OFFICIAL REPORT
AITHISG OIFIGEIL

Finance and Constitution Committee

Wednesday 7 February 2018

Session 5

The Scottish Parliament
Pàrlamaid na h-Alba

Wednesday 7 February 2018

CONTENTS

Col.

SCOTTISH FISCAL COMMISSION (REVISED FORECAST) 1
BUDGET (SCOTLAND) (NO 2) BILL: STAGE 2 15
LAND AND BUILDINGS TRANSACTION TAX (RELIEF FROM ADDITIONAL AMOUNT) (SCOTLAND) BILL: STAGE 1 35

FINANCE AND CONSTITUTION COMMITTEE
5th Meeting 2018, Session 5

CONVENER

*Bruce Crawford (Stirling) (SNP)

DEPUTY CONVENER

*Adam Tomkins (Glasgow) (Con)

COMMITTEE MEMBERS

*Neil Bibby (West Scotland) (Lab)
*Alexander Burnett (Aberdeenshire West) (Con)
*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
*Ash Denham (Edinburgh Eastern) (SNP)
*Murdo Fraser (Mid Scotland and Fife) (Con)
*Emma Harper (South Scotland) (SNP)
*Patrick Harvie (Glasgow) (Green)
*James Kelly (Glasgow) (Lab)
*Ivan McKee (Glasgow Provan) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

John Ireland (Scottish Fiscal Commission)
Derek Mackay (Cabinet Secretary for Finance and the Constitution)
John Nicholson (Scottish Government)
Professor Alasdair Smith (Scottish Fiscal Commission)
David Stone (Scottish Fiscal Commission)
David Wilson (Scottish Fiscal Commission)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Finance and Constitution Committee

Wednesday 7 February 2018

[The Convener opened the meeting at 10:03]

Scottish Fiscal Commission (Revised Forecast)

The Convener (Bruce Crawford): Good morning and welcome to the fifth meeting in 2018 of the Finance and Constitution Committee. I remind everybody present to switch off their mobile phones, or at least to put them into a mode that will not interfere with our proceedings.

Agenda item 1 is an evidence session on the Scottish Fiscal Commission's revised forecasts, which were produced following policy changes that were announced last week at stage 1 of the Budget (Scotland) (No 2) Bill. We are joined for this session by Professor Alasdair Smith, who is one of the commissioners; David Wilson, who is also a commissioner; John Ireland, the chief executive; and David Stone, the head of economic and income tax forecasting. I warmly welcome our witnesses to the meeting. I think that Professor Smith wants to make a short opening statement.

Professor Alasdair Smith (Scottish Fiscal Commission): Yes, thank you. Good morning. We are grateful to have this opportunity to discuss our updated income tax forecasts following last week's stage 1 debate. As you said, during that debate the Cabinet Secretary for Finance and the Constitution announced a number of changes to the budget bill that had been based on the draft budget published in December. Those changes included a reduction to the higher-rate threshold for income tax, an extension of the Government's public sector pay policy and a number of additional expenditure commitments totalling £137.8 million in 2018-19.

Last Wednesday, the Scottish Government published its provisional estimate of the additional revenue of around £220 million in 2018-19 from the income tax policy. That is the income tax policy in its entirety. It includes an additional £55 million, which is associated with the reduction in the higher-rate threshold.

The Government noted that the Scottish Fiscal Commission would provide the official revenue estimate, and that is what we did yesterday afternoon when we published a supplement to our December forecast. That timing was agreed with the Parliament and the Government before Christmas. The written agreement was published on our website.

The Government's final income tax policy is forecast by the commission to raise £219 million in 2018-19, which is £55 million more than the policy that was announced in December. In addition, the extension of the Government's public sector pay policy is forecast to raise a further £7 million in income tax revenues.

We have been told that the cabinet secretary intends to put it on the record at stage 2 that the additional spending will be funded from tax revenues plus a combination of Scotland reserve drawdown and underspends. The Government does not intend that the additional expenditure that was announced by the cabinet secretary will require additional borrowing or impact on the position of the non-domestic rates rating account, which is also known as the NDR pool.

In light of the announcement, we see no need to change our December assessment of the reasonableness of the Government's borrowing plans. Our next forecast will be published in the spring to accompany the proposed medium-term financial strategy focusing on the longer-term sustainability of Scotland's public finances. In May, we will review both our assessment of the reasonableness of the Government's borrowing projections and its scope.

That is all I want to say by way of introduction. We look forward to your questions.

The Convener: Thank you. That was a very helpful introduction. We are also very grateful for the Fiscal Commission's ability to turn round its forecasting so quickly, given that stage 1 of the bill was completed only last week.

Your report suggests that the extension of the 3 per cent public sector pay award from those earning more than £30,000 per annum to those earning up to £36,500 is expected to generate an additional £7 million of tax revenues in 2018-19, rising to £8 million per annum by 2022-23. How did you arrive at that figure of £7 million?

David Wilson (Scottish Fiscal Commission): May I ask David Stone to talk you through the detailed modelling on that?

The Convener: Yes.

David Stone (Scottish Fiscal Commission): Our starting point for those forecasts is the survey of personal incomes, which provides detailed income tax payer data sets. That allows us to identify individuals who we think are working in the public sector. We take the detail of the Government's extension to the public sector pay policy and, using information provided to us by the Government, work out the number of people who are in the scope of that 3 per cent pay award and the number of people who are in the scope of the 2 per cent pay award.

We then have a specific adjustment for public sector pay in our income tax model. Using the information that we were given, we saw that in 2018-19, before the extension, public sector pay would have increased by an average of 3.2 per cent; with the extension, that average increase is now 3.3 per cent. Running those two numbers through the model and finding the difference gives us the £7 million figure. We increased the total amount of income tax liabilities in 2018-19 by the £7 million difference that was introduced by 3.3 per cent growth versus 3.2 per cent growth.

The Convener: Can you unwrap what you mean by "public sector"? Does that include people in local government or those parts of the public sector that are not under the direct control of Scottish ministers, or do you identify the public sector as a whole?

David Stone: We have to use the data that we have, which is the survey of personal incomes. There is a broad sectoral classification for each individual in that database, which can be things like healthcare, education or finance. We look at that list of sectors and work out for each of them whether the workers will be primarily public sector or primarily private sector. That gives us our breakdown in our data set between public sector and private sector.

For those sectors in the model that we identify as having primarily public sector workers, we apply the public sector wage growth rates; we work those out in a separate exercise, based on information that the Government gives us.

The Convener: Can I delve a wee bit deeper into that? If we are then looking at the public sector, the issue of the 3 per cent public sector pay award being extended to those earning up to £36,500 can only really affect the core bits of the Scottish Government that it is responsible for.

David Stone: Yes.

The Convener: How do you account for the difference between that core group and others in the public sector? How do you deal with it methodologically? That is what I am really asking.

John Ireland (Scottish Fiscal Commission): In a sense, the Government is very clear about who its pay policy covers. You asked about local government, and the policy does not cover local government apart from teachers. We use the information that the Government gives us on the scope and we can, therefore, make an appropriate estimate of the size of the coverage of the pay policy.

The Convener: Patrick, do you want to follow up on that?

Patrick Harvie (Glasgow) (Green): Yes. I am not sure that I quite followed the answer to the convener's supplementary question. Are you saying that you have made a judgment on who is directly covered in the Scottish Government's pay policy and that the £7 million projection of additional income tax revenues is about those people who are directly covered by that pay policy?

John Ireland: Yes, that is correct.

Patrick Harvie: If local government achieved a similar pay policy, or perhaps even something better, would that generate additional income tax revenues on top of that £7 million?

David Stone: Yes. We did not include local government in the scope of this.

Patrick Harvie: That is helpful. I want to ask about the process and protocol that has gone on over the past few days.

The Convener: Let us cover the behaviour stuff before we move on to the process. We will try to get through all the issues about the numbers first.

Alexander Burnett (Aberdeenshire West) (Con): I have a quick question on the behavioural response. Were you surprised that the cost of it is almost 20 per cent of the additional amount raised? Was there an anomaly between the decreases from behavioural responses in the top two rates and the number of taxpayers in those rates, which you say will increase over the next five years? Is there an anomaly, in that you have revenue on that reducing but numbers of people increasing? Can the behavioural response be broken down into people who will manage their affairs differently but remain in Scotland and people who will actually leave because of that?

David Wilson: The overall approach that we have taken to costing the new approach that the Government announced at stage 1 is exactly the same as the approach that we took back in December. That is the key thing to emphasise. As you put it, it may look as though the behavioural impact of the change in policy is much less than the behavioural impact of the initial policy that was announced back in December; that reflects the particular nature of the announcement.

Our overall approach recognises that when there is a change—for example, to the additional rate for very high tax payers—that is likely to be an incentive to adjust tax affairs for many people who might have the ability to do that. That is reflected in our modelling approach, which leads to the reduction between the static impact, as we call it, and taking into account a behavioural impact.

The new proposal and the adjustment in the personal allowance will affect a large number of people, but it will do so in a relatively limited way.

The Government's numbers are that it will, in effect, increase the tax payment by around £170. We do not expect that to have a very significant behavioural impact compared with the initial proposal. The incremental behavioural impact of the new proposal over what was announced in December we would expect to be more modest, based on the assessment that we have made.

10:15

Ivan McKee (Glasgow Provan) (SNP): I would like to touch very briefly on the behavioural stuff. I may also follow up on the issue about local government in order to get clarity on that and the wider public pay impact. I thank the witnesses very much for coming along and for the excellent work that they have done on this.

I am looking at table 10 in your updated income tax forecasts. If I have understood it correctly, you are saying that you would have expected—on the static costs and the Government's recent changes to the threshold—to have raised £61 million, but that you are losing £5 million of that because of behavioural impact. It is something less than 10 per cent. Is that correct?

I would like to clarify a point that was made earlier. The reason for that figure being lower than your previous forecast is that the change hits a number of people who are in the range of the £43,000 or £44,000 threshold and who are the most likely not to be able to change their affairs dramatically. It hits a lot of people, but it hits them to such a small extent that you do not expect it to drive any change in their behaviour. Is that assessment correct?

David Wilson: It hits them by a fixed amount. If someone who is earning over £150,000, for example, reduced their time worked or slightly adjusted their affairs, the maximum amount that they could save would be limited. It is the difference between an average tax and a marginal tax. We would not expect the behavioural impact to be anything like as great as, for example, the impact of a change to the additional rate of tax.

Ivan McKee: Have you done that using the numbers that you gave us before for the tax income elasticities, which were 0.35 up to 0.75 per cent?

David Wilson: It is the same approach—the same model.

Ivan McKee: Thank you for clarifying that.

The convener and Patrick Harvie asked whether the assumption of £7 million in tax revenues applied only to Scottish Government employees or to the broader public sector. I think you said that teachers were included in that, but not other workers. If the increase was applied across the piece, and if local government and others awarded those increases as well, how much extra would that raise over and above the £7 million? Can you quantify that?

David Stone: To clarify, we got advice from the Government on who would be included in the scope of the policy; it also told us who it believed would be aligned with this policy. The Government said that that would include around 260,000 public sector workers, and that would include the national health service, the police, the fire service and teachers. It is up to the Government to clarify exactly who the pay award will cover, but that is the advice that we received. It covers around 260,000 public sector workers in Scotland out of a total of—I cannot remember the figure—400,000 or 500,000-odd. It applies to a fair chunk of all individuals in the public sector, and then we break down the increases in pay for that group.

Ivan McKee: Based on what you have just said, that sounds as though it applies to roughly half.

David Stone: Yes, but it does not apply to local government. Local government workers are excluded from that 260,000 figure.

Ivan McKee: Correct, so the £7 million will become a number that may be double that. I am trying to see whether you can quantify that number for us in any way, shape or form.

David Wilson: We have not done that quantification because it is not stated Government policy that the increase will apply to local government.

Ivan McKee: Okay. That is clear.

David Wilson: If all local government employees were to receive that level of pay award, those would be the order of magnitude numbers. However, we have not done that quantification.

Ivan McKee: That is clear. It could be double, give or take. Thank you very much.

The Convener: That whole process becomes even more difficult to make a judgment on because of the number of United Kingdom civil servants who are employed in Scotland. We do not know yet where they will be in terms of the final pay position. UK civil servants might not achieve the same levels as individuals who are directly affected by the Scottish Government. The picture is pretty complicated at this stage.

David Wilson: Yes, it is a complicated picture. Estimates could be made but, to be clear, that is not an estimate that we have made or which would be within our broad remit to make.

The Convener: That is fair enough.

Patrick Harvie: On the behavioural effects, you have stated:

"The greatest behavioural response comes from those in the higher and top rate bands."

In discussion with Ivan McKee, I think that you agreed that there is likely to be a larger effect at the highest end of the income scale, but you are still saying that the higher-rate band is where the greatest effect will be. What is the evidence base for the extent of the effect of behavioural changes around tax avoidance at the higher-rate band? In particular, I am thinking about the bulk of higher-rate taxpayers who may be at the bottom end of that range. On what evidence have you based your assumptions?

David Wilson: We set out in our papers that were published in December—we also published an earlier paper—our overall approach to forecasting income tax. There is academic literature that sets out the experience of countries and areas that have—as far as such comparison is possible—comparable variations in income tax, but that literature is far from comprehensive or definitive in terms of the conclusions that can be drawn from it.

The principal source of analysis—or the best example that we draw on—is the work that was done by Her Majesty's Revenue and Customs going through the experience of the change to the higher rate of tax in 2010 to 2012 in the UK, when there was an increase to the 50p rate of tax that was subsequently removed. That experience has enabled people to assess the likely behavioural impact. HMRC published in March 2012 an assessment that I think has been quite influential on how people think about behavioural impacts. The Institute for Fiscal Studies has also subsequently produced assessments.

I will quote from the HMRC study, which I think is quite informative. One of the key things that it says in its conclusion is that

"Behavioural responses to tax changes are often large and highly uncertain."

That is our starting point: we should expect, especially for higher-rate taxpayers, a large behavioural effect, but the precise level and impact will, inevitably, be uncertain. A conclusion of the assessment of that experience was that there was

"considerable behavioural response and a substantial amount of forestalling".

We have attempted to take advantage of work that has already been done. We have developed an overall approach, which we have published. We have stated what our approach is to behavioural response through tax income elasticities, and we have stated our assessment of how we think forestalling would work, depending on policy options. We have set out our overall approach and have evaluated the stated Government policy against that background.

Finally, we plan to publish a paper on 7 March setting out an even more detailed approach to modelling income tax, including behavioural responses.

Patrick Harvie: That will be very helpful; I look forward to it. It will be a couple of years before we can reconcile your projections with reality. Will we know earlier than that what the reality is? Will you be in a position to refine your projections for next year based on information that you will gather during the coming financial year about the amount of tax revenue that has been generated and the amount of tax avoidance behaviour that has taken place?

David Wilson: There are two things to say. We will undertake a forecast evaluation: we will assess annually how well we have done and what we have missed, and we will publish a report setting that out. If that evaluation suggests that we should adjust our overall approach or our elasticities assessment, we will of course do that, and we will set out the reasons why.

One element to be cautious about in looking at the data and the outturns as and when we get them is that there will inevitably be a delay. It might not be in the next year but in a subsequent year that we get the detailed information. Disentangling the likely behavioural effect from the change in tax from all the other factors—economic change or wider changes in Government policy—will also be a challenging exercise, but we will do it as best we can. We will set out all the reasons and the assessments that we make.

Patrick Harvie: I was going to ask a couple of things beyond behavioural effects.

The Convener: Does anyone else want to ask about behavioural stuff? I know that James Kelly is interested in some of that. Is your question more about the process?

James Kelly (Glasgow) (Lab): Yes—my question is more on the process.

The Convener: We might as well bash on. What you have been saying has reminded me of what Robert Chote said to the committee about forecasting being like a spot-the-ball competition but somebody is always moving the ball. No matter how much we want to make this an exact science, we cannot and will never get it exactly right. The reality is that it will never be bang on.

David Wilson: I am grateful that you are saying that, as well as us.

The Convener: It is the reality. We all have to remind ourselves of it, being so close to the process. You are making the best judgments that you can make: your assumptions are based on the information that comes in front of you.

Patrick Harvie: It is very reassuring to know that we are all getting it wrong one way or the other, at the end of the day.

You have said that there is an assumption that the higher-rate threshold will increase by inflation in the absence of any other policy change. Increasing the higher-rate threshold by inflation is itself a policy decision. Am I understanding the commentary in your update report? Is that a policy decision that the Scottish Government has informed you of, and will you work on the basis of that decision?

David Wilson: John Ireland will give you a more specific answer on this, but there is a distinction. There is official stated policy for this year, but we have to make assumptions about what might happen in the future to enable us to undertake five-year forecasts. We look to the Government to give us an indication of what it thinks its future approach will be simply to enable us to do the assessment. In terms of status, the official stated policy for this year is of a different order to the best assumption about what policy might be, going forward.

David Stone: We need to make assumptions about what thresholds will be in future years, and we try to make them as neutral as possible so that we are not introducing policy changes. It is not realistic to leave assumptions fixed exactly as they are. We do not have such a tax history for Scotland, but in the UK the higher-rate threshold has, over the long term, increased in line with inflation. Even if there had not been policy decisions, there is statutory indexation in the UK that ensures that that happens. In discussion with the Government over time, we have established that the neutral starting point for us in assessing where thresholds will go over the next few years is to increase them in line with inflation. We would adjust for policy around the thresholds on top of that.

John Ireland: I will add to that, to be crystal clear. Paragraph 11 of our report says:

> "Therefore, while not a policy, the Scottish Government suggested a set of assumptions for further years".

The Government has made it clear that it is comfortable with our assumption, but it is not a Government policy.

Patrick Harvie: I presume that it would be helpful for you if there was a policy intention. For example, if it became Government policy that tax policy should reduce economic inequality year on year, rather than that it should continue to give stability, would it be helpful for you if that was a stated policy that you could base your longer-term assumptions on?

John Ireland: It is helpful for our forecasting that the Government be as clear as possible about its future policy, whatever that policy is.

Patrick Harvie: Okay.

I was also going to ask about the process and the protocol.

The Convener: You have had a good crack at it, so I think I will let James Kelly come in on the process stuff first, then we will come back to you.

James Kelly: On the process, you published a report after the publication of the draft budget, and then the Cabinet Secretary for Finance and the Constitution announced changes last week. You have had, I guess, interaction in order to be able to produce your report. Can you describe the process between the announcement in the chamber last week and the subsequent publication of your report?

John Ireland: Yes. After the announcement last week, we were sent, by the Government, formal notification of the policy, including a description of the policy. That notification also contained some background information about other aspects of what had happened, including the expenditure announcement, and it said a little bit about how the Government intends to find the money to pay for the additional expenditure.

10:30

After we had received that, we turned around our costing and sent the Government the preliminary results of that on Friday. On Monday, we sent the Government a near final draft of our report for fact checking. We offered the Government a challenge meeting so that it could discuss our costing with the commissioners. The Government thought that it had had enough conversation with us, so it did not take us up on that opportunity. Yesterday, we sent another version of the report for fact checking, and by about 2 o'clock we had a small number of comments back from the Government. We published at 3 o'clock.

James Kelly: That is helpful. You mentioned that a challenge meeting was offered, which the Government did not take up. Did such a meeting take place before publication of the first report?

John Ireland: There was a series of challenge meetings before publication of the first report. We published on the commission's website a protocol describing the interaction with the Government. The challenge meetings looked at individual taxes and the economic forecasts. At various points we provided preliminary forecasts to the Government.

It looked at the assumptions and came back with methodological points about how we had done our forecasting. That process is very clearly explained in the protocol.

James Kelly: In table 9 you outline a position where the end behavioural impact is minus £56 million. If the Government disagrees with that after all the discussions and challenge meetings, is it able to use its own figure or is it legally bound to use the figure that you calculate?

John Ireland: The Scottish Fiscal Commission Act 2016 requires that if the Government wishes not to use our figures, it must write to, I am pretty sure, Mr Crawford to explain why. The Government is able not to use our forecast figures, but if it goes down that path it has to explain why it has made that decision.

James Kelly: This will be my final question. If the cabinet secretary were to decide again to change tax policy, say the weekend before the rate resolution debate on 20 February, how would you be able to deal with that in terms of going through a process such as you have just described happened in the past week?

John Ireland: We have had preliminary discussions earlier in the process with the Government about eventualities like that. We have agreed a rough timetable with it for any further changes. The next obvious point at which the Government could change policy is at the rate resolution. If the Government intended to make a change at that point it would need to tell us in advance, and we would go through a similar process.

The Convener: Patrick Harvie will follow up on the process stuff.

Patrick Harvie: I was preparing for—believe it or not—a relatively consensual debate yesterday afternoon about some aspects of the budget process, and was looking at how it used to be done, when there was a six-month budget scrutiny process for what were much simpler budgets. I am thinking about my reaction when I read the protocol: a stage 1 vote on Wednesday; notification to the SFC of policy changes by Thursday; an amendment deadline of Friday; then, I presume, you work over the weekend on your analysis, which comes to the Government for a potential challenge meeting on Monday morning, followed by deadlines at 1 o'clock and 2 o'clock; and publication at 3 o'clock. It is a bit of a breakneck process, is it not? What can be done to improve that and ensure calmer reflection on what are not trivial questions about Scotland's finances?

Professor Smith: Through the process that John Ireland described we had an extended period of engagement with the Government, in accordance with the protocol, before the December announcement. The details of our income tax model are well understood by the Government and are clearly set out by the commission. A change in the Government's policy that was announced to us last week could be processed quite quickly through a model that we and the Government understand. My colleagues will say more. The work is done speedily and efficiently. It is not fair to say that it is "a breakneck process" or that people are working under stress. There would be application of an established model in respect of a change to previously announced policy.

John Ireland: I will add to what Alasdair Smith said. What is really important—as was the case with the report—is that we have sufficient time to do quality assurance. I am very grateful to say that we did not work over the weekend, and we made sure that we had sufficient time to do quality assurance. During the process, David Stone and his colleagues spent an awful lot of time checking the calculations. We checked with Government analysts, because they were using a similar model and we could compare notes on how we and they had done the work. We also have an internal checking process within the commission, and people who were not involved in the work checked our numbers as well. We are pretty confident that the quality assurance process that we have in place and the time that we have for it are sufficient.

On the wider point about the budget process, as you know there is a budget process review group that worked during the course of last year and produced a report that made a number of recommendations. Those include recommendations on the work that we are doing and about moving towards the SFC making a second forecast in late spring, in May. Our working through this, and recommendations being accepted or evolving, will change the whole nature of the process—it will elongate it.

Patrick Harvie: That is helpful.

The Convener: Politicians will still get in your road with last-minute decisions and make it difficult for you. The question for us should be to ask whether we can make decisions come quicker. That would probably be the right way to think about this in the round. I am not asking you to comment on that.

Murdo Fraser (Mid Scotland and Fife) (Con): In your paper at paragraph 18, you have a calculation of the impact on income tax liabilities. You come to the conclusion that taxpayers with gross incomes below £26,000 will have a reduction in their tax liabilities of up to £20 a year, and taxpayers with gross incomes above that threshold will have higher tax liabilities. The cut-off point that the Scottish Government has cited is £33,000. It would be helpful if you could explain why you arrived at a figure of £26,000.

David Stone: When considering the costing, we compare what taxpayers would have paid in 2018-19, in our baseline assumption. I go back to our earlier discussion about how we grow the higher-rate threshold without a policy change, compared with what would happen with a policy change. Tables 5 and 6 above paragraph 18 show what the parameters would previously have been in 2018-19 and what they will be with the policy change. In that comparison, the cut-off point is £26,000. The £33,000 figure I believe is based on comparing what taxpayers paid in 2017-18 with 2018-19. That is where the difference comes from. I think that the Scottish Government's published income tax fact sheet makes that distinction, as well: it has both sets of figures.

The Convener: Willie—do you still have questions on forecasting or have they been exhausted?

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): No, I have a number of questions, if that is okay.

I will ask more about your five-year forecast, which you have illustrated in table 12 in your paper. We see that your estimate for tax take for the year ahead is £12 billion, and for year 5 it is about £14 billion. Can you explain why there is such a significant increase? That is a significant jump in tax take in the five-year period.

David Wilson: There are a number of reasons for that. One is that inflation's impact will be an increase in the tax take. It will be a particular factor in the current circumstances. Another factor will be the increasing tax take through public sector pay increases. Thirdly, an increasing amount of tax will be received by virtue of the fact that, as thresholds change, there will be an increase in tax take built into the tax system. Through those factors and others, we expect the overall tax take to increase by the degree that we suggest. So, inflation is a big factor and the cumulative impact of decisions by the Scottish Government this year and last year also contributes. John Ireland and David Stone might want to add to that.

David Stone: We are forecasting economic growth at around 1 per cent a year, which will also add to income tax revenues. As people's incomes increase, income tax revenues will increase. The numbers are in nominal terms and include the impact of inflation, which also adds to people's incomes. I think that those are the main driving factors. Population growth also contributes through growth in the number of people in employment. Many factors will lead to that increase over time.

Willie Coffey: I will ask about margins of error in forecasting. I know that it is difficult territory to get into. Are you more on the cautious side or on the optimistic side? As we go through the five years for which you have forecast, are we likely to see a divergence between your estimates and what the Government of the day might produce for itself?

Professor Smith: As a general point I say that our central forecasts are our best estimate of what we think the numbers are going to be. One is always careful with the assumptions one makes, but the assumptions are not pushed downwards in order to be deliberately cautious.

John Ireland: On forecasting error, I think that people are quite used to seeing fan diagrams that show confidence in forecasts over time. Because the Fiscal Commission has not previously produced forecasts—this is our first set of forecasts—we do not have historical forecasting errors so we cannot produce fan diagrams. When we have enough information about forecast outturn, we will produce such diagrams so that the committee will have a much clearer sense of the confidence intervals.

We have—and we did this in the December report—produced a number of sensitivity analyses. One can look back to that December report and get a sense of the impact on the income tax forecasts of moving some assumptions.

The Convener: No one else has said that they want to ask a question. I thank the witnesses very much for coming this morning to give evidence. We are very grateful for it: it has been helpful and has provided some clarity.

10:42

Meeting suspended.

10:45

On resuming—

Budget (Scotland) (No 2) Bill: Stage 2

The Convener: The second item on our agenda is to take evidence on the Budget (Scotland) (No 2) Bill at stage 2. This item is intended to allow the committee to put questions on the bill and the amendments to the cabinet secretary and officials before we turn to formal stage 2 proceedings. We are joined by Derek Mackay, the Cabinet Secretary for Finance and the Constitution. The cabinet secretary is accompanied by the Scottish Government officials John Nicholson, deputy director of financial scrutiny and outcomes, Graham Owenson, head of local government finance, and Jonathan Sewell, head of the income tax and tax strategy unit. I welcome our witnesses to the meeting and invite the cabinet secretary to make an opening statement.

The Cabinet Secretary for Finance and the Constitution (Derek Mackay): I welcome the Finance and Constitution Committee's report on the 2018-19 draft budget. As I informed Parliament last week, I will respond to the report in full in advance of the stage 3 debate on 21 February. Today's committee session will focus on the content of the budget bill, as approved in principle by the Scottish Parliament. In addition, following the spending changes that I announced at the stage 1 debate last week, there are a number of amendments to the bill that the committee will need to consider.

I will begin by focusing on some of the presentational differences between the draft budget that I published in December and the budget bill that was introduced on 25 January and that we are considering today. To assist the committee, I will explain the main differences, with reference to table 1.2 on page 3 of the supporting document. Column H in table 1.2 sets out the draft budget spending plans, restated for budget bill purposes. Columns B to G provide details of the specific adjustments that have been made, including the necessary statutory adjustments, to meet the requirements of the parliamentary process. There is only one actual change to the spending plans outlined in the draft budget that I would wish to take the opportunity to highlight to the committee.

To ensure that budgets align with the latest available information, there is a decrease of £222.4 million to the annually managed expenditure budget provision for teachers and NHS pension schemes. This reflects Her Majesty's Treasury update to the discount rate applied for post-employment benefits announced in December 2017. The rate changes announced in December are used in preparing budget estimates but will have no effect on the current contributions paid out of salaries by scheme members or on current payments made to retirees.

Other adjustments set out in table 1.2 include the exclusion of £165.6 million of non-departmental public body non-cash costs, which do not require parliamentary approval and which relate mainly to the depreciation and impairments for NDPBs; the exclusion of judicial salaries and Scottish Water loan repayments to the national loans fund and the Public Works Loan Board, which again do not require parliamentary approval; and the inclusion of £5.4 million of police loan charges that need to be approved as part of the budget bill.

There are adjustments to portfolio budgets to reflect the requirement for separate parliamentary approval for a number of direct-funded and external bodies. Those include the National Records of Scotland, the Forestry Commission, Food Standards Scotland, the Scottish Courts and Tribunals Service, the Office of the Scottish Charity Regulator, the Scottish Housing Regulator, Revenue Scotland and the teachers and NHS pension schemes.

The restatement of local authority specific grants included in the overall 2018-19 local government settlement is there to ensure that they are approved and under the control of the appropriate cabinet secretary with policy responsibility. Full details of all grants that are treated in this way are included in the table on page 43 of the supporting document.

Those are all the technical adjustments and do not change in any way the budget that has been scrutinised by this and other committees and approved in principle by the Parliament. I also remind members that, for the purposes of the budget bill, only spending which scores as capital in the Scottish Government's or direct-funded bodies' annual accounts is shown as capital. That means that capital grants are shown as operating expenditure in the budget bill supporting document. The full capital picture is shown in table 1.3 on page 4 of the supporting document.

The stage 2 amendments that the committee is considering today give effect to the changes to spending plans that I announced to Parliament in the stage 1 debate last week. They will be formally moved later in this meeting. As I announced to Parliament last week, I will be providing a total uplift of £170 million to local government as part of the deal agreed with the Scottish Greens.

The amendments that I am proposing today allocate £10.5 million to support interisland ferries for the Orkney and Shetland isles; an additional

£125 million to local government in 2018-19, with the balance of £34.5 million being allocated in 2017-18; £2 million for fuel poverty; £200,000 to accelerate the delivery of our four marine protected areas; and £70,000 in funding for the Scottish Sports Association. I have also agreed to make available up to £2 million for a local rail development fund, but that is not covered in the amendments, as discussions on how that will be taken forward are still on-going.

Those commitments will be funded through a combination of around £62 million in expected additional income tax revenues and around £110 million from a combination of anticipated underspend in 2017-18 and drawdown from the Scotland reserve. As the committee has just heard, the SFC has forecast that an additional £55 million will arise from the change in the higher-rate threshold and that there will be a further £7 million of tax revenues due to the change in the pay policy threshold to £36,500. The final mix of underspend and reserve drawdown will be determined at the end of the financial year, once there is greater certainty on the year-end financial position.

I hope that those introductory remarks have provided the committee with a useful explanation of some of the key aspects of the budget bill. I am happy to take any questions from members.

The Convener: I want to pick up on one of the themes that I tried to explore during the stage 1 debate about some of the future challenges around the budget.

You will note from our report on the draft budget that we highlight a potential risk to public finances if there is any significant forecast error in future. You will also have seen that we are looking for further details from the SFC on why, despite the fact that it forecasts lower economic growth per capita relative to that in the UK, it forecasts that income tax revenues per capita in Scotland will grow at the same rate as those in the rest of the UK. Given that uncertainty and volatility, can you provide the committee with some understanding of how the Scottish Government intends to address this challenge and avoid as much as possible any unwelcome surprises when we eventually get the final outturn data for income tax revenues in September 2020? It would be helpful to know about your planning on that.

Derek Mackay: That is a good question, and one that we will all be focused on. Obviously, we want forecasts to be as robust as possible. I was watching the evidence earlier and I think that I heard Patrick Harvie say that no economist gets forecasts exactly right and to the penny, such is the nature of forecasts. Of course, we want SFC forecasts to be as robust as possible but, that said, there is a range of interventions that we can make.

First, there is the reserve to help with smoothing from one year to the next if that is required. The budget is substantial, at around £40 billion, so there is obviously flexibility to accommodate some of that but, if the forecast error was on such a substantial scale that it was beyond our financial means to resolve, there are the borrowing powers as part of the fiscal regime. So there is in-year budgeting, managing the issue from one year to the next, the reserve, the overall approach on tax take and, of course, the fiscal framework, through which the methodology that we have is tax to tax. In that regard, even though gross domestic product growth is not what we would want it to be, the analysis shows that wage growth is individually and specifically stronger. There is a range of actions, from in-year management, use of reserves and all the other tools that we have in the box but, if the scale of the error is substantial, there is provision to borrow in accordance with the fiscal framework.

The Convener: If the forecasts were so far out, would you require Treasury agreement to enter into that process of drawdown from borrowing powers to help to smooth it out?

Derek Mackay: Yes. We would have to meet the necessary criteria and we would require Treasury engagement.

The Convener: Adam Tomkins has questions on transparency.

Adam Tomkins (Glasgow) (Con): Cabinet secretary, do you agree that it is essential for effective parliamentary scrutiny of the budget process that the Scottish Government is as transparent as possible about its budget proposals?

Derek Mackay: Yes.

Adam Tomkins: We have not had the pleasure yet of your response to our report on the draft budget, which was published a couple of weeks ago, but you will see when you look at that report that there are a number of specific recommendations about transparency. Have you had a chance to reflect on those recommendations yet?

Derek Mackay: Yes. I think that those should be taken into account as part of the overall work around the budget process review group as well. We will consider all of that in full in considering the process.

Adam Tomkins: Is it compatible with the principle of transparency, which you have said is essential to effective parliamentary scrutiny, or is it a breach of that principle for you to produce more than £160 million of additional spending between the publication of the draft budget and the actual budget?

Derek Mackay: I do not think that there is any breach at all. It is a substantial budget, and there is obviously flexibility. When I appeared before the committee previously, I was asked about what financial resources the Government has and I have repeatedly made the point that areas such as budget exchange and carryover can be determined as the process moves and we get to the year end. If you take—

Adam Tomkins: What kind of—

Derek Mackay: Let me make the point, if I may, because it relates to the budget. I have also presented information on the Scotland reserve to Parliament. On other matters, such as the non-domestic rates pool, I have been perfectly clear about what the Government's plan is.

Adam Tomkins: Sorry, I thought that you had stopped.

Can you give us a bit of transparency on the Scotland reserve? What size is it? What size was it before you made the deal with the Scottish Green Party and what size is it now that you have made that deal?

Derek Mackay: As I have previously reported to Parliament, and as I am sure Adam Tomkins actually knows, there have been years when we contributed to the Scotland reserve. As a consequence of the fiscal framework, there are parameters around budget exchange from one year to the next. Where we have generated tax revenues that could go into the Scotland reserve, that is what I did, to the tune of £74 million, which has been reported to Parliament. That can be deployed now and in future years. I have described the decisions that we can take around budget exchange—that is year-end flexibility or, if you like, the carryover—and the Scotland reserve. There is also the tax change to fund the proposition that will secure the passing of the budget. At all stages, I have been forthcoming on the Government's financial position. If we use the tax reserve for the balance, there will still be Scotland reserve resources available for next year.

Adam Tomkins: Perhaps the problem that we have is that we have different definitions of transparency because, with respect, I do not think that that was a very transparent answer. I asked you what size the Scotland reserve was before you did the deal with the Scottish Green Party and what size the Scotland reserve will be now that you have done the deal with the Scottish Green Party. You have not answered either of those questions.

Derek Mackay: I have tried to answer the question, but there are the issues that I set out in my opening statement. If you listen to what I am actually saying, the final determination on what is deployed will be based on what is available in budget exchange. If there is more available for carryover at the end of the year, we will use less of the reserve. As it stands right now, on current planning assumptions, we would use about £40 million of the £74 million in the Scotland reserve, but that may change as a consequence of what might be available in budget carryover. In the interests of transparency, that figure for the reserve is annually reported to Parliament and any underspend that may arise. That is normally provided with the June outturn figures, which is what I have done since becoming finance secretary, in a very open and transparent way.

James Kelly: The money that is being drawn from the underspend and the Scotland reserve is £110 million. A similar situation arose last year, when £120 million was drawn down from that. Is it not the case that, in effect, you have that block of money set aside almost as a slush fund for your negotiations as part of the parliamentary process?

Derek Mackay: I would not describe it as that, Mr Kelly, although you can use any term that you want. In previous years, any underspend at the end of the year might have been carried over and used through the course of the year. If we want to be fully transparent, it is not a bad thing to set out what the underspend might be and how the Government proposes to use it. In fact, if it is being used to agree parliamentary support, I think that that is a good thing, and I am sure that Mr Kelly would welcome that. It is far more credible than the plans that I have seen from the Opposition Labour Party on how to fund a budget. It is a very prudent, wise and transparent use of resource.

The only thing that is fluid at this stage, which is the point I was trying to make, is exactly how much will be available at the end of the financial year. Of course, we are getting to the end of the financial year, but there is finessing of that at the end of the year of a substantial multibillion pound budget.

11:00

James Kelly: If you are really committed to transparency, as you have tried to reiterate in your answers to Mr Tomkins, would it not be better, when you publish the draft budget, to also publish the underspend figures and the Scotland reserve figure, so that we all know what you are taking into the negotiations?

Derek Mackay: I think that the Scotland reserve figure is in the documentation.

The Convener: The information is in table 1 of annex A.

Derek Mackay: So it is in the documentation.

Budget exchange is a moving figure, so whatever I put in the draft budget will be the figure at a point in time. As the committee considers its approach to the budget process and financial planning, it can make requests for updates, but it is a moving figure, in terms of any underspend that might exist in the organisation.

James Kelly: I accept that it is a moving figure, but in December you must have a forecast of what you think the underspend will be at the end of the year. If that figure was available for all involved, we would get an idea of how much you might be looking to introduce at a further stage in the budget.

Derek Mackay: I suppose that the point I am trying to make is that we can make a judgment at a point in time, and on 14 December the draft budget set out the potential use of budget exchange at that point.

Neil Bibby (West Scotland) (Lab): What was it?

Derek Mackay: The figure of approximately £158 million was in the draft budget. It is in the same table. The point that I am making is that that figure will change before we get to the year end, because we cannot get spending exactly right.

Of course, the important point is to make sure that we can carry it over. There have been years when carryover was lost to Scotland, but we have been deploying it. The difference in the past couple of years has been that we have been able to use it as part of budget negotiations and deploy it. One could argue with the will of Parliament in advance as to how that is deployed, because, previously, it may have been deployed over the course of the next financial year.

The Convener: I would like some clarity, so that I am absolutely sure of what we are talking about here. There is a table 1 in the annex to the draft budget, which was published in December.

Derek Mackay: Yes.

The Convener: In that, the budget reserve figures are £203 million for 2017-18 and £158 million for 2018-19.

Derek Mackay: Yes.

The Convener: Were the amounts that you have been talking about that gave you the required flexibility to finance the arrangements with the Greens taken from those figures?

Derek Mackay: No, those figures were what were produced at that point in time, as part of the budget. That was the snapshot of where the budget underspend was expected to be at that point. That answers the question.

Incidentally, that improvement to the budget—putting in the table to further explain how elements were being funded beyond the use of tax-raising and revenue-raising devices—was made as a result of recommendations of previous years. It is an innovation.

The point that I am trying to stress is that that number changes because spending continues in the Scottish Government.

Murdo Fraser: I would like to get some clarity on the extra £110 million from underspend and reserves that you spoke about. You said to Adam Tomkins that you expect that about £40 million of that will come from reserves. Can we assume that £70 million is coming from underspend?

Derek Mackay: Approximately, yes.

Murdo Fraser: Thank you.

When you came to the committee on 15 January, when we met in Aberdeen, I asked you about the amount of money that was available in the budget in this area. In relation to the "Budget Exchange/Reserve" line, the figure for which is £158 million, you said:

> "In the past, finance secretaries may have been able to hold on to that money for financial management reasons, for example. I have used the money up front for the purposes of budget negotiations. The figure is what it is because there is very tight financial management, and that is the figure that officials think is most appropriate."—[*Official Report*, *Finance and Constitution Committee*, 15 January 2018; c 32.]

When you presented your budget to Parliament on 31 January, which was 12 working days later, that figure of £158 million had gone up by £110 million. That is a 70 per cent increase in 12 working days. Is that reasonable?

Derek Mackay: Yes. Some of the reason for that—if you want a deeper understanding as to why some of these issues emerge—is demand-led budgets, and some of it is factors outwith our control, such as Treasury issues or other elements of funding. Those figures can change, and it is not unreasonable for me to report to the committee, using the best information that I have been given at that time, and then take forward the budget. That figure will continue to be fluid until the end of the financial year.

Murdo Fraser: With respect, we are talking about a period of 12 working days from when you gave evidence to this committee, which is trying to conduct budget scrutiny, to when you presented your budget bill to Parliament. When you are not providing full information to this committee and the other committees in this Parliament that are trying to carry out budget scrutiny, is that not holding the committees in contempt?

Derek Mackay: Absolutely not. I am sure that the Tories are just using colourful language here. What I have done is present the information that I have—the official fiscal position of the Government—in a transparent and productive way. I am happy to provide some official engagement on why we arrived at the current underspend figure, if you wish.

The Convener: Well, I wish, so let us have it out with all the information just now.

John Nicholson (Scottish Government): What Mr Mackay was explaining at the committee on 15 January was the rationale by which he arrived at the £158 million underspend figure that was printed in the draft budget. The period between that figure being fixed and what we are talking about now is not 12 working days, but a longer period than that.

Murdo Fraser: No, no—hold on. With respect, Mr Nicholson—

The Convener: We will let Mr Nicolson conclude what he is saying.

John Nicholson: The other point that Mr Mackay made was that in previous years, far less of the anticipated underspend has been allocated at the point of the draft budget, and more has then been secured as part of the final budget deal. This year, we have secured more of the underpinnings of the draft budget from our anticipated position on underspend, and the room for further movement since the draft budget was published has been more restricted.

As Mr Kelly pointed out, we have reached an end position that is broadly equivalent to last year's position, in terms of the overall quantum that we are talking about, but the movement between the draft budget and the budget bill is far smaller than it has been in previous years because there has been less additional resource available to allocate.

Murdo Fraser: Thank you for that response, but, to be clear, Mr Nicholson, on 15 January I was not asking Mr Mackay about what was in the draft budget. I was asking quite specifically—as you will see from the *Official Report*—how much additional money might be available. I was asking about the position as at 15 January, so the appropriate period is 12 working days.

Derek Mackay: To be clear, that would have been an accurate answer at that time. It is as simple as that.

The Convener: We will move on to a different area. Ash Denham has some questions on health.

Ash Denham (Edinburgh Eastern) (SNP): Obviously health is the largest portfolio, and within it is an ongoing process of—I do not really like this word, but I will say it—modernisation and change. In the budget there is a quite a big increase to the "Transformational Change Fund" line. Does the cabinet secretary think that that strikes the right balance in that portfolio, given the modernisation agenda? How will that money be allocated?

Derek Mackay: That is a good question, because funding of the national health service is significant and important. There has been a real-terms uplift, which has been welcomed. The Cabinet Secretary for Health and Sport is very clear. The agenda is about investment and, at the same time, reform or modernisation—if you do not like the word "transformation"—to support the kind of changes and interventions that will help to reduce demand. Some of that might be around better use of technology and specific interventions to improve performance.

That figure of £126 million is a mixture of transformational and reform funding amounts, and it will also support the regional delivery plans. It is a once-for-Scotland approach, through which those national improvements will be felt at a more local level. It is also about supporting more sustainable models of care—I have touched on digital capability.

The health secretary is very clear with me that, although there are increasing demands on the health service, investment has to go hand in hand with that transformation in relation to better delivery of services and the adaptation of services to be able to respond to those pressures.

In addition to that, there is more for mental health, which is good for preventative purposes, and more for social care, to support the infrastructure at community level. There has been good work around health and social care integration. Part of the package will support the territorial boards, so it is absolutely about delivering transformation and improved performance, at the same time as investing an amount that is well above inflation.

Ash Denham: I would also like to ask you about low-carbon infrastructure. As part of that, there is a £2 million rail development fund. Do you have any more details on what that might look like?

Derek Mackay: We are exploring that. Frankly, although there is a new stations fund, there are the on-going issues with the Treasury around the rail settlement to Scotland.

There is a need to support those who want to take forward feasibility studies to get a sense of how they could progress the prospect of rail enhancements or rail stations in a local area. There are people with particular expertise on that with whom we will engage to make sure that such a fund could be properly channelled. The purpose of the fund is not necessarily to raise expectations that a new station might be coming down the line immediately—although it might be—but to give people the necessary support to take forward bids and provide the potential for infrastructure developments to happen. It was identified through the course of the negotiations as something that should be explored. That is what we are doing, and I have made a commitment to fund that.

Ash Denham: Thank you.

The Convener: We will now look at local government issues.

Patrick Harvie: Good morning. In addition to low-carbon infrastructure investment and the significant and welcome shift of the Government's position on public sector pay, local government was a significant focus of our discussions and, in the exchange of letters between us that is already in the public domain, it is very clear that we were focused on achieving the reversal of the cut that the Scottish Parliament information centre had identified in the Scottish Government's funding to local government. We put significant options to you for how you could do that; it is the Scottish Government's decision to fund that at least partly from reserves and underspend rather than from additional tax changes. Bearing in mind the earlier discussion about the importance of the reserve, are you satisfied that the tax changes and the other changes that are necessary are adequate to fund the complete reversal in the £157 million cut that SPICe identified in local government funding?

Derek Mackay: I do not agree with the terminology because, of course, we were giving more cash and there was a debate, which we have had at the committee, about what should be included in the figures. Anyway, I am absolutely confident that the extra £170 million will be provided for, so much so that, when we move the local government settlement order—the redetermination order—it gets the money. I am therefore absolutely confident of that investment.

Patrick Harvie: I was going to ask you about the local government finance order. In your opening statement, you drew attention to the fact that some of the overall £170 million package is coming from what would be an additional 2017-18 local government finance order. I would like to know when you expect that to be laid and when you expect it to be moved in Parliament. Also, just for the record, could you give us a clear confirmation that councils will be in a position to move that additional 2017-18 money into their budgets for 2018-19?

Derek Mackay: Yes, councils absolutely can carry forward the funding—there is no rigidity about it. Councils have welcomed it.

The redetermination order will be laid in Parliament on 20 February

11:15

Patrick Harvie: So that will be laid before the stage 3 debate on the budget.

Derek Mackay: Yes.

Patrick Harvie: That is helpful.

You will also be aware that we have had correspondence from the Convention of Scottish Local Authorities, which welcomes the progress that has been made in supporting local government. It has also drawn attention to the question of whether that change will be in the baseline for the future. The change to the previous year's budget happened ultimately, but local government needs to have some degree of certainty for the future. It has clearly said that it is important for councils in setting the budgets to know whether the funding is recurring, and it has asked the committee to raise that point with you. What is your response?

Derek Mackay: I will need to deal with that in the budget discussions in 2019-20. I have not set any portfolio budgets beyond this financial year. Yes, there is project funding. Yes, there are multi-year commitments for elements such as housing, and there will be commitments on childcare, city deals and so on. I am hoping to get the 2018-19 budget through Parliament successfully. I have not proposed to set out the baselines for 2019-20. I would not ordinarily do that. I am not proposing to do that, because that would all be subject to discussion, budget preparation and negotiation for the next year.

I absolutely understand the point that local government wants as much certainty as possible and would like the funding to be in the baseline, but I have not set that degree of certainty for any portfolio in the Scottish Government or, as is the case with communities, part of a portfolio. That will be a matter for planning for the next budget year.

Patrick Harvie: Obviously, the purpose of Scottish Government funding local government at all is to ensure that vital services that people need in every community in Scotland can be delivered. The point of having debate and discussion on the level of that support is to ensure that those services can meet people's needs. Even if you are not able to answer the question about the baseline before stage 3 of the budget, surely you would accept that local government will be in a far better position to protect those services for the long term if you are able to give clarity on this question earlier this year than you did last year. It was left until very late in the current process to confirm whether last year's changes were baseline changes. Surely that needs to be done much earlier in the current process to give local government earlier clarity on the question.

Derek Mackay: It is a fair point, and I understand it, but it is the nature of the process and the timescales, which I know we have touched on as well. We can do all the scenario planning with all the assumptions we like, but there is then the impact of the UK budget and then, of course, our own process. I get the point, though, about giving local government as much certainty as possible. That would apply to every part of Government, in terms of delivering transformation.

The other unknown within that is the dynamic of what might change in the provision of local services. For example, if we make further progress on health and social care integration, we do not know exactly what that will mean for the financial formulas for either local government or health. I would just make the point that I understand the need for greater certainty.

I do not think local government minds that the extra £170 million has come a wee bit late in the day. I think that it welcomes the £170 million; certainly it has in the correspondence and council communications that I have seen. I understand the point, but it relates to the nature of the relationship that we still have in Scotland on fiscal policy, whereby a large chunk of the spending decisions that affect the country and therefore determine what we have are still made by the Treasury and the Chancellor of the Exchequer. That drives our timescales.

I throw to Opposition parties the offer that, if we were to have greater certainty at an earlier stage in the budget, I would welcome that more than anyone. That is certainly not a criticism of the Scottish Green Party, but if we had greater certainty from the other parties, maybe there could be earlier discussions on what the asks are and what the outcomes might look like. The only sense of delay now for the local government figure is that that was clearly a point of negotiation, and it improved to the benefit of local government.

Patrick Harvie: I have one brief final point. We have just heard a few minutes ago from the Scottish Fiscal Commission that if the wider public sector—in particular, local government—is able to achieve a similar pay policy to the Scottish Government's pay policy, that will increase the extra income tax revenue beyond the £7 million that it has already projected. What will you use that for?

Derek Mackay: I was watching the Fiscal Commission earlier, and I can say that that is the cheeriest news I have heard all day.

Patrick Harvie: It was an "if".

Derek Mackay: If it factors that in, it is up to the Fiscal Commission to justify its forecast and for local government to determine its pay policy. I must not—

Patrick Harvie: It would be reasonable if local government manages to achieve a more generous pay policy, and the extra income tax generated from that would benefit local government as well.

Derek Mackay: That is not a proposition that I am making. I think that local government has benefited very well out of the Government's tax policies and budget.

The Convener: Neil Bibby had some questions in this area.

Neil Bibby: After the revised funding for councils that was agreed with the Scottish Greens, many councils still believe they will have to make significant cuts. With the revised funding and with a 3 per cent rise in council tax across the board, do you believe that councils have enough funds to avoid making further cuts over the next year?

Derek Mackay: Broadly, I think that that will leave councils very well resourced indeed. There is an above-inflation increase in the resources coming from the Scottish Government and, in addition, councils can raise the council tax. I think that that puts local government in a very strong position, which is why COSLA and a number of reasonable council leaders have welcomed it. Again, this is in the fiscal context of a reducing resource budget coming to Scotland and reducing front-line resources. We have been able to overturn that by using our tax powers to invest in services, whether that is the NHS or education or the uplift in the economy brief, and now local government has an above-inflation increase in its settlement from the Scottish Government, as well as all the other schemes that we are working in partnership with local government on.

Councils will be looking at expanding elements of service, such as childcare, and there is the city deals investment and investment in housing. That is hundreds of millions of pounds of extra investment to support local economies and local services. Local authorities are also able to raise their council tax, so I believe that it puts them in a very strong financial position.

I know that some councils will have been consulting on what might have been seen as radical options. They do it every year; they did it when I was in local government. Sometimes it is officer inspired; the elected members are never going to choose those options, but they are presented. It is good in the sense that it gives transparency and there is then dialogue and engagement and an understanding is reached. Invariably every year most of those decisions are made and are not followed through, and I would argue that the settlement to local government should address a number of the concerns that Mr Bibby may have had.

Neil Bibby: I will just restate that many councils are still saying they are going to have to make significant cuts over the coming year. Over recent months, as you have said, we have had councils all across Scotland publish plans for cuts, but you have said that that was before the revised budget settlement. As you know, in Renfrewshire, for example, we have seen the prospect of day centre closures and proposals to reduce grey bin collections, introduce parking charges and cut funding for family support services. Is it your position that there is now no financial necessity to make such cuts?

Derek Mackay: That would be me determining what Renfrewshire Council should do with the extra resources that it will have.

Neil Bibby: I am not asking you to determine what it should do. I am asking you whether there is a financial—

Derek Mackay: I think that, if you check the *Official Report*, you will see that that is exactly what you asked me to do.

Neil Bibby: I am asking whether there is a financial necessity to make such cuts.

Derek Mackay: I think that the enhancement to the settlement should allow councils to revisit the necessity, perceived or otherwise, for some of the reductions that might have been consulted on. Let us just see how some of those proposals work out, but it is not for me to make those decisions. I am no longer leader of Renfrewshire Council, and Neil Bibby is no longer a member of that council sparring with me there either.

The Convener: Ivan McKee will raise issues to do with pay.

Ivan McKee: Welcome to the committee, cabinet secretary. I want to talk about the changes that you have made to the public sector pay increase. You have increased the level at which a 3 per cent increase would apply from £30,000 to £36,500. How many people are affected by that and what kinds of job roles are we talking about?

Derek Mackay: Obviously, that figure helps with the whole spectrum from the lower paid up to those on £36,500. My understanding is it would cover more teachers and nurses, although I recognise that teaching is very specific and is a matter for tripartite negotiations.

The increase will benefit a majority of the public sector workforce—well, those under our control. We have touched on how it is a benchmark. It is a benchmark in health and I have already said, on 14 December, that I would match anything that may come from the UK-wide NHS review anyway, for the avoidance of doubt. Local government in its discussions expressed the view that it would feel pressure to match Government policy, or that there would be an expectation that it would do so. It is entirely a matter for local government.

Of course, much of the local government workforce is learning less than £36,500. It covers a great deal of public sector workers. Obviously, the increase has benefits to the Government in terms of tax take, but the way we have done it, by capping the increase at £80,000 and setting the threshold at £36,500, also helps to tackle inequality.

I know that there was some discussion earlier as to what Government pay policy covers. It might be helpful if I supply the policy papers that were announced on 14 December—I know that the numbers have changed—to the committee if that is helpful, so that you know exactly who it covers. I saw some debate on that in your earlier evidence session with the SFC.

James Kelly: How much of the funding that you announced last week has specifically been allocated to cover the pay policy?

Derek Mackay: That is a fair enough question. I do not separate out pay as a specific part of the Scottish budget. It is part of portfolio spending and part of the settlement to organisations. It is deemed that organisations should follow the pay policy—that sets the parameters—but the funding is within the settlement. We should bear in mind that every portfolio—I think apart from the rural economy and connectivity portfolio—has a real-terms increase in its portfolio line. REC is quite different because it is not necessarily about resource spending. Some of that is switched to capital as well, so there is satisfactory funding within the overall budget because we have used our tax powers and because we have made the investments to fund the pay policy.

James Kelly: Following publication of the draft budget report, SPICe analysis established that there was a £200 million shortfall between what was in the budget and what was needed to cover the full extent of the pay policy. You then announced an extension to that policy last week to cover those who are paid up to £36,500. I put it to you that the policy is not fully funded in the budget.

Derek Mackay: I would simply reply that it is in terms of the overall settlements to portfolios. As I say, all portfolios bar REC have had a real-terms increase in their budget lines and there is the provision there to deliver that. Certainly, the Cabinet is clear that the pay policy should be delivered, so I would argue that the resource is there and a deal should be honoured.

James Kelly: Finally, what is the additional cost of the extension of the policy that was announced last week and how is it budgeted for?

Derek Mackay: The extra cost for that specific element is £25 million.

James Kelly: How is it budgeted for out of the £170 million?

Derek Mackay: It is all part of the overall budget, as I have expressed. I do not separate out lines. It is all part of the overall settlement to portfolios, which have to live within the settlement and deliver the pay policy as outlined.

James Kelly: It sounds to me as if you have announced an additional £25 million commitment but not provided the funding for stakeholders and budget holders to be able to cover that.

Derek Mackay: I am simply trying to state that it is already within the settlements to portfolios, and if cabinet secretaries who lead departments and services felt that they could not deliver it, they would say so to me and they have not. It is an agreed position: they will deliver the pay policy and it is in their resources that have been set out. That is in the context, of course, of growing resources as a consequence of the decisions that the Government has taken.

The Convener: Willie, forgive me if I missed you out earlier, but I think that you still have a question.

Willie Coffey: I have a supplementary question on local government. You have said that it is an above-inflation increase of course and, from the figures that have been provided to us, I can see that my authority, East Ayrshire Council, is due to gain another £3.6 million from your amendments to the budget, which is very welcome in that part of Ayrshire.

11:30

Do you have any indication as to whether other authorities are going to exercise their power to raise council tax by 3 per cent? We know last year that some, despite asking you to give them more money, refused to raise any more money locally themselves. I think, if memory serves me correctly, that they were all Labour councils. Do you have any indication on whether all the councils will use their discretion this year or whether they are hedging their bets?

Derek Mackay: That is a very good question. Mr Coffey's recollection of those councils that did not use their ability to raise council tax last year is correct. I do not know whether it aligns with electoral cycles—maybe; I cannot give a Government view. I can tell you only that the intelligence that I have is that most councils appear to be planning to use their ability to raise council tax by 3 per cent. It is entirely a matter for them whether they do that, of course. We will see how their budget cycles pan out in light of the extra resources that have been allocated to local government, which give them a real-terms increase in resource and a substantial increase in capital.

Willie Coffey: You said that COSLA has written and welcomed the proposals.

Derek Mackay: COSLA issued a press release during the stage 1 budget debate. Do not get me wrong—local government will always ask for more money. I certainly did when I was a council leader. COSLA has given

"credit where it is due"—

its words not mine—and recognised the extra resources that have been given, and it is engaged in partnership on areas of joint priorities and so on, which is important to us all. Certainly, it has welcomed the extra resources of course.

The Convener: Neil Bibby has a question on child poverty.

Neil Bibby: Given the concerns that have been raised about child poverty during the budget debate, is it still the case that the children and families budget is facing a reduction?

Derek Mackay: I do not have that budget line in front of me. I can speak about the overall approach, as I have done in the committee on a range of interventions in equalities, welfare, social security, housing, the child poverty fund, and the ending homelessness together fund, for example. The child poverty action plan will be coming out this year and we will have the new mechanisms for social security as well.

The Convener: That completes the evidence session on the budget at stage 2.

Item 3 is the formal proceedings at stage 2 of the Budget (Scotland) (No 2) Bill. Everyone should have a copy of the bill as introduced, the marshalled list of amendments that was published on Monday and the groupings list of amendments, which sets out the amendments in the order in which they will be debated. We will begin that process.

Section 1 agreed to.

Schedule 1—The Scottish Administration

The Convener: Amendment 1, in the name of the cabinet secretary, is grouped with amendments 2 to 6.

Derek Mackay: Amendments 1 to 6 relate to the authorisation to use resources that are provided for in schedule 1 and will adjust individual portfolio allocations within the budget to reflect the spending announcements that were made at stage 1.

Amendment 1 adds £70,000 to the health and sport portfolio for the Scottish Sports Association.

Amendment 2 allocates an additional £200,000 to accelerate delivery of the four marine protected areas in the environment, climate change and land reform portfolio.

Amendment 3 allocates an additional £10.5 million for funding of the inter-island ferries for the Orkney and Shetland islands—allocated as a specific grant to local government—to the rural economy and connectivity portfolio.

Amendment 4 allocates an additional £127 million to the communities and social security portfolio—£125 million for local government and £2 million for fuel poverty.

Amendment 5 increases the total allocation of resources for the Scottish Administration by the net uplift of £137.77 million.

Amendment 6 increases the overall cash funding authorisation for the Scottish Administration under section 4(2) of the bill by £137.77 million, in line with the additional spending that was announced at stage 1.

I move amendment 1.

James Kelly: I indicate my support for the amendments that have been lodged on the basis that they introduce additional moneys into the budget, which is welcome. However, I believe that the overall budget package is still not fit for purpose.

The discussion that we had about local government and pay under the previous agenda item illustrates that local government is still underfunded, particularly given the £1.5 billion of accumulated cuts that there have been since 2011. I do not think that the pay intent announced by the cabinet secretary is transparent or fully funded, and I believe that other areas of the budget, including those relating to the NHS and action to tackle child poverty, do not go far enough.

Therefore, although Scottish Labour will support the amendments, we do not support the overall approach to the budget and will continue to oppose it.

Patrick Harvie: I put on record my support for the amendments. It is very positive that we have, for the second year in a row, managed to prevent additional cuts to core funding for local government. Nevertheless, James Kelly makes a fair point in saying that local government has suffered significant cuts in previous years and we have not yet repaired the past damage. I sincerely hope that this is the last time that the Scottish Government's budget process ends up as a rearguard action against local government cuts. We must ensure that, in the future, local government is in a far stronger position to make its own financial decisions. I hope that the Scottish Government engages in that discussion positively over the months ahead.

The Convener: As members have no other comments to make, do you want to wind up, cabinet secretary?

Derek Mackay: The amendments reflect the announcements that were made at stage 1, and I appreciate the engagement of the committee. As it has been raised, I reiterate that the local government settlement represents a real-terms increase for local government, even before it has the option of deploying its council tax powers. The settlement has been very well received, and the other amendments reflect the constructive deal that has been done with the Scottish Green Party. I would encourage all political parties, including the Labour Party, to engage more constructively in the future if they want to help to shape future budgets.

Amendment 1 agreed to.

Amendments 2 to 5 moved—[Derek Mackay]—and agreed to.

Schedule 1, as amended, agreed to.

Section 2 agreed to.

Schedule 2 agreed to.

Section 3 agreed to.

Schedule 3 agreed to.

Section 4—Overall cash authorisations

Amendment 6 moved—[Derek Mackay]—and agreed to.

Section 4, as amended, agreed to.

Sections 5 to 11 agreed to.

Long title agreed to.

The Convener: That concludes stage 2 of the Budget (Scotland) Bill. I suspend the meeting for five minutes to allow a changeover of witnesses.

11:38

Meeting suspended.

11:42

On resuming—

Land and Buildings Transaction Tax (Relief from Additional Amount) (Scotland) Bill: Stage 1

The Convener: The final piece of business on our agenda today is evidence on the Land and Buildings Transaction Tax (Relief from Additional Amount) (Scotland) Bill at stage 1 from Derek Mackay, the Cabinet Secretary for Finance and the Constitution. The cabinet secretary is joined by officials: Ewan Cameron-Nielsen, from the finance directorate, and John St Clair, the senior principal legal officer in the Scottish Government. Members have copies of all the written evidence that has been received, along with a SPICe briefing. Before we go to questions, I invite the cabinet secretary to make an opening statement.

Derek Mackay: Thank you, convener. The bill aims to give retrospective effect to an order that was considered by the committee in June 2017. That order and the bill consider the treatment of economic units—the term that is given to married couples, civil partners and cohabitants, and those who are living as if they are a married couple under the Land and Buildings Transaction Tax (Amendment) (Scotland) Act 2016. In 2016, the additional dwelling supplement—a 3 per cent additional rate of tax—was introduced. That supplement applies when, on the effective date of a transaction, a buyer owns more than one dwelling and they are not replacing a main residence. In the context of the legislation, replacing a main residence means selling the previous main residence and buying a new main residence.

It is the Scottish Government's intention that, when the additional dwelling supplement is paid, it can be reclaimed when a main residence is being replaced and the sale of the previous main residence occurs within 18 months of the purchase of what then becomes the current main residence. As ADS has been in operation, it has become clear that, in practice, the legislation has not worked as it was intended to in relation to economic units and the ability to reclaim the tax that is paid after a former main residence has been sold. That has been corrected for all transactions occurring after the order came into force, in June 2017.

Members of this committee and stakeholders highlighted a desire to secure retrospectivity for the relief in respect of the qualifying couples. The Scottish Government agrees with that view and has, therefore, brought forward primary legislation for your consideration to enable the relief to apply retrospectively. That will mean that qualifying buyers will be able to reclaim a payment of ADS when they have had to pay the additional amount despite having disposed of the previous main residence in the 18 months prior to the effective date or when they would not otherwise be able to reclaim the additional amount, having disposed of their previous main residence in the 18 months after the effective date.

I look forward to hearing the committee's views on the matter.

The Convener: Thank you, cabinet secretary. Ivan McKee has a question about groups.

Ivan McKee: Cabinet secretary, you will have seen that, in some of the submissions that we have received, there are comments from the Law Society of Scotland and others about other changes that they want to see to the LBTT regime. There are also some comments on the process whereby Revenue Scotland and the Government interacted and were involved in reviewing and making changes as required. I do not know whether you have had a chance to look at those submissions. Do you have any comments to make on any of those areas?

Derek Mackay: I am aware of some of those issues, but I want to be clear that the scope of the bill is really tight—it just gives effect to what we know we need to fix. The scope is tight, the purpose is clear and that is what I want to achieve.

Other people have engaged in other matters relating to LBTT, and there are wider issues. It would be nice to have a finance bill like the one at Westminster that is able to do a lot of tidying up when there might be unintended consequences and anomalies or when refinement might be required. That would be a great place for such issues to be addressed in the future. However, issues such as the group shares issue and other matters are not part of this bill. I think I have a remedy that would help with that specific issue, but I will write to the committee before I announce anything—I will not prejudice or preview that now.

There are other matters that are not relevant to the purpose of this piece of legislation but that I will reconsider in the light of the engagement that we have had over the last wee while.

Ivan McKee: Thanks very much.

Murdo Fraser: I remind members of my interest as a member of the Law Society of Scotland.

Before I ask my question, I thank the cabinet secretary for bringing the bill forward. He will recall that I wrote to him on the issue some time ago, raising a matter that involved constituents of mine who were caught by this particular loophole. I am delighted that the cabinet secretary has acted on that.

Derek Mackay: It is terrifying what we can do when we work together.

Murdo Fraser: Isn't it marvellous? We should do more of it, cabinet secretary.

The Convener: Hear, hear.

Murdo Fraser: My question relates to a comment that was made by the Law Society in the evidence it has submitted to the committee. The society welcomes the bill as it is drafted, but it makes the point—which I think is quite an important one—that the measure will require to be given wide publicity once the bill is enacted to ensure that the taxpayers who have been caught out are aware of the change in the law and that, if they have paid ADS, they are able to reclaim that. How does the Scottish Government propose to publicise the legislation, assuming that Parliament passes it?

Derek Mackay: I am not sure that a mass publicity campaign would be the most proportionate, effective or targeted intervention, whereas Revenue Scotland will have a very clear function. It has been aware of our desire to remedy the situation, so I think that we will engage with Revenue Scotland and see how it approaches it.

I am happy to have Revenue Scotland engage with the committee—it is not for me to do so—if the legislation is successfully passed, explaining how it will contact people who are entitled to reclaim the money. I am sure that constituency members will also get back positively to cases that have been raised.

We have estimates of the cost and of how many people the bill should affect—that is all in the financial memorandum. It is a fair point that we must try to identify them. In any event, the legal world will be well aware of the bill and will raise publicity, but it is a good question for Revenue Scotland.

The Convener: I think that Ivan McKee still has a quick question.

Ivan McKee: Just for the sake of completeness, I wanted to refer on the record to my entry in the register of members' interests with respect to residential property.

The Convener: No other committee member has identified that they wish to ask a question at this stage. Thank you, cabinet secretary. The clerks will now produce a report for the stage 1 process.

Meeting closed at 11:49.

This is the final edition of the *Official Report* of this meeting. It is part of the Scottish Parliament *Official Report* archive and has been sent for legal deposit.

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

All documents are available on
the Scottish Parliament website at:

www.parliament.scot

Information on non-endorsed print suppliers
is available here:

www.parliament.scot/documents

For information on the Scottish Parliament contact
Public Information on:

Telephone: 0131 348 5000
Textphone: 0800 092 7100
Email: sp.info@parliament.scot

The Scottish Parliament
Pàrlamaid na h-Alba