, so we will move to our next agenda item, which is formal consideration of motion S6M-02582.

Motion moved,

That the Net Zero, Energy and Transport Committee recommends that the Deposit and Return Scheme for Scotland Amendment Regulations 2022 [Draft] be approved.—[*Lorna Slater*]

The Convener: Are there any contributions from members? If you wish to contribute, please put an R into the chat bar.

Monica Lennon: I have listened carefully to the minister and to colleagues, and I have read the briefings from interested stakeholders. It is very disappointing to have the further delay on top of previous delays.

I welcome the ambition, but there has to be more than a paper exercise. I am very concerned about the regulations, and I would like the Government to bring them back to Parliament with a scheme in which everyone can have confidence and which takes account of the concerns that the organisations that I mentioned earlier have raised. I would find it very difficult to give my backing to the proposed regulations as they stand.

If we are ambitious and serious, we have to find a way to make the scheme work. I have read that not everyone is impressed by the gateway process and not everyone feels included. A lot of lobbying has gone on.

Maurice Golden was right to pursue questions of transparency. People are not making party-political points; we really want the scheme to work. I know that the minister, in her heart, wants it to work, so she has to think again.

Liam Kerr: I was not going to speak but, having listened to the minister's evidence sessions today and previously, I feel compelled to do so.

My friend Monica Lennon spoke rather well just now, and she made some really important points.

The regulations have been half a decade in gestation, and we are now being told that they will be delayed again. The minister blames several extraneous factors. That is rather difficult to square with the reality. Our friends elsewhere are striding on with schemes that are constructed differently and which, evidence suggests, might be effective and future proofed. That relates to my earlier question.

The minister has rather struggled to answer several direct questions from across the political spectrum, and the answers that have been given have lacked detail. As Monica Lennon rightly said, we are all, across the parties, keen to see a workable, effective and successful scheme as soon as possible. The minister has talked positively about what a scheme can achieve and its benefits, but I am very concerned that its detail, depth and finances remain opaque.

This is a debate. I respectfully request that, in closing, the minister gives clear details of commitments and figures on the funds and the likely cost to the public purse, which I asked about, in order to allay my and possibly others' significant concerns about what is proposed.

Mark Ruskell: It is fair to say that everybody on the committee is concerned about the delay, and I imagine that the minister is concerned, too. The original regulations that were put in place under the Climate Change (Scotland) Act 2009 gave the Government the opportunity to move quickly on a DRS scheme, and that opportunity was not taken at the time.

The minister has been put in a very difficult position with the establishment of Circularity Scotland only last summer. The fact that there is now a commitment to milestones and that we are going to hold Circularity Scotland to account—there is a critical role for the committee in doing that—gives me a lot of confidence that we finally have a minister who will deliver the DRS rather than its being the vague commitment on which previous ministers have not moved quickly enough.

I read the ENGOs' briefings, and I am as frustrated as they are that the scheme is not already in place. However, we have to bear in mind that it is incredibly ambitious—it is the most ambitious scheme in Europe. It is not as if we are following the path of other small countries that might have put in place a scheme for plastic bottles with larger retailers to start with, and then considered moving over to cans or maybe to an online scheme, adding glass a later date. We are trying to deliver an all-singing, all-dancing, ambitious scheme in the quickest time possible.

Parliament agreed a hugely ambitious scheme way back in 2019, and it would be really disappointing if members of the committee turned down the SI and effectively voted down progress on the DRS. All that that would do would be to create even more delay. It would force the Government to reconsider the scheme from square 1, create uncertainty for business and, ultimately, impact on our environment, including our marine environment, and on climate change.

Monica Lennon said that she wants to make the scheme work. So do I. We are all disappointed that we are where we are, but we have an opportunity now to move at pace. I want the scheme to work, so I will vote for it. I hope that other members will, too.

10:15

Fiona Hyslop: Liam Kerr said that the regulations are being delayed again. No—the regulations will be delayed only if the committee and the Parliament do not approve them.

The scheme is a hugely important one for tackling waste in Scotland. Undoubtedly, there have been some challenges and, indeed, disappointments along the way in trying to deliver it. However, in terms of innovation, the reach of the scheme and what it will deliver, I can tell the committee that, in my constituency, the supermarket chain Aldi has already introduced its first pilot deposit and return scheme.

Scotland wants us to get on with the scheme. Yes, we need to scrutinise it. I have listened to colleagues, and I recommend that the committee should take a strong line in scrutinising the development and implementation of the scheme. However, the Parliament has a duty and responsibility to tackle waste and to drive forward our agenda on net zero and wider environmental issues, and I strongly recommend that the committee should vote in favour of the statutory instrument.

Maurice Golden: Really ambitious schemes are being delivered throughout Europe. Wales, Northern Ireland and Portugal are trialling digital schemes, and Latvia has a traditional but more ambitious scheme, with refillable and standardised bottles. However, I have real concerns about the delivery of the scheme in Scotland. It appears that the minister is not in control of Circularity Scotland. Therefore, how can we as parliamentarians have any confidence that this shambolic scheme, which is shrouded in secrecy, will be delivered?

It is worth noting that the Scottish Government could have set up an independent non-departmental public body to deliver the scheme, but it chose to create a private company, which now refuses to reply to FOIs that I have sent to it. There is a big question with regard to secrecy. If the minister was not aware that Circularity Scotland was issuing tenders in October 2021 with a launch date of June 2023, how can we possibly be assured that the scheme will be delivered on the new, delayed date? I urge members not to vote for that delay at this time until the questions around transparency are answered.

The Convener: That is the end of contributions from members and witnesses. I pass back to the minister to sum up the debate, please.

Lorna Slater: I appreciate the depth of feeling on the issue and everybody's frustration with the delays. As I said earlier, there is no one who wishes more than I do that we could have kept to the original July 2022 date, so I completely understand that.

The plans that are currently on the table, with milestones agreed with Circularity Scotland, include really ambitious things, such as getting the IT systems in place, buying and setting up sorting centres, setting up all the logistics, registering the 35,000 retailers in Scotland that need to sign up to the scheme, and acquiring the reverse vending machines. I am confident that we can deliver that by the new date of August 2023 and that that date is, indeed, the quickest possible timeline. In fact, that date comes with potential risks, especially for small businesses and breweries, which have struggled so much during the pandemic.

I understand Mr Golden's frustration, but it is an industry-led scheme—that is the whole point of it. It is on the basis of the polluter pays principle. We live in a time of scarce resources. Rather than using the public purse and taxpayers' money to set up the scheme, industry is setting up the scheme itself. That has the advantage of industry paying for it. However, that also means that the scheme is one step removed from Government and not subject to FOI and so forth.

The approach has the advantage of industry expertise. The industry is absolutely incentivised to bring in the scheme philosophically, as it understands its importance to the environment, and because the scheme will generate about £600 million a year. There is a lot of money to be made, and industry knows that. The scheme will be a good boost for industry overall, with a lot of opportunities for business in Scotland. Industry knows that and supports the scheme, and we have agreed that timeline. I really hope that the committee supports the new timeline, because that is our best chance of getting in this ambitious scheme as soon as possible.

The Convener: Thank you very much, minister.

The question is, that motion S6M-02582, in the name of the Minister for Green Skills, Circular Economy and Biodiversity, be agreed to. Are we agreed? If any member does not agree, please indicate that in the chat bar.

I see that we are not agreed. There will be a division. As we are voting remotely, I suggest that we have a quick roll call for each member to confirm their voting intention. I will do that in alphabetical order. I remind members that the choices are "For", "Against" or "Abstain".

Liam Kerr: The ambition is not being delivered, and the minister has not answered the questions that were posed by Maurice Golden in particular. I abstain.

For

Natalie Don (Renfrewshire North and West) (SNP)
Jackie Dunbar (Aberdeen Donside) (SNP)
Fiona Hyslop (Linlithgow) (SNP)
Mark Ruskell (Mid Scotland and Fife) (Green)

Against

Monica Lennon (Central Scotland) (Lab)

Abstentions

Liam Kerr (North East Scotland) (Con)
Dean Lockhart (Mid Scotland and Fife) (Con)

The Convener: The result of the division is: For 4, Against 1, Abstentions 2.

Motion agreed to,

That the Net Zero, Energy and Transport Committee recommends that the Deposit and Return Scheme for Scotland Amendment Regulations 2022 [Draft] be approved.

The Convener: The committee will report on the outcome in due course. I invite the committee to delegate authority to me as convener to approve a draft of the report for publication. Do members agree to do that?

Members *indicated agreement.*

The Convener: That ends the session on the statutory instrument. I thank the minister, her officials and Mr Golden for attending.

I suspend the meeting briefly so that we can prepare for the next agenda item.

10:22

Meeting suspended.

10:25

On resuming—

Role of Local Government in Delivering Net Zero

The Convener: Welcome back. For our next agenda item, we welcome our third set of witnesses for the committee's inquiry into the role of local government and its cross-sector partners in financing and delivering a net zero Scotland. Today, we have representatives from the business and finance sectors.

For the first panel, I am pleased to welcome Tracy Black, Scotland director of the Confederation of British Industry, and Barry McCulloch, head of policy for the Federation of Small Businesses Scotland. I thank them for accepting our invitation. We are delighted that they are able to join us.

I apologise that we are running slightly behind schedule. We have just about over an hour for this panel and will move straight to questions.

My first question relates to the interaction between the business sector and local authorities in delivering net zero targets. During the 26th United Nations climate change conference of the parties—COP26—in Glasgow, we heard about the business sector's increasingly important role in delivering net zero. In previous evidence sessions, the committee heard concerns about whether local authorities have the necessary capacity, expertise and resource to deliver ambitious net zero targets, including in planning, transport and heat in buildings. How do those challenges and the limitations that local authorities face impact on CBI and FSB members' own transition to net zero and their wider ability to contribute to meeting national net zero targets in Scotland?

Tracy Black (CBI Scotland): That is a large question with a lot of parts to it. I will do my best to answer it.

There is no doubt that, across our membership, we have seen a step change in the past two to three years. The huge attendance by business at COP was a great demonstration of that. Governments are crucial to laying out the ambition and the plan but, ultimately, business will implement a lot of that policy.

Your question about local authorities and business working together is interesting. Before coming to the meeting, I spoke extensively to my members. There are lots of good examples of partnership. For example, the Net Zero Technology Centre in Aberdeen has been working well with business using city funding. Members of ours are also working as ambassadors on the circular economy with Glasgow City Council. However, the overwhelming feedback from our members is that there has been little proactive engagement from local authorities.

There is a lot of understanding about that. Resourcing is an issue that we hear about loud and clear. Scottish Renewables recently did some research that showed that the number of council planners employed in Scotland has fallen by 20 per cent in the past nine years, so there is a deep concern about the ability to implement change at pace with those constraints on the local authorities.

There is also a big concern about skills. Technology is changing rapidly, including the processes and systems that are used. Therefore—this is not a criticism—the private sector as well as the public sector face the challenge of keeping up the skills base in the local authorities to enable them to judge and assess new proposals that are coming through.

10:30

Another key message that we have heard from our members is that, often, it is they who are driving the conversations with the local authorities. Although there is a presumption that they will be favourable towards new and innovative builds, the reality is that—even with extensive consultation—at the last minute, they can fail or be put on hold due to a planning decision. It is a complex situation, and I am sure that, over the session, we will delve more deeply into some of the issues.

The business appetite is there. In relation to drivers for change, all our studies show that it is a global crisis and we have a moral imperative; however, if you want business to adapt and change rapidly, you need an executive who is educated and buys into it. As important, there needs to be a business opportunity—without that opportunity, there are too many other pressures, such as not having enough staff, the rising costs in supply chains, or the energy crisis. It is important that local government and the Scottish Government are clear to business about what the opportunities are and how they can engage with them. That will be a major factor in how fast we go.

The Convener: Thank you. Barry McCulloch, I put the same question to you.

Barry McCulloch (Federation of Small Businesses Scotland): Good morning. It is a relevant question, given that we have only eight years or so to cut our emissions by 70 per cent and we have ambitious climate change targets on the books. As far as our members are concerned, the gap in advice, support and financial incentivisation will not necessarily be filled by local government. To build on what Tracy Black said, although I realise that the members of the FSB are different from those of the CBI, it is important to note that many local businesses are already on the journey to net zero and have taken significant steps to reduce waste and increase recycling, become more energy efficient and enable home working.

In our discussions with local authorities, a common theme is that Covid-19 has had a huge impact on our ability to make material progress and execute the plans that were being developed prior to the pandemic. Therefore, although there has been engagement, particularly with the city councils, around the circular economy or measures to improve air quality, many of the plans have been put on hold because local authorities have been allocating their scarce resource to supporting businesses that have been hit hardest by the crisis.

As we heard in previous sessions, we are at a crunch point where local authorities, in conjunction with the local business community, have to introduce ambitious plans that detail clearly what needs to be done and the role of businesses.

Tracy Black made a good point that is worth reflecting on: clarity is the key word here. The need to tackle climate change has absolutely been bought into by many local businesses, but what it involves is quite unclear. In some cases, there is a stronger understanding of certain themes of what we might need to do—particularly around transport, heat in buildings or in our workforce—but the policy levers and interventions that will help businesses in that regard do not really exist at the moment. We have a lot of work to do to help businesses do what they are situated and prepared for.

The Convener: Thank you both for your answers. You have picked up on a number of issues that members will want to explore with their questions.

I will focus on the issue of the absence of detailed implementation guidance. For example, the heat in buildings strategy will require the conversion of tens of thousands of business premises, large and small, across Scotland in the years ahead. The target date is 2030, which does not allow a lot of time for such a massive undertaking.

Are members getting enough clarity and support from local authorities and the Scottish Government on what it will involve, the financial support available and what needs to happen in practice? I think that we all understand what the final target and end destination is, but my sense is that there is very little detail on the ground about what this massive conversion will involve. My question is for Tracy Black first.

Tracy Black: That is a really good point. The majority of our businesses are probably in old building stock. There is already a lot of debate and confusion about what solutions will work for those types of buildings. We talk about bringing heat pumps to domestic buildings, but we already know that there are questions about how effective those are in Victorian houses. The education piece is important. We need to reassure private households and businesses that are making a considerable investment that the technology is going to work and tell them what the options are. At the moment, that is quite vague. If their heating system works and is effective, many companies will stick with that, and wait to make sure the situation is really clear. I do not really see anyone trying to get that first mover advantage at the moment.

There are also complications around business rates. If buildings are improved with new, greener solutions, they can be subject to a higher tax rate: you improve your building and then you pay more business rates. That is not exactly a clear incentive. I know the announcements have been made about changes to that down south and we would advise a similar approach in Scotland to encourage businesses.

Many businesses do not own the building from which they operate. Is it for the tenant to make the improvement or is it for the landlord? That is another challenge.

We are predominantly a country of small and medium-sized enterprises—Barry McCulloch will know this better than I do—and more than 98 per cent of our businesses are SMEs. I always go back to the mechanics, the hairdressers and chefs. Our hairdressers across the country are probably all using gas boilers to heat their hot water. What is the option for them? There are tens of thousands of mechanics out there who have spent large sums of money on equipment for diesel and petrol engine cars and are now going to have to invest in equipment for electric vehicles. Pretty much every kitchen across the country at catering level will be using gas. What are the options for those businesses? What are the induction options for catering?

There is also the big waste issue that we will create from that conversion. Many of our members are asking whether, if businesses remove the thousands and thousands of boilers, the local authorities have the capacity to recycle them all and what we are going to do with all of that new waste that we will have created. It is very complex.

First and foremost, we need clear direction from local authorities about the solutions, giving businesses advice about where to go, what technology will work, and the real cost of that. If there are early adopters and the technology is not fit for purpose, it will slow down other people and prevent them from coming forward to make the same decision. That peer learning will be critical.

The Convener: As you say, there is an enormous number of complex issues to be addressed and there is not a huge amount of time to address them. I put the same question to Barry McCulloch.

Barry McCulloch: The challenges to decarbonising non-domestic properties are absolutely massive and the timescales are incredibly tight. It is a commitment that will require billions of pounds-worth of investment from either the private or public sector. Although the destination is somewhat well known, the way in which we get there or the route that different businesses will have to take, whether they are tenants or landlords, and what that looks like is not in place. Work is on-going in the Scottish Government to provide those practical details, but the route map that local businesses require needs to be urgently brought to the table.

The issue about ownership that Tracy Black picked up is worth dwelling on. My Westminster colleagues published research on the topic last year, ahead of COP26, which points out that about 20 per cent of our members are not able to make even straightforward, practical improvements to their energy efficiency because of the agreement that they have with the landlord. There is a lot to unpick and understand about the dynamics in who owns the property and what the tenant can do in practice without putting themselves in a disadvantaged position.

Finally, there is also the Covid angle. We are talking to the Government more and more about that tension between ventilation, which is important to make our workplaces safe—that is a multiyear commitment, and a £25 million ventilation fund was launched last year—and the need to further insulate our often dated, historic, non-domestic properties. That creates confusion in the marketplace. Many FSB members come to us asking for advice and are being told to open windows, ensure that doors can be kept open, install air bricks and so on, while at the same time there are people who want to ensure that their property is well insulated. Although people might understand why both those things are important, the average local business owner who is juggling many different plates needs that to be spelled out very clearly.

There are massive procurement opportunities that can be generated if we manage the process properly. Ahead of last year’s elections, we proposed a neighbourhood approach to procurement whereby we tackle non-domestic and domestic properties area by area, ensuring that we do not just aggregate contracts but give opportunities to SMEs that are more than equipped to help, whether that is central heating engineers or firms that could install secondary glazing or new windows. We need to use the local businesses that we have and ensure that the benefits stay within Scotland as much as possible.

The Convener: Thank you both for those responses. You raised several points that members want to come in on.

Fiona Hyslop: What are the top planning, practice and regulation changes that will be most helpful for your membership to deliver net zero in the short term and the long term?

Tracy Black: One of the key things is that many of our members operate across local authorities and across the UK. Where possible, standardisation across local authorities—whether that is approved technologies or new systems—would be helpful. Everyone gets the fact that the look and feel of what is acceptable for a building beside a loch can vary hugely from what is acceptable for a building in a city, for example. There is a planning side, but if there could be consistency of approach to building standards across local authorities that would really speed up adoption.

Secondly, reducing the time it takes to get decisions made would help. It can take 10 years for big infrastructure projects, such as wind farms or whatever, to get through the process. There is a lot of sequential decision making: first to go through the Government, then the regulator and then the planning process. Everybody can be in agreement and it can still come down to the local planning officer saying no, even though we have worked through the whole process. What I am proposing is not about trying to cut corners but is about finding a way to improve and speed up the process to get the ground dug up and getting going to make the amendments.

One of our key asks is, where possible, having that shared learning. At the end of the day, there is a huge skills challenge for local authorities—it is a widespread problem. Can every building standards officer really have time to get to the same level and learn all the skills? Could we have groups across local authorities of people who are experts in certain things and who advise, in order to speed up the learning? We need peer learning and sharing of resources and knowledge, and we need to somehow bring down the level at which decisions are made.

10:45

There also has to be increased commercial awareness. For example, we have a member that is a multimillion pound sustainable business that is supported by the Scottish Government to the tune of large sums of money but also by private funding. Some private funding was conditional on getting planning permission by a specific date. Even though the company worked really closely with the local authority, the planning officer did not approve the planning permission by the date that had been agreed. In that case, £5.5 million of funding was at stake, and it was not just about the funding; the company was at stake, too. There needs to be awareness of the significant impact that delays in local authorities can have on businesses. As I said, we will see thousands of applications being made.

Another point that we want to get across is about speeding things up through permitted development. A major supermarket wants to be one of the biggest providers of electric vehicle charging points. It has bought and is rolling out standard and well-known EV charging points. In England, those come under permitted development but, in Scotland, they are classed as too tall. Therefore, every single EV charging point that the supermarket wants to roll out at every single store across Scotland has to go through the planning system. However, the perception is that it would be really challenging to change that and, in effect, get the 32 local authorities to come together and say, “You know what, that is madness—they are only 20cm too tall, so let’s just agree.”

The same applies to packaging. We know from retailers that one of the biggest issues is about consumers not knowing what can be recycled, yet our local authorities all have different colours of bins, which makes it hard for consumers to know what can go in what bin. Something as simple as the local authorities agreeing that they will all have green recycling bins and black landfill bins seems like a huge task to overcome in Scotland. With pretty simple things like that, can we just make them happen rather than take years to debate things and get nowhere?

I am sorry that that was a very long answer.

Fiona Hyslop: Thank you—it was comprehensive. I ask Barry McCulloch the same question.

Barry McCulloch: Tracy Black made good points about standardisation and the need for prompt decision making. However, in truth, small businesses do not necessarily see the planning system as a barrier to growth or to adoption in relation to net zero. As you will know, most local businesses put in smaller-scale applications for small alterations to their buildings. On the whole, they are infrequent users of the planning system.

There is an interesting discussion about the indirect impact that local businesses experience as a result of the decisions that planning authorities take. An issue that is ripe for discussion is about the impact of town-centre-first policies and the decisions that planning authorities have taken to enable out-of-town developments. In essence, we are constructing new infrastructure at the expense of the infrastructure that exists in the town. That was a finding of a Scottish Government expert group that I sat on for the FSB and that looked into towns last year. There are interesting policy discussions to be had on that issue, and there is perhaps a need to look more seriously at it.

There is certainly mileage in investigating what more we can do to extend permitted development, and Tracy Black made a good point about charging points. In that regard, we can look to how the planning system responded to Covid-19. In effect, the chief planning officer enabled lots of alterations at speed and gave planning authorities the space and legal clarity to allow many local businesses to move quickly. There is something in that. We can look at how we enable firms to pivot and adapt quickly within set confines, working with local government, to meet the challenge that we have now—because it is a climate emergency. We need to think about what more we can do at pace in our local businesses and local economies.

Fiona Hyslop: I have a separate question, convener. Do you want to bring in Mark Ruskell on this issue, or can I move on?

The Convener: Ask your question, and then I will bring in Mark Ruskell after that.

Fiona Hyslop: We have heard about the importance of speed and scale in collaboration between the public sector, councils and private companies when it comes to co-investment in net zero schemes. The committee has heard that that will be key to delivering net zero. At the same time, the Economy and Fair Work Committee has heard about potential risk aversion in councils as a result of the centralising Subsidy Control Bill, which is going through Westminster. We need subsidy control, but we also need to ensure that the pace, ambition and clarity, as has been mentioned, and what can be delivered in local areas—[*Inaudible*.]—developed by the Scottish Government. That would be helpful in pushing ahead with the collaboration and co-investment of councils and businesses in net zero schemes at the speed and scale that we need.

I put that first of all to Tracy Black and then to Barry McCulloch.

Tracy Black: I am sorry, but my screen froze just when you were asking your question. Could you ask it again?

Fiona Hyslop: It is about the speed and scale of co-investment between councils and private companies, which is important if we are to deliver on net zero. The Subsidy Control Bill is going through Westminster. Obviously, we want subsidy control and understand its importance but, if there is risk aversion because of the nature of that system, that could affect the scale and speed of co-investment between private companies and councils. With previous co-investments between private companies and councils, there have been streamlined schemes to help to get rapid approval. Given that we need clarity to move forward with tackling net zero, would your membership welcome some kind of streamlined scheme for approvals of subsidy by local authorities?

If you want to come back to us on that, I am happy for you to do so, but that is a live issue in the Parliament just now.

Tracy Black: I am trying to think what the correct response is. I would probably want to go back and speak to the team on that.

I do not know whether this directly answers the question, but it is one point that I wanted to make today. There is no doubt at the moment that we are leaders on offshore wind because we have subsidised it well. We are now having to move to much smaller products. Every product that we have in our houses will change. Thousands of products that we use every day use petrochemicals. The reality is that green products are more expensive—there is just no doubt about that. We hope that, through scale, the cost will come down. A big issue that our members raise constantly is that the business opportunity needs to be clear. Companies need to know that the consumer or client—this relates to local authority procurement and to the general public—will buy a more expensive product. At the moment, people are not doing so.

For example, with house extensions, when I speak to my construction companies, I hear that, if people have a choice between getting the highest-spec green insulation or cosmetics such as granite worktops, they consistently go for the granite worktop. We have to consider how we make the green option comparable to the petrochemical equivalent. It is the same when we look at biochemicals versus their petrochemical equivalents. The green options are just more expensive. We have to be innovative and think about how we level that. It is a big topic. Do we use VAT or taxation as a way of levelling those up? In the next eight years, a big challenge for us will be about how we get that business demand when people cannot quite see the value.

House builders know that they can create really energy-efficient housing, but it will cost more and people would rather have a better kitchen. Rather than an energy performance certificate just saying that a building is energy efficient, can it say that the building will save the owner £1,700 in gas bills each year?

For us, the opportunity has been clear but, whether it is through procurement or consumers, there has to be a way of levelling the playing field between the green and petrochemical offers because, at the moment, it is not fair. A streamlined scheme for approval in principle sounds like a good thing—let me come back on that with more detail. However, the problem is that the consumer is a couple of steps behind business on that one. I do not know whether that helps you, but that is the sort of thing that is going on in my head.

Fiona Hyslop: Thank you; it would be good to hear back from you on that.

Barry, it would be good to hear from you with regard to small businesses that might be doing joint projects with councils that involve some kind of subsidy or incentive from the council. How do we avoid risk aversion for competition and subsidy issues?

Barry McCulloch: The new subsidy control regime might cause delays to co-investment. I confess that it is not an issue that has crossed our desks, but I am happy to pick that up with you separately.

However, over the past few years, European Union state aid also caused an issue. There was always that threshold at which either local authorities or the public partners began to get nervous, because of the de minimis regime that ran. There is an interesting discussion to be had about the function and operation of the Scottish National Investment Bank in that space, and many FSB members will look to the bank, in partnership with big finance providers, as a way to finance their net zero ambitions.

However, I caveat that by saying that I sense that there might be a reticence to take out debt or equity finance, as a result of the £4 billion upwards of debt finance that many small businesses took from the bounce-back loan scheme in response to Covid. A new model might need to be created to encourage businesses to co-invest. I highlight the fantastic success of the Scottish Government's digital boost scheme, which started at a level of 100 per cent grant and slowly tapered down. As the level has tapered down, the demand has not dampened, so there is something to be looked at in how we can use that within the green economy space as a way to tangibly encourage businesses to tackle their energy efficiency or replace a vehicle. A lot of the tools and resources that we relied on pre-Covid were zero-interest bank loans, for example, through the Energy Savings Trust. I am not sure of the appeal of that going forward, given how difficult business is for many of our members at the moment.

Fiona Hyslop: Thank you.

Mark Ruskell: I have a quick supplementary question in relation to Tracy Black's last answer. I presume that you are in favour of the free market, and there will be market-based solutions, so I am interested in your attitude to regulation. If you are talking about levelling up and effectively creating a level playing field, surely increased regulation does that. It provides certainty for business, but it also says that we will need to grow and innovate in the market for low-carbon heating systems or insulation to bring the cost down for consumers and suppliers. I am interested in your views on where regulation sits in relation to that market and whether it can drive innovation and cost reduction.

Tracy Black: [*Inaudible*.]—market conditions, because time is not our friend on that one, to let us play it out. We have a very tight deadline of a number of years. Plenty of experts say that, if we do not achieve the radical goal that we need to get to in the next 10 years, we will miss the point. It is not a normal situation. The real challenge is that everything has to be done at pace, and regulations and policy will move at a much faster pace than the required skills and innovation. We could say to all food and drug manufacturers that they have to use recycled packaging, but that packaging does not exist at the moment. It is not a case of the manufacturers not wanting to use it or of its being too expensive—a drug standard recycled plastic has just not been invented. A lot of different things are at play that hold back the free market economy in that regard. Bill Gates has spent millions of pounds trying to improve battery technology, but people have come to the conclusion that it just cannot be done.

11:00

One of our key messages about regulation is that the regulators, too, have to modernise. There is a lot of discussion about that in the energy sector at the moment. We need a regulator that has net zero at the heart of its framework, ties in with the Government's ambitions and is able to work with business on the ground.

I think that there is a huge appetite now; the business case for net zero has been made and—certainly for larger businesses—there are huge opportunities. ScotWind is a fantastic example of how excited business is to invest in Scotland. I took lots of calls last Monday from CBI members who had been successful in their ScotWind bids; I also had calls from businesses that were devastated that they would not be writing enormous cheques to the Crown Estate. There is masses of appetite there. We have to be clear about not losing the 60-odd companies that missed out, because there are opportunities all over the globe. How do we keep that cycle for businesses that want to invest?

One challenge, Mr Ruskell, is that there are not nearly enough big opportunities across the UK and Scotland. We want to see more. Another is that some projects—maybe the very niche or local—are just not that attractive. How do we fund those projects? That will be much harder.

We have seen that, where local authorities down south are doing this well, it is often a dynamic individual who is leading things and creatively putting packages together. The approach is quite risky when it all comes down to an individual; we need the strategy and policy that lay out the opportunity, and we need good regulation that reflects where we need to get to. At the moment, lots of regulation is 10 or 20 years out of date for a modern, green economy.

Barry McCulloch: Let me complement that answer and reflect on a couple of the committee's previous evidence sessions. A common theme that is coming through is that local authorities do not expect the Scottish Government to finance the entire transition to net zero at local authority level. Many city council leaders have made the point that a lot of funding will have to come from the private sector.

In that context, it is worth flagging up that, before the crisis, many local businesses were non-borrowers that did not take any debt or equity finance. They will not be sitting wondering how they will finance the transition to a net zero economy. Very much like households across the country, they are trying to figure out what advice, support and financial assistance will be required. Within that space, a lot of policy intervention will be needed throughout the 2020s and 2030s to help the smallest businesses, which, disproportionately, will find it difficult to meet the targets.

I have particular sympathy for businesses that have been hit hard by Covid-19. There is an important discussion to be had about how we make the transition just for such businesses and give them the tools that they need to decarbonise their operations.

Mark Ruskell: Okay. Back to you, convener.

The Convener: I will bring in Monica Lennon, then Liam Kerr.

Monica Lennon: Good morning, panel. I want to focus on procurement, which has been mentioned. The committee has heard about some of the challenges and we have had some good briefings on the issue. Will the witnesses talk about some of the positives when it comes to procurement, such as the implementation of the sustainable procurement duty? It sounds like the challenges are to do with skills and knowledge; what needs to happen in that regard? What are your top asks of local government and central Government on that? I will go to Barry McCulloch first.

Barry McCulloch: I will come in first, as Tracy Black has been answering first for much of the session. The answer to the question depends on the type of business that we are talking about. As you touched on, net zero is a huge opportunity for many small businesses, which will be central to the drive to net zero. That might involve retrofitting homes and premises, installing new heating systems or building new transport hubs—there is a long list.

However, it is worth considering how few small local businesses have won public contracts. Despite the previous procurement legislation, not enough local businesses are winning contracts, so our number 1 line on this issue, as it is on other issues, is that we want more local businesses to win public contracts. We want contracts to be broken up into smaller pots. We want local authorities to stimulate demand if it does not exist in their local economy—North Ayrshire Council, for example, is already doing that. How do we ensure that the proceeds and benefits of getting to net zero stay within local economies? That is why, in producing our manifesto for the elections last year, we talked to many interested parties about a place-based model for procurement.

We should not make the mistakes of the past. We need to have X number of warm homes by 2030, and we need cost efficiencies to stem from that work, given the amount of money that is being pumped into the national health service and Covid relief for businesses. With the local government elections just around the corner, there is a lot to do to get local authorities to spend more on local businesses, to stimulate demand and to use that demand to build community wealth. The community wealth building agenda has a lot of synergies with what we are talking about.

For too many local businesses, procurement is a complex and costly endeavour. They cannot necessarily write off the thousands of pounds that it will take to bid for contracts. With local authority partners, we are keen to make the process easier and to discuss the opportunities with local businesses.

Monica Lennon: It is good to hear you mention community wealth building.

Tracy Black: We see procurement playing a huge role, as there are massive benefits in developing local supply chains and local skills. I am sure that Balfour Beatty will not mind me saying that it is working on a couple of exciting projects: the prison in Inverness and the botanic gardens in Edinburgh, which are both net zero construction sites. The projects are hugely ambitious and are using state-of-the-art technology and machinery. The sites are basically case studies. We hope that Balfour Beatty, the local authorities and their suppliers are learning from the sites, and we hope that the learnings from the two projects can be used in the future. It is hugely valuable for local authority projects to showcase what can be achieved to other construction companies.

However, we have to realise that we will really slow ourselves down if we learn only from within Scotland, because the whole world is doing such work. At the CBI, we talk about being magpies. What can we learn from other parts of the UK and from the rest of the world?

Last year, I think—I lose track of time because of Covid—at our urban revival conference, I sat on a panel with representatives of Exeter City Council, which had looked at Passivhaus standards for its social housing because of the huge fuel poverty challenge that it had in the city. Fast forward 13 years, it will be building another 1,000 Passivhaus homes in the city. That has significantly reduced fuel poverty for the people who live in such houses. At the beginning of the process, the council had to go out of Exeter to get the experience and the skill sets to build such properties, but the local construction supply chain now has confidence that there is an order pipeline, and the skills have been developed. Exeter City Council is now moving over to doing community buildings. I think that it is doing a leisure centre at the moment that will be not only energy efficient but cheaper to run in the long term.

It is very much about us being open to talking and working with the whole of the UK, and looking beyond. We might have to bring expertise into Scotland or into our local authorities but, hopefully, by working with experts at this, we can develop those local skills and jobs.

I have some feedback from a member of ours who is a real expert in this. One of the points about procurement is that, understandably, all the people in procurement cannot be experts in everything they are procuring. To add the requirement for sustainability on top of that will therefore be a real challenge to getting the procurement skill base up.

There is certainly a perception among some of our smaller members who win procurement contracts across Scotland that the price per annum is still the main factor in procurement when looking at the implications. Basically, they say that a greener product with an initial cost of £10 and a long-term cost of £15 would still lose out to a less green product with an initial cost of £8 and a long-term cost of £18. We need to look at that modelling in procurement when assessing green solutions and we need to look at the overall long-term benefit and cost.

Those are a couple of the key points that our members would want to make about procurement.

Monica Lennon: Thank you, Tracy. The example of the Passivhaus and Exeter was interesting. I know that Alex Rowley MSP wants to propose a member's bill on Passivhaus standards, so I hope that he will read the *Official Report* of this meeting.

We do not have a lot of time, so my second question is about the Scottish National Investment Bank. Barry McCulloch mentioned it in response to a question from Fiona Hyslop. Perhaps you could keep it really brief, because we are short of time. What is your view of the role of the Scottish National Investment Bank in supporting small and medium-sized enterprises and in delivering on net zero objectives?

I think that Barry was trying to come back in on Tracy's point. I will hand over to Barry because he seems keen.

Barry McCulloch: FSB completely bought into SNIB's mission to encourage more SMEs and to take on the inequity of finance. There was an obvious market failure and the bank is trying to address it.

However, in complete honesty, sitting here a couple of years into Covid, I am not really sure what the bank is doing for SMEs. During the build phase, there were some exciting conversations about its role in providing place-based finance for its mission, whether that be regenerating town centres or changing the use of city centres.

More than £200 million has been allocated to the bank from the Scottish Government for the previous two years and the next eight years, so we are talking about a lot of money. At that point, we were quite excited about the opportunities that the bank might provide for long-term investment into places that, frankly, have seen better days and are struggling to adapt to the modern economy, through no fault of their own. Now, the bank is very much focused on burnishing its credentials as a major player in the finance market, which is important, but many of our members in the past year or so who have approached the bank have either waited some time for a response because the bank was still trying to set up and expand its headcount, or it was not really the right vehicle for the project.

We will build on that customer experience as more and more businesses go to the bank but, at the moment, it is too early to tell what its role will be, and there is a lot of confusion within the small business community about what the bank can do for it. Before the bank was created, a lot of the discussion was about how it would be a bank for SMEs, but we are not yet clear about whether it is and whether it will be. Does that help?

Monica Lennon: Yes it does; thank you, Barry. Tracy, do you have any thoughts on SNIB?

11:15

Tracy Black: It is very unfortunate that it was pretty much launched during the pandemic, so it has been through a particularly challenging time.

I have talked to bank representatives and it is clear that the bank should not be investing in areas in which it is easy to get private sector investment. There are lots of green projects that I have talked about that already have huge interest and can be easily funded, whether they be offshore wind or whatever. However, the reality with net zero and reaching sustainability is that we do not yet have a lot of solutions—much of the technology has not yet been invented—which means that somebody has to have the risk appetite to take that leap of faith and I see SNIB as being able to play that role, particularly with innovative SMEs that have a good business case, a good structure and a good product, but perhaps a product that has never been tried before, because to win at net zero and becoming sustainable will mean lots of failure. Nobody wants to talk about that, but we only have to look at innovation over the past 200 years to see that most inventions go nowhere.

SNIB plays a really good role in the more challenging and perhaps unattractive projects, which are not quite as exciting but will be essential if we are to meet our targets. I hope that it has the risk appetite and that it is allowed to fail. If everybody jumps on the bank about every investment that does not turn into a success story, that will really hamstring us. We have to allow SNIB to take brave steps towards some really good, innovative solutions and see where they go—as long as there is a good business case and a good team behind them. It should leave the market to deal with the easier stuff that everybody wants to get into.

The Convener: Next up is Liam Kerr, to be followed by Jackie Dunbar.

Liam Kerr: I shall be brief. Should SNIB be investing in listed managed funds? Tracy Black mentioned the city deals in her opening responses. As a partnership and funding model, will they deliver low carbon infrastructure?

Tracy Black: Nobody has spoken to me about SNIB investing in listed managed funds, so I do not feel that I have a proper response to that question. I know that the committee is speaking to Scottish Financial Enterprise and Phoenix later in the meeting; they might be better placed to answer it.

City deals play a very important role. To cite an example, Aberdeen seems to be one of the most forward thinking on that. Like everything, it is about the transparency around what is available to business. Over and over again, we hear from our members that they do not know where to go, they do not know who to talk to, and they do not know what is available. Whether the overall ambition for Scotland is clear is a consistent theme, but people are a lot more vague about delivering the ambition and it is quite hard work.

I imagine that certain enterprises know exactly what is going on within the city deal, but if you were to ask the vast majority of businesses across Scotland, they will have very little visibility on what they could be doing with them or how they will affect them.

Liam Kerr: Thank you. That is really interesting. Does Barry McCulloch have any thoughts on that?

Barry McCulloch: I am not equipped to answer your first question, Mr Kerr. I wish I was, but I do not have anything to add.

We are still not entirely sold on the concept of city deals. There is some good practice, particularly in the north-east, especially given the strong role and opportunity that the north-east provides for the private sector. However, city region deals are complex, tripartite arrangements that can be a little mystifying for a lot of local businesses.

As to whether they will deliver low carbon investment, they will deliver what was agreed back when the heads of terms were agreed, and that was in quite a different era. We have been pushing for some time for a re-evaluation of the city deals. Are the projects that we agreed, going back to the Glasgow city region deal to now, the right ones and if they are not, how do we give local authorities in partnership with the Scottish and UK Governments the space and creativity to change and adapt those projects? The world has changed and what looked like a good project four, five or seven years ago has changed. Local authorities need to be empowered to bring forward new projects using the investment that has been previously committed by the two Governments.

Liam Kerr: My second question is for Tracy Black first; Barry McCulloch can come in afterwards if he has any further remarks. Tracy, you talked about household products and the cost of doing things differently. You might have heard that we had a previous evidence session on the deposit return scheme and how important it could be for our net zero journey. One of the concerns that the committee heard about was DRS systems differing between Scotland and the rest of the UK. What does business think about those differing approaches and do you share those concerns?

Tracy Black: [*Inaudible*.]—many of our members have come to us. First and foremost, business sees the idea of the UK becoming a leader in sustainability as a good thing. One of the key parts of that is using less, being more efficient with what we use and reducing waste. Business is in full agreement with the ambition for Scotland and the rest of the UK to become world leaders in the area. The deposit return scheme is one of the methods for doing that.

There is general agreement and support for deposit return schemes, but there must be an understanding that the vast majority of food and drink suppliers in the UK, supply the UK, and that margins on food and drink products are usually incredibly tight. Therefore, having a standardised approach across the UK on what can be recycled, how it should be recycled and what materials and products should be used will make or break support for a system. Those supply chains are complex; it can take years for a company to change its supply chain and the materials that it uses, so it takes time to plan for that. If we end up with a two-system approach, the complexity and cost of the process will increase.

Our members have said all along that they support a deposit return scheme, but they want one system that works for the whole of the UK. What we are proposing is very ambitious. I cannot remember who on the panel said that we are going big scale here, with different materials and products, which is fantastic, but we want everybody to be able to deliver it in an affordable and effective manner. That is the big concern.

I made the point about having different coloured recycling bins. If the whole of the UK had standardised bins, Tesco could put “blue” on every piece of packaging that needs to go into that recycling bin and put “black” on everything that has to go to landfill. It is very confusing for the consumer to know what they can and cannot do in relation to recycling, and it will be the same with the deposit return scheme. Let us keep it simple and make sure that everybody knows what they can and cannot do with it, whether they are supplying the process or using it. There is no appetite for two different approaches.

Liam Kerr: That is really interesting.

Barry McCulloch: I will come in briefly. Our membership, as independent retailers, is likely to be pretty agnostic about whether the DRS in Scotland is different from the one that might be created for the rest of the UK, because we tend to trade locally and regionally. That changes for our members who are micro brewers and who want to sell their products across the UK. At the very least, they will want compatibility. The Scottish Government was the first out of the blocks in developing its DRS and we are now at the point where how we get two separate but entirely alike regulatory schemes to work together will be critical, particularly in relation to cross-border trade.

To go back to the previous deliberation on the DRS, for FSB members, it is all about the practical aspect. They want to know how the scheme will impact them and what help they will get to mitigate some of those costs. We urge the decision makers—the ministers in the Scottish and UK Governments—to work together to arrive at a sensible compromise.

Liam Kerr: I am grateful to the panel. Back to you, convener.

The Convener: I will bring in Jackie Dunbar next.

Jackie Dunbar (Aberdeen Donside) (SNP): Thank you, convener, and good morning, panel. I am aware that we are running over time, so I will just ask one question.

We are all saying that net zero will be achieved only if we work together; businesses and local authorities need to work together. As you know, I am still a serving councillor for Aberdeen City Council. In my role as an MSP and in my role as a councillor, I am hearing from some businesses that sometimes there is little engagement from local authorities and that it is sometimes difficult to have an open and transparent conversation with them.

I am interested to hear how the panel thinks that we can achieve true joint partnerships between local authorities and small businesses so that it is an equal partnership and things are being done with each other rather than done to, if that makes sense.

Barry McCulloch: Absolutely—I was nodding vigorously in agreement there. I agree entirely about the importance of partnership working, particularly in the scope of net zero.

In many ways, the way that local authorities engage with small businesses on net zero is quite similar to the way that they engage on other areas. The engagement will be formed around a big idea or a lengthy policy document, or a plan will be written in fairly technical language that lots of business owners do not understand. The engagement might often arrive too late or our members can feel that the local authority has already made up its mind. There are good examples of that regarding the spaces for people initiative.

Having said that, there is a lot of good practice and it is important to highlight that we are not starting from scratch. I would particularly emphasise the repeated attempts made by the likes of Aberdeen, Edinburgh and Glasgow city councils to engage with FSB and local businesses on their low-emission zone plans and their city centre transformation work, so there are good building blocks there. How we use and activate those building blocks to make it as practical and easy as possible for businesses to engage and shape plans is a big discussion that I think we will be having post-election.

Tracy Black: Another angle to this is to ask how the private sector can help local authorities solve problems. One of the key things that businesses need to understand is what the problem is that the local authority is trying to solve, whether it is around transport, pollution, waste, and so on, and they also need the details.

Something that we do not talk about nearly enough is data. One of the key things is about whether the local authorities can provide those datasets. If we look at transport, do local authorities know who is on the roads, where those people come from and where they are going to? Smart ticketing on public transport can give you a lot of information. Whether it is public transport, vans or cars, did they start their day in that vehicle or did they come from somewhere else?

It is the same with housing. Do local authorities know how many houses need to be retrofitted? Do they know what streets they are on? Do they have a priority list, whether it is pensioners or people who have young families or people who are on benefits? If local authorities can start providing those datasets, that is one thing, but it is also about asking—what do you do with that data? Who do you share it with?

Other countries have made whole sets of data available, not just for net zero but to solve many challenges. That is when you attract the innovators. Singapore has had some really smart traffic apps developed, for example. The developers could be in South Korea, London or Edinburgh, going, "There is an opportunity there—I can identify the problem that they want to solve and they are providing me with the data to give me the insight so that I can build something."

We often overlook that issue. If we do not know the size or scale of the problem, we cannot address it. Scotland has been very slow at getting that type of data out, across housing, skills and transport, for example. That is a powerful point: if we got there we could see partnership with the private sector and innovation to deal with some of the massive problems that we face.

The things that will really shift the dial will be to do with heat at scale and transport at scale. Given the urgency of climate change, we have to identify the projects that will have a meaningful impact for the country overall.

11:30

Jackie Dunbar: Thank you. Back to you, convener. I just had the one, quick question, as I said.

The Convener: That's great, Jackie. Natalie Don has the final question.

Natalie Don: I thank the panel. The discussion has been very informative.

This is another quick question. We have talked a lot about partnership work in local authorities, and I want to get your views on some of the partnership mechanisms that are highlighted in the updated climate change plan. For example, I am thinking about the Grangemouth future industry board, the National Manufacturing Institute Scotland, which is in my constituency, and Dundee's Michelin Scotland Innovation Parc. Given the tone of this morning's conversation, I assume that you are quite positive about such arrangements.

Barry McCulloch: There are perennial challenges with partnership arrangements, irrespective of the topic, when it comes to getting meaningful engagement from local businesses, which are busy running their businesses and do not have the time or resources to be able to get involved in such discussions.

Although representative bodies such as the Federation of Small Businesses, Scottish Chambers of Commerce, CBI and others do their bit, there is a need to try to make things as simple, straightforward and actionable as possible. We use phrases such as "net zero" and "just transition"—I am guilty of that, as we all are—which are not widely understood by most business owners and households across the country.

A partnership arrangement that keeps things simple, perhaps by starting small and focusing on just one or two things and then building momentum, can be a fine forum for change, but some of the regional partnerships that have morphed out of the city region deal arrangements have become far too complicated—but they need to be complex, given their vision and spend. There needs to be a big discussion about how we encourage and facilitate greater engagement in important partnerships on the part of local businesses that are directly impacted by decisions.

Natalie Don: Do you want to add anything, Tracy?

Tracy Black: You gave good examples of what is going on. The Michelin site, which is about advanced manufacturing, is fantastic and amazing.

I keep coming back to the point about net zero being a global and enormous challenge. Although the local focus is critical, we need—in any initiative that we have—to be open to having partners anywhere. It is about how we make that ask more widely, whether that is across the whole of Scotland or the whole of the UK. We cannot be too siloed and too parochial.

The task at hand is huge. No real solution exists for retrofitting old buildings to the standard that is needed. Our domestic buildings account for about 40 per cent of our emissions—it is enormous—and the technology just is not there.

Partnerships are fantastic, and they work when they are done well, but the challenge that I am hearing from across my membership is that they are pretty localised. There might be businesses in a community that are experts and know about an issue, but as soon as you try to widen that out a bit, you probably find that people have no clue. If you were to speak to businesses in Edinburgh, I bet that you would find that they do not know anything about Michelin; a host of manufacturers across Scotland probably do not know about the manufacturing.

How do we set out our stall to show what the opportunities are and what is available? It should not be a postcode lottery. Aberdeen City Council put out a couple of great opportunities, but they were not available to businesses in Aberdeenshire. A good scheme should be available to any business, wherever it is.

That is an issue at the moment. The problem is so huge that we need to be fully open to support, innovation and investment, wherever it comes from. We should not be too worried about where the brass plate is.

Natalie Don: Thank you both.

The Convener: That brings us to the end of our allocated time. Tracy Black and Barry McCulloch, thank you very much for joining us this morning and for sharing your expertise and giving us your insights across a number of important areas. That was very much appreciated.

I suspend the meeting briefly to allow for a changeover of panel.

11:36

Meeting suspended.

11:39

On resuming—

The Convener: I welcome our second panel, which comprises representatives of the finance sector. We are joined by Sandy Begbie CBE, chief executive officer, Scottish Financial Enterprise; Jeremy Lawson, chief economist and head of climate scenario analysis, abrdn; and Tim Lord, head of climate change, Phoenix Group.

Thank you very much for joining us. I apologise for the fact that we are running slightly behind schedule. We have about an hour for this session and we will move straight to questions.

As you will be aware, the Glasgow Financial Alliance for Net Zero, which was announced during COP26, has highlighted the unprecedented scale of private capital that is potentially available for net zero investment. When we took evidence from a range of local authority leaders a few weeks ago, there was recognition that many local authority projects will have to be funded almost entirely by private sector capital. For the heat in buildings strategy, for example, the numbers are massive—tens of billions of pounds of capital investment will be required over the next five to eight years.

What needs to happen in practice for us to be able to channel that unprecedented level of private capital into such public sector projects? Is there a sufficient scale of investment opportunity in each of the 32 local authority areas to attract that capital? Do we have the right institutions in place to facilitate the public-private partnership that is necessary? What do local authorities and the Scottish Government need to do now to accelerate the movement of capital?

Rather than answering every question, panel members are welcome to pick up on the issues that they most want to focus on. We will start with Sandy Begbie.

Sandy Begbie (Scottish Financial Enterprise): Good morning, everyone. There was a lot in those questions. I will focus on four or five key points about what is important in making that happen. My first point is about ways of working and collaboration, which is a word that is used a lot these days. If we are to deliver against the commitments and timescales that we are working towards, the private and public sectors will have to work together in a way that, if we are honest, has been pretty challenging for us in the past. The collaboration will need to be on a scale that we have not seen before, because of the scale and pace that are required.

As you rightly point out, convener, we face significant challenges, and they need to be addressed at scale and pace. In coming to the table, we must recognise that, at times, we will need to look across local authority boundaries in order to develop business cases of a scale such that the private sector will want to consider them.

My third point is about investable business cases. As you rightly pointed out, one of the positive things to emerge from COP26 was that the availability of capital is not the issue here. Globally, plenty of capital is available to fund such projects. It is a question of making sure that there are investable business cases and connecting the public and private sectors.

My final point is that we will have to be innovative in how we look at the products that will connect the capital pools with the needs that we have. Home insulation is a good example. As has been mentioned, plenty of capital is available for things such as wind farms, but we are talking about retrofitting the majority of the private households in Scotland, and doing it quickly. If we are to do that, we must think innovatively about how we will connect the capital with that need.

We also need to look at the issue through an inclusion lens, because 20 to 25 per cent of citizens in Scotland probably do not have the means to retrofit their homes even if they wanted to do that and understood the need for it. We will therefore have to think about how the financial sector can work with the public sector to think creatively about how to ensure that the work that needs to be done is affordable for everyone. There would be no point in getting to 2030 and discovering that a large portion of the public could not make the transition that is required. We need to look at the pilots that are being run elsewhere in the world, in countries such as Italy, where attempts are being made to connect the public and private sectors in a way that is quite different from what happened in the past.

There needs to be collaboration on a level that we have not seen before, and it is important that the work is done at scale and pace. We need to ensure that the projects are put together in such a way that they are investable, and innovation will be necessary, too. Those are the issues that will be really important.

The Convener: Thank you. You have raised a lot of issues for us to follow up on. I put the same questions to Jeremy Lawson.

11:45

Jeremy Lawson (abrdn): I thank the committee for having me at the meeting. I will go back a step, if that is okay. It is really important to frame the problem or challenge in the right way. We have to recognise that climate change is a result of an enormous market failure. Excess emissions represent an externality. They are a cost to society, the environment and, in the long run, the economy that is not fully factored into the decision making of those who create the emissions.

We immediately recognise that there an intersection between the public and private sectors, because one of the most fundamental responsibilities of the public sector is to set policy in a way that forces the private sector to internalise that external cost. That can be done in a few ways, one of which is through the mechanism of carbon pricing. Until the United Kingdom left the European Union, it was part of the EU emissions trading scheme. The UK is now establishing its own emissions trading scheme. It will be essential that it has a carbon budget and pricing that is completely consistent with the net zero 2050 objectives because, if there is any wedge there, one of the most important mechanisms for achieving those objectives will not exist.

I am sure that some members of the committee are aware that there are proposals to expand the EU emissions trading system so that it covers the buildings and transportation sectors in a way that is not currently the case. They will be controversial, and we will see what happens. That will likely occur through bringing the upstream producers of emissions into the scheme, and not through bringing households into it, for example. Nonetheless, there is recognition that, because of the costs of the energy transition, with the challenges in the building sector in particular, but also in the transportation sector—those challenges are arguably more significant than the ones in the power sector—the transition will be made more difficult if those two sectors are not brought within the pricing mechanism. Price signals are a phenomenal way of incentivising changes in private sector activity and investment.

There may be reasons why that pricing cannot be extended to all the areas that it needs to be extended to. In those cases, it is important that regulation is aligned with the same goals and, arguably, that it effectively replicates the costs that would otherwise arise through an emissions trading scheme. For example, vehicle emissions standards and other types of regulations have to be designed in a way to generate the same pathway. That is foundational.

The convener raised the issue of the availability of private sector finance. Large pools of capital are ready to aid the transition, but they will not generate that transition on their own if policy settings are not aligned with the goals. If we consider a lot of asset owners and asset managers and their commitments around the net zero transition—whether in the UK, in Europe or, even more so, globally—we see that almost all of them have some fine print in those commitments that says that they will provide the capital and reorient their organisations to aid the transition as long as global policy makers do the right thing. There is a circularity to those commitments that has to be recognised, because financial flows will not align with net zero if there are no mechanisms to force that. That is a really important point.

A related point, which is also really important, is that a lot of the private sector investment—at least in our view, with the way that our company, abrdn, is structured—is likely to come through non-recourse project financing, for example. Our company is very closely involved in a number of public-private sector partnerships around concession infrastructure in which there are close relationships between the providers of the finance, the maintainers of the facilities and the public sector.

However, when it comes to infrastructure projects that have to be aligned with net zero goals, we must recognise that, in many cases, the economic case for such investment is not strong enough on its own to generate enough of the financing. That financing gap represents the externality or cost that needs to be overcome and, ultimately, absorbed by the private sector. The size of the externality—the financing gap—will vary from project to project.

That underpins the importance of partnership between the public and private sectors because, in many cases, the public sector will need to take a portion of the risk—in effect, providing a subsidy—in order to bring forth the optimal amount of private sector investment and crowd it into such projects. If that does not happen, there will be a suboptimal amount of investment. In sectors in which there is no formal carbon budget that generates or guarantees a particular outcome—particularly sectors in which the cost of abatement is particularly high—we run the risk of emissions not declining as rapidly as they need to.

I will make a final point about the important issue of scale, which has been mentioned. A barrier to investment relates to the point that—let us be honest—a lot of the investment that is needed, certainly in the housing sector but also in some elements of transportation, is what we might describe as microinvestment. It is not the role of the private sector to talk about the optimal way of building local government institutions, but there will be a need to look at pooling mechanisms to ensure that the scale problem can be overcome.

For example, there might be options, particularly when it comes to debt, around securitisation. That can be a dirty word in some circles, but it is a way of scaling pools of finance across a wider range of assets and geographies in circumstances in which the finance would otherwise be very localised.

This probably relates less to institutional capital but, to be transparent, I note that I worked as a policy adviser to the then leader of the Opposition in Australia, Kevin Rudd, in the run-up to the 2007 election. I was his climate policy adviser. I do not need to tell the committee what a disaster Australia’s climate policy has been over the subsequent 15 years but, early on, we recognised a problem related to retrofitting.

Why are households not incentivised to retrofit in the way that is necessary for the sector to decarbonise in line with the transition to net zero, or any other transition? It is because the pay-off structure and the implicit costs that have to be absorbed are not fully rewarded, so households need to be encouraged to internalise that externality. Rather than penalising households, it might be better to provide them with subsidised loans. We would have to identify how much retrofitting would occur in the absence of loan subsidisation and how much needed to occur, and then the financing gap could be provided in order to help to meet that need.

We designed a policy at the time, although it was lost after there were changes in Government, so there are ways of designing policy to bring that forward. It is unlikely that a large institutional investor such as abrdn will get directly involved in such work but, speaking as a policy expert in these areas, I think that it is essential to be creative with the mechanisms and think about how the costs might be internalised in order to generate more rapid decarbonisation.

The Convener: You have made a number of interesting points. I am sure that we will come back to you to look at them in more detail.

I put the same questions to Tim Lord. I believe that the Phoenix Group has been involved in some private and public sector investments in social housing. I am not sure whether you want to touch on that or to address some other issues.

Tim Lord (Phoenix Group): It is a pleasure to be here. Phoenix is the UK’s biggest long-term savings and retirement business, and we manage about £300 billion in assets. We are a purpose-driven organisation. We see the scale of the investment challenge in Scotland and across the UK, but we also think that we have a significant role to play in addressing that, including in the social housing sector. You mentioned that, convener, and I will touch on it.

Going back to your question about what needs to happen, I would identify three things when it comes to that challenge. The first concerns opportunity. As others have said, the issue is not so much a lack of available capital as the lack of a pipeline of investable projects, although that varies across different sectors. In some areas, the pipeline is much more developed; in others, it is less so.

The second issue concerns the complexity of the investment process. Often, as we get out of large-scale, centralised power generation and into things such as investment in buildings in communities, cities and regions across the country, projects are very complex and fragmented. As I think the committee touched on in the previous evidence session, there is a lack of comparable data, which is a big challenge.

The third issue, which is fundamental, concerns the financial attractiveness of those opportunities. We are a purpose-driven organisation and we have ambitious net zero targets. We are not alone in that, as the sector more widely is setting ambitious targets. However, we also have fiduciary duties to our customers—our investors—to make sure that we get appropriate returns. I have no doubt that, during this session, we will unpack many things that we can do to address that, but I will briefly identify five of them.

The first concerns policy certainty and investment frameworks. Policy certainty does not mean that we need to say exactly how we are going to get to net zero—in 2045 in Scotland or 2050 in the UK—or exactly how many gigawatts from each technology and how many heat pumps we will need. It is about making sure that we have investable frameworks that private capital can come in behind. We have seen the effectiveness and success of that approach in the renewables sector, in which Scotland has achieved genuinely world-leading deployment. We saw the outcome of the auction last week. We have a really strong project pipeline and, in the contract for difference, we have an investable instrument. The challenge is how we replicate that approach across different sectors.

The second challenge is about thinking in a systemic way rather than simply in a sectoral way. Traditionally, when we have done decarbonisation, we have thought about houses, cars, power generation and industry. The next phase is not going to look like that, because all those sectors are going to interact. Our electricity system provides energy not just for our lights and so on, but for our cars and heat pumps and all those kinds of things. Those systemic issues are happening across the transition. Local authorities are superbly well placed to play a huge role in that, because the change happens at that level. It is about local energy systems and local economic systems, and thinking about those things in a systemic way will be hugely important.

The third challenge concerns collaboration—you have touched on that, so I will not labour the point—and particularly collaboration across boundaries. Often, the systems and projects that we are talking about will not be limited to a single local authority area but will cross boundaries, or there will be synergies with activities in other areas. It is important to ensure that we exploit that.

The fourth challenge concerns skills. That is often talked about. I think of skills in two respects, and the first concerns the ability of local authorities to package the financial opportunities in an effective way. I do not mean that pejoratively. It is not an easy thing to do and they are hugely constrained by resources. There are examples of good practice, not just in Scotland but in other parts of the UK, but at the moment they are relatively isolated. Upskilling local authorities to be able to package the opportunities in an attractive way is critical.

My last point is about how we bring projects together on a scale that makes them more attractive, particularly to large institutional investors. One challenge is that, in talking about buildings and about chargers on individual streets, we often talk about smaller-scale projects. We need to package those together on a larger scale and make sure that we use the role of public sector finance. It should not take the majority of the load, but it can have a hugely important role in de-risking some of the projects and making them more attractive.

12:00

The Convener: My next question brings us back to the main focus of the inquiry, which is about what local authorities can do and what additional support they need. Sandy made the point that we are not looking at private investors and private capital cherry picking the most attractive assets. For example, for the heat in buildings strategy, it is not 50 per cent that needs to be done; it is pretty much 100 per cent, which includes the most attractive assets as well as some of the more challenging assets.

Based on the three responses, it strikes me that there are a number of threshold structural issues that need to be addressed in order to unlock private capital investment in public sector projects. One issue relates to the data required to identify the hundreds of thousands of assets, whether they are tenements or public sector buildings, and allow them to be packaged up as investment projects in order to attract private capital.

The second issue is scale. Scotland has 32 local authorities of different sizes. When we had our evidence session with the leaders of the three largest local authorities in Scotland—Glasgow City Council, City of Edinburgh Council and Aberdeen City Council—we heard that even a city of the size of Glasgow, let alone some of the smaller local authority areas, might not be able to package together assets on a sufficient scale on its own.

Sandy mentioned innovation, and Tim and Jeremy spoke about securitisation and developing new markets. Are we looking at a need to develop a new market or new financial products? In the US, the municipal bond market has a long history. In Scotland and in the UK, we do not really have that level of historical municipal bond financing. It will take a lot of time to develop, because the financing will not happen all at the same time—some pathway investments will, hopefully, set the standard and test out market and private capital interest in the projects.

You have helped to identify some of the threshold structural issues. In your experience, do local authorities have the necessary capacity and expertise to manage it all? If not, across Scotland and in the UK, do we have in place the right institutions to help to address some of the structural issues? For example, what role can the Scottish National Investment Bank play?

On Jeremy's point, what regulatory changes will be required in order to unlock private capital to help to fund many of the public sector assets?

I apologise that I have asked about a range of issues, but I am trying to cover the points that you each identified in your opening statements. Sandy, I will go to you first, and you can pick up whichever of the issues that you think are more pressing. I will then bring in Tim and Jeremy.

Sandy Begbie: On the point around scale, in Scotland, the city deal model is at least worth looking at. For the Edinburgh and south-east Scotland city region deal, which covers West Lothian, Midlothian, East Lothian and Fife, the chief executives of the councils need to come together to consider how assets can be packaged together at scale. There are various ways that you could cut it, but, as you pointed out, even some of the largest cities are thinking about how they can develop scaled propositions.

The second point is about innovation. Earlier, I mentioned a scheme in Italy. I am not suggesting that it is the right answer, but it gives you an idea of what has been tested. In Italy, the cost of the retrofit of homes is not borne by the owner; it is added to the property, and at some point in the future, the equity that is built up in that property is released by a certain mechanism.

That would allow long-term funders to invest for 15 or 20 years, particularly in the pension fund space. That is underpinned by a guarantee from Government around making good any loss but, ultimately, the repayment of that is built into the future inflation of the value of the property that would kick in. I am not saying that that is the right answer, but I am giving you an idea of the fact that there needs to be a bringing together of public and private, to really look at challenges that require significant amounts of money.

I think that the convener asked whether we have the infrastructure in Scotland. One of our strengths is our financial and professional services industry. Some people might say that, given my role, I would say that, but we have every aspect of financial services here in Scotland—quite often at scale. We have very strong professional services. You asked specifically about SNIB, and, although its launch during the pandemic—and everything else—has created some challenges, there are really good examples of investments that it has already made in line with its purpose. The challenge is how we get SNIB plugged into that infrastructure and make sure that we connect all those components. As we speak, we are working on that directly with SNIB, and it is part of the new Government engagement group that we set up with the industry, which was launched last week.

With regard to regulation, through some of our members, we have engaged directly with the Bank of England around some of the regulation barriers that might exist. It is important that SFE and our members can engage all parties in thinking about how we present a coherent position on the changes that we think might be necessary and some of the things that are important, particularly around some of the solvency II changes.

Again, to get to scale, first, we need to look across those traditional boundaries. Secondly, innovation is going to be important, and all parties need to be open to that. Thirdly, I think that we have the infrastructure, but we need to make sure that it is all aligned and pointing in the right direction. Fourthly, around regulation, again, through public and private collaboration, we need to be prepared to go to the regulator with some of the things that we think are important, in order to make that transition happen.

The Convener: Thank you, Sandy.

Tim, let me put some of those questions to you, as well as an additional question about timing. It seems that quite a lot needs to be done here, and not all of it can be done in parallel; some of it has to be done sequentially. In Scotland, we have a target to retrofit domestic and non-domestic dwellings by 2030. I presume that all of that will take some time.

Tim Lord: As you say, there is a lot to unpack in there, and I will try and cover a few of the questions that you asked.

The first thing, which links to your point about timing, is the data question, and the understanding of systems question is absolutely critical. I do not mean just how we package the data on what building 1,000 houses in an energy-efficient, low-carbon way will achieve in terms of carbon. I mean that we need to ask what the decarbonisation journey looks like for a city such as Edinburgh, Glasgow or Aberdeen. What investment is needed to make that happen and how should that investment be sequenced? Although net zero is complex, in some ways, it is not all that complex. We are pretty sure that we are going down an EV route, so we are pretty sure about what we need for an EV infrastructure. We have less clarity around what decarbonising the heating of the housing and building stock looks like. To pick up on a point that was made in the earlier session, I think that the technologies do exist. In many cases, they are too expensive, and one of the reasons that they are too expensive is because they are not being delivered at scale, and because local supply chains cannot accommodate the demand that is coming. I have heard quotes of £1,000 per day to get a heat pump installed, whereas it costs about £150 or £200 for labour to get a boiler replaced. Data is at the heart of all those kinds of issues. If we know what the decarbonisation pathway looks like for all those cities, the innovators can start packaging up some of those opportunities.

Secondly, you asked about the financial products that we need. Local authorities have a huge role to play, but they cannot do it on their own. I made the point previously about investment frameworks bringing clarity. You have seen a huge flow of investment into renewables because the investment framework is in place. Some relatively novel products were made to enable that, but, fundamentally, once the contracts for difference scheme was in place, finance could come in behind that.

If I think about getting a heat pump for my house, where I am sitting now, that would cost me more than a high-carbon alternative and increase my bills because of how we structure bills in the UK currently. That has to change. It does not really matter what local authorities do when they are facing barriers such as that.

If you look at a much larger scale, such as at carbon capture and storage, there are a lot of reasons why we have not seen the investment in CCS that we will clearly need to hit net zero. The fundamental problem is that that is not an investable proposition at scale currently. Local authorities need the Scottish and Westminster Governments to do a lot to design the frameworks that would enable investment to flow.

I am always cautious when it comes to thinking that we need to rip up institutions in particular to deliver something that we must do at real pace in the next 30 years. Having said that, I think that there is probably some institutional space for convening and packaging such opportunities.

A couple of years ago, before I was at Phoenix Group, I spent a lot of time in central Government in Westminster. One of the projects that we were working on was in Teeside in the north-east of England. That started with a very fragmented set of propositions. Those were packaged together into what looks like an overall economic transformation for the region, which crosses a number of local authority boundaries. I guess the question is whether, institutionally, we have the capability in Scotland, and in many other parts of the UK, including in the rest of England, to bring together such transformational economic decarbonisation opportunities. It feels to me that that is where the institutional gap is.

The Convener: I am conscious that I have not brought in Jeremy Lawson, but I am keen to bring in other members. At this stage, I will hand over to Fiona Hyslop, who, I am sure, will want to bring you in.

Fiona Hyslop: I am glad that the witnesses could join us to share their valuable insights. I will ask you separate questions, to pursue some of the points that you have already made.

The Scottish Government has established a green heat finance task force. As its work has just started, your perspective on what that should cover would be helpful.

I will come to Jeremy Lawson first on the idea of aggregating investable propositions. I very much appreciate your comments on wider concepts and frameworks, but what does that look like in terms of aggregation? The Scottish Government has established a green investment portfolio, but even with £3 billion-worth of funding, things will be challenging, particularly given that there are subsets to that portfolio. What size of investment would your investment colleagues consider it worth coming to the table for?

Jeremy Lawson: It varies by project. I do not want to give the impression that every project that an institutional investor wants to consider must be a megaproject. Each project needs a certain amount of thinking and resources devoted to it to make a consideration of it. Effectively, there is a fixed cost of going through a process of evaluation. The ratio of that fixed cost to your return rises the smaller the project, whereas that cost can be spread over a larger return stream and be absorbed more easily in larger projects.

What I am driving at most of all is simply the idea that there need to be cooling mechanisms. I think that one of the other witnesses mentioned that. Let us consider the need for charging stations. If you think about that in terms that are too local, you will not take advantage of the potentially enormous economies of scope and scale that a large-scale installation regime might capture and therefore make it more attractive to bringing or crowding in private sector capital.

12:15

Equally, I think that it is clear that that type of infrastructure has a large public good element. I think that we would recognise that. It relates to the part of the subsidy that the public sector is going to have to absorb at some level in order to ensure that the architecture—the infrastructure—is large enough to generate the necessary scale of investment.

If we leave it to the private sector, we will ultimately get less charging infrastructure than is optimal to achieve the other part of the platform, which is the transformation of the vehicle stock. It is not just about the passenger vehicle stock, because there are also big technology questions about what will happen over time to larger, heavy-haul road transport, where the costs of the net zero transition may be significantly higher and the technological barriers have not been overcome yet.

We are ultimately going to need a different set of solutions for retrofitting than we will have for charging infrastructure, because retrofitting will largely have to be done through decision making by households and small asset owners. Sandy Begbie mentioned a mechanism for that. We could also focus on relieving the borrowing constraints for individual households. In one way or another, we have to come up with more creative financing mechanisms. We have heard about the institutions that are developing, which were also part of the question before.

We have the constituent parts—local government, national Government and financial institutions—but in my experience what we really lack is a pooling mechanism for expertise whereby people in those constituent parts can work together on deeper, finer-grain problems and be incentivised to do so. It is easy to set up talking shops. It is much more difficult to set up new co-ordinating mechanisms that will solve the problems. Given the speed with which the Scottish Government is trying to achieve some of its aims, there really is no time to wait. We need to put those mechanisms in place. In their absence, emissions may continue to decline, but they will do so more slowly than the overall goals require, so the gap will get larger and larger over time.

Fiona Hyslop: Tim, I am very interested in what you said about looking at this from a systems point of view and not looking just at the separate sectors. Heat in buildings and the role of councils are the focus of a lot of our interest, but your point about the importance of looking at energy production and distribution as a package, as well as looking at what is useful in houses, is an interesting one. Is that the area that you were thinking about?

I will also ask my other question now, because I am conscious of the time. Will you talk about pension fund investment? People have said that the local authority pension funds could and should be investing in this area. What needs to change in order to encourage that? Is there a danger that the easier option is carbon offsetting and natural capital investment, as opposed to developing a partnership for decarbonisation?

Tim Lord: On your question about systems, the challenge for me is what we all need to do in our local communities. We are all going to need better electricity infrastructure, because we are going to put a lot more load on the electricity system. We will need energy efficiency to be rolled out across the housing stock, and there is a question about how we can do that most efficiently. Is it best for me to make a decision at the right time for me, for my next-door neighbour to do it eight years later and for the person over the road to do it eight years after that? Should we do it in a more coherent way if we are able and willing to do that?

We need to transition our heating systems. In my view, we will be pretty heavily dependent on heat pumps, but heat networks will also have a role to play, particularly in Scottish cities. We will need a lot more chargers for electric vehicles, and we will need to shape different systems for that according to local capabilities. For example, if somewhere is near a hydrogen production facility, hydrogen may be suitable for heating in that area.

The challenge at the moment is that we have some fantastic pathways from the Climate Change Committee at the UK level and the Scotland level but we do not really have a translation of what that means for me and my neighbours or in my local authority area. The consequence is that we do not have the packaging of those opportunities that we need for investors to get in behind them in a straightforward way.

That is not to say that it is not happening already. Also, as Jeremy Lawson mentioned, in some cases, smaller propositions can work. We are funding some projects of around 1,000 houses. The more you can package those together, given the scale of the opportunity, and the more you can do it in a systemic way, the better. We are thinking about putting energy and heat together instead of getting everyone to install a bunch of energy efficiency measures and then knocking on their door five years later and telling them that they also have to install a heat pump when they could have done it all at one time for a larger investment proposition. That seems to be the right way to go, but I do not think that we have that data or capability yet.

On your question about pensions, my view is—I probably would say this, as I am at Phoenix Group—that they are the great untapped resource in the sense that pensions investment is generally long-term and pretty patient, and a lot of the investments are long-term systemic changes rather than looking for very high short-term returns without an eye to the medium and longer term. The regulators can do various things to incentivise that investment even more than they are doing, although we have made a lot of progress on that in the past two or three years.

The other important point is about the public's understanding of this. Do people understand the impact that their pension has on emissions? No, not in the vast majority of cases. Many people do not even understand that their pension is invested in anything. It is incumbent on the pensions sector to deal with the information around that. There is also a much wider public information and understanding challenge for politicians and ministers at all levels of Government in explaining to people that, although they are concerned about climate change, this is where their carbon footprint occurs and these are the things that they can do to influence it. That consumer pull will be particularly important in driving change at the pace that we need it.

Fiona Hyslop: Is it easier to do offsetting to address that issue than to be part of the decarbonisation agenda for pension funds and their trustees?

Tim Lord: I was in the Westminster Government when we moved from an 80 per cent target to net zero, and the interesting thing was that I discovered what I had always suspected, which is that everyone thought that they were in the 20 per cent. If you have a net zero target, everyone is in and everyone understands that all sectors of the economy need to decarbonise.

The next challenge is to decide what "net" means. It means that we get rid of all the emissions apart from the essential ones and we offset the remainder. The challenge is to decide what is an essential emission, and you will get different answers to that question if you ask different people.

It is incumbent on things like pension funds, or any other part of the economy, to deliver genuine emissions reduction rapidly where they can. Offsetting, particularly high-quality offsetting and the use of nature-based solutions, has a role in that but the challenge for us, as it is for others, is in how we absolutely minimise that role and deliver genuine and credible emissions reduction.

When there is a need for offsetting—which will, hopefully, reduce over time as we get closer to 2050 and technologies are developed that will enable more emissions to be cut at source—we will need to invest in offsetting that has a positive impact on communities and that is genuinely sustainable and appropriately priced.

Jeremy Lawson: Could I chip in on that question? On the offsetting point, part of the problem is that, particularly in the voluntary market, offsets are incredibly cheap. One of the things that attracts investors and, potentially, individual corporations to go down that pathway is the fact that they can achieve the given emissions reduction at a much lower cost.

That is not really viable in the long term. It reflects the fact that a lot of offsetting projects are like low-hanging fruit that are being plucked when there are very cheap abatement options. However, as the activity scales up, their cost will increase substantially. Also, what you might call the regulatory failures in the offsetting space mean that some offsetting is not truly additive or making the necessary contributions. There was a lot of activity around COP and the article 6 process highlighting the need for significant institutional improvements and regulatory tightening around offsetting, natural capital and the nature-based solutions markets, to ensure that we do not end up with an inefficient allocation of capital through those channels just because they create the appearance of cheaper abatement options for companies or institutions that are trying to achieve net zero.

Fiona Hyslop: Thank you. I am conscious of the time, so I will move on to Sandy Begbie. You were talking about potential equity release products and packages. You could perhaps see a mortgage modification product in the private sector, but in the public sector, when looking at local authorities and the securitisation of assets, are you looking at some kind of—dare I say it—private sector share in publicly owned stock? That would be a massive change for many local authorities, but do you see a risk-based approach on a city deal basis as a potential solution? Sandy, do you have any comments on that or on pensions?

Sandy Begbie: We have already touched on the point about pensions. Pension funds are arguably one of the untapped potentials that we have got in this space because they are looking for long-term investments. It is patient capital. They are looking for steady returns and to balance and manage their asset and liability profile over 10, 15 or 20 years. It is a natural place to look for that type of investment.

On public housing stock, it would require something like that. Various numbers have been quoted for the amount of private sector money that will be needed to help with the transition. Obviously, it will depend on what area we are talking about, but at COP26 they were talking about requiring upwards of 80 to 85 per cent of the money that is going to be required to transition the economy to come from the private sector. That would then naturally drive us to look at innovative ways in which private money can invest in public housing stock with local authorities and think about what that could look like.

I have no answers to that, Fiona, but those issues need to be on the table in a way that they probably have not been in the past. I do not think that we are going to be able to address those issues unless we have those types of conversations. Going back to my point about inclusion, across all economies, a sizeable proportion of people will not be able to afford the transition, and we will need to think creatively about how we support those people. Whether it is in housing, transport or whatever, it is going to require support.

Fiona Hyslop: Thank you. I will pass back to the convener.

The Convener: Mark Ruskell is up next, to be followed by Liam Kerr.

Mark Ruskell: I was just reflecting on some of the comments about the convening power of the public sector, and I want to press the witnesses a bit on that. Our inquiry looks specifically at local authorities. What is your sense of where local authorities can really crowd in that investment and drive programmes on the ground that can make propositions attractive to investment in the low-carbon space? I am thinking particularly about housing stock or other investment opportunities, where they work and, perhaps, where they do not work or where there is not the capacity. I would like to hear any brief comments that the witnesses have on that.

There is another aspect to that convening power. We are talking here about innovation in financial mechanisms, and it was interesting to hear about the Italian model—I know that other models around heat as a service can also be developed. To what extent do you see it as being the role of Government to effectively bring together energy companies and financial institutions to work on that financial innovation? Does the market need to lead on that and come up with solutions that minimise costs for home owners, ensuring that they can invest over a reasonable timescale instead of just getting a bill for £10,000 for something that they cannot afford?

I realise that time is getting on, but I would like some quick comments on those points.

Jeremy Lawson: On that last question, it has to be both. I will go back to my previous point. We are having to take positive steps to get on to a net zero pathway because private sector mechanisms cannot do it on their own. There will need to be different degrees of subsidy, loss absorption or however you want to define the financing gaps that exist. The challenge is in what the private sector is likely to be good at, which is innovation. It will be turning the power of capitalism towards the challenge of decarbonisation. The UK is good at financial innovation. However, there is likely to be some financing gap because of the nature of the climate problem, so the public sector's participation becomes critical in the codesign of the mechanisms if any financial innovation is not self-financing.

12:30

There has to be a discussion about how much of that implicit financing gap or catalysation the public sector has to absorb. How does the public sector ensure that it gets value for money in that work? It does not want to provide subsidy for risk-taking activity that, ultimately, does not have a social pay-off but lines the pockets of the people who provide the finance.

All sorts of regulatory and loss-absorption mechanisms are at play. That is why the partnership model is the best, and it would be useful to have task forces that can examine in granular detail the potential options and what works. What about, for example, the US municipal financing model? That works. However, if we are talking about bringing private sector capital in, it is not just a matter of issuing municipal bonds, pooling that money and making decisions about how to advance it.

Sandy Begbie: I would—[*Inaudible*.]—Mark, on your first point. There almost needs to be a layering of how Government works, which we have struggled with a little bit at times. As we talked about, there needs to be a collective view across local authorities. Perhaps the city deal model addresses that, but individual local authorities also need to own that delivery. We need to consider a more macro approach to packaging the scale and the opportunity together, but delivery will be on the ground in the individual local authority.

In addition to working for SFE, I worked on the young persons guarantee. That work highlighted the need to ensure that we have the skills to enable us to execute the projects, and Government and local authorities have a key role in that. If we assume that the funding model is made to work, the question is whether we have the skilled labour to, for example, install the home insulation that will be needed at scale and at pace over the next eight or so years. During the work that I did, it was clear that we have a shortfall in that. How do we partner the funding with the skills to make that combination work effectively?

Tim Lord: You are right, Mr Ruskell, to question what convening power means. To me, it means principally two things. The first relates to packaging and scale. Local authorities, and local actors more broadly, are well placed in many sectors to bring those together in a way that institutional investors can more comfortably get behind.

The second relates to funding and de-risking. It is absolutely right that the private sector needs to provide the vast majority of what will be a capital-intensive transformation. In many areas, public sector funding is not needed to do that because the investment frameworks are already well developed. However, where they are less well developed, where we need innovation and where we are looking to deliver rapid change, convening power can be brought with limited funding as well.

On your question about the relationship between innovation and markets, the key point for me is that we need both in the sense that you have to design the market to incentivise the kind of innovation that you want. There is a cliché that we used to have a liberalised energy market and now we do not. We kind of had a liberalised energy market, but we had an enormous externality in terms of CO_2 emissions, which is hugely market distorting. That is why we ended up in the position that we found ourselves in 10 years ago. We have reasonably successfully but imperfectly tried to internalise that in the power sector.

We have to learn the lessons from that for designing markets that will deliver the kinds of investment that we want and that will de-risk them where that is appropriate. Offshore wind has got cheaper because the renewables obligation put a lot of risk on investors and the contracts for difference approach puts less risk on them. That is not to say that we should completely de-risk investment. It is right that investors take some risk, but that needs to be done in a way that delivers a positive outcome for consumers and enables the investment to be made at the pace that we need it.

Liam Kerr: I will ask one question because of time. I will direct it to you, Tim Lord, and then, if Jeremy Lawson and Sandy Begbie want to add to your answer, they can indicate that in the chat box.

The deputy convener's question about investing was a good one, and the answer that you gave about pensions and public influence is important. You said that one of the roles of pension funds is genuine emissions reduction, and, in your answer to Mark Ruskell's question, you talked about the energy market.

One of the ways to achieve emissions reduction is to increase our sourcing of local rather than imported oil and gas, which will also help to reduce energy costs to the consumer and increase our energy security. Companies such as BP and Shell are investing a great deal in EV charging while other oil and gas companies are investing in wind power. How do you decide what investment decisions are green and, thus, which companies or projects it is appropriate to invest in or divest from? How much are those decisions influenced by the attitude of Governments and the public towards, and their understanding of, the domestic oil and gas industry, for example?

Tim Lord: That is a great question, and we could talk about it for a long time. Clearly, any investor takes a range of factors into account when thinking about longer-term strategy.

There is a strong movement for divestment from oil and gas, as you will be well aware. We are keen to work with many of the companies in which we have invested, because we need stable, long-term returns. Although there is a place for divestment and that movement has been powerful in some regards, it is also important to acknowledge that the oil and gas sector has many of the skills that we will need to deliver the transition and the big-scale infrastructure that we want. Therefore, it is encouraging to see the diversification of, in particular, the UK-based oil and gas majors into renewables. We have seen that elsewhere with Ørsted in Denmark, which has completely transformed its business model, has delivered a lot of value and is now, in essence, a renewables company. That is the kind of transition that we want.

When we take investment decisions for the longer term, we take account of broader political developments, policy developments and political risk. The key thing for us is that we want to work with the companies in which we have invested on their transition plans. Are those plans sufficiently ambitious? That does not mean that they need to turn on a dime in the next six months, but it means that they need to have a clear pathway to get to net zero with ambitious interim milestones—ideally, science-based targets like the Phoenix Group's target. We are doing that to decarbonise our portfolio and, in doing so, to help to drive the wider decarbonisation of the economy, not just to shift those emissions elsewhere.

Liam Kerr: I am grateful for that response. Does Jeremy Lawson wish to come in?

Jeremy Lawson: That question is fundamental to our approach to investing in the energy transition. A lot of the work that I have been doing in Aberdeen has been building a scenario and analytical framework that allows us to consider different technology and policy pathways and how those affect the fair, long-term valuation of different companies that will be influenced by the energy transition but that also have the potential to influence that transition through their actions.

When we build those frameworks, we are focused on a few things, but fundamental to that process is credibility. Many countries have net zero objectives, but, when we go underneath the bonnet of those objectives, we find that there is little substance to support any sense that those objectives will be met in the timeframes that have been set out.

I will again use the example of Australia, which made a 2050 net zero commitment at the COP26 meeting but made no new policy announcements and suggested that it would not do anything new between now and 2030. We would mark that down as having low credibility, and we would take that into account when trying to understand how companies in that jurisdiction are likely to behave, because the policy environment pins down what companies in aggregate are likely to do.

The same credibility principle is just as important when thinking about individual corporations. As you are probably aware, a variety of initiatives exist whereby individual companies set objectives and many sign up to, for example, science-based targets—that is much more common in less fossil-fuel-intensive sectors than in more fossil-fuel-intensive sectors. We spend a lot of time thinking about the transition strategies of individual companies, because the energy transition will not happen if companies that are currently brown do not become green. Not all brown companies will successfully become green, and we need research and analytical mechanisms to decide on that, because that will have a crucial bearing on where investment risks and opportunities will occur. As I said, we spend a lot of time doing that. It is the intersection, both at corporate and policy level, that shapes our investment processes and how we ultimately allocate capital around such questions.

Another important point is about technology pathways. In companies that are in countries with large fossil fuel sectors, there is naturally a lot of focus on carbon capture and storage, which seems to offer a mechanism through which those industries might have long-term viable futures, even along an aggressive decarbonisation pathway. However, countries have to be careful, because the future of those technologies and their price compared with other low or zero-carbon technologies is highly uncertain. I would not want to give the impression that carbon capture and storage might not be viable at scale in the future, but it is a sector that has had its fair share of challenges over recent decades—partly for public policy reasons.

From a policy perspective, you should always be wary of locking yourself into technology pathways that are themselves uncertain. Good policy recognises that there are many different ways in which you might get to your end point and that you are more likely to get to that pathway at the lowest cost by keeping options open and creating the right incentives rather than by locking yourself into something that might turn out not to be the best way to solve the problem.

Liam Kerr: I understand. Thank you very much. Back to you, convener.

The Convener: That brings us to the end of the questions and our allocated time. I thank Sandy Begbie, Jeremy Lawson and Tim Lord for taking part in the evidence session and for sharing their expertise and insights across a number of important areas—it is very much appreciated. I hope that you enjoy the rest of your day.

12:42

Meeting continued in private until 12:50.

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