



**OFFICIAL REPORT**  
AITHISG OIFIGEIL

# Finance and Constitution Committee

**Wednesday 26 September 2018**

**Session 5**



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**Wednesday 26 September 2018**

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**FINANCE AND CONSTITUTION COMMITTEE**

**23<sup>rd</sup> Meeting 2018, Session 5**

**CONVENER**

\*Bruce Crawford (Stirling) (SNP)

**DEPUTY CONVENER**

\*Adam Tomkins (Glasgow) (Con)

**COMMITTEE MEMBERS**

\*Tom Arthur (Renfrewshire South) (SNP)

\*Neil Bibby (West Scotland) (Lab)

\*Alexander Burnett (Aberdeenshire West) (Con)

\*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)

\*Angela Constance (Almond Valley) (SNP)

\*Murdo Fraser (Mid Scotland and Fife) (Con)

\*Emma Harper (South Scotland) (SNP)

\*Patrick Harvie (Glasgow) (Green)

\*James Kelly (Glasgow) (Lab)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

Jim Cuthbert

David Eiser (Committee Adviser)

Caroline Gardner (Auditor General for Scotland)

Elaine Lorimer (Revenue Scotland)

Helen Martin (Scottish Trades Union Congress)

Jenny Stewart (KPMG)

Mari Tunby (CBI Scotland)

**CLERK TO THE COMMITTEE**

James Johnston

**LOCATION**

The David Livingstone Room (CR6)



**Scottish Parliament**  
**Finance and Constitution**  
**Committee**

*Wednesday 26 September 2018*

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

**Interests**

**The Convener (Bruce Crawford):** Good morning and welcome to the 23rd meeting in 2018 of the Finance and Constitution Committee. For agenda item 1, I welcome Tom Arthur to the committee and invite him to declare any relevant interests.

**Tom Arthur (Renfrewshire South) (SNP):** Thank you, convener, and good morning. It is a pleasure to join the committee.

I confirm that I have no relevant interests to declare, and I would like to take this opportunity to give you my apologies, as I will have to leave at 11.40 to attend another committee.

**The Convener:** Thank you very much, Tom. I am very grateful to you.

**Decision on Taking Business in**  
**Private**

10:01

**The Convener:** Item 2 is a decision on whether to take in private item 5 on today's agenda and consideration of a draft report on the United Kingdom Trade Bill legislative consent memorandum in private at a future meeting. Are members agreed?

**Members** *indicated agreement.*

## Common Frameworks

10:01

**The Convener:** Item 3 is a report on the committee's fact-finding visit to Brussels last week, during which we explored how common frameworks operate in other countries and, in particular, how they relate to trade negotiations. We will shortly publish a note from the clerks summarising the discussions that we had with the non-governmental organisations that we met and representatives from Germany, Norway, Switzerland and Canada, and we have also commissioned some research on these areas, which will also be published. For the moment, however, I will quickly give my own feedback on the visit, which I thought was very successful. It was highly educational, certainly for me, and I ask other members to reflect on their own findings.

First of all, I thank those who commented on these matters yesterday in the Government's chamber debate on future trade negotiations. I realise that some reflections have already been offered; I am not looking for them to be repeated, although I suppose that some of that will be necessary. For me, the common theme that came through from all of the countries to whom we spoke was the early and deep engagement that there was between the state and the sub-state and which involved the Parliaments, stakeholders, NGOs and so on, and the way in which they went about their business in their own countries. I thought that that was something that we could learn from.

Moreover, the fact that engagement happened not just at the beginning but continually helped build a level of trust and understanding of the various positions of the sub-states. The framework that was provided as a result ensured more co-ownership of the final position by the state and more collective understanding of why a particular position had been reached and agreed. That probably strengthened the state's own position in negotiations, because it knew that everybody was behind them and that the rest of the country was well in tune with the nation state's up-front position in those circumstances.

Clear, formal structures were also very helpful in making sure that discussions actually happened. Obviously a lot of informal discussion was going on, too, but there was also a formal process that I think helped everyone clearly understand the remits and roles of the various bodies.

My own reflection is that, because of where we have come from, our default position in Scotland has been about finding ways of improving the dispute mechanisms instead of ensuring that we

reach consensus and agreement and thereby front-load the process. That was quite a useful learning point for me. It is certainly clear that having such an in-depth process from the beginning and ensuring that general agreement had been reached resulted in less use of dispute mechanisms and fewer costly court proceedings. Indeed, as Willie Coffey said in the chamber yesterday, the Swiss were quite surprised to hear us talk about disputes, because of the way in which they involved the cantons in discussions. That was very useful.

What do we need to learn? It is pretty obvious—it is the need for devolved institutions, civic society, NGOs and other organisations to have meaningful engagement in the development of the common frameworks and for us as a committee to find out how we go about that as part of our job. Obviously there is a relationship between common frameworks and how future trade arrangements will work, but having early and on-going discussions in order to reach better agreements and have fewer disputes was, I think, an important lesson for us. We need those kinds of well-understood structures, but I think that the biggest and most important lesson is how we build trust and confidence for the future.

Those are some of the things that I learned from our visit. Do others have any reflections to offer?

**Angela Constance (Almond Valley) (SNP):** Like you, convener, I was struck by the early and on-going investment, negotiations and discussions and how such an approach led to outcomes that were better for the nation state as a whole, if you want to put it that way.

Although each case study—each country—that we looked at had different histories, different structures and different cultures and even though we cannot necessarily do some sort of easy lift and shift or cherry pick, there are, I think, opportunities to look at those experiences further and adapt them to our own situation. It gave me some cause for hope: if other countries are able to achieve better local, regional and national dialogue and to seek agreement early, surely we can find new ways of working together with our various partners, particularly in relation to trade.

**Murdo Fraser (Mid Scotland and Fife) (Con):** Convener, you have given a very fair summary of what we heard. However, one thing that struck me was the difficulty in finding direct parallels with the common frameworks that we are talking about in the United Kingdom. That is not to say that there was not a lot that we could learn from the people whom we met, but the fact is that other countries do not have the exact arrangement that we are likely to enter.

The point that you and Angela Constance have made about up-front discussions being more important than complex dispute resolution procedures is, I think, very fair. The other issue that came up in our discussions with the European Free Trade Association Surveillance Authority was the need for a watchdog to oversee the common frameworks to ensure, in particular, that the rights of citizens and entities such as businesses were properly safeguarded. Perhaps we need to consider that issue further.

**Patrick Harvie (Glasgow) (Green):** As I was able to take part only in the first day of the visit, I am interested in speaking more to colleagues about what was gathered on the second. On Murdo Fraser's point about the need for monitoring and accountability arrangements, I think that one of the things that might test the asymmetric nature of devolved or decentralised power within the UK is the question of the levels of government to which such structures should be accountable or to which they should report.

Convener, you gave a very clear description of the open, participative and communicative process that works well elsewhere, but the starkest thing for me is how far we seem to be from that. If that is where we are looking to get to, we are not starting as we mean to go on. What we have at the moment is pretty much a behind-closed-doors discussion between two Governments that is not taking place in an open and participative spirit. I think that both Governments need to be challenged more strongly on that in the immediate period before we start implementing common frameworks.

**James Kelly (Glasgow) (Lab):** The nub of why we went over to Brussels was to tackle these dispute resolution issues and explore how we can get reach agreement and consensus. Clearly the issues around common frameworks are difficult and challenging. As others have said, we saw from a range of examples—Germany, Switzerland and Canada—that, with clear rules and mechanisms in place and discussions on-going, agreement was, in many cases, able to be reached without the need to go to court. That is a challenge for us—as Patrick Harvie has rightly said, we are not at that stage yet—but, as Angela Constance pointed out, the visit showed that there are ways of doing that sort of thing and that there is a way forward. I think that the challenge for us is how we move to one of those models.

Essentially, what we need is a change in culture from all the parties involved. We have all been too confrontational about this, but I suppose that that is the very nature of politics. It was interesting to hear from some of the participants in our sessions that, even when they disagreed, they very much

came from the position that, at the end of the day, agreement had to be reached.

**Willie Coffey (Kilmarnock and Irvine Valley) (SNP):** I agree with everything that colleagues have said. I was genuinely surprised at how co-operative our colleagues in Europe, particularly the Germans and the Swiss, are on these kinds of matters. They have put an awful lot of effort into ensuring up-front advance engagement at Government and even at civic society level. If we take this forward, I hope that we can reach out to the UK Government on behalf of Wales and Northern Ireland and say, "Do you agree to engage with us on these issues to see if we can make genuine improvements and progress in this area?" I genuinely think that we will all win if we have that kind of process.

**Neil Bibby (West Scotland) (Lab):** I agree with your summary, convener. Indeed, I touched on a lot of those issues in my contribution to yesterday's debate in Parliament.

I particularly agree with—and would repeat—Patrick Harvie's point about transparency of intergovernmental relations. I would also repeat James Kelly's point about the need for formal structures and new ways of working. If they are underpinned by a spirit of co-operation and goodwill from all involved, it will go a very long way to resolving a lot of the issues that we face.

**Emma Harper (South Scotland) (SNP):** I echo everybody's comments, and I also thank the committee clerks for their diligence in organising the meetings and the events—indeed, the whole trip. It was seamless. Everybody at our meetings—the organisations, the NGOs and so on—showed continual professional engagement and a willingness to listen to us and to try to support our ask with regard to common frameworks when they do not often use that particular language.

I remember one particularly interesting moment in our meeting with the director general of agriculture and rural development, who mentioned that the focus of the common agricultural policy, which we will be exiting, was evolving to a more nationalistic or independent country approach. There was a recognition that each country might have different needs when applying certain principles of the CAP or the agricultural approach.

**The Convener:** Thank you for that feedback, colleagues. As I have said, the clerks' notes will become a public document.

I see that we are a bit ahead of schedule. As not all the witnesses for our next item are here, does the committee agree to take item 5 in private now and get that business discharged? We will come back to the round-table discussion afterwards.

**Members** *indicated agreement.*

**The Convener:** In that case, we will now move into private for item 5.

10:14

*Meeting continued in private.*

10:31

*Meeting continued in public.*

## **Pre-budget Scrutiny 2019-20**

**The Convener:** Our next item of business is evidence taking in a round-table format. This is the first year of the new budget process, which emphasises the year-round approach that the Scottish Parliament and its committees are now taking. Today's round table will be the second of five evidence-taking sessions that we will hold on the draft budget for 2019-20.

We will take evidence from a number of people but, first, let me say that Peter Reekie, the director of investment for the Scottish Futures Trust, sends his apologies. Other things have come up in his diary that he has had to attend. It is a shame that Peter cannot be here, as I have enjoyed his contributions at other events that I have attended. However, we still have some good folk around us. We have Caroline Gardner, the Auditor General for Scotland; Helen Martin, the assistant general secretary of the Scottish Trades Union Congress; Mari Tunby, the assistant director of policy at the Confederation of British Industry Scotland; Jim Cuthbert, an independent researcher; Jenny Stewart, a partner and head of infrastructure at KPMG; and, last but not least, Elaine Lorimer, the chief executive of Revenue Scotland.

I warmly welcome all our witnesses to this round-table discussion. Please feel free to contribute at any stage, because it is genuinely a free-flowing discussion. Members have received a couple of briefing papers from some of the witnesses around the table, and some excellent material has been provided by our Scottish Parliament information centre colleagues and our adviser, David Eiser, to help us to understand why we are having this discussion today.

I am going to ask a different member of the Scottish Parliament to lead each of our discussions in three separate areas: operation of the fiscal framework; relative economic growth and the structure of the Scottish economy; and demographic change. After that, other MSPs and contributors should please feel free to chip in. Willie Coffey will kick off on the operation of the fiscal framework.

**Willie Coffey:** Good morning, everybody. One of the principles that was agreed in the fiscal framework was a review of its effectiveness around 2020-21. Bearing in mind the variations in forecasting we have seen from the Office for Budget Responsibility and the Scottish Fiscal Commission, that review needs to look a bit closer at the impact that forecasting error could have on the Scottish budget. What ideas can you offer that might assist the process and smooth out the



potential impact that that might have on the overall budget?

**The Convener:** That is a good starter for 10, because page 9 of David Eiser's report—which everybody has a copy of—describes quite well some of the challenges around the different mechanisms, processes and approaches that are used by the SFC and the OBR, the potential for varying forecasts and the impact that that could have on the Scottish budget without the Government making any change to its policy.

**Jim Cuthbert:** I submitted a paper that has been circulated—thank you for that—which is very much on that topic, so I would like to say something. In my paper, I make the point that the way in which the fiscal framework has been set up—clearly, it was set up under political constraints and under considerable time constraint—in a sense maximises the risk of forecast error around the effect of the fiscal settlement, which is important.

That should really be looked at on two levels. On one level, a number of things should be done within the existing fiscal framework. There should be a mechanism that throws up potential anomalies. I took one particular set of figures, which will now be outdated, and showed how, within that set of figures, there is quite a strong potential anomaly in that the SFC is forecasting that per capita, non-savings, non-dividend receipts in Scotland will grow at a faster rate than the corresponding receipts that are forecast by the OBR in the rest of the UK even though it forecasts that per capita gross domestic product and average earnings will grow at a slower rate in Scotland than in the rest of the UK. That strong potential anomaly is not explained just by the Scottish Government's policy changes on tax. I do not know whether that anomaly indicates something worrisome, but it needs to be understood before the Scottish Government can take a view as to whether the potential benefit of £500 million per annum that it is getting from the operation of the fiscal settlement tax changes is likely to be real.

To my mind, there needs to be a mechanism that identifies anomalies like that and then digs into the figures and says, "This is occurring because of the following factors," maybe even taking a view on whether it looks reasonable or not, as the case may be. That is one thing that needs to be done, although I do not know what that mechanism would be. I do not know whether it is up to the SFC and the OBR to get together and do that sort of work or whether it is up to the Scottish Government. I do not know whether it is up to academics such as the Fraser of Allander institute but, in my view, somebody should be detailed to do that work.

Secondly, we are dealing with an entity—the effect of the fiscal settlement—that is the difference between two large forecast numbers. In that circumstance, one needs to maximise the correlation between the different forecasts. It was interesting that, when the committee asked the SFC precisely the right question about why similar anomalies were occurring in previous figures, the SFC came back with—to my mind—completely the wrong answer. It said that part of it was due to tax changes, but the rest of it was due to differences in economic factors, modelling and so on. It is precisely those things that we should be worried about and should seek to remove from the system by maximising the common ground between the OBR and the SFC. The OBR and the SFC should be working together to identify the areas on which they can find common ground and why, which would contribute to the understanding of any anomalies.

You need a mechanism that does those two things and that also addresses commonality. What I mean by that is a bit complicated. Let us say that the change in the SFC's forecast NSND receipts in Scotland depends on its assumption about UK GDP and the OBR's assumption, which leads to the block grant adjustment forecast and the change in BGA, depends on forecast UK GDP. It may be that the difference between the two is not sensitive to UK GDP, in which case they should use the same assumption of UK GDP in making their forecasts, which would remove from the forecast error the difference between the OBR's and the SFC's assumptions on UK GDP. I give that only as a potential example, but commonalities such as that need to be identified by someone in the modelling process and steps must be taken to deal with them.

You need a mechanism that is able to do those three things, but, in the longer term, when we review the fiscal settlement, we need to think very hard about issues such as those. In the run-up to the determination of the current fiscal settlement, insofar as I had an input—which was limited—I argued that the system that we were setting up did not make sense. I argued for a different system in which the block grant adjustment was increased by a constant percentage each year, subject to review. A mechanism like that could well reduce possible forecast error, though it might not—it all depends on the correlation, which needs to be looked at. We need to take that sort of effect into account when we redesign the whole fiscal settlement in the forthcoming review.

**Caroline Gardner (Auditor General for Scotland):** On the one hand, it is too soon to say that we know what is happening with the devolved taxes except that they are very small in the context of the overall impact on the Scottish Government's budget. We have only now got control over income

tax, and we will not start making adjustments until 2020-21. We will not know the outturn until 12 months from now. At the same time, we are all getting a much better sense of how complex the situation really is.

I agree with a lot of what Jim Cuthbert says about not just the importance of the forecasts but our understanding of the interaction between them and what happens if they are diverging rather than moving in the same direction. That will have a very different effect on the smoothness of our budget over time. We are also getting a stronger sense of where the risk lies in terms of economic performance, policy risk and the budget risk management that the Government needs to do. For Audit Scotland, the important thing is to understand how complex the interactions are and to get a feel for how far the variations that might come out of the other end of the process can be managed within the provisions of the fiscal framework.

We have had a look at what the implications would be if the latest outturn forecasts for income tax from both the SFC and the OBR were correct. It looks as though the fiscal framework provisions would be enough to manage that. However, if the difference continued over two, three or four years, you would very quickly start to run up against the limits of the fiscal framework. We know that, for the first time, there are long-term commitments in the budget around things like capital borrowing that need to be played into the process, but there is no really clear picture of what that will look like in financial reporting terms to enable the committee and the Parliament more widely to understand it. Therefore, although I think that the forecasting approach is important, my view is that we are only just getting a sense of how important all of those elements are and how they interact with each other.

**The Convener:** Before I bring in Jenny Stewart, I would like Caroline Gardner to build on the risk in terms of our using the reserve money. If we cannot get a closer correlation between the OBR's and SFC's forecasts, what needs to happen to the mechanism that enables this turbulent process to be dealt with through either cash reserves or borrowing?

**Caroline Gardner:** Within the fiscal framework as it currently stands, we have the Scotland reserve and the revenue borrowing powers, which are quite limited even in the event of a Scotland-specific shock—I think that they are only £600 million a year. There is then the option—perhaps the requirement—of reducing spending, which is less palatable when done in that sort of emergency way than a planned redistribution of what you are spending and investing.

At the moment, I think it is genuinely too soon to get a sense of how quickly we might come up against the limits of the fiscal framework, because we do not know what the outcome will be for the biggest tax that has been devolved so far—income tax. We will not know that until this time next year. We are not close to having devolved VAT, which will be the second biggest element, but it feels as though you can model some scenarios that show you are coming up against the limits of the fiscal framework relatively quickly over three or four years—no further ahead than that.

One aspect of the fiscal framework that is worth marking for review, as well as the forecast approach, is whether the limits and flexibilities within the fiscal framework are sufficient for the taxes that have been devolved and the likely variation in them.

**Jenny Stewart (KPMG):** On the issue of forecast error, we all know that the forecast will be wrong. We all recognise that the forecasts are never going to give exactly the same number; it is really about the span of the difference. The medium-term financial strategy—it is great that we now have one—gives some sense of the scale of how that might impact overall. However, I stress that the medium-term financial strategy assumes that the fiscal framework will be pretty much the same after 2020-21, which is potentially quite a big assumption when looking at the figures for 2022-23. You are obviously exploring that in your evidence.

10:45

I will pick up on an area that you will want to look at in terms of the sensitivities. You have had evidence from the SFC, but its latest outturn report, which was published in September, showed quite clearly the differences that forecasting different groups of taxpayers makes—there was a £500 million difference because there were 2,000 fewer top-rate taxpayers and far fewer 45p-rate taxpayers. That shows the real sensitivity around not just the overall forecast but how the forecasts are divided, particularly on income, across the different bands.

By moving to a more banded structure as you move towards 2021, when the new bands will come in, forecast error—the difference in forecasts for bands—will also need to be looked at quite carefully. As Caroline Gardner said, it is early days in terms of numbers, but that is an area that I think you will want to look at, because the numbers are quite stark. The other key variable is the overall growth in the economy, and there is a much wider debate on that, which I think will come up under your second topic.

**The Convener:** We will get into that in a moment.

**Angela Constance:** I want to pick up on Jenny Stewart's point about new tax bands and the different proportions of citizens in different tax bands in the context of whether there is flexibility in the fiscal framework. I am aware that the Welsh experience is different, as block grant adjustments are calculated in accordance with each band of income tax. What would be the pros and cons of that approach, and would that work in a Scottish context?

**Jenny Stewart:** In looking at the Welsh system, you would open up the whole debate around the Barnett formula. The Welsh have long argued that there should be a needs-based system rather than the Barnett formula, and you would start to open up that debate.

In terms of the different tax bandings, the critical point will be around getting the data from Her Majesty's Revenue and Customs and, as we build up more knowledge over time, really understanding the drivers behind where people sit in different tax bands, because that will make quite a difference overall. You can see from the numbers how sensitive that area is, and by adding in the different tax bands you will get a sense of that going forward.

**Angela Constance:** What, in your view, are the drivers behind where people sit in the tax bands?

**Jenny Stewart:** That is part of a wider debate about the economy. Clearly, you have what is happening on wages overall. How many people are sitting outside the tax system? The bands do not kick in until quite late. What is happening on overall wages versus inflation? This is probably coming on to the second topic, but what are the drivers around productivity? If we can improve productivity, that should drive up wages, which should drive up the number of people in the higher tax bands. The drivers are much more the overall economic drivers.

**The Convener:** I have a question for Elaine Lorimer. On the basis of some information that HMRC may have, can we learn any lessons from the outturn figures for the fully devolved taxes for 2017-18 in relation to the forecasts, particularly with regard to the robustness of the data?

**Elaine Lorimer (Revenue Scotland):** Revenue Scotland's role in the debate is about the data and the quality of the data, because the SFC and the OBR are both dependent on the data that we provide for our wholly devolved taxes.

From our perspective, the wholly devolved taxes are, as Caroline Gardner has said, small taxes in the wider scheme of things. They are wholly devolved to Scotland; therefore, the way in which

our systems and processes have been set up is based around the timeliness and transparency of the data. When we set up our processes internally within Revenue Scotland, we are thinking all the time about the data requirement that the Government and the SFC are going to have as we receive and manage tax returns.

It is easier for us to produce more timely data because our taxes are small and because our systems and processes have been set up deliberately to produce information in a timely way. A lot of our systems are automated. We also have lots of quality checks on our data, and we are able to publish our land and buildings transaction tax data on a monthly basis and our Scottish landfill tax data on a quarterly basis. So, the SFC, the OBR and the Government are getting information that is robust and timely.

Whether that can be extrapolated to the information that HMRC provides is a question for HMRC rather than for me. The taxes that it is managing are more complex, and, as Caroline Gardner has pointed out, there is a lag in the data on income tax coming through. That is because of the way in which income tax operates and the timeliness of returns from people in relation to their income tax.

You are not necessarily comparing like with like, but, when taxes are being created, there is definitely a need to think about what information will be needed here to enable accurate forecasting and monitoring of the performance of the tax—because, over time, the stats provide a really good basis for trend analysis and an insight into how a tax is performing.

**The Convener:** Is there any scope to reduce the time lag between the income tax forecasts and the reconciliation? I recognise the scale of the challenge of getting the information out any quicker, but when we are waiting such a long time we could end up with a big surprise—in either direction.

**Elaine Lorimer:** Again, I think that that is a question for HMRC. I do not know enough about its systems and processes or indeed the tax.

**Jim Cuthbert:** I do not know whether I am offending committee protocol here, but I would really like to hear from David Eiser about Wales, because he will know more about that than anyone here. David, what are your thoughts about the Welsh adjustment?

**The Convener:** David Eiser can chip in; this is a free-flowing discussion. On you go, David: you are on the spot.

**David Eiser (Committee Adviser):** Thanks very much, Jim.

Interestingly, I am going to Cardiff tomorrow to talk to the Welsh Finance Committee about the learning from the Scottish experience and the implications for scrutiny of income tax revenues, which of course becomes operational in Wales next year, 2019-20.

That takes us back to the point about it being really too early to say how important it will be for Wales and how important it might be for Scotland to have a block grant adjustment for each of the different bands of income tax. Whether that becomes an important factor in influencing the size of the Scottish budget will depend on where the growth in income tax revenues in future years comes and how tax policy changes at the UK level and at the Scottish level. It is not a given that Scotland is disadvantaged by having one block grant adjustment for the whole of income tax, but it is possible that that could be the case.

**Jim Cuthbert:** How would such a system operate, given the Scottish ability to change tax bands? Would that be a problem?

**David Eiser:** I do not think that that is an issue, because the block grant adjustment is a calculation based on a counterfactual—that is, what would have been raised in Scotland had income tax not been devolved in the first place. Therefore, I do not think that having a different tax system in Scotland is an issue. What is an issue is whether the distribution of income tax payers in Scotland relative to the rest of the UK is such that the way in which the block grant adjustment is calculated implies that Scottish revenues would have grown more quickly than they actually would have done, given the distribution of taxpayers.

**James Kelly:** Does Caroline Gardner have any ideas about alternative data sets that might be available to feed into the reconciliation process, to improve it and potentially speed it up?

**Caroline Gardner:** I am not sure that I can add much to what Elaine Lorimer said. The problem is that we do it well already for the devolved taxes and they are small, so the total impact on the budget is not significant.

For income tax, I think that, for people who process all their income through pay as you earn, there probably is room to speed things up. I know less about HMRC than Elaine does, but it seems to me that given how employers have to submit real-time data, it should be possible to bring that through more quickly than currently happens. However, I think that most of the income tax that is collected from higher-rate and additional-rate taxpayers is not known and often is not paid until well after the end of the fiscal year. That is the most variable bit in relative terms for Scotland, anyway.

We suspect that one reason why the figures that we have just had for the first time on Scottish taxpayers are lower than was expected from the survey of personal incomes is that we have fewer of those people than we thought that we had, based on a statistical calculation. There is also a suspicion that the state of the oil and gas industry in the north-east is playing into that and bringing down the relative numbers. It is hard to see how we can bring that through significantly earlier in ways that would let us bring it right to the front end of the process, so that more certain numbers could go into the budget and we would not have to reconcile two, two and a half or three years later, as we currently have to do.

It is well worth exploring that—and that might be one of the things that the Parliament and the Government want to do as part of reviewing the fiscal framework. However, my sense is that there is not much that we can do about the areas that would be most important in that regard—the areas where there is most variability and most impact on the budget. That is before we get to VAT and all the uncertainties about that, with the data not being available and no agreed methodology yet for allocating it.

**The Convener:** If no other member wants to talk about the fiscal framework issues at this stage, I will ask a general question, to give some help to the committee about the direction that we should take. On the issue to do with the OBR and the Scottish Fiscal Commission producing different forecasts, is there general agreement that we need to ensure that there is, at least, more discussion between those bodies, with a greater understanding of each other's methodology and perhaps more co-ordination, so that we avoid some of the surprising forecast differences? Is everybody in general agreement with that? I do not hear anyone say no.

**Caroline Gardner:** I would be surprised if there was not general agreement about that. It is important that such co-ordination does not compromise the independence of either body, given their accountabilities to their Parliaments.

In this committee's deliberations recently, I picked up the comments on the Scottish Fiscal Commission's access to some UK data, such as Department for Work and Pensions data. It seems to me that that issue is part of the same mix, and that it would be well worth getting results sooner rather than later.

**The Convener:** We are leaving that to the relevant committee—whatever its name is.

**Adam Tomkins (Glasgow) (Con):** It is the Social Security Committee.

**The Convener:** It is the Social Security Committee's remit, rather than the Finance and

Constitution Committee's remit. That is a good point to raise, because the issue surprised us when it came up in evidence.

We move on to economic growth and structure of the Scottish economy.

**Murdo Fraser:** In the previous discussion, Jenny Stewart strayed into this territory a little. I want to frame the discussion around the impact of the fiscal framework. We know that it is the relative growth of the UK economy—or, more specifically, the growth of Scottish tax take relative to UK tax take—that will impact on the amount of money that is available to the Scottish budget, which we will be scrutinising in some weeks' or months' time. I am interested in hearing views on the impact that that is likely to have on the budget, given what we know about movements between Scottish growth and UK growth.

Also—and without getting into a discussion about the constitutional arrangements—will our witnesses talk about the levers that are available to the Scottish Government that might influence the rate of economic or wage growth in Scotland, and how the Scottish Government might use them to ensure that we maximise the benefit to the Scottish budget and, therefore, the Scottish public finances?

11:00

**Mari Tunby (CBI Scotland):** I am here to represent the business community in Scotland, and it is clear that, with the fiscal framework being what it is today, growing the economy is increasingly critical to the Scottish public finances. We would obviously argue that private sector growth is and will remain the key to unlocking economic growth. Given the demographic challenges that Scotland has, having businesses grow and continue to create jobs will be necessary to help to secure sustainable public finances for the long term as well as a widening of the tax base.

You talked about the levers that the Scottish Government has. Someone mentioned productivity earlier. Obviously, improving Scotland's overall productivity performance will be critical if we are to grow the economy and raise living standards.

Although we might have caught up with the rest of the UK when it comes to productivity, we are still lagging behind international competitors. As we see it, this is very much a shared challenge between business and Government. There is no silver bullet, but I think that there are levers that can be used: exports, investment, infrastructure and skills are all areas in which changes can be made, and which are within the gift of the Scottish Government. Changes in all those areas can help

us to push forward productivity performance as well as grow the economy.

**Helen Martin (Scottish Trades Union Congress):** Thank you. I think that we are at an interesting time for our economy in Scotland. While I have sympathy for some of what Mari Tunby said about the need to grow the economy, I think that we need to focus on wage growth within that. We have heard quite a lot about the fact that we have quite a low wage base in Scotland and could usefully focus on moving people up through the income-tax bands and into better-quality and higher-paid jobs. That is not simply about growing the economy; it is about improving the quality of work that is on offer and the skills levels that are associated with that work.

We are also at an interesting time for the labour market, given that it is very tight. We are running at very low levels of unemployment, yet we are still facing some quite interesting demographic challenges. We have an aging workforce and, potentially, a change to access to immigration in the next period, with the limitation of freedom of movement. There is also the fact that, unfortunately, some of our EU nationals feel somewhat unwelcome in the country because of some of the debates around the EU, and they are potentially going to leave Scotland as a result. That creates a real challenge around how we supply labour into certain key sectors of the economy. We need to think about how we can ensure that those jobs are filled, and that they are good-quality, attractive jobs. Those are difficult questions for us to consider as we are considering some of those issues.

The question around productivity is also quite interesting, because we are about to see high levels of automation in the economy. That could improve productivity rates on paper, but it will not necessarily increase the income tax take, given that it might replace jobs. Again, that involves changes to how we look at and think about the economy. For us, the main thing is how we ensure quality work and high wages.

**Patrick Harvie:** I want to pick up on some of the STUC's earlier comments on tax policy. For example, there was a paper last year in which you advocated a broader tax base, particularly at the local level. At the moment, local government is a fairly sizeable chunk of the overall Scottish budget. It has already been said that the fully devolved taxes make up a relatively small proportion of that budget. What role could there be for a broader tax base at the local level, not only to decouple the reliance of local government on a block grant but to raise revenue in a way that would be totally separate from the fiscal framework and which could reduce the vulnerability of revenues that are dependent on economic growth alone?

**Helen Martin:** I agree that that is a key issue. The STUC has been doing quite a bit of work on it. You mentioned the paper that we produced last year, but we are working with the Institute for Public Policy Research to produce a more detailed report about what should be on offer in terms of local taxation in order to do exactly the things that you just described.

We think that it is really important that we maximise use of all the tools that are available to local councils to raise their own revenue, and I think that there should be quite significant tools in that regard. We also need to think about empowering local authorities to grow their own economy and do what is right for their local area.

For a while, we have been discussing the need to focus on the foundational economy—some people call it the real economy—and to think about how we can ensure that money stays in a local area rather than drifting off into big multinational companies that could take it somewhere else. There have been some quite good results from Preston, for example, where procurement has been used in a very localised way that retains the money in the area and supports the local economy. For Scotland, given the rural dimension and some of the challenges that we have, that kind of approach could pay quite large dividends in providing quality jobs and quality public services in local areas.

**Patrick Harvie:** I would be interested to hear other views on the role of broadening the tax base as a way of increasing revenues, as opposed to changing the level of economic activity.

**Jenny Stewart:** I would first like to reinforce the points about the importance of growing the overall economy and productivity. I also want to pick up on the points that the CBI has made. We have also done a lot of research on regional productivity and growth across the regions, focusing on management and leadership skills in particular—and there is a job for business to do around exports and innovation—but also on lifelong learning, which we see as much more important. In Scotland, people think, “Great—we have fantastic universities and graduates.” However, this really is about how we skill up the workforce overall if they are to be able to take advantage of those higher-paid jobs that—hopefully—we are creating. I just wanted to make that point.

However, when we unpack all that, we get down to what happens in a place, to pick up on Patrick Harvie’s point. How do we grow a city region economy, for example? What do we need to do practically to drive that economic growth? We think that it is very important to have vibrant city regions that are focused on growing their economies for the benefit of all their citizens—and we are seeing that across the UK, but obviously in

Scotland, too. Mechanisms are available. For example, the Glasgow city region deal is on the hook for economic growth in order to unlock the funds that will come through the deal. That is one area. A lot of work is being done on land value capture, which I appreciate is a sensitive topic. We did some work on that with Transport for London, and others are looking at it, too. That is a potential source that will need very detailed consideration; it is sensitive, but it is a new area that people are looking at.

**Mari Tunby:** I thought that I would come in on the issue of growing the local economy, although I will look at the Scottish economy at a macro level. Nearly 80 per cent of employment in Scotland is in the private sector, so it is obviously important to support and grow that business base, be it small, medium or large. Using procurement as a way of attracting people to a locality sounds very interesting and is something that I will look into more.

Digital infrastructure is significant when it comes to local employment and finding ways of encouraging job creation in different places in Scotland. It also relates to the fact that technology is changing. That is one area where we are seeing only the beginning of a changing world of work. The key components to support that are the digital infrastructure and the skills element, which has already been mentioned.

Eighty per cent of the workforce today will still be of working age in 2030, so there is clearly much that needs to be done when it comes to supporting in-work training and upskilling on the job.

**Jim Cuthbert:** I am very interested in the discussion about localisation of the tax base. Clearly, in some respects, income tax is not a good tax on which to base the funding of the Scottish Government. We are weak in income tax, with receipts that are lower than the population share and so on. Helen Martin made an important point about the potential effect of automation on income tax. Broadening the tax base is to be encouraged, but I think that there are a couple of issues that one would need to look at.

A feature of the fiscal settlement that has greatly worried me is the potential for negative feedback effects: if we respond to a shortage of resources in Scotland by raising tax rates, we potentially make the matter worse and get into a downwards cycle. The Scottish Government would need to keep a close eye on that. If it was to localise tax decisions, it would need to have some form of central control that, if necessary, could put the brakes on increasing local tax rates to stop those negative feedback effects.

The other problem with localising tax decisions is the problem of inconsistent assumptions, which is a big danger with tax increment financing and so on. Each local authority assumes that it is going to do well and increase its revenue base and makes assumptions accordingly, but it might be clear that the national aggregate of their collective assumptions is unfeasible. Again, you have to have a strong centre that is able to keep an eye on that and make sure that spending plans and tax plans that are made locally are nationally consistent in some sense.

You need to look at such things if you are going to go down the road of broadening the tax base at a local level. However, in principle, we need to broaden the tax base.

**Caroline Gardner:** I need to be careful in responding to Patrick Harvie's question because policy questions are clearly outside my remit. However, I think that it is safe to say that the package of tax measures that we have in Scotland was not designed for coherence. There are things in there that perhaps do not join together, and some bits are missing. We all understand the reasons for that.

When we look at that package of tax measures, it is inevitable that we also have to look at the taxes that are not within the fiscal framework, local taxation and the theoretical freedom to introduce new taxes, and plan for what might look like a more coherent set of measures that would work together as a sustainable, longer-term approach to the public finances.

I would also like to pick up on the CBI's comment about infrastructure, which seemed absolutely right to me. We often think about infrastructure in terms of big bricks-and-mortar-type investment, but we need to move away from that. We published a report recently on the challenges of getting superfast broadband coverage right across Scotland and into the areas where it could make the most difference to economic activity. There has been lots of investment from the Government but there have also been some real challenges in how that is done.

11:15

Beyond that, another example is the percentage of new vehicle registrations that are of electric vehicles, which is around 40 per cent in Norway but around 3 per cent in the UK. I suspect that the figure in Scotland is quite a lot lower because of our geography and the availability of charging points.

I have a concern that the attention that is placed on the infrastructure investment budget, as part of the overall budget, is quite fragmented. We tend to

look at it through funding streams, such as capital borrowing, capital departmental expenditure limit, the public-private partnership and the private finance initiative, rather than standing back and asking, "What is the pipeline of potential investment? How are we making choices about that across different types of infrastructure in different parts of Scotland?" The Parliament might want to think about that as part of the new budget process. Inevitably, choices and political considerations are involved in that, but I think that having that big picture over a longer period of time would help you make longer-term choices that are more sustainable.

**Helen Martin:** I have a small plea: do not focus too much simply on digital infrastructure and forget the bricks-and-mortar kind of infrastructure, which I think needs a lot of attention in Scotland. We have an aging ferry fleet. We have a lot of problems with our current rail and road activity, particularly in the north of Scotland. It is really important that those things are considered in the round because, particularly in the north, we will never get the economic growth that we need without that infrastructure development.

**The Convener:** Quite a few people want to contribute. I will come back to Jenny Stewart—we have time.

**Tom Arthur:** Caroline Gardner characterised the package of tax in the fiscal framework as lacking coherence. Clearly, some taxes are absent from the framework—they are still reserved to Westminster. Murdo Fraser kicked off the conversation by asking about the levers that the Scottish Government has to influence the Scottish economy. I would like to hear views on what levers are exercised by the UK Government that determine economic growth and wage growth in Scotland.

**The Convener:** Okay—someone will try to pick that up. I will come back to Jenny Stewart in a moment—both she and Mari Tunby want to contribute. I want to pick up some of the MSPs' comments just to make sure we are getting everything out.

**Alexander Burnett (Aberdeenshire West) (Con):** This is really on the back of what Caroline Gardner was saying, but it is also to do with what Helen Martin, in particular, was saying about bricks and mortar and the construction sector, in relation to which I note my entry in the register of interests. One of the biggest sectors that we have been hearing about in previous sessions on forecasting is construction, which I think influences a lot of decisions made about improving productivity in the sector. Do members of the panel have any comments about improving some of the data forecasting so that some of those decisions can be improved?

**Angela Constance:** I was interested to hear more about place-based approaches. I am a little bit familiar with the Preston experience and how the council increased the proportion of the local government budget that is invested locally, but I wonder whether we could take that a step further and ask whether the Preston experience or other experiences demonstrate how particular place-based approaches could increase income tax take. I am also interested in Helen Martin's point about the importance of infrastructure. Housing is an important local and national investment. Has any up-to-date work been done that demonstrates the very clear economic impact of investment in housing?

**The Convener:** There are quite a few themes coming through here, folks. I am not expecting Jenny Stewart and Mari Tunby to pick up on all the things that have just been mentioned, but they can pick up on the ones that they wish to.

**Jenny Stewart:** Where to start? I will pick up on the point about the numbers in the construction sector. The economic growth figures suddenly improved for quarter 1 in 2018, when growth went from 0.2 per cent to 0.4 per cent. That is great, but I think that you have to be aware of and focus on what the actual position is, as opposed to the growth rate. If your economy is 100 and it was previously 99, then you have grown by 1 per cent, but if you look back at your figures and you think, "It used to be 95," then suddenly you have had a massive growth rate, but the actual position has not changed. Keeping an eye on not just the growth rate but what is underlying that in the economy is pretty important.

On the infrastructure point, I absolutely agree with Caroline Gardner about having an overview of the whole of infrastructure and being able to make trade-offs. I did the Howat review in 2005 and 2007. These are always ultimately political choices, but there are now much better economic modelling tools available that allow you to measure the trade-offs and the impacts of different types of infrastructure. In some ways, because I know the Glasgow city region deal best, that is quite a good example, but how the different impacts can be assessed has moved on even since then. I think that that is something that we would want to see further developed, to allow you to have the information that is needed to make those trade-offs.

With a place-based approach, ultimately it boils down to this: if you want to attract more people and you want them to be paid more so that they pay more income tax, how do you attract them? Whether it is Scotland, a city region or whatever, how do you make it more attractive? A lot of work is done on infrastructure and constantly renewing infrastructure. We did work across a range of

global cities and saw that it is not about resting on your laurels and saying, "Right, we have fixed that; it is all fine and everybody will want to come here." It is about the renewal of infrastructure.

Housing is critical. We always see the population trends, but if you can do quite a bit about place and if you can get decent housing, so that companies say, "Actually, this is an attractive place; we will come and invest here," there are huge amounts that you could do. Doing that, particularly at a local level and having city regions—I agree with Jim Cuthbert that, if you are just looking at one small TIF scheme, you are not getting the whole picture—then you can really start to attract people. We are seeing a lot of that good work. If you had said 15 years ago that all our young people in the firm would want to live in Finnieston, I would not have believed you, but it has all completely changed now. There is a lot that can be done, but housing is critical.

Just while we are on the economy, I say that we are focusing quite a lot of effort on health as part of that place-based approach to improving local economies.

I am not sure whether I have picked up on everything, but there were a few points.

**The Convener:** Nobody has picked up yet on Tom Arthur's point. Obviously, we are very focused on what happens as far as the Scottish Government's levers are concerned, but what can the UK Government do with its levers to help us as well? That is a germane point.

**Mari Tunby:** Yes, that was a point that I thought initially I would pick up on. Scotland and the north-east of England are the two areas of the UK that are projected to see a reduction in total available workforce by 2025. That means that we need a UK immigration policy that is fit for purpose post-Brexit, and that is an area that obviously needs to be addressed at a UK Government level. The businesses that we have spoken to so far—I am obviously verging into the demographic question, if you will permit me—have said that now is not the right time to devolve immigration powers and they would rather focus on getting the UK immigration system right in response to Brexit. Obviously, if it becomes a very restrictive system, flexibilities for Scotland will need to be addressed in some shape or form. It is a moving feast, but I just wanted to pick up on that point.

Then there was a point about housing—

**The Convener:** Before you leave that point, I note that those indicators were emerging for the Scottish economy and for the north-east before we got to Brexit. I do not want to forget about what is going on in the real world, where we are just now, but are there any other specific policy levers in relation to that demographic change that either the



UK Government or the Scottish Government should have been pulling anyway before we got to the situation that we are currently facing with migration? There may be things that we should be employing in any case. That is a theme that has come through in a number of discussions, so I would like to unpick that a bit more. Does the CBI know of any levers that we should be pulling?

**Mari Tunby:** To take it back to the skills point as well, after the financial crisis, we rightly focused on supporting young people and the skills needed to enter the workplace. That is still important, but I think that there also needs to be more of a focus on our current workforce, which, as I said before, will be working for some time. Therefore a clear policy lever is getting a skills policy that is fit to address those challenges, which includes what has been mentioned before in relation to lifelong learning and in-work training.

**The Convener:** Sorry, I interrupted your flow. You were going to address other issues.

**Mari Tunby:** I was just going to say that housing is a crucial part of that macroeconomic picture. The key levers that the Scottish Government has there are to do with planning policy and skills, because the construction industry has a number of different challenges both in attracting people into the industry and in training them in the various different skills that are required. In addition, planning policy needs to be set in a way that encourages the industry to build more homes.

**Caroline Gardner:** I want to pick up Tom Arthur's question about the interaction between Scottish levers and UK Government levers. It seems that there is a useful link back to the previous agenda item that the committee was considering about the framework for that relationship. One of the things that we have not talked about today is the fact that the UK Government's decision about the mix of tax and spending measures that it wants can be budget neutral at a UK level but affect Scotland's fiscal position. For example, if the UK Government shifted from income tax to corporation tax within the overall mix, that would have an impact on income tax here because of the way in which the block grant adjustment works but it would not have Barnett consequential that would push the block grant element back up again, and vice versa obviously.

That is a very good example of why we need to have much better dialogue between the two Governments and between the two Parliaments about what the overall direction is, so that we can at least understand the consequence of some of that. We can then think through the way in which it might work in practice, reflecting again that it is a political world that you are all operating in but

doing what we can to minimise the scope for tit for tat or for defensive decisions being taken in advance of the conversation about what the overall good might be.

It brings me back to the point that we are still finding our way through how the framework will work in practice, which it will do in ways that we do not fully understand the consequences of. There is a risk of quite serious consequences of decisions being taken in a less than fully informed way at this stage.

**The Convener:** That is quite helpful, because tomorrow we have the Chief Secretary to the Treasury coming to speak to us, so that is a useful thing that we can pickup.

**Jenny Stewart:** Just to follow up on that point, and to reinforce what Caroline Gardner was saying, a particular area might be high-net-worth individuals who own their own businesses, for example. There is obviously a common view that, if income tax goes up at the top level, then potentially those people convert to taking dividends from their company, which impacts on the Scottish tax take but increases tax at the UK level. However, there is also the possibility that those business owners decide to leave their cash in the business and both the UK and the Scottish Government end up with a reduced tax take as a result. We need to tease out those interesting implications.

On the point about UK and Scottish Government policy levers, again I agree with what Caroline Gardner said. One specific point is that, obviously, there is a lot of effort on the industrial strategy at the moment at UK level. Within KPMG, I have a UK role as well, and I sit on our group on the response to the industrial strategy and Brexit. On the industrial strategy, there is a lot going on there. The Scottish Government has its own policies. There are different levels of support available, either through Scottish Enterprise or through the industrial strategy.

11:30

Both Governments are talking, but I think that, if you are an individual business owner, you do not really care whether the funding is coming from the UK Government or a Scottish Government-funded programme; you want to be able to access it easily. There is potentially more that both sides could do to have a co-ordinated approach so that each is aware of the programmes of the other.

**Tom Arthur:** With your permission, convener, I will give an example from my constituency. The employer in question pays the real living wage and is incredibly flexible with its employees, but it is struggling to maintain that position because other companies and competitors do not do the same

and simply meet what the UK requirement is. For example, there is a relationship there between employment law and the salaries that employees in Scotland have. I think that this also relates to the question of productivity. There is an argument that is being made by the IPPR and others that businesses currently are not incentivised to adopt innovations because of existing national living wage and minimum wage levels. When we have these deliberations and debates around productivity, in comparing Scotland to the rest of the UK, it can be something of a false debate if, ultimately, the levers that can be used to determine productivity rest with Westminster.

**Jenny Stewart:** Just on the living wage, we care passionately about it and we were involved right from the outset and are keen to see it adopted as far as possible. There is quite a good body of evidence that says you can pay the real living wage as opposed to the set one and drive productivity and improvements at the same time. There was quite a lot of research done on that, so that is something that would be worth publicising more widely.

**Jim Cuthbert:** I just want to make a couple of points. I cannot agree more that infrastructure is vitally important, but I think that an issue that should particularly concern this committee is at what price it comes. There are significant worries about the funding mechanisms for infrastructure. I have a particular bee in the bonnet about regulatory asset base pricing, which is a particularly invidious variant of current cost pricing and which leads us to pay over the odds for things such as rail improvements. The committee should be interested in that and should be making sure that we are not paying over the odds for infrastructure.

There is also an issue about the cost of, for example, hub finance. Peter Reekie and I have an on-going debate on that. It is a pity that he is not here today. I think that potentially some of the statements that have been made about the cost of SFT finance underestimate the true cost of the finance. I think that there is something there that is important.

I have one other aside. Murdo Fraser asked what levers we should be pulling. One potential lever that we may not have made optimal use of is water charges. It worries me that the Water Industry Commission for Scotland interprets its remit very narrowly and does not take account of the potential effect on economic development. It is waiting for the Scottish Government to give it a steer on that. I am not sure that the Scottish Government has given it a steer, and I think that it is an area that needs to be explored.

We are at a particular juncture just now where effectively we are hardly borrowing for water at all.

Do we want to continue borrowing to take account of low interest rates? There was worrying stuff in some of the consultancy documents produced by the Water Industry Commission about the next review of charges saying that we should be paying now for future replacement. I do not think that that is a road that we want to go down, I do not think. We should be making sure that we are getting the cheapest possible water, subject to prudence. That could have a major effect on economic development.

**The Convener:** While we are in this conversation, it strikes me that we have not really dealt with some of the smaller taxes, for want of a better description, such as LBTT. If, for whatever reason there is a property boom south of the border and prices increase—which is not impossible; it has happened many times in the south-east in particular—that might have a distorting effect on the mechanism for how we deal with differences between what happens in the rest of the UK and Scotland. It made me think about how volatile the revenue from LBTT might be in those circumstances, even though it is a smaller tax. Does Elaine Lorimer have any views on that from Inland Revenue—sorry, Revenue Scotland?

**Elaine Lorimer:** I will answer from the perspective of Revenue Scotland—certainly not Inland Revenue. We have only three years' worth of data, so it is still probably too early to draw those sorts of comparisons, but what is evident from the data that we have is that there is reaction in the market to changes in tax. For example, if you look at our LBTT residential stats, you will see that there was forestalling before additional dwelling supplement was introduced; there was a spike in property purchases. I understand the question that you are asking about the possible Barnett or block grant adjustment consequentials of a boom south of the border that is not reflected north of the border. That is something that Scottish Government officials would need to be keeping an eye on, but these things take time to follow through in the system.

The other area that is worth mentioning is that everybody always focuses on residential LBTT, but there is non-residential LBTT, too. Actually, from the short information that we have for the first three years, it is the more volatile of the taxes. Because it relates to commercial property and leases, it is also the one that it is good to look at to see what is happening in the economy. However, what you can see from our non-residential LBTT is that a spike can be because of one significant transaction that has happened in Scotland. In terms of volatility and impact, it is non-residential LBTT that is worth keeping an eye on.

**The Convener:** We need to move on to other areas, because of timescales. Unfortunately, I

might have started to stray into the territory that James Kelly was going to ask questions on. We have covered a fair bit of demographic change already, but I am sure that we can still get a bit more out of that.

**James Kelly:** As the convener said, we covered some of this in the previous session. The overall population of Scotland is now 5.424 million; it has been increasing, which is good. As we have touched on already, there are issues around migration and immigration. Another major issue is the growing elderly population. Over the past 25 years, the 65 to 74 age group has grown by 27 per cent and the over-75 age group has grown by 31 per cent. People are moving from working and paying taxes into the pensioner block of the community. What challenges and risks does that present for the Scottish budget?

**The Convener:** That is a heck of a question. While you are thinking about it, what specific things can we do to address some of those issues? Are there any policy levers we could pull that would help?

**Jenny Stewart:** Our population is 5.4 million, and we have a workforce of about 2.6 million. One of the positive aspects is that more and more people in the older age groups are still working, so when we look at the tight labour market, there could be some untapped potential there. Some people are continuing to work because they have to, but many more do so because they want to and they want to stay engaged. I recognise the challenges for the national health service of the older age group, but people in that 65 to 74 age group are much healthier than they were in previous times. I hope that that continues.

**The Convener:** So do I—I am getting close to that.

**Jenny Stewart:** There are definitely challenges, but there could be some opportunities to be looked at. As we said earlier, fundamentally we want more people in Scotland.

You asked about particular policy levers. It would be helpful if we could reintroduce the post-study work visa, which used to be in place, or another version of it. Some pilots are going on at the moment, but more would be helpful.

Given the impact of Brexit, we have seen the latest net migration figures and we know that far more EU nationals are already not coming to the UK. The interesting piece about the latest Scottish data was that we were attracting more people from elsewhere in the UK to Scotland. Therefore in terms of future policy development, and returning to the place-based discussion that we had earlier, it would be worth considering a focus on how we can attract more people from the rest of the UK into Scotland.

**Caroline Gardner:** The SPICe paper on demographic change was really excellent and helpful; in some ways, there is not much to add to the issues that are set out there.

I had a couple of thoughts in response to James Kelly's question. First, the paper understandably focuses on the revenue side of the equation. Lots of Audit Scotland's work is about the spending side, and I think that we have the risk of a double-whammy there, as you hinted. I agree with Jenny Stewart that the fiscal outlook document is a great step forward and it is good to have it. If I have a criticism, I think that it is stronger on the revenue forecast than it is on the expenditure forecast and what is likely to drive them.

We can do more to look at the likely impact of the demographic change that we know will happen over the next 30 years. Our work has shown that the policy response to that change is the right one. Integration of health and social care, and moving lots of the care that people need out of hospitals, where it costs more and it is not as good for individuals, and delivering it much closer to their homes has to be right, but the pace of change is still way too slow for the pace of demographic change that we are seeing. That is a good example of where a place-based response can not just help older people themselves, but have real benefits for the local community more widely.

I am interested in quite small third sector initiatives such as Food Train, which started in Dumfries. It involves people in a local community helping older people who are just about managing at home by doing their food shopping for them. It is a small intervention, but it means that people in the community get to know the older person and can spot when they are starting to struggle; they can talk to the general practice and get a bit more help in. There are benefits for the volunteers, who are often older people themselves, who get a boost from helping their older neighbours, or younger people with learning disabilities or mental health problems. Again, the initiative builds on their ability to feel useful and to hold down a responsible role. Such place-based responses can be really powerful; there is room for far more of them and for them to be part of the whole approach to community empowerment.

One other dimension that I will mention briefly—again, it is going back to the essential interaction between the UK and Scottish Government responses—is around pension taxation changes. For reasons that I fully understand, we are seeing a reduction in the amount of tax relief that higher-rate taxpayers can receive on their pensions in terms of both annual and lifetime allowances. There is increasing evidence that that is having some unintended consequences for people like doctors, who in their 50s are coming up against

their caps and are making decisions about whether to continue working. That is not great for public services, but is also likely to put further pressure on the number of higher-rate taxpayers we have in Scotland and, therefore, the consequences of the fiscal framework as it currently stands. I do not think that we understand that well enough yet, but we can see it coming through.

**The Convener:** That is a good example.

**Helen Martin:** I agree with quite a lot of the points that have been made about the role of older workers in the workforce. Some employers have already done good work around supporting workers to stay on at work, and I think that taking a fair work approach is really useful. Far be it from me to advocate a work-till-you-drop society; it is certainly not that. However, a lot of workers get a lot out of being able to stay on in the workforce and to keep their skills. If we can do that in a positive way that supports the employer and the worker, that will be really good for the economy.

Brexit presents a significant challenge. From what the UK Government has said so far, it is clear that it will not necessarily maintain low-skilled immigration routes into the UK. It has talked a wee bit about a specific visa for agriculture but, beyond that, there may not be that many routes that replace the EU national routes.

11:45

Glancing at the figures around payment for UK workers versus non-EU workers versus EU workers, we can see that EU workers, despite being very well qualified, are often doing quite low-paid jobs. The median hourly pay for an EU worker was £8.60; for a UK worker it was £11.20; and for a non-EU worker it was £13.20. The non-EU workers are coming in on high-skilled visas and taking up jobs at high rates of pay; that is reflected in the sort of pay packet that those workers are taking home. EU workers are often doing different roles in the economy and we will need to think about how those roles are filled in the future if that immigration route is not there.

It is clear that we will need to think about the treatment of workers in those sectors. The STUC did some work in Skye this summer on the treatment of hospitality workers and found that workers have to pay £50 a week for access to accommodation, which amounted to staff bunks that were shared between workers between shifts. There were some very poor terms and conditions. Issues around access to housing, particularly in rural areas, will really affect how much the tourism industry will be able to grow in the context of operators having to provide proper accommodation for workers.

There are a myriad of issues about how we can protect workers' rights. There are questions about the UK's response to Brexit and how some of those things may be eroded in future trade deals. We are quite concerned about that.

**The Convener:** Last week at the cross-party group in the Scottish Parliament on tourism, the issue of immigration and how people are treated in the tourism industry was to the fore. If one of the biggest pools of workers out there is those who are 65, why is the tourism industry not tapping into that group and providing them with opportunities and encouragement? Those people will be staying on Skye. We probably need to think about that.

Before we leave that subject, I will come back to Mari Tunby on the question of what the industry is doing to encourage older people to stay on, if they want to. That is one of the areas that we need to look at for the economy.

**Jim Cuthbert:** The SPICe paper on demography was excellent and great food for thought, but it strikes me that some of the problems are longer term and that this is something that should be built into the review of the fiscal framework. It is always dangerous to come up with ideas off the top of one's head, but one possibility would be that, instead of the indexed per capita method of indexation, one could move to the indexed per working-age capita method. That might address some of these problems.

Secondly, we should not shy away in that review from bringing in an assessment of needs at some stage. The extent to which the existing fiscal framework really weakened the basis of the UK monetary union was interesting. A proper monetary union takes account of need in assessing fiscal flows, and when we are doing the review I think that we should bring an assessment of need into the mix as well.

**Emma Harper:** It has been really interesting to hear everybody's contributions. I am interested in some of the issues around the recruitment of health staff such as GPs and radiologists. The south of Scotland is also an area of low economy and high tourism; of course agriculture is a big issue, too. The president of NFU Scotland has argued that the rural workforce is a skilled workforce; I think that we need to consider that. I support an immigration policy that works for particular recruitment issues in Scotland.

As we move forward with investment in infrastructure—physical or digital or whatever—is there a natural flow of people who will be recruited or move to an area, especially if the house prices are lower, such as in Dumfries and Galloway? Is it not just a natural progression or do the Governments really need to find out what

programmes and processes they can have to bring migrants, immigrants, and UK migrants here too?

**The Convener:** I will come back to Jenny Stewart and Mari Tunby, who can reflect on some of the questions that are being asked as we go along, because I know that they raised those issues. However, I will bring in some MSPs now, so that we can get some other thoughts into the process.

**Angela Constance:** Given that we are heading for a divergence in the dependency ratio—not that I like that label—and that we know that migration has a strong and lasting impact on population growth that helps to alleviate the transition to an ageing population, although it does not entirely overcome it, I would be grateful if our guests could help us distil what the Scottish Government can do to mitigate that and what the case is for and against having a policy divergence on things such as migration. How could the UK and the Scottish Governments work better on that?

To pick up on Jim Cuthbert's point, what other ideas are there for the fiscal framework to take into account the overall age profile and the impacts from our having a relatively higher ageing population compared to that in the UK, given that some of the issues, particularly immigration and migration, are not within our gift or control?

**Willie Coffey:** My point is kind of related to that, but it focuses on the digital economy, which has been mentioned by a few people. I do not want to drop into the politics of this, but we are—we think—going to walk away from the digital single market, which is worth about €400 billion a year and supports hundreds of thousands of jobs. Given that Scotland is facing a demographic time bomb, why on earth are we doing something to ourselves that will further reduce the skill base, particularly the information technology skill base, which is already in short supply in Scotland? Without asking politically loaded questions, is there anything that we can do to try to reverse that or influence change to draw in the skills and talents that we really need to move forward?

**The Convener:** A lot of points have been made and a lot of issues have been raised. I cannot expect everybody to cover everything, but I ask Jenny Stewart to begin a response.

**Jenny Stewart:** I will pick up on a couple of things. Caroline Gardner mentioned the interplay between pensions and other issues, and the fact that higher earners are bumping up against their cap. One interesting thing about that is that, if people do not retire and continue to work and are not then putting more into their pension, that means that they are paying more income tax, so that is a potential benefit for the public finances.

We have talked a lot about the tax side but, on the spend side, we could do a lot more to understand that better. To go back to the infrastructure point, I agree that infrastructure is good, but one piece of infrastructure can be a lot better than another. For example, when we were doing the Manchester city deal, there were two tram schemes with exactly the same cost of £800 million but, in terms of economic benefit, the difference was a factor of 10 to one. It is really important to get a more rigorous analysis of the spend, the benefits and the opportunity costs.

On migration, I have already said that something along the lines of the post-study work visa would be helpful. At UK level, KPMG and many other businesses—as I am sure the CBI knows well—are struggling with the tier 2 cap. We cannot get people in because of that. People have not been able to join us because of that, so it is constraining.

The dependency ratio is really interesting. If I were a policy maker, I would get some work done on whether the dependency ratio is exactly right for now, because the workforce has changed so much. We have talked about older workers being in the workforce and we use a standard measure of the dependency ratio to calculate potential costs and benefits. If I had some spare time, I might consider whether that standard measure is the right basis going forward. It is worth looking at that.

I have one final point on flexibility and policy choices. If, as we are seeing, we are adrift by a lot of money—potentially we could be £250 million or £500 million adrift—it is important to understand flexible policy choices, where the tap can be turned on and off. Obviously, that is hugely complex and difficult for public services, but there should be an understanding of the flexibility in the system to do that. For example, there is a big commitment on early years provision, but is that something that can be flexed if money is tight? I am not necessarily advocating that one way or the other—that is an illustration of the point. It is pretty important to have that flexibility in policy.

We have talked about data. Obviously, you have to use standard data sets to set the budget, but we get lots of real-time data that lets us know whether things are on track. To go back to Elaine Lorimer's point about commercial and residential property, we know that, in the past six months, there has been way more commercial property investment in Scotland than there has been for quite some time. We know that the south and the south-east are struggling so, if anything, the balance is going the other way.

We have done forecasts that show that house prices in Scotland will continue to grow at higher rates for the next five years, whereas our chief

economist's estimate is that prices in London will drop and prices in the other regions will go up a bit, but not nearly as much as they have been going up. That real-time data that is coming through will not particularly help you in your budget setting, because you need the historical data, but it is certainly there and available for policy makers to know whether you are on track and where the potential gaps may be.

**The Convener:** Wow—you covered a lot of ground there.

**Mari Tunby:** On the point about helping older people to stay on in work, there is obviously an important role for employers in offering flexible working opportunities and working around different needs as they arise. Age Scotland is doing some interesting work on a different approach to retirement and encouraging older workers to consider scaling back their work patterns and staying on almost in a mentor role. Again, the in-work training element is important in supporting older workers, as business operations and technologies are changing. The flexible workforce development fund is a mechanism that could potentially help with some of that, if it lived up to the name around flexibility.

There was a conversation about how to attract people from the rest of the UK or from outside the UK. We would say that that is best done through opportunities, jobs and investment. The STUC point about infrastructure and connectivity through roads, rail and so forth should not be ignored. Although digital infrastructure is important, getting people to jobs is an essential part of making Scotland an attractive place to live and work.

On the point about immigration and how the UK and Scottish Governments can work better together, obviously that is something for those Governments to do in unison—it is not for only one side or the other. I flag up the CBI's recently published report "Open and controlled", which contains recommendations about a new approach to immigration post-Brexit. The report touches on the need to put immigration on the table in future trade talks, the need to ensure that EU workers are not subject to burdensome non-EU visa rules and a recommendation to scrap blunt targets on immigration. Those are some of our suggestions on how to make the UK immigration system more responsive to the needs of the economy.

12:00

**The Convener:** I have been struck by the commonality of approach. Whatever sector people are in, they are saying the same things, but are we going to be heard?

**Helen Martin:** I agree with a lot of what Mari Tunby has said. Removing the cap on migration,

which is very much politically driven, would be a good start. It is also important to have a much more humane and responsive immigration system.

When it comes to attracting people to Scotland, even just from the wider UK workforce, we should not underestimate the quality of our public services and some of the approaches that are being taken in Scotland, such as maintaining free access to education, including higher education, and expanding childcare provision. The quality of life that we have here through that kind of investment in public services is really important and is another selling point for Scotland.

When it comes to economic development in local areas, we need to remember the interconnectedness of issues. We cannot simply look at things bluntly and say how much we are investing in business relief or in one sort of project or whatever; instead, we need to think about how all the different budget lines work together. If bus routes are being eroded or if there is no access to housing, it will be difficult for companies to grow, because they will not be able to access the workforce.

We have a large domestic workforce who can be tapped into, because work is changing and a lot of sectors are under pressure. For example, in retail, workers are facing redundancies and a lot of issues. We need to consider how we support those workers into different opportunities and different parts of the economy. That goes back to Mari Tunby's comments about lifelong learning and access to opportunities for all workers. It is a sad situation that so many workers in the economy do not get any access to training at all and that low-skilled workers are much less likely to have that support. We should be thinking about how we support low-skilled workers in that respect.

**The Convener:** We have covered a heck of a lot of ground today in sometimes complex areas where there are difficult challenges. Your input will be very valuable in helping us to focus on the things that really matter in the report that we will eventually produce as part of our budget considerations. We could have spent a lot longer discussing the issues. I was surprised when I looked up at the clock and saw that we had come to the end of our hour and a half. I thank everybody round the table for your invaluable contributions. I hope that, eventually, you will see that some of the discussion is reflected in our report.

*Meeting closed at 12:03.*

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Published in Edinburgh by the Scottish Parliamentary Corporate Body, the Scottish Parliament, Edinburgh, EH99 1SP

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