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Finance and Public Administration Committee

Tuesday 5 September 2023

Session 6

The Scottish Parliament
Pàrlamaid na h-Alba

Tuesday 5 September 2023

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FINANCE AND PUBLIC ADMINISTRATION COMMITTEE
21st Meeting 2023, Session 6

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*Michael Marra (North East Scotland) (Lab)

COMMITTEE MEMBERS

*Ross Greer (West Scotland) (Green)
*Jamie Halcro Johnston (Highlands and Islands) (Con)
*John Mason (Glasgow Shettleston) (SNP)
*Liz Smith (Mid Scotland and Fife) (Con)
Michelle Thomson (Falkirk East) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Professor Francis Breedon (Scottish Fiscal Commission)
Liz Cairns (Unite the Union)
Gordon MacDonald (Edinburgh Pentlands) (SNP) (Committee Substitute)
David Melhuish (Scottish Property Federation)
Claire Murdoch (Scottish Fiscal Commission)
Professor Graeme Roy (Scottish Fiscal Commission)
Derek Thomson (Unite the Union)

CLERK TO THE COMMITTEE

Joanne McNaughton

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Finance and Public Administration Committee

Tuesday 5 September 2023

[The Convener opened the meeting at 09:30]

Interests

The Convener (Kenneth Gibson): Good morning, and welcome to the 21st meeting in 2023 of the Finance and Public Administration Committee. I hope that everyone has had a good summer recess.

We have received apologies from Michelle Thomson.

Before we start, I thank those who participated so actively in our pre-budget scrutiny event last week in Largs and on the following day in West Kilbride. I know that members had lively and interesting discussions with local people, organisations and businesses about their priorities for the Scottish budget, which will help us with our pre-budget scrutiny. We will publish a summary of the discussions on our website in due course.

I record our thanks to Douglas Lumsden for all his hard work in supporting the committee's scrutiny. I am pleased to welcome Jamie Halcro Johnston as a new member of the committee. We are also joined by Gordon MacDonald, who attends the meeting as a substitute member in Michelle Thomson's absence.

I invite first Jamie, and then Gordon, to declare any relevant interests.

Jamie Halcro Johnston (Highlands and Islands) (Con): The only interests that might be of relevance are that I am a partner in a farming business and that I have a number of shares in Tetragen (Knapton) Ltd and in Standard Life.

Gordon MacDonald (Edinburgh Pentlands) (SNP): I have no relevant interests to declare.

Scottish Fiscal Commission (Publications)

09:31

The Convener: The next item on our agenda is an evidence session with the Scottish Fiscal Commission on its "Forecast Evaluation Report" and its paper on "Productivity and Fiscal Sustainability", both of which were published on 29 August 2023.

I welcome from the Scottish Fiscal Commission Professor Graeme Roy, chair, Professor Francis Breedon, commissioner, and Claire Murdoch, head of fiscal sustainability and public funding.

I intend to allow up to 75 minutes for this session. Before we open to questions from the committee, I invite Professor Roy to make a short opening statement.

Professor Graeme Roy (Scottish Fiscal Commission): Good morning, and thank you for inviting us to give evidence on our latest "Forecast Evaluation Report" and our paper on "Productivity and Fiscal Sustainability".

Forecast evaluation is an important part of how we work as an organisation. Our forecasts are an essential part of the budget. By evaluating them, we aim to improve transparency and confidence in the process.

I will start by talking about income tax, for which we now have outturn data for 2021-22. Looking at our budget setting forecast for that year, made in January 2021, we see a significant underestimate of the outturn data—by around 12 per cent, or £1.5 billion. Importantly for the Scottish budget, there was a similar scale and direction of error in the block grant adjustment, based on forecasts by the Office for Budget Responsibility.

What caused that underestimate? It is partly a good-news story in that the early 2021 lockdown was not as severe or as long as many had feared that it would be, and the economy and labour market recovered more rapidly than many people had anticipated. Because of the rapid global recovery in 2021, inflation also started to rise, pushing up nominal incomes. Another factor that we have seen is strong growth in tax revenues from the top end of the income distribution in Scotland, particularly among those paying tax via self-assessment.

As the financial year 2021-22 progressed, we published updated estimates of Scottish income tax revenues in that year. For that, rather than relying on revising our economy forecasts, we use real-time information—or RTI—on pay-as-you-earn collections from His Majesty's Revenue and

Customs to incrementally update our forecasts. By December 2022, our estimates for that year were based on complete RTI tax data.

That RTI data helped to inform our upward-revised estimates of Scottish income tax as the year progressed and as the economy opened back up. However, the committee will recall that, when we met in June, we were discussing a potential reconciliation of £712 million, based on a comparison of those latest estimates and those of the OBR. We now have a near-final reconciliation figure for 2021-22 of £390 million based on the outturn data. The difference between those two figures is explained by two factors. First, the outturn data was stronger than what was suggested by the RTI data. Secondly, there were higher than expected Scottish income tax revenues at the top end of the income distribution, particularly through self-assessment. We continue to see RTI as a helpful tool for monitoring income tax revenues in-year. We continue to look at what options there are to improve accuracy and to communicate the range of uncertainties that we face.

I will turn briefly to some of our other forecasts. Land and buildings transaction tax revenue of £848 million was £99 million higher than was forecast for 2022-23—an error of 13 per cent. Residential properties saw faster price growth, and there were more high-value transactions than was forecast.

Spending on devolved social security payments in 2022-23 was £4.2 billion, which was £127 million—3 per cent—higher than was forecast. That was a result of higher spending on disability payments and post-budget policy announcements by the Scottish Government. We might come on to this in discussion, but a higher part of that spending being on disability payments appears to be a United Kingdom-wide trend.

The Scottish and UK Governments recently published a joint communiqué following the fiscal framework review. Both Governments support this committee's recommendation that we publish frequent full and supplementary fiscal sustainability reports, and I am pleased to say that we will develop that work over the coming months.

Last week, we published a paper exploring how changes to productivity growth would affect the projections made in our fiscal sustainability report. In that paper we conclude that, although higher productivity growth leads to faster economic growth, higher wage growth and likely better public services for the people of Scotland, on its own it does not necessarily translate into a more sustainable fiscal position. Improvements in fiscal sustainability are likely to require changes not only in the economy but also in public spending and tax policy.

The Convener: Thank you very much for that, Professor Roy.

I will kick off the questions and then open up the discussion to members of the committee.

I will start with the issue that you have just touched on. I will not quote the full paragraph in your letter, but you have said:

> "While higher productivity growth has a clear positive effect on the economy, the net effects on the public finances are complicated and to improve fiscal sustainability will require changes in public spending or tax policy."

Professor Spowage talked about that at our away day last week. I would be interested if you could explain the reasoning for the fact that increased productivity might not reduce the sustainability gap. That is crucial to our deliberations as we move forward, and it is important to get that on the record.

The second issue is the changes that would be required to close that gap, even in a situation in which we have increasing productivity.

Professor Roy: I will kick off. My colleagues will probably want to come in on that subject, too.

The first important point to make is that faster productivity growth improves the economy of Scotland overall and therefore potentially leads to better public services. However, if we think about the issue in a fiscal and public finance context, we see that certain different factors are going on.

Faster productivity growth leads to higher wages, which lead to higher revenues. That is a positive effect on the public finances. On the other hand, faster productivity growth leads to a faster-growing and bigger economy, and what we assume about what happens to public services in that context is crucial. The assumption that we make, which is the same as the OBR makes, is that, essentially, public services maintain the same share of the economy as the economy continues to grow. Therefore, as the economy gets bigger, the relative public services share will increase in line with that.

There are good reasons for that. Let us think about wages, for example. If wages in the economy grow at 3, 4 or 5 per cent, we would expect public service wages to grow at the same rate, to keep pace without having a gap between the two.

There are two effects. There is faster revenue growth and faster spending growth. In a devolved Scottish context, a proportion of revenues is from income tax, non-domestic rates and council tax. That is a smaller proportion in the overall spending envelope. Two elements grow. One is the larger public spending element, which grows with the faster growth in productivity, and revenue grows at the same rate, but one is smaller than the other. That is why the gap opens up. Growth in productivity does not necessarily lead to an improvement in the fiscal position.

What is crucial is what is done about the benefits of faster productivity growth. Do you choose to increase spending by the same amount or by less? That is ultimately a policy choice.

That goes back to our conclusion, which is that you would need to make a conscious decision to change the relative share of public spending in the economy, make a decision on taxation, or make a decision on how much growth you are translating through to the public finances over time.

The Convener: You are absolutely right. That is, of course, a policy choice, and I am not asking you to make such policy choices, because you would demur if I did so. However, it is interesting that you have touched on the situation with the current devolution arrangements and have said that we would have to change public spending or tax policy. What would we have to change to bring the finances into long-term sustainability?

Professor Roy: That goes back to what we said in our fiscal sustainability report. In the context that we have looked at so far, spending is running ahead of the funding that is likely to be available and is being driven by demographic pressures and the rising costs of key services.

Long-term sustainability will come from a combination of everything. Improvements in the economy will lead to better quality public services, which might mean that you can make savings on public services over time. Secondly, there will be choices about prioritising some areas over others, which does not necessarily mean cutting expenditure or reducing services but could, as was discussed before, mean a shift to prevention in order to reduce the long-term spend on healthcare during someone’s lifetime. Ultimately, there will have to be a conversation about what to do with taxation. Where might you look to increase the amount that you raise from the economy in order to spend that on public services?

Another point that is really important, as we have said before, is that the challenges that we are talking about here are not unique to Scotland but interact with the fiscal framework and with decisions made at the UK level. If the UK had faster productivity growth, we would get more money coming through the block grant. If Scotland and the UK were to have faster productivity growth, we would get more funding as a result of that, but, at the same time, there would be pressure at the UK level for public spending to rise in line with the economy.

There are lots of different moving parts, and we conclude in our report that there cannot be a purely economy solution or a purely public spending or taxation solution. There must be a combination of all three elements.

The Convener: Obviously, if the economy improved, one would expect fewer people to be dependent on public services, and there would be the same impact if people’s health improved.

Professor Roy: Exactly. We are speaking from a purely public finance perspective and on a numerical basis. If we have faster productivity growth and invest in public services, those public services will be better. There will be higher-quality public services and improved outcomes. We are saying that doing that means that spending will increase, so there will not be an automatic reduction in fiscal sustainability. I do not want to create the impression that faster productivity growth is not a good thing for public services, because it is. However, unless you take a conscious decision not to pass the benefits of that on to public services, you are not going to close the fiscal sustainability gap.

The Convener: I think that that is pretty clear. Colleagues can ask further questions about that if they wish.

Let us move on to look in more detail at the forecast evaluation report. Page 19 shows that the number of top-rate taxpayers has increased from 14,700 to 18,000. Yet, on page 46, you say:

> “the tax revenues paid by top rate taxpayers have actually fallen in two years.”

Why is that? If there is a significant increase in the number of such taxpayers, and given that we are in an inflationary situation, why have those revenues fallen?

Professor Roy: I will make a general point first. We were surprised by the growth in the number of top-rate taxpayers in Scotland. The number of people at the really high end of the tax distribution was higher than was being reported through the pay-as-you-earn system and higher than the number we thought we would get. That offset a fall that we had seen in previous years, when the rate of growth in that number was less. There was an increase for just one year, 2021-22.

We have spoken in the past about there being 13,000 or 14,000 top-rate taxpayers in Scotland. That number is now up to 18,000. A chart on page 47 shows that the number of people paying the top rate of tax had actually fallen in the two preceding years and that there was then an increase this year. So, there is an increase this year, but that comes on the back of relatively weak growth in the preceding couple of years.

09:45

The Convener: Right—so, the revenue from that group is not decreasing. I asked the question because there seems to be a contradiction between what is said on page 19 and what is said on page 46. One talks about—

Claire Murdoch (Scottish Fiscal Commission): On page 46, we are saying that the tax revenues paid by the top band have fallen over two years, not in the last year. The tax revenues paid by the top band fell from the previous year in both 2019-20 and 2020-21, but in the year that we are now evaluating—2021-22—the revenues paid by the top band increased significantly.

The Convener: I touch on that issue because about one sixth of income tax comes from 0.7 per cent of taxpayers. Throughout the document, you make a point of talking about the volatility of that specific group. I therefore think that we have to keep an eye on that issue.

Another point that comes through quite strongly in the report on a number of occasions relates to self-assessment. Looking at the graph on page 21, I was quite astonished at the jump in the outturn figures for self-assessment—they far exceed any others. Can you, for the record, explain that a wee bit?

Professor Roy: Before I get on to that issue, I want to come back to your general point about the importance of the higher and top-rate taxpayers. The nature of the income tax system is that those taxpayers are absolutely crucial to the revenues that are raised, because of the progressivity of the system, and small changes in the number of people in the top rate or their earnings will have significant impacts on tax revenues. That is why that forecast is in there. We do our best to estimate the number of taxpayers and the changes that might arise, but the fact is that very small percentage variations can lead to significant swings in income tax. On page 46, I think, we say that the 18,000 taxpayers in the top rate are equivalent to about £2.5 billion. As a result, if you change the numbers and percentages, you can get large swings.

That brings me on to your question about self-assessment. All top-rate taxpayers—that is, those who earn above £100,000 and have complex tax affairs—pay through the self-assessment system. Even at the UK level, it is the most volatile element of the tax system, and it is subject to the greatest change, because it reflects a whole manner of different factors, including adjustments for previous years, sources of incomes, classifications and the like.

It is the hardest bit to forecast at the UK level, but it is even harder at the Scottish level, because of the data that we have. We do not get any self-assessment data until the January after the end of the tax year. We can look at, say, PAYE and track that through the year, but we will not get any idea of self-assessment until the end of the January of the following year. HMRC has said that many people pay their self-assessment returns in January, so we really have to wait until the very end to get to that data.

Secondly, the quality of the data and the information that we have about Scottish self-assessment is really quite weak. That is probably the biggest gap that we have in the income tax system. We do not have, for example, regional self-assessment data across the UK, but, again, that reflects some of the complexities with regard to taxing individuals. PAYE is quite obvious, because it is quite a simple mechanical transaction involving an employer and an employee, while self-assessment is much more difficult to pin down.

Self-assessment, therefore, has always been the greatest unknown in our forecast. When there is a 20 per cent growth in self-assessment, as the graph on page 21 that you mentioned shows, it becomes very difficult for us to forecast, and that is why the margin of error becomes that much greater overall.

The Convener: You say in paragraph 26 in annex A of the report:

> "The variation in tax revenue generated by the highest earners is likely to continue to be a source of significant uncertainty and forecast error, with very limited data available on this group. In the future, HMRC's MTD project may improve the situation."

You then say:

> "To continue to improve our forecasts, we will focus on better understanding what determines changes in tax revenues of the highest earners."

That brings us back to page 3, where you mention "points for improvement". I take it that that is one of the areas that you are talking about in that respect. What specifically will you be able to do, given the paucity of data with which to improve forecasting in this volatile area?

Professor Roy: I do not underestimate the difficulty. We are speaking to HMRC about what more information we can get on self-assessment, on the PAYE data and on how they relate.

I caution that the nature of self-assessment means that it is quite difficult to get the data in a Scottish context and that, even in what we can get, small variations lead to big swings.

Thirdly, I am keen that we be as transparent as possible and clear about the range of uncertainty and variability that could exist in the forecasts. We now have a number of years of data points that show how volatile self-assessment could be. We can factor that into our forecast and say that there is good potential for variability.

To give an example of the potential variability, PAYE real-time information—administrative data that is tracked by HMRC to show PAYE income in Scotland—picked up around 12 per cent growth in incomes, while self-assessment showed 20 per cent growth. It is therefore difficult for us to think about whether growth could be 20 per cent or 2 per cent next year. We need to get a better handle on that, doing our best not just to estimate it but to communicate that volatility and the fact that it has implications for how the Government plans its budget and the potential scale of the reconciliations that could come from the difference between forecast and outturn.

Professor Francis Breedon (Scottish Fiscal Commission): Even in retrospect, we do not really understand why that big surge in self-assessment incomes has happened. At the edges, we can improve our forecast in that area, but we will always have to manage its volatility, as Graeme Roy has said. It is a very difficult area of tax to get a handle on. Indeed, the OBR, which has a longer history of doing it, with more data, finds it extremely challenging. We have to live with the double problem with self-assessment: it is very volatile and it is pretty much the last data that we get, so there is always the potential for surprise right at the end of the process.

The Convener: There is just one more question from me, and then I will open up to colleagues round the table. In paragraphs 8 and 9 of annexe B to your report, you say that

"Scotland's lagging earnings growth since 2016-17 has been exacerbated by much stronger earnings growth in the financial services sector in London and the South East",

and that

"Scottish employment linked to activity in the North Sea has ... fallen, lowering the average participation rate in Scotland. These jobs ... were generally high paying, which has likely contributed to the divergence in average earnings between Scotland and the UK."

What kind of pace are we talking about? What decline in overall earnings is coming from that sector, relative to the rest of Scotland? Obviously, that is fundamental—including for the green transition process that we are trying to undergo.

Professor Roy: We can get some updated numbers. We had a box—not in last December's forecast, I think, but maybe in the May or December before that—with a bit of analysis about trends in employment and income in the north-east, and we saw that divergence. We can send an update on that to the committee, but it shows far less employment growth and far slower earnings growth than in the rest of the country.

That comes back to the point about the importance to the forecasts of the progressive nature of income tax. People in oil and gas tend to be on high earnings, because those are difficult places to work and involve high profits and risks. If that sector does not grow, or if jobs are lost there, that has a disproportionate impact on the tax revenues. That is one of the factors in the opening of the gap between Scotland and the rest of the UK.

From a policy perspective, the key is to think about how we transition those high-paying jobs, which we know will disappear in the next few decades as oil and gas transitions, into other high-paying jobs in other sectors, including renewables but also in broader sectors of the economy, in order to offset the differences in earnings. In the fiscal framework, what matters is the relative growth in earnings.

The Convener: Given that we are coming out of a pandemic and that we have the Ukraine war, the cost of living crisis and high inflation, a GDP forecast error of 0.2 per cent is remarkable. I know that there have been one or two areas in which the figure has been quite high, but the Scottish Fiscal Commission has still done an excellent job.

I open up the meeting to colleagues.

Ross Greer (West Scotland) (Green): For clarification, you mentioned that there is not enough self-assessment data for Scotland. Is that unique to Scottish self-assessment data, or is it a UK-wide issue but one that matters more to us because of scale and the way that our public finances work?

Professor Roy: There are a couple of reasons. Self-assessment is always difficult to forecast, even at the UK level. The OBR would tell you that it is one of the most difficult elements for it to forecast. However, it does not matter as much to the OBR, because it is one element of income tax among a multitude of other taxes. In the Scottish fiscal framework, it is a key element of the one big tax that we have. If the OBR had forecast errors of 15 or 20 per cent in self-assessment tax, it would just get washed up with everything else. However, it matters more in the Scottish context.

There is also an extra element. At the UK level, identifying the location of self-assessment taxpayers is more difficult than is the case with the PAYE system, where there is an employer and an employee in residence, which makes it very simple. Self-assessment is much more difficult, and we do not get the information until later.

A combination of those factors makes it difficult to forecast on self-assessment.

Claire Murdoch: In Scotland, we are forecasting based on when tax is due—when people earned their self-assessment income—but at the UK level they are slightly more worried about when the cash is coming in. That difference means that the UK gets real-time information on how much self-assessment is paid during the financial year. Ultimately, that is what the UK Government cares about when managing its budget and borrowing, but the way that the Scottish Government has to manage its budget means that we are a lot more concerned about when the tax was liable and not when it was actually paid to HMRC.

Ross Greer: You mentioned that you have been speaking to the Treasury about that. We can ask ministers about this when they come to give evidence, but are you aware of whether the Scottish Government has engaged with the Treasury on those points?

Professor Roy: I do not know. We do it from a purely technical point of view. We are dealing with analysts and officials to try to get their insight, because they have been doing this for much longer than we have. We try to get their insight about the quality of the information and the quality of the data.

Our forecast in May was a surprise on the downside—the outturn data was higher—but so was the OBR's; the OBR forecast for Scottish income tax was similar to ours. We are all trying to wrestle with this to get a better understanding of the drivers of the flows.

Professor Breedon: It is fair to say that not much is going to change with regard to the self-assessment data. We are looking for other indicators that will give us a clue as to what the self-assessment data will be. That is the sort of thing on which more data is coming, because the range of stuff that we are getting from RTI is expanding.

Secondly, we struggle across all our forecasts—this is true of the forecast evaluation—because we still have a very short history of data to work with. When we try to do statistical analysis to find out what the issues are, five observations are simply not enough to give us a lot of that, so the passage of time will help improve the way that we do this.

Ross Greer: On a somewhat similar point, about the challenges of the short period in which we are doing this, I am going to ask the same question that I ask every year at this point about the work that you do to look back at behaviour change estimations that are related specifically to changes to income tax. We started making significant variations to the UK from 2018. Given that we are now getting somewhat further away from that point, and recognising that it is hard to disaggregate that from all the other changes that might result in a change in the revenue that is eventually raised, do you have any further observations about whether your estimations on behaviour change related to income tax rises have borne out?

Professor Roy: One thing that we are talking about and looking to do, as we now have more data points, is whether we can start to look at some of the data that is being collected to see whether there are patterns of behaviour and change. However, it is still quite early. I know that you will probably be fed up of me answering that question in that way, but we will start to get information that enables us to see changes in categories in the PAYE system, such as earnings and residence, although it will be subtle.

10:00

We have talked about behavioural change. A lot of the time, people think that the obvious behavioural change is that, if you put up tax, people will leave or, if you cut it, they will come in. The behavioural change that we are talking about is really subtle. It is about people changing their earnings, changing how much they work at the margin or changing their classification between non-savings, non-dividend income and dividend income. It is very marginal, so it means that we will need data for a longer period to see what happens.

Ross Greer: Thanks very much.

Liz Smith (Mid Scotland and Fife) (Con): Good morning. Professor Roy, I come back to an answer that you gave to the convener about the important issue of the increase in public spending and tax revenues. You set out that increasing productivity is all very well but there are issues about the rate of change in the public spending commitment as well as the rate of change in tax. That is what will be crucial.

I relate that to a comment that David Bell made:

> "Nevertheless, given the potential consequences of a widening fiscal gap on the ability to provide public services, it is important that as full an understanding of the causes of changes in demand for public services and changes in tax revenues be available to"

the Scottish Government as possible. How easy is it to get the necessary data to understand what is causing the changes in demand for public services? That is critical to policy decision making.

Professor Roy: To be clear, in our report, we take the existing demand for, and use of, public services and push it forward with the changes in population. We do not make a judgment about changes in drivers of demand within that. We just say what the entitlement is, how much we spend on healthcare at this moment, age the population and ask what the additional increases in public expenditure will be. We do not make a judgment call about demand.

The quotation that you gave from Professor Bell starts to get to the heart of what you do about that. You can continue to have the same amount of public expenditure but shift the balance within it so that you change the drivers of the demand.

An example is the high amount of healthcare expenditure that we have. We just push that forward but, at the moment, a lot of that expenditure is on corrective surgeries or addressing ill health. If we can change that to be more about preventative spend and reducing demands over time, that will change how much money you put into the healthcare budget over the longer term. That would allow you to make choices about how much you spend.

The question is how you change what you choose to spend that money on. That could come through discretionary choices to shift balances of expenditure or by changing the demand on those services, which is the point that David Bell makes.

Liz Smith: I am interested in the issue because, as you rightly said, it gets to the heart of policy making. I fully understand the Scottish Fiscal Commission's role in the matter and that you are very much involved in the quantitative statistical analysis, such as projecting demographic trends and how the population is changing. However, what matters to policy makers is whether there are trends within those demographic changes that lead to changes in demand. That is the crucial point for the Scottish Government. From the work that you do over years, would it be possible to isolate some trends in that change in demand or would the commission not do that?

Professor Roy: We have done it to an extent, in the sense that, in individual portfolio components, we change the demand. For example, in our projections, we reduce the share of expenditure on education because we have fewer young people, and increase it on health because we have more older people.

The question is whether we could go a level below that. Within the components, we make an assumption that the average spend on health increases as the population gets older. Could we potentially consider whether, within that, there are different elements that we could use—for example, if there are higher proportions of degenerative diseases, could we change the margin? That is one potential area we could look at.

In our fiscal sustainability consultation, we spoke about looking at what could be driving health inequalities, which lead to higher demands over time. We considered what the effects could be if that changed. Drilling into those elements is one thing that we could do.

Liz Smith: I ask the question because, before the summer recess, we held a number of sessions with witnesses from the public sector. As a committee, we have been asking what we can do to progress public sector reform. The answer depends on some of the stuff that you are saying, because knowing what the future demand for some public services will be, and whether demand will increase or fall, is absolutely critical for the Scottish Government to be able to make sensible policy announcements. I am anxious to know whether we think that we have the right data to enable us to get to that set of information, so that the Scottish Government, and the committee, are able to make sensible policy suggestions.

Professor Roy: We can definitely have a look at that. We can see what we would do with our projections and individual components of them. A key point is that our analysis shows that, if you try to make any adjustments on the spending side, essentially, you need to reduce spending per head over the lifecycle of someone demanding healthcare services. If you do not do that, and if we all demand at the same level, as we become older, expenditure will increase. You would need to consider how to shift into things such as prevention, which gets you into challenges about how to prioritise.

We could consider doing a deeper dive into an area such as healthcare and the different components in the health budget, looking at what might happen if we project forward for particular elements. We would want to be quite careful that we were not making choices about health policy. However, we could consider whether we could decompose the elements of health into some that are particularly tied to demographics or to inequalities.

Liz Smith: I understand the point that you are making—it is not your job to suggest the policies. However, to be effective in policy making, we need the right data. In your sustainability report, you have projected increases in health spending, social care spending and social security spending over 50 years. Those are all big asks. It is helpful to understand what the demand is composed of and whether there are other areas of public sector spending in which there might be a little more scope for efficiencies. That is a dilemma that faces the committee.

Professor Roy: We could potentially write a bit more about the individual components that are underneath the portfolios when we do our update. In areas such as education, it is relatively simple, which makes it obvious to split—it is high schools, universities, colleges, primary schools and nurseries. However, healthcare gets a wee bit more tricky, because it does not go into sets of boxes. In health, we could look at different elements and consider whether there is data available that could help to provide an idea about the different pressures that may be felt as a result of demographics and age over time.

Liz Smith: My final question is about preventative spend. I find it incredibly difficult to measure, because it is almost an unknown. However, it matters as an opportunity cost as well as in considering how much money we could save because of it. Do you have any guidance as to what methodology we should use to look at preventative spend? It will matter for policy.

Professor Roy: Perhaps less can be done on that within the context of our work on fiscal sustainability, because the aggregates that we use are so high. For example, a key aspect of reducing health demand over the next 10, 15 or 20 years could be housing, or it could be education or employability. It would be much more difficult to pin that down.

That takes us to the point where the evidence base must become better. If we invest in a particular area, we must know what the long-term outcomes are. We should be better at that and there should be more tracking and evaluation of programmes. We have had expansions in childcare and changes in employability policies and in different elements of healthcare and education. If those are preventative policies that are designed to create long-term outcomes, the key question is whether the evidence shows that they have actually had an impact. Once you have that evidence, you can update projections to see how you might tackle issues over time. That is the sort of thing that we will cover in our work on health inequalities.

Professor Breedon: There are very good microstudies—done not by us but by others—of some of the work on preventative measures and on the cost of benefits. Those studies evaluate the impacts of individual measures. As Graeme Roy said, we do not go into that level of detail, but those studies are a good source if you are thinking about particular areas.

John Mason (Glasgow Shettleston) (SNP): I am going back to some of the predictions and forecasts that were made, both by you and by the OBR. I accept that the war in Ukraine was probably not predictable—although some experts in the field might say that it was—but neither the Fiscal Commission, the OBR nor wider society saw the rise in inflation coming. In retrospect, should we have been able to predict that inflation was coming?

Professor Roy: The projection was always that inflation would increase after the pandemic. The significant expansion in monetary policy at the time was designed to prevent a slowdown in the economy, so there was always going to be an increase in inflation. The real surprise that we and economists did not fully anticipate was that the dislocated start-up across the global economy immediately after the pandemic meant that supply chains across the economy became gummed up, which led to a significant spike in manufacturing prices, particularly because of what was happening in China.

If you look at the track record in forecasting, there was a forecast increase in inflation, but that grew as it became more obvious that global supply chains would act as a brake. On top of that, there was the war in Ukraine and the spike in energy prices, which led to the really significant increase in inflation that we have seen.

There is still a debate about how quickly inflation will come down. Francis Breedon knows the area far better than I do and may want to come in. Every time we get monthly data about inflation, everyone jumps in to comment on whether the change is below expectations or is a faster than expected fall. We know that inflation is coming down, but the question is how sticky it will be, which takes us into questions about wages and so on. Inflation was always going to increase, but I do not think that anyone expected it to increase as much as it did.

Professor Breedon: I have had quite a long career in forecasting. If the conditions that we had prior to the Ukraine war, with tight labour markets and trade shock, had happened in the early part of my career, we would have been forecasting very high inflation. What we have seen since the era of low inflation is that inflation has been incredibly anchored. There have been all sorts of shocks for so many years and we all got used to the idea that you could shock anything and inflation would stay anchored. That was the mistake that we all made. Perhaps old hands like me should have come in earlier. It is not that I thought that this was going to happen, but it was what we were used to in the 1970s and 1980s and we have not been used to it for a very long time.

John Mason: I remember 15 per cent inflation. We just lived with that, but people are not used to it now. Do we have to accept that the same thing is likely to happen in the future and that we might see a bit of inflation coming but that it will be hard to predict how much?

Professor Breedon: The idea of incredibly anchored inflation is gone now; the anchor has been lost. We are not back in the 1970s and 1980s, but we are in a period when the economy cannot be shocked in any direction while inflation stays at roughly 2 per cent. We are in a world where we will have to get used to a bit more volatility.

John Mason: I just want to touch on some of the minor taxes, although I accept that their impact is much less. Someone commented that house prices are unpredictable and had risen more than was anticipated. Was that just purely because of the inflation factor?

10:15

Professor Roy: It is a combination of things. Higher prices and higher-value transactions were the two drivers on the upside. Overall, there were fewer transactions than we were expecting, so there was a smaller turnover of houses, but the houses that were being turned over had a higher value and increase in price. The situation is quite volatile and we have underestimated and overestimated in the past, but we are getting a better handle on the genuine volatility that exists at the moment.

John Mason: On landfill tax, the comment was made that incineration capacity was limited and uncertain. I do not know whether that was about machinery breaking down or what it was, but I assume that it meant that more had to be put into landfill when it should have been incinerated.

Professor Roy: Yes. We make assumptions about what can be incinerated, and we forecast that more would be incinerated than was incinerated. In a report, we talk about various aspects, including capacity, new things coming on stream, faults in incineration and so on, that vary that forecast.

John Mason: The bigger question is about social security. We now understand that the Scottish Government is generally nicer than the UK Government and so is more generous in handing out social security. Is that built into the system now? You seem to have slightly underestimated how much was going to be paid out each year.

Professor Roy: There are a couple of things going on there. We were forecasting 2022-23, when the adult disability payment, which is the really big one, was only just coming on. It is therefore less about what the Scottish Government has been doing with the new system relative to what has gone before.

Our error on social security is essentially driven by two elements. One, which is a smaller element of around a third, is a change in policy by the Government since we made our forecast, and that was the introduction of the Scottish child payment earlier than we had anticipated.

The main change and therefore the main reason for the forecast error was the growth in adult disability payments, but we do not think that that is due to the Scottish Government changing policy or your interpretation of the two Governments' niceness. It is more to do with trends in disability payments across the UK.

You have probably heard that a lot of discussion is going on at the moment about the increase in the number of applications for disability benefits across the UK and the rise in inactivity among people who are in ill health, perhaps as a hangover from Covid or perhaps because of broader concerning trends in things such as mental ill health. Across the UK, we are seeing an inflow of people on to disability payments that is much higher than it was pre-Covid, and that affects their number in Scotland. Our error therefore mirrors the error that we see at the UK level, and that is probably more of a reason than a differentiation between Scotland and the rest of the UK at this stage.

John Mason: I will move back to income tax to carry on with some of the points that have already been raised. I get the point about higher earners and self-assessment. If people are self-employed, they might not know what their earnings will be for a year, let alone anyone else knowing. However, the earnings of higher earners such as the chief executive of a council or someone like that, who, I presume, will be in the self-assessment category, would be quite predictable. Are they just swamped by the ones that are unpredictable?

Professor Roy: Yes. Some people who do self-assessment pay through PAYE and we get the returns in that way, but other people have much more volatile and complex tax affairs. Self-assessment does not just cover high earners; it covers people who have complex tax affairs and that is the part of self-assessment that is much more volatile.

In our report, we also talk about the difference between the RTI PAYE data that we can track and the outturn data on PAYE, and again, we see differences in that. This is about people perhaps changing tax codes at the end of the year through being identified as a Scottish taxpayer rather than a UK taxpayer, for example. That just means that the PAYE data that is collected through the year is different from the PAYE outturn data at the end of the year. People having complex tax affairs mean that those numbers move around a lot.

John Mason: That is a little bit disappointing, because, when you were at the committee previously, I got the impression that the RTI information would be the big answer and would give you a lot more clarity. Has it disappointed you a bit?

Professor Roy: It is surprising just how different it is this time around. It is still a really helpful indicator, because it meant that we were uplifting our forecast all the way through. If we can see from administrative data what has been collected by PAYE through the year in Scotland, that is still really useful. The bit that we do not know at the end is how it looks once people have reported, once all the changes have been made to people's tax codes and once various adjustments have been made. It might just be because it is the end of Covid and it has been a volatile tax year with lots of things going on, but that gap—the error—between the PAYE outturn data and the PAYE RTI data is bigger than we had hoped it would be.

Professor Breedon: The other surprise is that Scotland was stronger than the rest of the UK. We worked on the assumption that self-assessment would be roughly the same across the UK, so the divergence between the two parts was a bit of surprise.

John Mason: Is the self-assessment money in Scotland more volatile than that of the rest of the UK, or are we not sure about that?

Professor Roy: The potential for it to be more volatile is higher in Scotland because of the numbers, particularly if we are talking about people at the really high end, because there is a small number of them. Percentage variations are likely to be higher, as we see with top-rate taxpayers, because there is a smaller number of them and it is a smaller sample size; variability is likely to be higher.

Professor Breedon: We have too little data to say anything much more than that.

Professor Roy: There is an interesting chart on page 50 of the report that shows the self-assessment revenue growth for Scotland and for the rest of the UK. You can see that the numbers for Scotland are more volatile than those of the UK.

Professor Breedon: I would keep the warning that, with that many observations, I am nervous about making a strong statement about volatility.

John Mason: That does not necessarily reflect the economy or anything like that; it is much more to do with just individuals.

Professor Roy: As I said, on the latest information, there are 18,000 taxpayers in Scotland who pay the top rate, which amounts to about £2.5 billion. If you have a few hundred of those moving around, that number becomes that much bigger. It is just a scale effect. It is also because, due to the nature of the devolution settlement, we have this one tax, which is the most important. In the UK context, it would be matched by errors in VAT or corporation tax that would offset it all, but it becomes so much more important in our context.

John Mason: The final thing that I want to touch on is the fact that the total number of taxpayers has increased by 5.1 per cent, if I understood that correctly. Perhaps linked to that, the immigration numbers were higher than expected, with immigration from the rest of the world rather than from the European Union. Can you say anything about that?

Professor Roy: We revised up our migration forecasts last time, in part through the international element. The growth in the number of taxpayers can be due to things such as people moving into the system. It does not have to be about there being more people in Scotland but, if there is a higher number of people in Scotland, that will clearly lead to a growth in the number of taxpayers. That growth could also be due to people moving into tax bands. Measures such as freezing the personal allowance and not increasing the personal allowance by inflation mean that, as people's earnings go up, more people move into the tax system.

There is an interesting table on page 19 of the report in which we talk about the growth in the number of taxpayers. What we see is people moving into higher tax bands, which is quite interesting; it potentially affects the fiscal drag and where earnings growth is concentrated in the labour market. Unpicking that and understanding it will be really important for our updated forecasts. Are we seeing something of a trend in higher earners' earnings growth contributing to higher income taxes?

John Mason: I suppose that I expected people to move up the tax bands as the limits were frozen, but I was a bit more surprised that the total number of taxpayers had increased.

Professor Roy: Yes.

John Mason: Fair enough. Thanks, convener.

The Convener: A quick wee calculation off the top of my head tells me that, if there are 18,000 top-rate taxpayers, they each pay an average of just under £140,000 a year. That is a very interesting section of the tax-paying public indeed.

Michael Marra (North East Scotland) (Lab): I will stay with that area for a couple of minutes, if that is okay, convener. It is a subject of significant political debate, so the panel will understand why we are particularly interested in it. Given the level of volatility—from the sounds of things, that is partly tied to how few of such people there are and to small variations—how much confidence should we as a Parliament and the committee have in your work and predictions? Do Government predictions about the contribution of the top rate of tax to cover the deficit come with a strong health warning?

Professor Roy: I think so. As we get more data points, we can offer much more clarity about the potential for variability, change and uncertainty that exists. Given the nature of what we do, we must make a central forecast. Around that, we can do more to talk about the potential variability.

We have a really good data point—the RTI data and all the information that we had suggested a reconciliation of about £700 million, but it has turned out to be about £400 million. Next year, if I tell the committee that the reconciliation is £200 million positive, I will be able to ask the committee to remember the potential variability that we saw when we were here last year. That really matters for top-rate taxpayers, too.

We are talking about one data point. We do not know whether this is a really good year for Scotland. Does it represent a bounce back after Covid, or is it part of a trend over time? It will be important to be clear with the committee about the changes that could happen and how to interpret that.

Michael Marra: The Fraser of Allander Institute has told the committee that it could take up to a decade to provide sound modelling of behaviour effects. Does that sound realistic? You have said that having more data points is a good thing.

Professor Roy: Exactly—we will be able to see more over the next few years. HMRC has been working on pulling together data sets that can be used not just by us but by academics to look at the effects and see whether changes are happening.

We need a combination of data points, so that we are not dealing with individual years, and we need change. You want Governments to change policy, because you can see behaviours moving after that. In many ways, Governments announcing and doing things is quite good from a statistical point of view, and we can see what happens over time.

Professor Breedon: It is slightly amusing that we would like you to roll the dice and set some policies so that we can see what happens. I make the point every time that, although we have errors around our forecast, the errors are on both sides. If there is a really big number in our forecast, the wrong way to interpret it would be to say, “They make mistakes, so we can just ignore it.” If we have forecast a big number, you have to say that, in practice, it could be even bigger or could be smaller—we do not know—and you have to work with that number and not say that it is not worth anything because it has an error around it.

Michael Marra: It strikes me that, five years down the line, there could be such significant externalities from the behaviour of such a small group of people that the data points that we have talked about might be moot.

Professor Roy: That could be the case. There are various techniques for reflecting on that. You can match taxpayers across the UK and control for different effects. In relation to LBTT, stuff has been done to look at changes in tax policy and at people shifting forward—you can see behavioural effects there. The UK has decades of income tax data, so there are lots of detailed studies about how people shift and change behaviours to move figures up or down. We just need such data sets.

Michael Marra: You talked about the increasing level of applications for adult disability payment. Is that matched by an increasing level of awards? Is there a differential between awards in the UK and in Scotland?

Professor Roy: Across the UK, we are seeing an inflow of applications and an inflow of people claiming personal independence payment in the rest of the UK and adult disability payment in Scotland. We are seeing increasing applications, but I caution that we do not yet have definitive evidence of a disconnect between Scotland and the UK. We think that that will happen, because of the nature of the policies, but at this stage all that we are seeing is an inflow. We need to see more data points before coming to a conclusion.

10:30

Michael Marra: There are more applications, but is there a higher proportion of awards? Are more being approved?

Claire Murdoch: We do not have that information yet. Social Security Scotland has said that there are processing delays with the applications, so we do not yet have information about whether the large number of applications that we expected to see—and have seen—for the adult disability payment is translating into a different success rate in terms of whether people receive the award and what the payment amount is.

What Graeme Roy is saying is that a lot of the spending that we are classifying as being on the adult disability payment is actually still spending on the personal independence payment, because people have not yet moved over to the Scottish system. Across the UK, we have seen that increase. At the moment, in most of the forecast area where we are seeing higher disability spending, it is to do with that UK-wide trend. We are not yet seeing evidence that there is no additional cost in Scotland. It is as we would expect. It just takes us a bit longer to get the actual data.

Michael Marra: It would be useful if, as you do more of that analysis, you could apply a time series to it as well. It would be interesting to see, for example, whether there is a spike in awards versus applications against a particular timeframe. Some anecdotal evidence that I have heard suggests that part of the issue about delays in awards might be driving an increase in awards. It would be useful for the committee to have a way of understanding that, given how significant the area is in terms of spend.

Professor Roy: In our forecasts, we are clear about what we are forecasting in terms of spend, average payment, applications, case load and so on. That allows us to have a discussion about what that shows us.

You will remember that, when we came to the committee last year, we spoke about data needs and so on. We were keen on having much greater dialogue with Social Security Scotland about exactly those qualitative indicators, so that we could get a sense of what is happening with the case load, what the trends are, what its expectations are and so on, and then make judgments based on that information. We are more than happy to set that out in our forecast in December.

Michael Marra: Is Social Security Scotland open to those conversations?

Professor Roy: Yes, it has been very helpful.

Michael Marra: Excellent.

My last question concerns modelling around productivity and childcare. In recent years, the country has invested a significant amount in the uplift in childcare to 1,140 hours. What can you tell us about the relationship between that investment and the productivity of the economy?

Professor Roy: There are good theoretical arguments to suggest that investing in childcare leads to improvements in productivity in terms of better access to the labour market, improved skill levels, jobs and so on. I have not seen any evaluation of whether the policy has had the intended effects in a significant way or what the indications have been in terms of dead weight, so that has not informed our forecasts and we have not been able to say what the impact of the policy has been in terms of productivity. We cannot say anything specific about it in a Scottish context.

Michael Marra: It is a significant area of public investment. Who would you expect to be doing that analysis? If increased productivity is one of the aims of the Government’s investment of taxpayers’ money in that area, we should be seeing those numbers.

Professor Roy: That comes back to an evaluation of policy. When significant investments are made, you would expect to see the evaluation of policy. If we can see evaluations by Government or academics who have been commissioned to do them, we can use that to inform our assessments of what might happen in terms of productivity or changes in policy over time. However, I have not seen anything that we could use in the way that we have used data in our forecasts in the past.

Michael Marra: Am I correct in thinking that the broad indicator is that there has been little growth in the productivity of the economy in recent years?

Professor Roy: Yes. That is part of a much bigger conversation about what has been happening to productivity in the UK context and issues around measurement, management, changes in sectors and so on. The two key ways in which you would expect changes in childcare to come through are in labour market participation and, crucially, in productivity. In theory, we could expect to see positive economic improvements from the policy but, as I say, we have not seen any explicit evaluations that would enable us to say that an investment of X amount has resulted in outcome Y.

The Convener: I think that about 12,000 more people are employed in the sector. However, the productivity outcome is not something that we looked at when we were doing post-legislative scrutiny in this area a year or so ago.

Jamie Halcro Johnston: Good morning. I just want to follow up on a couple of points that have already been made. On the point about productivity, what would be the impact if there were high UK productivity but low Scottish productivity?

Professor Roy: In terms of our fiscal sustainability?

Jamie Halcro Johnston: Yes.

Professor Roy: This is where I have to think off the top of my head.

In that instance, you would get faster growth in the block grant. Spending at UK level could go up, which would then feed through to a positive position in the Scottish spending component; however, it would also mean a faster growing block grant adjustment relative to tax revenues, which would lead to a squeeze. Whether the net effect of that would still be positive or—

Professor Breedon: I think that it would still be positive. Faster productivity growth in the UK is positive for Scottish finances.

Jamie Halcro Johnston: I was interested in the discussion that was had with regard to Michael Marra’s question about top-rate taxpayers, of which there are 18,000. You have said that we do not yet have the data from the Scottish context; however, we obviously have historical UK data. What analysis can be done on the tax mobility of those individuals, admittedly within an international context? Of course, such mobility would probably be even more beneficial within a UK context.

Professor Roy: In our forecasts, we look at what are called tax elasticities, which are about how people potentially respond to changes in tax, and we look at, for example, average and marginal effective tax rates. The marginal rate is all about how people change their behaviour at—as it would suggest—the margins, for example, by choosing to work more hours or shifting to different types of income, while the average rate relates to people making much bigger strategic decisions about whether to work or not or whether to move, relocate and so on. We build in assumptions about such effects, based on international and UK evidence, and it means that every time that we make a forecast, we have both a gross and a net estimate. The net estimate is the effective one that accounts for these factors.

Coming back to the discussion that we have just been having, I would point out that we do not yet have a specific Scottish elasticity that captures people's behaviours, because we just do not have the data or the time series for that. We therefore use other people's evidence of what has happened elsewhere to help inform the Scottish context.

Jamie Halcro Johnston: When you look at the data from the UK—or, indeed, from other countries, depending on how you do it—you must find additional flexibility within, say, the UK market. Is that what you expect to see?

Professor Breedon: When we have looked at international evidence, we have very much focused on countries with similar situations, such as Spain, for example, where there are different complexities across different regions. For a period in the United States, there was a thing called the millionaire tax, as a result of which very-high-income people paid higher tax in some states but not in others. We have drawn on those kinds of specific examples, because, as you have said, the tax situation is different with internal rather than external migration, and that has informed our current numbers.

However, as Graeme Roy has said, we would ideally like to do something specific on Scotland to find out the answer in that context. As I have said several times today, though, I am afraid that it is still too early to say anything about that, but a Scotland-specific study of such effects is certainly very much on our agenda. In any case, the international evidence from all of those countries is relatively similar: there is an effect, but it is not very powerful.

Jamie Halcro Johnston: Because there could be various reasons for people choosing to relocate. It might not be because of tax.

Professor Breedon: Yes. Perhaps the US example is the most surprising, because people stuck to whatever state they were brought up in or had chosen to live in. Even though the US has a very mobile economy, you will find that the tax difference did not generate a very big amount of movement.

Jamie Halcro Johnston: I just want to ask briefly about a couple of other things. We have talked about fiscal sustainability over the next 50 years, but I wonder whether that can be broken down on a regional basis. In the Highlands and Islands, which I represent, healthcare and other services are very difficult and more expensive to deliver, and one would therefore expect the fiscal sustainability of those services to come under even more pressure. How much can the data forecast or reflect that?

Professor Roy: That is a really good question. There is a bit in the fiscal sustainability report where we looked at population projections across the regions of Scotland; I think that we looked at local authorities. We saw huge variations, particularly between places where there are population declines, such as rural areas and old industrial parts such as Inverclyde, and the east of the country, where there is increasing expenditure.

We did not go into the detail of that in the report, because we look at the national level, but that variation at the local level means there is a really interesting subtlety around how fiscal sustainability can be managed on a more local basis. On the one hand, there are places such as Edinburgh, Midlothian and East Lothian that have rapid growth, and there is pressure on spending as the growth increases. On the other hand, in rural areas, there are potential increases in the costs of delivering the same quality of service to fewer people, and that has the potential to become really expensive as well. If we look at that level below, we see those interesting subtleties around what the fiscal sustainability questions could be at a regional level, and therefore at a national level. It could potentially become more costly overall because of the pressures of delivering the same level of service in areas where populations are growing and, equally, where they are declining.

Jamie Halcro Johnston: Although you do not look at that aspect, the data is there to be enable those projections to be made. In rural areas and island communities, such as the one that I live in, there is already concern about how expensive services can be, and I will not even go into issues such as ferries. Lots of decisions to do with spend there will need to be made in the future. The concern is that that pressure is only going to grow, so how does the Government prioritise that spending, or at least ensure that that spending is there?

Professor Roy: I hope that the principles that we have used in the fiscal sustainability report will give people who are interested in the local context ideas about doing something similar to what we have done: looking in a very transparent way at population and costs of delivery and then pushing them forward. These findings are not forecasts; they do not say "This is exactly what will happen". They are just raising awareness that if you do the arithmetic on what happens around the cost of service delivery and population demographics, these are the pressures that you will see.

Jamie Halcro Johnston: My last question is about house prices. There was an underestimate of the revenue from the land and buildings transaction tax. Given that there now seems to be a slowdown and houses are taking longer to sell, would you anticipate that there might be an overestimate for next year?

Professor Roy: We lowered our forecast. We thought that LBTT would be under more pressure next year because of falling prices and fewer transactions because of rising interest rates, the economy and so on. That had an effect on our forecast. When we made our forecast in December last year, we were more cautious about the growth in this year, because we thought that the slowing nature of the economy would have an impact on it. We will not know until next year whether that has had an impact.

We can make intuitive judgments, recognising that interest rates have gone up and the economy is slower—for instance, that house prices could fall and revenues might be under pressure. However, if there are a small number of high-value transactions in some key areas, or if house prices are resilient to changed interest rates, we could be surprised on the upside. That is just the nature of forecasting.

Jamie Halcro Johnston: Thank you.

Gordon MacDonald: It has been an interesting discussion. I have three quick questions to round things off. Professor Roy, you quite rightly said that forecasts play a central role in setting the budget, but you have highlighted forecasting errors in revenue from income tax at 12 per cent and from land and buildings transaction tax at 13 per cent. What impact did that have overall on the Scottish Government's budget in terms of what was available to it?

Professor Roy: In broad terms, one thing to remember is that the block grant adjustment is changing as well. The income tax forecast error of 12 per cent should be couched in the fact the Government also had to deal with the BGA change. What really matters there is the reconciliation, which was ultimately £390 million. That, essentially, is the consequence of those forecast errors on income tax. That gives you the scale or the size of the issue. It comes back to the discussions that we have had before about the fiscal framework and the ability to manage that risk in future years.

Gordon MacDonald: You estimated that the reconciliation would be £745 million.

Professor Roy: That is where it gets quite complex. Members may remember that, while the nature of our forecast back in January 2021 was that we were forecasting higher revenues than in the rest of the UK, we were cautioning to say, "Hold on a minute—we think this is a timing issue. The UK BGA is going to be revised up."

We then updated that forecast over time, and we knew that there was going to be a big reconciliation. We did not know how big it would be—I cannot remember what we were saying at the start; I think that we were talking about £300 million or £400 million.

10:45

As we were getting the real-time information data, we were saying, "Look—it looks like it could potentially be even more significant", and that is when we pushed it up to £700 million. It has come in at £400 million, and that is ultimately the forecast error between ourselves and the block grant adjustment.

Gordon MacDonald: The difference between the higher and the lower forecast element could have been resource that would have been available to the Scottish Government.

Professor Roy: With the £390 million, the reconciliation there is essentially money that the Government has had and has spent, and it is now essentially having to manage that back—

Gordon MacDonald: With the timing differences.

Professor Roy: Exactly. That is the fiscal framework.

It is not money that the Government has lost—it just has to manage how it then deals with that forecast error.

Gordon MacDonald: It has to manage a lower amount than was previously estimated.

Professor Roy: Yes. The £390 million is now going to come out of the budget next year and that, ultimately, is what we have potentially to remove.

Gordon MacDonald: Have the forecast errors led to changes in the model going forward, so that you can reduce the level of forecast errors?

Professor Roy: Again, there are a couple of points to make. I would not say that we are going to change much on our forecast—the budget that we push out. That is the one that really matters; that is the £390 million. That comprised our judgments on the economy, employment, earnings and so on, and they were pretty solid and accurate.

What we have been discussing today is how we update the information as we go to give the committee and Government a potential real-time indication of how accurate these forecasts are going to be. That is the discussion that we have had about the RTI data, which is essentially tracking administratively pay-as-you-earn data for Scotland, so it should be really good. This year, we see that, instead of predicting 14 per cent growth, it was predicting only 12 per cent growth, and that is where the error is.

Gordon MacDonald: I come to my final point. I accept that you may not have seen these figures, but we were talking about the volatility around self-assessment taxpayers. What impact do you think the acceleration in the move to a cashless society has had? A report last year said that 23 million people in the UK no longer use cash, and that within a decade, the proportion of cash payments would be close to 6 per cent.

Professor Roy: It is an interesting question. I have not thought too much about it, in the sense that self-assessment and PAYE are much more about the earnings that you take and your track record in terms of the income that you have received.

The question, I guess, is that there is a suggestion that if we are moving to more of a cashless society, there is more tracking, which means that there is potentially more reporting going into it. That is interesting. Whether that means that there will be more official stuff coming through PAYE and self-assessment because there will be less stuff coming through some particular activities is an interesting point to consider.

The Convener: That concludes questions from the committee. I have one further question, which is about David Bell's paper. John Mason touched on it, so I thought that I should do likewise.

In the exchange, we discussed the issue of potential spending changes and tax changes that will be necessary—not the specifics, but the fact that they might be necessary. Professor Bell talks about loss aversion, which is something that I have raised before in the committee. That is the issue whereby people, if you give them additional funding for whatever, simply shrug their shoulders and say, "Thanks", but if you take something away, they are extremely hostile to that, and it causes much more of a political backlash than the gain that you would get from doing something to give them the same financial sum.

What implications does that have for long-term fiscal sustainability and the ability of Governments to take decisions that may require to be taken?

Professor Breedon: We have not covered that in the productivity paper, but it is clear that, at a time when incomes are rising, changing tax policy is easier because there tend to be fewer total losers—there are net losers, but you can make more changes with less resistance. In a period like the one that we have been going through, in which incomes have risen very little, tax policy becomes very sensitive, because you are imposing genuine losses on people rather than just taking away some of the gains.

Professor Roy: Your question gets to the heart of the question that we have been debating in Scotland for 10 years since the Christie commission. We know that we need to move into prevention and shift expenditure into certain areas to reduce demand and improve outcomes in the long run, and improve people's wellbeing, but how do you do that when budgets are under pressure? That means that you are going to have to take money from one area to another, and that is the bit that is really difficult for any Government to do.

Our fiscal sustainability stuff is, I hope, about trying to say, "Look—you need to do this, because if you don't, it becomes unsustainable." You cannot afford to keep spending in these key areas without discussions about the economy, taxation and which areas of service you prioritise.

The Convener: I wanted to end on that because fiscal sustainability is going to be the key issue in our budget scrutiny this year.

I thank you very much for your evidence today, Professor Roy and Professor Breedon, and I also thank Claire Murdoch. It is very much appreciated, as always.

It has been a reasonably long session so far, so I call a break until 11 o'clock.

10:51

Meeting suspended.

10:59

On resuming—

Subordinate Legislation

Land and Buildings Transaction Tax (Green Freeports Relief) (Scotland) Order 2023 [Draft]

The Convener: The next item on our agenda is evidence on the draft Land and Buildings Transaction Tax (Green Freeports Relief) (Scotland) Order 2023. I welcome to the meeting David Melhuish, director of the Scottish Property Federation; Derek Thomson, Scottish secretary at Unite the union; and Liz Cairns, researcher at Unite the union.

I intend to allow up to an hour for this session. If a witness wants to be brought into the discussion at any point, they should indicate that to the clerks, please, and I can then call them. I will direct my questions for Unite the Union to Derek Thomson, but if he would prefer Liz Cairns to answer them, I would be quite happy with that. We will simply suck it and see, so to speak.

We have your submissions, which I thank you for. We will go straight to questions.

My first question is to David Melhuish. In response to our questions, you talked about the five-year timespan being

"simply too short for the nature of long term investment in the two green freeports"

in Cromarty and Leith. You also said:

"we note that the green freeports will not be fully operational until at least 2024 or perhaps even 2025. We therefore suggest that the qualifying period should be extended to at least 7 years."

What would be the benefits of that to your industry and, indeed, the wider Scottish economy? How much investment and employment do you realistically expect to come into those two green ports?

David Melhuish (Scottish Property Federation): Thank you very much for the opportunity to give evidence to the committee.

We think that the green freeports are a very positive initiative. To go directly to the question that you asked about the timespan, the nature of our business tends to involve very long-term investment. To be frank, it can be several years before some investors can do the statutory pre-application planning and so on for major developments. Albeit that there is intended to be a smoother planning process as part and parcel of the freeports, it nonetheless takes some time to get together the capital expenditure and teams, and to get the potential attracted businesses into the location. Our fear has been that, although we think that the schemes are really positive, five years might simply be there and gone before the relief could kick in. Our fear about that—the "So what?" aspect, I suppose—is that it might put off investors who are looking at a potentially lengthy process from coming at all. We simply think that some flexibility on timescales would give them the best chance of maximum success in bringing the jobs and added value to the economy, and the spur to sustainable growth that is envisaged in the plans.

On what is realistic, we are well aware that Forth Ports has suggested something like £6 billion supercharging the economy and more in added value, and I think that the brochure mentioned 50,000 jobs, but these developments take time. That is absolutely feasible, and there have been well worked-through business plans over a period of time, but a bit more time to pull together all of the investment would help both freeports to be the successes that they could be.

The Convener: Derek, you talk in your submission about some 75,000 jobs. I have to be honest and say that the numbers seem quite fantastical to me. What are your concerns regarding displacement? When previous Governments have introduced enterprise zones, there have been concerns that they have simply moved jobs from one part of the country to another part. Obviously, that is particularly acute in areas that border such zones, including, in this case, green freeports.

Derek Thomson (Unite the Union): Thanks for the opportunity to contribute.

Our estimates are 50,000 jobs at Leith and 25,000 at the Cromarty Firth. That is where we got that figure from.

On displacement, the idea of creating those 75,000 jobs is welcome. Obviously, that is a great step forward in respect of what can be brought into the economy. However, our fear is that business will simply run to the cheaper rates and cheaper areas and will start to move people and work in. There is a lot of deprivation and poverty in some of the areas that surround the two key areas, and a lot of people rely on jobs there. Our fear is that, if we start to move cheaper jobs and labour into the areas, people will be displaced and there will be poorer jobs, communities and areas. In our view, big business will rush to try to claim the tax relief at the expense of some of the workers.

This is not really the committee that deals with this, but we are looking at serious skills and jobs shortages when the just transition comes in, because we are not yet in a position to determine what a green job is. Our fear is that, if we start to move jobs out of different areas into the freeports—or green ports, as we like to call them in Scotland—displacement will take place and that will lead to further poverty if we do not reinvest in proper jobs in different parts of the community.

Although we welcome the idea of the green freeports, real concerns exist about how they might displace current jobs and people. Our fear is that, if we do not get the support to those communities absolutely right through that period, it will leave them devastated.

The Convener: You have said in your submission that you

“cannot accept an economic situation which allows for private sector employers in Freeport areas to increase profits as a result of government subsidies while vital local public services that our communities and those in greatest need depend upon, are allowed to wither on the vine.”

Where is the evidence that that will happen? The whole point is to create economic growth, which will increase tax revenues, which will allow further revenues overall for the Government to invest in services.

Derek Thomson: Freeports will create more revenue if the jobs are properly paid and there are proper terms and conditions. One of our reasons for wanting to be here is to discuss the issue of collective bargaining. Our fear is that companies will rush in because they will be given the tax relief that is in this legislation and that that will drive down wages, because that is what big business has done numerous times. If we do not get the balance right and have proper wages in these areas, the tax relief will count for nothing. No tax relief will come in via big business and little more will come in through the jobs that are created, because no proper pay system will exist that generates tax and income.

To us, you are putting the cart before the horse a bit when you say, “We’re going to create all those wonderful jobs, but we don’t have an infrastructure in place yet,” and when you talk about the five to seven years investment programme. In our view, the people who will come into this will be big business, and they will exploit the workers and the system that you are putting in place, so we urge a bit of caution.

The evidence is that, if people are displaced out of current jobs and those jobs are moved into those new areas, poverty will start to increase in the areas to which the jobs are moving, because business will move to the cheapest area that it can get. So, we have a bit of a situation.

The Convener: Business might move but, with less than 4 per cent unemployment in Scotland, why would workers move to an area if their wages were to go lower? Would they not just get a job somewhere else? Surely, 75,000 people will not move into those zones to get lower wages. It is not really credible that people will move to accept lower wages in an economy where there already are chronic labour and skills shortages, is it?

Derek Thomson: Sorry—are you saying that people will not move into those jobs?

The Convener: Well, not from existing jobs. You have talked about displacement. If people are going to be displaced, they will not be displaced on the basis of lower wages and poorer working conditions, will they?

Derek Thomson: I am pretty sure that big businesses will move their business to one of the green ports if they get the idea to move it. That is the reality.

Liz Cairns (Unite the Union): The national insurance relief applies up to £25,000, and in Cromarty, in particular, where the community is spread over a vast area, the jobs that are offered will be very attractive. We made a freedom of information request—I think that I say that in my submission—asking about the level of loss to the public purse from the relief on national insurance contributions. HMRC, to which we submitted the FOI request, advised us that there is a £2,400 loss for every job. We are potentially talking about 75,000 jobs—25,000 in Cromarty and 50,000 on the Forth—so that is a £180 million loss just for the most recent tax year.

The Convener: That assumes 100 per cent displacement, however, and I thought that the whole point of the green ports was to create new, additional jobs.

Liz Cairns: Displacement can happen without an individual having any responsibility over it. If an employer decided that it wanted to move for that reason, it might close its factory, move into the new green port, start new jobs—to benefit from the tax relief, they have to be new jobs—and make people in those communities redundant. The employer would go but the people might stay. Although some people might be willing to go, others might not be or might be unable to do so.

The Convener: I will put a lot of these questions to the minister when he gives evidence, to find out what he has to say.

David, what kind of jobs and what kind of businesses do you envisage will go to the freeports?

David Melhuish: I think that the intention is that the jobs and businesses will be part of the new-style economy—in other words, that they will be in green manufacturing and support for maintenance. I think that it is generally accepted that that is an area where Scotland as a whole hopes to do better. There have been one or two false starts. I would like to think that there will be less displacement than is feared by colleagues.

I am also aware of the commitments that have been made by the people behind the freeports to, for example, the real living wage. I hope that that will alleviate some of the concerns that have been expressed. Although it is not my area of expertise, on national insurance contributions, I think that the Cromarty Firth freeport has proposed reinvesting the equivalent of NICs in reskilling, in order to avoid an imbalance with businesses around the area.

The proponents of the two successful bids have been very aware of the concerns, which have been taken on board by the Government and the local authorities that have been behind the bid brochures in how the schemes have been developed. I think that the emphasis is on encouraging things that might not otherwise have happened. In that sense, it will, on balance, be new jobs that are created, although possibly not in 100 per cent of cases. However, I do not think that there will be 100 per cent displacement. I think that, overwhelmingly, there will be more jobs and more investment in the new technologies and the new manufacturing opportunities.

The Convener: I do not think for a minute that there will be 100 per cent displacement, but I do not think that there will be zero displacement either; it is bound to be somewhere between the two. That is a concern. Do our guests have any evidence on what level of displacement they think there is likely to be? I will ask the Scottish Government about that specific issue, but are you able to give us best and worst scenarios?

Derek Thomson: You have raised some important points about the jobs that will be created in the green port areas. Mention has been made of green jobs and green manufacturing.

I come back to the displacement by companies that Liz Cairns has alluded to, whereby the business moves but maybe not the people. There is talk of green jobs and green manufacturing, but, as yet, no one can tell us what a green job is. Will someone using an electric bike for deliveries be classed as having a green job? There is no guarantee when it comes to green jobs and green manufacturing.

Let us take the oil and gas industry, the upstream and downstream elements of which extend from Aberdeen down to Grangemouth. There is a whole list of jobs in that industry that could change to green jobs under a just transition, but that has not been defined yet. Mention has been made of the possibility of green jobs being moved to Leith and the Cromarty Firth, but those jobs could displace jobs in the oil and gas industry if the green manufacturing has to be done in those areas.

The issue of manufacturing needs to be raised, because the Scottish Government is not investing in manufacturing. We want manufacturing to be done in this country. If we are to have new technologies, new green energy and new construction, those things should be built and manufactured in Scotland. Perhaps jobs can be created in those areas.

However, wider thought needs to be given to what the economy will look like. We cannot just say, "We'll put green jobs in here," without thinking where the green jobs will go. The oil and gas companies are investing in doing their new green energy work onshore in this country, so building work will be done here. Why is the manufacturing for the offshore wind farms not being done in Scotland? Why can that technology not be built in some of the areas that we are talking about? We keep asking those questions because there is no agenda for how we achieve a just transition. In our view, green ports are part of the just transition agenda. Jobs are being moved to the green port areas. It is claimed that those jobs will be new green jobs. However, if those jobs are new jobs, existing jobs will have to be replaced, because the technologies are not there to get things done.

The issue of a just transition is so much bigger than people think it is; it goes beyond just oil and gas. It is a massive issue that extends across a raft of areas, including the energy networks and local authorities, where jobs will be under threat and new training is needed. Perhaps we need to have another go at thinking about how those areas will be utilised by the Scottish Government and by the economy.

11:15

I will mention another area while we are talking about that. The first road into those two places will be construction, because construction will need to grow: the buildings will need to be built and the foundations will need to be put in. However, there is a real danger in construction that we do not want to see. If you do not get the procurement processes and investment right, you will have self-employed and bogus self-employed companies making fortunes out of those areas, and you will have people not paying tax. That is exactly what happens under bogus self-employed companies. The tax gains that you think you will get from that are not reasonable at this point in time. I am being as critical and as fair as I can be—I do not think that it has been well thought through in relation to the bigger picture of the wider Scottish economy.

The Convener: Anyone who has read the latest issue of *Private Eye* will have seen the comments about the alleged shenanigans going on in Teesside, where a freeport is being developed. One of the issues about displacement is that, if there was not a freeport in Leith, perhaps there would be displacement to Teesside. Perhaps that was one of the reasons why Leith was considered as a location.

Let me turn back to David Melhuish. You raised concern about forward funding arrangements. Could you elaborate a wee bit on that?

David Melhuish: That is closely tied to the point that was made earlier about the long-term nature of investment. The developers tend to be facilitators of capital—they go and attract the investment from around the world, often beyond Scotland—and they compete for that capital. So, yes, if we did not have green freeports, we would be disadvantaged compared to the freeports not just in Teesside but elsewhere in England.

The developers often attract that forward funding. In other words, they passport that investment into the ground, as it were. Nonetheless, in the immediate period, they take on the development risk and make sure that the structure goes up as intended. They will find the tenants and so forth that will come in and be the businesses that, in the long term, will provide the employment and the tax revenues in those locations.

Typically, and much more nowadays, rather than getting old-fashioned lending from a bank, developers will get it from an institutional funder or a range of institutional funders, which could be located anywhere. To get the capital expenditure, the developers need to be able to depend on forward funding for the lifetime of the project.

Our concern in the arrangements that were expressed was whether the relief would go to the developer that is initiating all the up-front capital expenditure and works or to the long-term owner. We put that question to the Government, but it has decided not to amend the regulations, as the committee will be aware, so that remains a concern of ours.

I understand anecdotally that it was not picked up in England either under similar regulations, but nonetheless it remains a concern of ours based on what developers in Scotland say to us.

The Convener: I will open it up to colleagues around the table, but I have a final question for Derek Thomson and Liz Cairns. You said in response to question 3 that

> "Unite would argue that there is a deliberate lack of clarity on whether trade unions will be able to access and organise workers operating within the zones, and to bargain with employers over pay, terms and conditions."

Who do you think is responsible for that lack of clarity?

Liz Cairns: One difference between the freeports in England and the green freeports in Scotland is the ability to have an effective voice, which was mentioned specifically in relation to trade union engagement. Signing up to the business pledge was raised within that, but we know that the business pledge has failed. The last time that I looked, 0.4 per cent of registered businesses had signed up to the pledge, which is something like 700 businesses.

The voluntary arrangement for businesses to be fair to workers will not happen at these sites. It does not happen generally, but it is less likely to happen at these sites. If you deregulate and give incentives to organisations, the last thing that they will do is dish out any of that. The employees are unlikely to benefit from any of that.

As I said earlier, we also feel that the £25,000 cap will be used as a comparator to suppress wages generally beyond the region. Businesses might come up with creative ways of paying more than £25,000 that do not go through the normal routes to attract some workers, but we think that the £25,000 cap will suppress wages not only within the green freeport area but externally.

The Convener: Colleagues will press some of those issues further as we progress through the meeting. I do not want to hog the whole meeting. The first colleague to ask questions will be Ross Greer and he will be followed by John Mason.

Ross Greer: I go back to the convener's original line of questioning about displacement and the request for evidence. The theory behind freeports has been tested in the UK. In the 1980s, freeports were one of Thatcher's signature economic policies, and studies have been done on displacement as a result of freeports. I think that the study that I am looking at just now is regarded as the major study in this area but I could be wrong about that; I have certainly seen higher figures. Larkin and Wilcox's 2011 study said that there was 41 per cent displacement—that is, 41 per cent of the jobs in the UK's freeports of the 1980s were not new jobs but were displaced from elsewhere.

David Melhuish, you acknowledged that there will not be 100 per cent new jobs at the freeports and that there will be some level of displacement. Would 41 per cent displacement be unliveable? Would that be satisfactory, or would it be too high a rate of displacement if we saw that happen again this time round?

David Melhuish: We are in a very different economic environment, are we not? The labour market is a lot tighter than it was in the 1980s when there were very deep industrial recessions and so on. I would not anticipate a 41 per cent displacement.

Displacement could happen in many ways. Could people be going to better jobs and a better location? There are other factors that could be argued might be positives. However, given that we are focused on trying to create new jobs here, there would be some disappointment with such a level of displacement.

Ross Greer: One of the growing areas of economic inequality in Scotland is between east and west. Given the location of the freeports, a lot of concern has already been expressed, particularly by local authorities in the west of Scotland, which are already dealing with significant challenges of deprivation and depopulation. I take Inverclyde and Argyle and Bute as examples. They are concerned that, as a result of the expected economic displacement resulting from the freeports, there will be further depopulation and less investment in the economy in the west of Scotland, which has already seen far lower growth and income, for example, than the east coast.

Would it be of concern to the Scottish Property Federation if we saw further displacement from west to east aggravating those existing inequalities?

David Melhuish: The SPF is a Scotland-wide organisation, so we are there to encourage investment across the country. Look, I am aware of this. I am also aware that Cromarty and Edinburgh got picked for the green freeports and Glasgow and Aberdeen got the innovation zones, and that Dundee was not happy at all because it is on the east coast and did not get either. We are aware of those considerations, but I would like to think that, because we are boosting new jobs, we are looking to boost the economy overall.

In the west, the area around Glasgow has a hugely diversified economy and it is already attracting a lot of investment from our industry. Other forms of investment, particularly based on the strength of its universities, will come to the Glasgow area.

Yes, it is something to keep an eye on—

Ross Greer: Surely those other forms of investment will, inevitably, be drawn to the east and the north now. I accept that you are saying that there are strengths to greater Glasgow's economy—of course there are—but the depopulation and relative growth in income and earnings show that there has been a clear shift from the west to the east. Do the freeports not just exacerbate that to the disadvantage of your members in the west?

David Melhuish: You are talking about a long-term trend, but there are other initiatives that will balance things out. Glasgow is still the greatest population centre in the country. There are, as we speak, around 2 million people in the area. As I have said, with some of the other initiatives at play, including the boost for manufacturing, advanced manufacturing innovation districts—or AMIDs—and so on as well as the growth that the city is trying to push and turn around in the city centre itself, I think that, in the long term, there will be opportunities in the west and the east.

However, they might well be different opportunities, because what will go into the freeports will be very business specific, will it not? It is therefore difficult to draw broad generalisations, and the trend that you have talked about has been apparent to factors for some time now. The only answer that I can give at this stage is that I do not necessarily think that this move will necessarily exacerbate things; it is all crystal-ball gazing, to a degree, but I think that other initiatives and investments in areas to the west—and further up to the north and north-east—will help to balance things out.

Ross Greer: I get why you say that, but given the evidence that we have from the last time that the UK tried freeports, the massive displacement that happened then and, indeed, the gap that we already have between the east and the west, it is reasonable to see this as a risk that, at the very least, needs to be mitigated.

I am interested in the part of your written submission where you talk up the fact that investments in the freeport zones

"will meet strict environmental and social ... criteria",

which will mean not just economic benefits but wider social and environmental benefits. However, going back to what Liz Cairns touched on a moment or so ago, I understand that, although the tax incentives are very clear and have been laid out in the statutory instrument, a lot of the environmental and social criteria ultimately depend on voluntary agreements. Is there not a significant risk that organisations that invest might fulfil those environmental and social criteria for the first few years and then not do so over the long term? After all, there is no way of guaranteeing they will do so, because there is no clear enforcement mechanism in the instrument to ensure that the criteria are met in the long term.

David Melhuish: It is my understanding that the proposals were accepted on the basis that those commitments would be maintained—indeed, that is what is behind that bit of our written submission—but the governance arrangements that are in place for both proposals relate not just to the private sector. There is public and private involvement, so I think that accountability is being built in from the outset.

I am sorry—I do not know the details of the 1980s arrangements, so I do not know if that was the case then, but I would argue that this feels different, both economically and governance-wise.

That would be our reply to that question at this stage.

Ross Greer: I have a final question for Derek Thomson and Liz Cairns. Going back to a question that the convener asked, I note that your submission mentions

“a deliberate lack of clarity”

particularly on union access to workers in the freeport zones. I think that the word “deliberate” is really charged, so can you say a little bit more about why you think this is deliberate rather than just an oversight or something that neither Government is prioritising? Do you think that there is a deliberate attempt to leave the fair work stuff pretty vague while pressing ahead with the tax breaks, and, if so, what makes you think that?

Derek Thomson: History makes us think that, when we are talking about such levels of investment. For us, sustainability needs to be built in; if there are going to be new jobs, protection has to be built in for workers, and that should be laid out from the very start. Any bidding process or procurement policy should build in protection for workers, and we are not seeing that in any way, shape or form.

With all due respect to everybody here, and to David Melhuish, I have to say that history tells us that when this kind of new business or investment starts, the worker is generally the one who gets left behind the most. In particular, when tax relief is given to people coming into these big zones, our experience is that the person who pays the most is predominantly the worker, because they have no health and safety rights. That is why we are asking for some of these things, including the fair work stuff, to be built in.

I can give you an example. When one of our deputy regional secretaries met the City of Edinburgh Council to discuss the freeport issue, they got very little from it about anything. There was no consultation; we had to ask probing questions. We are having to ask for information—it is just not forthcoming.

That is one of our bigger issues with the initiative. We are generally supportive of the jobs involved, but how are we supposed to support such an initiative without workers’ protection and rights or health and safety being built in or without built-in procurement policies that will allow us to ensure that it is properly funded, that people get proper wages and that it is not done on the cheap? We want something more concrete in any bids or proposals for it.

Liz, do you want to add to that?

11:30

Liz Cairns: Yes. In the absence of any devolved employment law, the only thing that we can ask the committee to hear relates to procurement. The sort of money that we are talking about on procurement is a way for the Scottish Government to lay down the rules.

We should have been at the table. We feel that we have been put behind the curve. We are not being listened to when we get opportunities. That is why we have come to the committee.

You can tell that we are not tax experts. The earlier conversation with Professor Roy about fiscal situations was over my head. However, we have been given an opportunity to put forward our position with regard to the lack of consultation with trade unions generally and the lack of engagement with trade unions on the issue. We are not at the table.

It is unfortunate that the Scottish Trades Union Congress cannot be at today’s meeting as well. It would be able to reiterate a lot of what we are saying not just from the perspective of our union but from the perspective of other unions and affiliates of the STUC that have concerns.

Employment law has not been devolved. Procurement is an opportunity. Public money is going into the freeports and green ports and we should have a bigger say. If effective voice means something and if fair work means something to the Scottish Government, it has to bring us on board and listen to what we have to say.

Our members are concerned, and we are here to represent them. They are more than 140,000 workers and they want their voices to be heard. They need to know that their concerns about the matter are heard. Those can be put into a paper, but we need to be at the table. Evaluation and monitoring are important. We need to look at when the decisions are made and who made them. Who made the decision not to include trade unions rather than to include them, which we want to happen?

Ross Greer: You have given us plenty to ask the minister when he comes to speak to the instrument.

John Mason: We have covered quite a lot of ground already. On the timeframe, five years seems quite short, Mr Melhuish. Even seven years seems quite short. Clyde Gateway, which is in my constituency, is looking at a 10-year timescale for filling up a development.

What are the risks on the timescale? Is it that nobody will be interested to start with because it is too short, or is there a danger that people walk away after the five years?

David Melhuish: The up-front danger is the one that you identified: that, as alluded to earlier, people might look at the initiative and think, “Well, if we’ve only got a few years to get everything in place, it might simply be too short.” We have members with single buildings that can take eight or nine years to develop because of the complications that are involved.

The timescale is short. We discussed the proposal for seven years with our members. We realise that the timescale could not be open ended because, at some stage, the Government will want the new economic transactions to start delivering the full revenues that are anticipated in time. However, the fear is that it is too short a timescale for a major investment to fully deliver on its potential. That is our concern.

John Mason: Would seven years make a difference?

David Melhuish: We think that it would. I accept that longer would probably be more beneficial given the fact that, as I explained, individual projects can take eight or nine years. We tried to strike a balance at seven years. People felt that it would add a little bit more time for investors to make progress but that, at the same time, the Government might not regard it as too open-ended.

John Mason: I will ask you my other question then come back to the Unite folk. I think that the Scottish Fiscal Commission has said that the impact will be less than £5 million in lost LBTT. Therefore, it is not commenting further because that is a relatively small amount compared with the whole Scottish tax take. That £5 million of lost LBTT is fairly definite, whereas any money coming in is fairly uncertain. Does it concern you that, if we go ahead with the scheme, public services will have to face a cut to match that?

David Melhuish: No. I recognise the Scottish Fiscal Commission’s expertise on the matter, but this is about making things happen that are currently not happening. That is probably where we are coming from. In the longer term, even when the buildings are built, they will change over, new tenants will come in and tax will be paid at that point. New buildings will be replaced and created on sites once there is critical mass and success of investment, which might be beyond the seven years that we are asking for. There will be more LBTT in the long run, because the intention is to get new investment into places where that is not currently happening.

John Mason: I have the same two questions for Mr Thomson. Are you concerned about the timescales, or is that not a factor for you?

Derek Thomson: For us at this stage, it is probably the longer the timescale, the better—getting things right is where we want to be. I alluded to the Scottish Government needing to consider the issue in more detail. I know that you will question the minister on that later, but the implications of what we are discussing here worry us even more in relation to new jobs, because nobody can tell us what those new jobs will look like. We will have to have a serious think about how—I am sure that we will be back in front of a committee at some point on just transition—the effects of the movement of work under just transition will impact new jobs. We want to get much more involved in the talks on the issue, but that longer period is not a concern for us.

You mentioned cuts to public services and tax revenue coming down. That will be a massive concern, as we have spoken about, in relation to displacement. There is an on-going issue with the amount of tax that is coming in due to the stagnation of wages, and that must be recognised in relation to where the money for investment is coming from.

On public services, we obviously represent public sector workers, and our fear is that more money will be taken out of that sector and pushed into different areas; that is a concern. I take it back to the same issue, which is that, if we create good new jobs, they have to be well-paid jobs. Well-paid jobs bring more taxation into the country and generate wealth in local economies, but we cannot do that at the expense of the areas that will experience displacement. As Ross Greer says, we will have real concerns in some of those areas.

Michael Marra: I will focus on the application process. I hear evidence so far of a globally acknowledged problem around special economic zones, special export zones and their impact on workers’ terms and conditions and their rights in those areas. I turn to Unite first. How important is it to have a transparent process of application and evaluation for such schemes?

Derek Thomson: That is critical for us to reassure our members and ourselves, and for the Scottish Government to reassure itself, that things are happening. We want to see a clear process in relation to how the tendering started, and who has invested, their investment history, their portfolio across the rest of the economy and their history in terms of jobs, pay and conditions for their workers. It is like asking for due diligence to be done on investors to make sure that, when they come in and invest in the Scottish economy, they are not only investing in the Scottish economy but in the Scottish people and its workforce. That is really important for us.

On evaluation, there are two things to say. There is an evaluation of how the economy is progressing in relation to LBTT, which we are talking about here. However, for us, the evaluation should be whether such schemes bring what is required into the economy. That is one of the critical questions that we need to ask ourselves.

If we are talking about green ports and investment in new green jobs and new technology, we need a fair analysis of what those jobs will be. I made a joke earlier about green jobs and somebody flying about on an electric scooter delivering food for Deliveroo, but, at this time, we do not know what a green job looks like. There is no definition of what those jobs will be that enables us to make a comparison.

We do not want new jobs thrown into freeports and green zones just for the sake of those being new jobs; a new job must be valuable and it has to contribute to the economy. We hope that they are proper new green jobs, that they contribute to the just transition and that they address the country's future economic and environmental needs.

Michael Marra: In essence, this is about spending public money; that is what we are involved in here. Do you have confidence in the evaluation process for those bids?

Liz Cairns: Not really, no. Not enough has been done on being transparent about how the bids have been delivered and who is involved in the bids. We at Unite are doing our own mapping to find out who is already in those areas and look at what existing companies might be attracted to such schemes.

More work could have been done to make the process much more transparent. Trade unions and the STUC could have been involved in order to alleviate any concerns that we might have. Instead, we have to come to you to express our concerns, because we do not feel as if we have been involved in the process.

Michael Marra: The essence of the Scottish Property Federation's submission is a concern about whether the plans can be delivered, and you mention the timeframe. How robust does the evaluation of applications have to be in order to make sure that we can deliver them? Do we need a robust process to evaluate the plans that are put forward?

David Melhuish: I agree that the process needs to be robust. Part of the reason why we raised concerns about the timescale for when reliefs will kick in was to do with the partnerships that were being put together as part of the bidding process, although they are already strong. They have been appointing chief executives, managing directors and others to drive forward the plans. I would trust the people on the ground; there are strong partnerships between local authorities and the investors and businesses involved in those areas, and the Scottish and UK Governments have been involved as well.

There is quite a strong organisational process, which should lead to robust scrutiny and accountability, but you are talking about giving reliefs, and we have talked about the issues there. I expect that this committee and others will keep a close focus on progress.

Michael Marra: Would it be acceptable to your organisation to have a process that had no published criteria or advertised application route, and for those decisions to be taken behind closed doors?

David Melhuish: In relation to appointing the successful bids or as we go forward?

Michael Marra: To appoint the successful bids.

David Melhuish: The issue with appointing successful bidders is that it was always going to be a decision made by the UK and Scottish Governments. It is inevitable that there would be sensitivities around that.

Anecdotally, having talked to some of the officials behind the UK Government's freeports prospectuses back in the day, I know that they were very impressed with the prospectus that was put together by the Scottish Government, and they thought that it had picked up on some lessons. I think that it had picked up on some of the lessons from history that we have talked about. That process was good.

Michael Marra: There was a process and a prospectus there, but would it be acceptable to spend public money in the absence of a process and a prospectus?

David Melhuish: No. It is about giving a fair chance to bidders around the country, so that prospectus was helpful.

Michael Marra: That is a point well made. I put the same question to Unite. Would it be acceptable to spend public money without an application process?

Derek Thomson: No. The process would have to be fair and transparent.

Liz Smith: Mr Thomson, you have been excoriating in your criticisms of the situation as we face it. In section 4 of your submission, you say:

> "We find this attempt to lure businesses to these sites on the back of taxpayer funded tax breaks abhorrent".

That is pretty strong language. Do you actually believe in the concept of the green port, or do you think that the aims and objectives could be achieved by another means?

11:45

Derek Thomson: We are not opposed to freeports and green ports at this stage, but it all depends on what comes out of discussions such as the one that we are having today. As you have rightly said, these discussions are being had in different areas the length and breadth of the UK, and we are dealing with the Scottish side of it.

Obviously, we welcome the investment in up to 75,000 jobs and what that will bring in terms of new skills, what it means for taxation issues and so on. It will be critical in building local economies. However, the idea that we should just bring them in and give them tax relief without their giving anything back is something that we just cannot agree with.

That brings us to the issue of proper pay, proper terms and conditions, proper health and safety legislation and a proper procurement process that is open, fair and transparent and which does not just throw money at something. I am sure that youse have been at many committee meetings where you have heard the horror stories about public procurement and where the funding has gone; you need look only at some of the stuff that goes on in the health service under the health and social care partnerships, where it can cost £150 to change a light bulb in different areas. We do not want to see those things happening again, so we want to ensure that the trade union—the effective voice that Liz Cairns referred to—is there from the beginning.

However, I fear that this could end up with our just handing over money and tax relief to big business. When we start moving businesses into these areas, they become almost deregulated or unregulated in a way that, for us, potentially opens up a can of worms. Going forward, we want assurances that there is proper health and safety regulation in those areas and that the procurement, the construction work and so on are open and honest from the very start and follow proper employment law.

Liz Cairns referred to employment law in Scotland, and I hope that our union is pushing very hard to try to make all this happen. I hope that that will give us more protections, but what we find abhorrent is giving money over and getting nothing back.

Liz Smith: Thank you.

The Convener: I call Jamie Halcro Johnston.

Jamie Halcro Johnston: Good morning. I should say that I supported the Cromarty Firth bid; that is not a declaration of interest or anything, but I think that it important to say that. Ross Greer talked about the east-west divide, but there is also the north-south divide, and undoubtedly there is an important need to invest in remote and rural areas, particularly across the Highlands and Islands.

My first question is for Derek Thomson and Liz Cairns. You have talked about not being engaged in the process and have said that you are not sure what green jobs are—I do not think that you are the only ones to find themselves in that position—but what engagement have you looked to have or have you been having with the two successful bids from Port of Cromarty Firth, Global Energy Group and Port of Inverness as well as, obviously, the consortium led by Forth Ports?

Derek Thomson: Most recently, we met the City of Edinburgh Council. We are trying to engage on those areas, but as I have said, what happened in Edinburgh was null and void.

I think that there is a lack of understanding out there about the engagement—the negotiation and stuff—that has to happen. That is why we keep reiterating that we want to be in at the beginning so that we can discuss workers' issues as these things come in. We might not be at the stage of boots on the ground, but it is important to set a standard.

Liz, did you want to come in?

Liz Cairns: I was just gonnae say that we have a number of members at Forth Ports; in fact, we have a very organised workforce that is pushing these issues. However, it is pushing at a different level from where the decisions are being made about the bids coming in et cetera. It might be happening at a low level, but we are having discussions with our members in Forth Ports; it is just not happening at the point where the decisions are being made about who will make the investment, whose bids will be accepted and so on.

We want to be in from the beginning, and we want to make our voice heard when people talk about which companies are coming in. We have had situations, particularly in construction, in which a number of very large organisations have been involved in blacklisting. Are they gonnae be in there getting public money again after they have had to pay money back to workers who had been blacklisted? We need to be more mindful of that.

We have some of the answers that require to be heard, but we are not being asked. That is frustrating for us.

Jamie Halcro Johnston: I recognise what you say about wanting to be there from the beginning of the process and be part of that decision making. This is a devil's advocate question, really, but do you not see value in that engagement even now, with the two winning bids—the two consortiums—at least around getting that information to them and ensuring that they are aware of it all?

Liz Cairns: Absolutely.

Jamie Halcro Johnston: Have you tried to do so?

Liz Cairns: No, not in my capacity; however, if there were opportunities to do so, we would take them up. We are trying to do our own mapping, because we cannot get the information that we need to know. If our conveners at those sites cannot get that information, where can we go? That might be something that we can take up—

Jamie Halcro Johnston: I understand the point that you are making and the arguments that you have made previously, but it does not sound at this stage that you have asked either, so that might be an area in which to start.

Liz Cairns: It does sound as though we are coming here to say that we are not being listened to while we have actually made no attempt to try to get heard, but we are not being heard at the level at which we need to be heard. We are contacting people and saying to them, "We need to be heard. Can we get a meeting?" and those sorts of things, but we need to pursue that because time is moving on. Bids are being accepted and funding is being given to organisations already.

Jamie Halcro Johnston: It would be interesting, from our point of view, to be updated on how that engagement goes.

Derek Thomson: We will pursue that.

Jamie Halcro Johnston: I was pleased that the Cromarty Firth bid was successful, but one of the issues that we all recognise is that a huge amount of other investment is needed, in infrastructure for example. Transport infrastructure in the Highlands is not particularly good, and housing will be needed if those jobs are created and people move to those areas. David Melhuish, how important do you feel that that could be?

David Melhuish: Very important is the short answer. Clearly, the Highland Council is closely involved in the bid and has a track record of success in taking forward a lot of initiatives, which should give us some encouragement in the process. However, I agree entirely that it will be important to build the infrastructure that people will need to make those areas a success.

Jamie Halcro Johnston: Obviously, a lot of work still needs to be done, given that the bids have only recently been successful, but do you think that, at the moment, the UK Government, the Scottish Government and local government are working together enough on delivering the peripheral infrastructure? I say "peripheral", but perhaps it is also key.

David Melhuish: Highland Council is already progressing long-term development plans, and there is a related city region deal process as well. For us, it is very noticeable that the Department for Levelling Up, Housing and Communities, for example, is much more on the ground and active around the country than it perhaps was a few years ago.

The Convener: Thank you very much. That concludes questions from the committee. Are our witnesses happy to make any further points to the committee on something that has not been covered? If you feel that we have not asked anything that you would like to mention, now is your chance.

Derek Thomson: I would like to reiterate a couple of points that we skipped over. First, we would be hoping for direct employment—no zero-hour contracts in those areas that have work. It is really important to ensure that the community and local areas are developed—you talked about the housing of people who will need to move—and to ask, if jobs are displaced, how that affects the local community.

Secondly, one of the key things for us is to ensure that the products, the concrete, the steel, and whatever is used in what is done in the freeports is all manufactured in Scotland. Money in those areas needs to be used for things that are built in Scotland. It needs to become a proper economy and not about selling things off, which is what is happening with the wind turbines—we are importing everything from another country when we could be building them here.

On some of those issues, I get a feeling that we are running before we are walking. A massive change is coming under the just transition; there will be an environmental impact and an impact on productivity and manufacturing, and things will need to get done.

With freeports, in our view, there is an opportunity to get something right from the beginning—to get the right legislation; ensure that the manufacturing is done in this country and that the jobs are kept here; and ensure that everything is done reasonably and above board, gives a proper boost to the economy and is not just about shoehorning things in because we want to try to create a bit of a boost in the economy. For Unite, there is a longer-term thought process when it comes to this, and we hope that you consider the wider economy issues that will come alongside freeports. The just transition agenda will have a massive impact on freeports and the biggest impact on our economy in any generation, and I hope that those points have been taken on board.

Thank you very much for your time.

Liz Cairns: I want to mention skills training and apprenticeships in those communities. It is important to put in place proper facilities in order to create jobs for the next generation. We have talked about not having the green jobs, but what are the green jobs? There were green jobs in Machrihanish and they have gone, which was devastating for that community. We cannot have jobs that were there and are now lost.

We need to ensure that there is a future for our young people, and that skills training and robust apprenticeships—where real training on renewables is given—are put into the green ports so that they will not be unsuccessful in five years, which would mean that people would move. We have seen in other areas in Scotland that organisations come into a place, extract every part of public funding that they can get and then leave—we cannot have that happen. We need to leave a legacy and ensure that freeports, if they do anything, offer a future. Real opportunities exist, especially in areas such as the Cromarty Firth and the Highlands and Islands, to get sustainable jobs for young people, which will stop a movement out of those communities to the central belt, for example. It is about ensuring that a proper skills training and apprenticeship agenda exists within green ports.

David Melhuish: Going back to the displacement question, although we firmly believe in additionality, new businesses and, in the long term, new revenues and so on coming from green freeports, not all displacement is necessarily bad. If freeports help to retain some of the 50,000-odd fossil fuel-related jobs in the north-east that are facing decline or loss, I would like to think that that element of retention—even if it is displacement—would be seen positively, because we would be retaining those jobs in Scotland instead of losing them elsewhere.

The Convener: Thank you very much for those final points, which are much appreciated, and for taking the time to give evidence to the committee. We will continue to take evidence on the draft order next week when we will hear from the Minister for Community Wealth and Public Finance and take a decision on whether we ought to approve the order.

That concludes the public part of today's meeting. The next item on our agenda is consideration of our work programme.

11:58

Meeting continued in private until 12:05.

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