



OFFICIAL REPORT
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Finance and Constitution Committee

Wednesday 16 November 2016

Session 5



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FINANCE AND CONSTITUTION COMMITTEE

11th Meeting 2016, Session 5

CONVENER

*Bruce Crawford (Stirling) (SNP)

DEPUTY CONVENER

*Adam Tomkins (Glasgow) (Con)

COMMITTEE MEMBERS

*Neil Bibby (West Scotland) (Lab)
*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
*Ash Denham (Edinburgh Eastern) (SNP)
*Murdo Fraser (Mid Scotland and Fife) (Con)
*Patrick Harvie (Glasgow) (Green)
*James Kelly (Glasgow) (Lab)
*Dean Lockhart (Mid Scotland and Fife) (Con)
*Ivan McKee (Glasgow Provan) (SNP)
*Maree Todd (Highlands and Islands) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Russell Gunson (Institute for Public Policy Research Scotland)
Derek Mackay (Cabinet Secretary for Finance and the Constitution)
Professor Anton Muscatelli (University of Glasgow)
Michael Russell (Minister for UK Negotiations on Scotland's Place in Europe)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Finance and Constitution Committee

Wednesday 16 November 2016

[The Convener opened the meeting at 09:30]

Interests

The Convener (Bruce Crawford): Good morning and welcome to the Finance and Constitution Committee's 11th meeting in session 5. As this is the first public meeting of the committee that Dean Lockhart has attended, agenda item 1 is a declaration of interests. I warmly welcome him to the committee and invite him to declare any relevant interests.

Dean Lockhart (Mid Scotland and Fife) (Con): Thank you, convener, and good morning. I am a member of the Law Society of England and Wales, I own heritable property in Scotland and I have a shareholding in a smart metering company that is based in England and has no business interests in Scotland.

The Convener: Thank you.

Deputy Convener

09:30

The Convener: The next item is to choose our deputy convener. Prior to doing that, I express very sincere thanks and gratitude to Alex Johnstone for the work that he has done not only in this committee but in the Devolution (Further Powers) Committee, which we were both members of in the previous parliamentary session.

Members: Hear, hear.

The Convener: On behalf of the committee, I pass on our best wishes to Alex and his family.

Parliament has agreed that only members of the Scottish Conservative and Unionist Party are eligible for nomination as deputy convener of the committee. I invite nominations for that position.

Murdo Fraser (Mid Scotland and Fife) (Con): I nominate Adam Tomkins.

The Convener: Only one nomination has been received, so I invite the committee to agree that Adam Tomkins be chosen as deputy convener of the committee. Are we agreed?

Members *indicated agreement.*

Adam Tomkins was chosen as deputy convener.

The Convener: I congratulate Adam Tomkins and look forward to working with him.

Adam Tomkins (Glasgow) (Con): Thank you—me too.

Public Finances and Economic Performance

09:31

The Convener: Under item 3, we continue our pre-budget scrutiny by taking evidence on the public finances and economic performance. I welcome our two witnesses: Professor Anton Muscatelli, principal of the University of Glasgow; and Russell Gunson, director of the Institute for Public Policy Research in Scotland. We have received submissions from both our witnesses. Before we move to questions, does either of the witnesses want to make a short statement? I take it from your nods that you both do—on you go.

Professor Anton Muscatelli (University of Glasgow): Thank you for the invitation to attend the meeting. The committee will have seen my submission, so I will not detain members too long. I emphasise as an overarching point that the current Scottish budget is being set in an uncertain environment. The United Kingdom's economic scenario has changed markedly. If we look at what most forecasters expect now compared with what they expected in March or May, we can see that the economic outlook has deteriorated. Some of that has nothing to do with recent events but has to do with a general deterioration in the economic outlook for the world economy and a slowdown, and some of it might be to do with local issues because of uncertainty about the Brexit referendum, but it is difficult to disentangle the two effects.

Scotland has also had a slowdown in its recent relative economic performance that, with the new fiscal framework, will impact on the available finances that the Scottish Parliament will have to decide on in the budget. As I said in my submission, there are other effects because of the depreciation in sterling that will have an indirect effect, through spending decisions, on the economic situation in Scotland and in the UK.

Another key issue is the interdependencies with the UK Government's and Chancellor of the Exchequer's decisions in the autumn statement, which now has a tradition of containing a number of budgetary or taxation announcements—there is no longer just the showpiece of the single budget. That is the case even more this year because, in effect, a new UK Government has taken office and we know that the fiscal policy will be reset. How that fiscal policy is set out will be critical for the traditional Barnett effects and for the impact through the interdependencies of income taxation decisions that might be announced ahead of next year.

Those are the main uncertainties that the Scottish Parliament and the Scottish Government face as they set their budget. I am happy to explore those issues in detail, as set out in my submission.

Russell Gunson (Institute for Public Policy Research Scotland): Thank you for having me here. Anton Muscatelli has already used what will probably be the word of today, which is "uncertainty". We had uncertainty before the Brexit vote in June, we have certainly had it since then, and the US election last week only adds to that for Scotland and the UK.

We have begun to see some of the likely effects. In the short-term, the economic outlook was looking weaker prior to June's vote, but it has looked weaker still since that. The vote will certainly bring strong headwinds against the Scottish and UK economies, and the effect is likely to take two forms. One is that we are likely to see an inflation shock. Some estimates put it at 4 per cent, but there will certainly be an increase in inflation towards the second half of next year, with reductions in living standards coming on the back of that.

Secondly, we are likely to see a growth shock. The Institute for Fiscal Studies has put a figure of about £25 billion a year on the black hole that the UK Government is facing by 2019-20. That will affect our public finances across the UK and in Scotland. In Scotland, we were already facing significant cuts—let us not forget that, not that any of us round the table would. Those cuts amount to about £2 billion a year for non-protected departments and, by our estimates, cuts to benefits will amount to £600 million a year by 2020. If there are further cuts in the autumn statement next week to fill the black hole, we are likely to see further cuts to the Scottish budget.

Over the medium and long term, there are things that we in Scotland and the UK need to focus on regardless of Brexit, and one of the main ones is productivity. The absence of productivity growth has been at the core of our missing and misforecasting many economic growth targets in the past few years. Regardless of where we sit in relation to the European Union and the UK, a focus on productivity has to be a key thing for the Scottish Government in the current session of Parliament and beyond.

On the public finances over the medium to long term, unfortunately, cuts are likely to continue through and beyond the current session of Parliament, and beyond that, demographic change will hit our finances across the UK and in Scotland. In short, public spending pressures will not disappear any time soon.

That is, if you like, the dismal part. The more positive side is that there are things that we can do about that, and it would be great to get into some of those potentials today.

The Convener: Some of my colleagues want to ask about productivity and growing the economy, and also about consumer spending and the impact on those who are on lower incomes. However, I will get some of the scene setting done first.

You set out clearly in your submissions the significant challenges that the UK economy as a whole faces but, given that the overall size of the Scottish budget in the future will be linked to the Scottish economy's performance, I would be interested to know whether you have a take on what the differentials might be between what will happen in Scotland and what will happen in the rest of the United Kingdom, particularly as a result of Brexit. I would like to understand where the performance of the UK and Scottish economies is likely to be similar, where there may be a divergence and, if a divergence happens, which direction we will go in.

Russell Gunson: The key issue in the Scottish Parliament's budget is tax revenue differentials. There can be different economic growth rates, but the key is whether tax revenue per head is increasing at a faster or slower rate in Scotland than in the rest of the UK. To answer that question, we have to look at where there might be risks or opportunities in Scotland given the particular make-up of our economy.

On the positive side, the drop in the pound's value has had a strong positive impact on export industries—such as whisky and tourism—that have quite a lot of the supply chain based in Scotland and which import fewer things from outside. However, energy costs might affect that in the future. On the negative side, I will leave it to Anton Muscatelli to talk about higher education, where there are headwinds—caused by Brexit and other things—that might particularly affect Scotland. We can also talk later about the inflation effects that might affect Scotland a bit more than other parts of the UK.

Professor Muscatelli: The concern over the next three years is not likely to be the direct impact of Brexit because, even if it goes according to the timetable that the Prime Minister announced, Brexit is unlikely to happen before the end of the forecasting period. Therefore, we are looking more at the expectation effects of Brexit: the depreciation of the pound and what it does to consumer and business confidence.

Russell Gunson mentioned that the depreciation of sterling will have a differential effect. We would expect food and drink—for which the value chain is largely in the country, so costs are not likely to

increase too much because of import costs—to do well.

We would also expect higher education to do well because of depreciation effects making it more competitive. The problem is what might happen on net migration targets and any impact that that might have on student visas. Higher education is interesting because it was outside the top 10 exports from Scotland but is getting quite close to being one of them. However, it could be hampered by any tightening on student visas.

There are some interesting effects on the oil industry because revenues are in dollars and the cost base is partly in pounds. That could help, but it is also connected largely to what might happen to the oil price, so the situation is a bit more complicated.

The depreciation of the pound in the short term and the inflation shock, which might be aggravated by the depreciation of the pound, might affect consumer spending. As I said in my paper, a lot of employment in Scotland is linked to the public sector, and salaries in the public sector might well be constrained by the public finances.

We then have the inflation shock, which might be aggravated by the depreciation. As Russell Gunson said, inflation could reach 3 to 4 per cent next year, depending on which forecast we believe. That will reduce the purchasing power of public sector salaries and have an impact on consumption locally, so it will be an issue for the Scottish economy's performance relative to that of the rest of the UK, as we depend more on public sector employment than the rest of the UK does.

The Convener: That begins to paint the picture for us. I will take us to a slightly bigger issue in terms of the numbers, as Ivan McKee has put it: the £25 billion.

Ivan McKee (Glasgow Provan) (SNP): I thank Mr Gunson and Professor Muscatelli for coming in to talk to us. I am looking for a bit more background and for you to shed some light, if you can, on the £25 billion black hole, which you both mentioned. A number of issues drive that, such as the growth shock, the inflation shock, the drop in the value of sterling, the anticipation of a reduction in demand and the anticipation of a reduction in inward investment. As far as I can see, all of that is Brexit driven. Is that fair to say?

Professor Muscatelli: Not all of that is Brexit driven. As I said, a slowdown was in train even before Brexit, post this year's budget. Brexit has possibly had an impact on consumer spending and business investment spending in the UK but, to disentangle the two effects, we will have to wait for a few more quarters to see exactly how that has worked.

I will try to disaggregate the £25 billion effect. The Institute for Fiscal Studies report that Russell Gunson and I mentioned in our submissions shows that £24 billion of that is slower gross domestic product growth. Slower growth in the UK economy between what George Osborne said at the time of the budget and now means that, if we look at growth over the next two or three years, there will be a gap in the tax take.

I will show the committee how sensitive the figures are. If the growth projections by the IFS and by other forecasters such as the Bank of England come true, by 2019, we will have reached only the level of GDP that we would have reached a year previously under George Osborne's forecast—the Office for Budget Responsibility's forecast, to be precise. Therefore, in effect, we will lose a year of growth, which gives members a measure of the tax take.

There are higher inflation effects, because of taxation.

It is important to say, too, that the IFS is assuming that we will get some money back in EU contributions by leaving the EU by 2019-20. If that were not to happen because we had entered into a deal with the EU on a free-trade agreement, and if we carried on paying between £8 billion and £10 billion, the gap would be not £24 billion but £24 billion plus £8 billion or £10 billion, because people are accounting for £8 billion.

09:45

Ivan McKee: I was going to ask whether that had been factored in. I know that £350 million a week must be the true contribution, because I read it on the side of a bus. That amounts to about £17 billion a year, so the black hole might be double that. Has the contribution been factored in?

Professor Muscatelli: It has been factored in.

Ivan McKee: It is possible that we will have to fork out in a kind of pay-as-you-go approach for the EU services that we currently enjoy, so the black hole could easily be £32 billion or £34 billion.

Professor Muscatelli: That is an issue, whether we are looking at the Norwegian model or the Swiss model. The Swiss model is a self-standing free-trade agreement, and the Swiss pay quite a lot per capita into the EU budget.

Ivan McKee: So the Brexit black hole could be £25 billion or as much as £34 billion or £35 billion, depending on the payments.

Russell Gunson: As Anton Muscatelli said, a chunk of that was in train before June's vote, but there has been a large effect on the back of the vote.

Ivan McKee: The previous forecast was made in the March budget, and there were only a few weeks between that and the vote on 23 June. I assume that George Osborne was not so completely clueless that the forecast changed within days or weeks of his budget. Unless you can give me evidence to the contrary, I must assume that the vast majority of the black hole is the Brexit black hole.

Professor Muscatelli: Much as I would like to attribute everything to Brexit, I think that we need to wait for a few more quarters to see the effect, but I agree that there is an effect.

Ivan McKee: It is clear that there are some issues. We potentially face cuts of 20 per cent in certain spending areas and we need to grow our way out of the situation. What extra powers could Scotland get in the short term, in addition to what is coming, to give us levers to drive growth in the Scottish economy?

Russell Gunson: Two weeks ago, one of the two Davids—David Heald and David Bell—gave members a smart answer when he said that he would not give a political answer to a political question. However, you ask a fair question. In the short term, there are only a few additional powers that the Scottish Parliament could get that would affect the situation.

As I said in my opening remarks, it is productivity growth that underlies the issue whereby making forecasts seems to be more like chasing rainbows. Almost every time the OBR makes a forecast, it says that in 18 months' time everything will be back to normal, but the trouble is—

Ivan McKee: That is a UK-wide problem.

Russell Gunson: It is a UK-wide problem. The trouble is that a budget event happens every six months, but we are always 18 months away, and we have been like that for the past five years or so.

The underlying issue is productivity, and how do we affect that? I have to say that that is a bit of a holy grail. The Parliament already has huge powers that could affect productivity. It has powers in relation to skills and the education system, and it has powers to borrow for infrastructure investment, although the question is whether the borrowing powers are significant enough for such a purpose.

Ivan McKee: The borrowing powers are there to cover shocks in the fiscal forecast, not to drive significant investment.

Russell Gunson: There are small capital expenditure borrowing powers, are there not?

The short answer is that this is a long-term problem. Powers in the short term might have some effect, but we need to focus on the long-term issue.

Ivan McKee: Is there nothing specific that the witnesses think that it would be helpful to have in Scotland?

Professor Muscatelli: You will have seen the report from the Council of Economic Advisers, of which I am a member. I strongly endorse the part of the report that covers the issue.

Within the wider UK picture that Russell Gunson described, an issue that Scotland faces is the onshore impact of the decline of the oil and gas industry. We need to look at sectors that are highly innovative. From engineering to life sciences, there is huge potential.

Two thirds of research and development spend is happening in the higher education sector, which has strengths that absolutely are global, but we need to generate the demand pull. The report shows how complex the innovation ecosystem is. Some of that complexity is important, and it is not straightforward to manage. However, how we seed the space around the highly successful scientific base that we have in Scotland, to try to create more demand pull to attract more R and D units to Scotland in major industries, will be absolutely key.

The Scottish Further and Higher Education Funding Council has invested about £90 million—I will need to check that figure; it is certainly tens of millions of pounds—in the innovation centres, but that is still only a fraction of what Germany invests in its industrial strategy. If we look at the UK picture, we find that what Innovate UK—it is supposed to play a similar role—puts in is a fraction of what Germany spends. Germany has increased its research and development spend from the public sector considerably in the past few years, and so have China and France, even at times of fiscal stringency. The UK has not. We need to look at how to get the best possible investment in the interface space between industry and the science base, which is strong in the UK and in Scotland in particular.

Murdo Fraser: Good morning. I have a follow-up to Ivan McKee's questions to Professor Muscatelli about the £24 billion that he mentioned as the economic shock cost of Brexit. Is that figure predicated on a hard Brexit? Might it vary, depending on the type of Brexit that might occur?

Professor Muscatelli: As I understand it, I do not think that the IFS makes such a distinction in its report, partly because it is a forecast up to 2019-20. I was being slightly facetious earlier. The main impact of Brexit that we have seen so far is a slight slow-down in addition to what was

happening on consumption and business investment growth. As I have said previously in the press, the real impact will happen after 2019, or whenever Brexit happens, because that is when our trade links will get disentangled, particularly if it is a hard Brexit. At the moment, the IFS is not making a judgment on that. The gap is largely because of the slower than projected GDP growth. That has happened partly in expectation of Brexit and partly because the global environment has deteriorated in the past few months.

Murdo Fraser: Is it fair to say that the UK economy has performed relatively well since June compared with the economies of our European competitors? In the past few minutes, the unemployment figures have come out. Unemployment is now at its lowest rate since 2005 and economic growth in particular sectors seems to be accelerating, so should we be so downbeat about our prospects in the short term?

Professor Muscatelli: It is all relative. It was not just the chancellor who in March was forecasting better GDP growth; it was the OBR, too. There has definitely been a deterioration in prospects. You are right that we have not fallen off a cliff, but a number of commentators on Brexit, including me, said that it was not to be expected that we would fall off a cliff before Brexit happened. The effects of Brexit will come once the trade linkages are broken—if they are to be broken, for example through a harder Brexit.

It is good that we are still getting growth in the system, but I come back to a point that Russell Gunson made: the employment figures are good but, given that growth is slowing down, that does not paint a very good picture on productivity. That is a key issue. We are not generating employment through productivity growth.

Russell Gunson: I should add that what has happened is pretty much in line with the central estimates prior to the Brexit vote in June. It turns out that the experts that Michael Gove disparaged were not entirely wrong. The central estimate of what would happen with the devaluation of the pound has proved to be pretty much spot on. The IFS uses an average of a range of independent forecasts; it is not just a single forecast of its own.

We can look at the economic growth situation and the unemployment figures, but if we look at tax revenue or productivity growth, the picture is a lot more negative.

The Convener: I want us to move on and paint some of the potential scenarios for that big picture and how they might translate to Scotland. Ash Denham wants to pick up some of those issues.

Ash Denham (Edinburgh Eastern) (SNP): Mr Gunson, in your interesting submission, you present three different scenarios that you think

could affect Scotland's future public finances. They range from a 15.3 per cent cut in the public finances to a staggering 21.6 per cent cut over the period up until 2019-20. Could you lay out what those three scenarios are?

Russell Gunson: Yes. First, a large number of cuts are already on their way. We estimated that, as of March, prior to anything to do with Brexit votes and prior to anything to do with the economic shocks, there would be £2 billion of cuts per year in real terms up to 2019-20 compared to 2015-16. That is just in the spending of the Scottish Parliament; there is another £600 million of cuts for those who are in receipt of social security in Scotland aside from anything that comes through Holyrood.

In addition, we looked at how Philip Hammond, the chancellor, could fill the black hole next week in the autumn statement. One option would be for him to fill it entirely from additional borrowing, which would not be a stimulus in that it would just maintain public spending plans as they were in March. In essence, that borrowing would just allow us to stay where we were.

The alternative would be to cut day-to-day spending, which has been done in the past. We looked at three scenarios. In the extreme scenario, the chancellor could use public spending to find the full £25 billion to achieve the surplus that we heard so much about from the previous chancellor. That would lead to £1.3 billion of cuts in Scotland in addition to what is already planned for non-protected departments. If he took quite a balanced approach, but one that would still lead to additional cuts to day-to-day revenue spending, he could fill about a quarter of the £25 billion black hole from day-to-day spending, which would lead to cuts of about £340 million a year in Scotland. In the scheme of a £30 billion budget, that would be a 1 per cent cut, which some might say we could deal with. However, in the context of significant additional cuts having been made already and the Scottish Government having very little to spend, £340 million is a huge amount of money.

Ash Denham: Which of those options do you think is the most likely to be chosen?

Russell Gunson: I fall back on the keyword for today: uncertainty. Two weeks ago, one of the Davids said that he had never felt so unclear about the UK Government's approach, and I share that view. We do not know and we are receiving mixed messages. We know that a couple of the rules have been thrown away, but we do not know whether we are going to see significant fiscal stimulus or, indeed, any kind of stimulus. We do not know whether the chancellor is going to use the Government's books to find new forms of innovative funds or whether we are not going to see anything.

Professor Muscatelli: Like you, no doubt, I have heard that there might be a delay in achieving the budget surplus. That would take us towards scenario 1, at least for this horizon. The other possibility is that the Government might move towards a golden rule-type arrangement whereby it does not balance the books in total but shifts between current and capital spend. If that is the case, that could help us to offset some of the effects, although it would still mean having to find savings from within revenue budgets. Those are the two scenarios that have been painted by economic commentators as the most likely. The Government might not try to hit the target that was set originally but delay it by a year, and there may be a golden rule on top of that to avoid some of the more dramatic additional cuts of scenarios 2 and 3 in Russell Gunson's paper.

The Convener: Whatever scenario we have in the environment that is coming, it will impact on consumer spending, wages and those on lower incomes. A number of members want to ask questions about that area.

Neil Bibby (West Scotland) (Lab): You have mentioned a few times the issue of consumer spending and the effect of public sector wage constraints. We know that people on the lowest incomes spend more of their disposable income than those who are on higher incomes. Can you expand on the impact that public sector wage constraints would have on consumer spending? What sectors of the economy may be affected? You mentioned that Scotland is more reliant than the rest of the UK on public sector employment. How much more reliant on it are we?

Professor Muscatelli: I have not done any calculations of the impact that that could have on Scotland's growth, but we are quite a bit more dependent on public sector employment. People on lower incomes tend to spend more of their disposable income, so some impact on them would be expected. It would not help our aim of reducing inequalities because we expect that impact over the next two to three years, which is not at all helpful. I have not quantified what the impact would be for GDP growth or tax revenue; it would have less impact on tax revenue, as Russell Gunson has emphasised in his paper. For obvious reasons, that reduction in consumption would probably feed through to the tax base only after a lag.

10:00

Russell Gunson: With regard to the inflation effect on poorer households in Scotland, as well as public sector workers there are people who are on fixed incomes, in particular those on social security other than pensions. We should not forget that, although inflation reached around 5 per cent

after the 2008 crash, benefits were then index linked so that those who were on fixed incomes and the lowest incomes were protected to some extent from that inflation shock. This time—as of April this year—there is a cash-terms freeze on working-age benefits, implemented by the UK Government, so you could consider public sector workers in terms of the social aspect. It would be a different question if you were considering the economic aspect; if the Government wanted to boost the economy, would it do that through public pay increases? I do not know. However, the social effect on people on benefits of a cash-terms freeze when inflation is at 4 per cent is very different from the effect of a freeze in the low-inflation environment that I believe the UK Government expected.

Maree Todd (Highlands and Islands) (SNP): I want to ask about precisely that area. I understood from your paper that the full inflation shock will be passed on by the UK Government to the poorest people in society. A few weeks ago, I asked the two Professor Davids what the Scottish Government or the UK Government could do to protect those people and mitigate those effects.

David Bell replied that the UK Government could consider not passing on some of the benefit cuts that are planned, but I get no sense that that is a likely outcome of next week's budget. Although it is saying that it will freeze benefits—and not go any further—it has already committed to a considerable cut in social security budgets. I ask for your thoughts, in particular on whether there is anything that we or the UK Government can do to mitigate the situation, which is pretty dire for the poorest, most vulnerable people in our society.

Russell Gunson: The place to start is that pensioners should be protected from inflation shocks through the famous—or infamous—triple lock. Pensions go up by whichever is the bigger of earnings growth and inflation; inflation will no doubt be bigger than earnings this time round.

Therefore, we are looking here at people other than pensioners. It is uncertain as to when the social security powers will come to the Scottish Parliament, but it will not be in time for next year's inflation effect. If that effect is more prolonged, there may be things that the Scottish Parliament can do through those new powers, such as topping up. However, the cost of that would be very significant and would only add to the pressures in the budget that we have outlined elsewhere. It falls to the UK Government in the main. There may be some mitigation that the Scottish Parliament can do—as was done with the bedroom tax, for example—but that will be around the edges compared with what the UK

Government could do in its overall social security policy.

If members are getting no sense from the UK Government, there are a good few people who are getting no sense from the UK Government in a variety of ways. On social security, we do not know; there is pressure within the UK Government to abandon some of the cuts that are already planned, whether that is the freeze or, more likely, some of the cuts to work allowance and universal credit.

In short, the cuts to benefits that have yet to happen are greater than the cuts that have happened already. If inflation is on top of that, we can see how those very households that are facing big cuts could be under huge pressure.

Professor Muscatelli: I totally endorse what Russell Gunson has said—it is a poor outlook for those on working-age benefits. The only thing that I would add to what Russell said is that some commentators are urging the Government to look at that triple lock, especially for wealthier pensioners. If we are really worried about the effects on inequality, the triple lock is also protecting pensioners who have very good occupational pensions, so something could be tried at that end to alleviate what is happening at the bottom end of the income distribution.

James Kelly (Glasgow) (Lab): Russell Gunson's submission highlighted the inflation shock, which he has also spoken about in some of his answers. He looked at the potential impact on the Scottish budget and highlighted two areas where there might be exposure—the national health service and police budgets. Can he expand on that a wee bit?

Russell Gunson: There are only a few spending commitments—as opposed to policy commitments—within the Scottish Parliament's spending budgets. Those are, in essence, the protected departments. There is NHS spending, which is pledged to go up by £500 million plus inflation by the end of this parliamentary session, and police budgets, which are protected in real terms throughout the session. There is also a floor on college spending in cash terms; that is not necessarily protection, but it is still more protection than other departments may face.

The interaction with inflation is a relatively complicated one. It is not quite as simple as saying that, if inflation goes up, then, to protect those budgets in real terms, we must match the inflation rate. We use something called the GDP deflator, which I will not go into, but it is slightly different and likely to be a little lower than inflation. However, it is likely to lead to pressures to increase those spending commitments at a higher rate than otherwise.

On the revenue side, I highlighted the potential effect of the inflation shock on the income that is raised through the income tax policy of freezing the higher-rate threshold with inflation. In short, that may mean that the gap between the higher-rate threshold in Scotland and the higher-rate threshold down south is narrower than we expected it to be when we announced that proposal, which may mean that we raise less money, because the differential is the key to how much money we raise from tax policy in Scotland.

It is likely that there will be pressures across all budgets, although they will not be quite as significant as the numbers that we are talking about in relation to the impact of inflation on health and police budgets. That is regardless of whether we are pushing the pressures to deal with higher energy costs and so on down to the departments. There will be pressures across the public sector.

Professor Muscatelli: Some of the protected sectors are more dependent on those non-pay costs. In the NHS there is the drug budget, for instance, and energy costs. Those are areas that will experience additional costs, even if it is possible to control public sector pay to avoid that being fully linked to inflation, and they will erode some of the additional spend in protected departments.

James Kelly: Would you expect areas such as the drug budget to rise by more or less than the projected inflation rate?

Professor Muscatelli: As we know, those costs tend to rise faster than inflation anyway because new drugs are constantly being introduced. The exchange-rate effect arises largely because those drugs are internationally traded commodities, which will be priced higher in sterling. That would tend to match the exchange-rate effect to the GDP deflator.

James Kelly: Given that the Scottish Government is obviously aware of all those factors, what steps could it take to minimise exposure to those inflation shocks as it is preparing the draft budget that will be published in a few weeks?

Professor Muscatelli: That is not easy and they are not easily avoidable because the effects are complex. The Government should probably, as Russell Gunson pointed out, look at the differential effect between different sectors that are more exposed to an inflationary shock. Beyond that, there is not much that you can avoid.

Another effect—it was mentioned earlier, but we have not discussed it yet—depends on what the UK Government does with tax thresholds and whether they are fully indexed. If they are, that would have an interactive effect with the modified block grant that Scotland receives, so it would

need to be factored in. The Scottish Government has a difficult forecasting job on its hands in looking at that effect, too, because it will be key in determining certain things. For instance, the effect of freezing the thresholds on higher-rate tax might be eroded if the UK Government announces a change in policy in the autumn statement. Those things have to be properly calculated.

Patrick Harvie (Glasgow) (Green): Good morning. I want to return to the question about the differential impact on different groups in society, but I will quickly pick up on one of the points that Russell Gunson discussed with James Kelly about the potential for increased inflation to erode the extra revenue that the Scottish Government hopes to generate by retaining the current thresholds for the higher rate. Presumably, if that were to happen, it would take only a very modest increase to that higher rate to restore the lost additional revenue. Do you know how much that would be?

Russell Gunson: I am afraid that we have not done the modelling to give you an exact figure for that. However, to give you an idea, if inflation were to reach the levels projected by the independent forecasters that the IFS brought together, it would be likely to bring the higher-rate threshold in Scotland up to something like £47,000 a year by the end of this parliamentary session, as opposed to £46,000, which is what it was projected to be. A difference of £1,000 does not sound like a huge amount, but, back in March, that would have meant a difference of about £150 million a year in revenue. There is not an even distribution at that level of income—you could not simply say, “Reduce it by £1,000 and that will get the money back”. That is the rough ballpark figure for what you are talking about.

Patrick Harvie: It sounds as though only a modest increase to the higher rate would be needed to restore the lost revenue if the Government were to decide that its policy objective was not to freeze the rate for high-income people, but to generate the extra revenue that it had said that it would have.

Russell Gunson: We are actually talking about a decrease in the threshold from £47,000 to another figure.

Patrick Harvie: Sure, but the Scottish Government is free to set the rate now.

Russell Gunson: Yes, but the 40 per cent rate—40p in the pound—is not what we are talking about; we are talking about the threshold. Perhaps one would have to be a higher-rate taxpayer to say whether that is a modest amount.

However, you are right, in that the core of your question is whether the Scottish Government should protect, in real terms, the higher-rate

threshold or protect the revenues that it was seeking. That is a perfectly good question to ask.

Patrick Harvie: I want to return to the earlier set of questions about people who are at the sharp end of the impacts. They are not higher-rate taxpayers and they are not people on high incomes who can well protect themselves from the effects of increased inflation or from a squeeze on public services. The people who will be most at risk from reduced public sector pay, from the freeze on social security payments or from the impact of inflation and cuts to public services are likely to be the same groups of people who are most acutely affected by all those factors. Have you done any work on understanding the way in which particular groups—women, young people, or disabled people—will be affected, as opposed to the cumulative effect across society as a whole?

Professor Muscatelli: I have not done any modelling of that type, but an extrapolation could easily be done. The IFS usually does a very good impact analysis of the income distribution by decile that could easily be looked at for Scotland. I agree that that is where the negative impact is most likely to be felt.

Russell Gunson: Likewise, we have not done any work on that, but there are a number of studies that show the intersectionality between disability, gender and poverty. From that, you can extrapolate that, if those in poverty or on low incomes are being hit hardest, it is likely to hit hard on those other groups, too.

10:15

Patrick Harvie: One thing that might be called for in response to that is investment in social infrastructure. Traditionally, if there is a bit of extra cash floating around in the short term—people have suggested that there might be a little bit of short-term stimulus on the capital side—it is hard building infrastructure that gets priority, such as shovel-ready projects and the like. That has a lower economic benefit, particularly for women, as the area that gets the employment benefits is more male dominated.

If we have any loosening in the short term, a case can be made that investment in social infrastructure will have the maximum social and economic benefit. In areas such as childcare, traditional measurements of productivity do not really apply because, if we reduce the number of people working in the area and try to provide the same level of service, we get a rubbish service as a result. The benefit is measured in a less bean-counting kind of way. Will you comment on the case for investment in social infrastructure if, in a

week's time, we hear that there is some short-term loosening?

Professor Muscatelli: It is about striking a balance. In the report that we presented as the Council of Economic Advisers to the Scottish Government, we urged it to continue its work on an inclusive growth diagnostic—inclusive growth is at the heart of the Government's economic strategy—and to look at those areas in which we can have positive impacts on both growth and the distribution of income. You mentioned childcare, which is an interesting example. In that area, we can have a positive effect on outcomes for those groups, not all of which can be measured in terms of productivity and GDP, as you said, and also an impact on growth, because we will potentially improve employment prospects at that end of the income distribution.

However, returning to where we started in our conversation, I balance that by adding that we also need to consider what investments are going to boost productivity and the tax base of the whole economy in the longer term because, ultimately, it is about not just the next two or three years but what happens after that in terms of our growth and tax performance relative to the rest of the UK. I absolutely take your point, but it is about striking a balance.

Russell Gunson: I agree. We are facing two sides of the same challenge over the long term. One is to do with tax revenues, productivity growth and economic growth and the other is how we afford our public services and, potentially, get more efficiencies out of them. Those things are unified by potential investments that we can make now for the long term that will achieve one, the other or both.

It is about not just employing people to build new childcare centres or new roads—although, as members of the commission on widening access, we would agree that it is important to try to affect the gender balance in parts of those sectors—but the effects on the economy beyond that. Although the people who are employed through the investment might not be balanced, the effects on the economy may well be more balanced in terms of gender or any of the other aspects that you mention.

Patrick Harvie: Thank you.

The Convener: That is an interesting area. However, from what I have seen and what various commentators have said, if that room develops in the budget, it is likely to be strictly in the area of capital spend. It is less likely to be in revenue spend, which is what some of the areas that Patrick Harvie mentioned are driven from. Are there areas of capital spend rather than revenue spend, which is where the wages would come

from, that we can use to improve that social capital?

Russell Gunson: First, the capital budget, at roughly 10 per cent, is much smaller than the revenue budget, at 90 per cent. Secondly, any stimulus is unlikely to save us from the numbers that we talked about earlier. Any short-term boost may well be much smaller than the cuts that we already face, never mind any others that come.

Thirdly, a lot of the stimulus or investment that we have seen on the capital side in recent years has been not necessarily through cash capital but more through using the Government's books and the power of Government guarantees and so on. There have been innovative financing investments, and we have seen a lot of that in housing in particular. We get that money to spend, but how we can spend it and what on is quite restricted.

Having said all that, we can make capital investments in areas such as health and childcare that will get our public services and the social side of our country ready for what we need to face over the next 10 to 15 years.

The Convener: I guess the downside to that is what you said about the productivity and economic driver issues, which might not help as much with the tax take.

Russell Gunson: They might not be dislocated. Inclusive growth is absolutely the right priority. Investment in childcare is a perfect example of where we can see huge economic benefits while also tackling social inequalities.

The Convener: That would begin to address some of the longer-term issues that you described in your written submission, particularly that of the demographics out to 2060.

Murdo Fraser: I have a brief follow-up question that is topical, given that we will debate fuel poverty in the chamber this afternoon. If some extra capital money is available in the autumn statement, would it be possible to use some of it for energy efficiency improvements in public or private housing? If so, what would be the economic benefit of going down that route?

Professor Muscatelli: Again, as Russell Gunson said, if the money is aimed at the bottom end in terms of social housing to help alleviate fuel poverty, it could have quite a good impact on consumer spending, as long as it was translated into effective consumer spend, and it could alleviate poverty at the same time. It could also have a positive impact on labour supply, because, as Russell Gunson emphasised, the same people tend to be in fuel poverty and in the poverty trap and they probably do not add as much as they could to the economy through the labour supply. I

would therefore group money for energy efficiency improvements in social spend if it started at the lower end of the income distribution.

Dean Lockhart: My question is on a slightly different point. Both the witnesses' written submissions mention that the performance of the Scottish economy going forward relative to that of the UK will have an impact on Scotland's budget, and recent reports have suggested that there is a divergence in that regard that is expected to continue. A PricewaterhouseCoopers report that came out yesterday highlighted that point. Can you give us a sense of the impact going forward on Scotland's budget if that divergence continues, given that 50 per cent of the budget will be determined by that relative performance?

Russell Gunson: Economic growth is obviously a huge determinant, but the key factor here is actually tax revenue growth per head. Across the UK, we have had economic growth that has not been particularly tax rich. Equally, although this is very unlikely, we could have slower economic growth but much quicker pay growth and tax growth. It is important to be clear that, in terms of the Scottish Parliament's budget and direct effects on it, we are focused on tax revenue growth per head in Scotland relative to that in the rest of the UK.

Recently we have seen slower economic growth in Scotland compared with that in the rest of the UK. A big part of that has been the oil and gas sector in the north-east, which has faced hard times because of the fall in the oil price over the past couple of years. The projections are for the oil price to go up a little from where it is now, and the dollar to pound conversion might benefit at the margins. However, it does not look as though we will reach the oil price levels that we saw two years ago—at least, not any time soon. We might therefore see that drag on economic growth continue for a bit longer. On the other hand, as I mentioned earlier, whisky exports and other export parts of the economy that do not have huge external supply chains to Scotland or to the UK might benefit hugely from the pound's devaluation.

Again, we have uncertainty, but the signs have been that Scotland's economy has been growing more slowly recently than the economy of the rest of the UK, and there are signs that suggest that that will continue to be the case in the future. Equally, however, there are positive signs for some sectors, particularly given the devaluation of the pound.

Professor Muscatelli: It is very difficult. Trying to forecast GDP more than two or three years out is a graveyard for economists.

David Bell and some of his colleagues at the University of Stirling did a good exercise in which

they asked the counterfactual question about how the Scottish budget would have evolved if the current arrangements had been in place when devolution started rather than how it has evolved purely as a Barnett grant. We can see that there are periods when the Scottish economy has grown much more than that of the rest of the UK so, if that can be reproduced, it would clearly be of benefit.

I agree with Russell Gunson on the short term. The challenges on oil and gas in particular will take some time to overcome. Then, after 2019-20, the situation depends on the differential effects of Brexit. If it is a hard Brexit, it has some very serious implications, as has been pointed out, particularly because there are a number of sectors that might be affected although they might not export directly to the rest of the UK. For instance, we have a large volume of exports in legal, administrative and financial services to the UK but those are part of a value chain that re-exports to the EU, so Scotland could easily be hard hit if a hard Brexit causes a dislocation of the financial services industry and the value chain around it. Similarly, food and drink could be hit if there were major tariffs on products such as Scotch whisky.

Those are the things that we need to consider further on. In the next two or three years, Scotland will probably do well to keep pace with the UK. It depends how much of a revival there is in onshore impacts from oil and gas and the other industries that are sensitive to the depreciation of the pound and might benefit from it.

The Convener: Willie Coffey has issues that he wants to pick up.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): We are on the issue anyway—my question is about the pound. Will the witnesses give us a flavour of the other likely impacts of the collapse in the value of the pound? I know of an electronics company in Ayrshire that reports that its costs have gone up by about 13 per cent since that collapse. If that kind of effect is replicated across the economy, it is bound to have an impact on spending decisions that the Government takes. I have just noticed some figures that show that the value of imports to the UK this September topped £50 billion, which is a significant jump, even compared with previous months. What impacts could the value of the pound remaining roughly as it is have?

Professor Muscatelli: What you have highlighted shows that the depreciation of the pound is really not good for certain sectors of the economy—particularly if they are part of an integrated value chain and import lots of their raw materials. There is a serious effect.

There is another issue about such a sharp depreciation. As economists always know, there is a lag, even for sectors in which there is a positive effect: it is what economists call the J-curve effect. First of all, the balance of payments deteriorates because, as Willie Coffey said, the cost of imports goes up before the volume of exports has reacted. That is what we will observe for the next little while for the UK as a whole. Our balance of payments will deteriorate as a result, unless our exporting industries are particularly sensitive to the improvement in competitiveness.

To go to the heart of the question, I worry that other factors will stop us taking advantage of that competitiveness effect, even for industries that could gain from it. That is where Brexit comes in. An industry that considers that location in the UK might be a great idea now that the pound has depreciated might nevertheless, despite the competitive advantage, decide not to come here because it will not know whether we will be part of the single market. Such effects could be really dangerous because they would mean that we would rely on industry that is already in the UK to respond to the effect.

I have mentioned higher education, which is another classic example. We could take advantage of the situation, but not if we are going to reduce the number of tier 4 visas, because we could therefore not respond to the increased competitor advantage. I worry that there will be the initial deterioration of the balance of payments and, because of the Brexit risk, that there will be neither domestic nor foreign direct investment in the UK.

10:30

Russell Gunson: There is a potential benefit to exporters, but only if they do not import a huge amount of their supply chain from outside the UK, and if we are a much more open economy than we were prior to being in the EU.

As Anton Muscatelli said, business investment is what a company—domestic or otherwise—that wants to take advantage of the exchange rate being where it is, and potentially being there for some time, would do. Unfortunately, although consumer spending seems to be pushing the economy forward and continuing the growth that we have seen since the Brexit vote in June, it is likely—although we have not yet seen the figures—that business investment has shrunk because of the uncertainty that Anton mentioned.

In other circumstances, business investment may be coming to help us through an inflation shock that will affect consumer spending next year, I would guess. That could help us to take advantage of the devaluation of the pound, with

the uncertainty around Brexit—whenever that will happen. However, that is less likely.

Willie Coffey: Is there any prospect of the pound getting back to its pre-Brexit value of about €1.31, which it was at around May? What circumstances would allow it to return to that kind of level, soon or otherwise?

Professor Muscatelli: The one set of circumstances that would allow that is the one that would restore confidence that the UK's competitive position will improve—that is, the UK Government saying that there will be a soft Brexit and that we will remain part of the single market. If that were to happen, you would see the pound rise. You will have seen that when any bit of news suggests a softer Brexit—for example, the High Court ruling—the pound shoots up for several hours before coming down again. An announcement that we will still be part of the single market would take the pound pretty much back to where it was.

Russell Gunson: That is the positive aspect of restrengthening the pound, if you like. There is a more negative possibility in respect of other currencies weakening; we are seeing the US election potentially having that effect. The pound may strengthen relative to other currencies that weaken. There are things that we cannot really predict: a lot of people did not predict Trump winning in America, for example. Big events such as that, whether in Europe or in the US, could make the UK's currency stronger relative to others, but for more negative reasons.

The Convener: Adam Tomkins has questions about employment.

Adam Tomkins: Before I say anything, I remind members of the interests that I have declared in the register of members' interests—in particular, the fact that I hold a chair in the university of which Professor Muscatelli is the principal.

The panel has painted a gloomy picture: borrowing may go up, uncertainty is increasing, revenues are being hit, there are spending cuts, inflation is rising and growth is flagging. What cheers you up? [*Laughter.*] Is the answer to that question—at least in part—that we have record employment in the UK? It is record inclusive employment: there are more jobs in the British economy, more women in work and more disabled people in work than ever before.

As far as Scotland is concerned, there is a persistent problem in that the employment growth rate here lags behind the rate of the UK as a whole, which I presume cannot be blamed on Brexit. If that is right, why is the employment growth rate persistently lower in Scotland than it is in the rest of the UK, and what should we as a Parliament do about it?

Russell Gunson: We did some work in June, part of which looked at that. It looked at what has happened across the UK since the 2008 financial crash, and compared Scotland with the rest of the UK. Scotland went into the crash in 2008 with an employment rate advantage—which it had had historically—that we lost in the crash. Employment in both Scotland and the rest of the UK dipped, but the rest of the UK recovered more quickly than Scotland did. Our employment rates are therefore now about the same, whereas we used to have an advantage.

What keeps me positive? What are we hopeful about other than our personal lives and all the good things that keep us going? [*Laughter.*]

The Convener: There is nothing to smile at there.

Russell Gunson: We could keep to our hobbies. If you are pessimistic, you can be absolutely sure that you are going to fail.

Scotland could do things in terms of productivity growth that would tie right in to employment growth. On demographic change, it is a huge success that we have an ageing population: it is not a negative. People are living longer than ever before, and that is down to us as a society, over many years and many colours of Government, getting it right. Huge opportunities come from that. If Scotland could reform public services, manage the ageing population and grow our way, productivitywise, out of what we face, we would be among the first in Europe and the western world to do so. We could crack that not just for Scotland, but for other areas, too. That view is way more optimistic than the view in the briefing that came in.

Let us return to more pessimistic matters. Why has the employment rate not been as strong in Scotland? There are so many factors. The problems in the oil and gas sector have coincided with the change. In the financial services sector, we have seen the withdrawal of high-skilled jobs from Scotland to elsewhere in the UK and the reduction in employment in financial services in Scotland over the period. Of course, the sector is also now smaller.

There are global factors, UK factors and factors that are in the Scottish Parliament's control. We have to be cognisant of them all, but focus on those that are in Scotland's control. I say—again—that productivity growth and public service reform have to be the focus for Scotland.

Professor Muscatelli: I do not think that I can add anything to the employment analysis that Russell Gunson has given you, which was very accurate. The answer is about investment and the combination of skills, and about employability,

particularly at the lower end of the income distribution, as we have mentioned.

What keeps me positive? I hope that economic rationality begins to take hold at some point in the whole Brexit debate. Over the past two to three weeks, I have written a couple of times suggesting that even the people in the debate who suggest that a harder Brexit is what the UK wants should think of soft Brexit as a staging post.

At the moment, we have so much uncertainty and concern. That has been reflected in what has happened to the exchange rate, because there is no plan and people do not know what will happen. To be frank, if somebody had asked me to devise a rational plan to disentangle us from the EU and asked how long that would take, my answer would not have been two years. It would take seven to nine years to do that in a rational way that considered all the aspects. Something that gives assurance to the economy that there is the prospect of a rational way out of the impasse will be really important. What keeps me positive is that economic rationality tends to come to the fore—not always, but usually. If it does not, people quickly learn the consequences of their actions.

There are not many other things that I can look to, I am afraid. I am probably slightly less optimistic than Russell Gunson. I can give you one other positive effect, although it has a negative tinge to it as well. If there were a rebalancing of fiscal and monetary policy and a rise in long-term gilt yields, pension deficits would begin to come down in the UK. However, we need to recognise that that would have an impact on borrowing rates, which would have an impact on families who are dependent on borrowing for housing. We have not talked much about rebalancing fiscal and monetary policy, although we are beginning to see the impact not only of the Trump election, but of Brexit on gilt yields in the UK.

The Convener: That would probably open up a whole new session of discussion. In the meantime, I am very grateful to Professor Muscatelli, and to Russell Gunson from the IPPR, for coming along today and giving us their evidence. I hope that members have had the chance ask all the questions that they wanted to ask.

10:39

Meeting suspended.

10:45

On resuming—

Intergovernmental Relations

The Convener: Item 4 is evidence on intergovernmental relations from two Scottish Government ministers: Derek Mackay, Cabinet Secretary for Finance and the Constitution; and Mike Russell, Minister for UK Negotiations on Scotland's Place in Europe. They are accompanied by Scottish Government officials Gerry Hendricks and Alison Byrne.

The First Minister is appearing before the Conveners Group at 12.30, so I will need to bring the meeting to a close by 12.25 at the latest. We have plenty of time, I think—

Adam Tomkins: That is an hour and a half away.

The Convener: I was just making sure that these guys realise what is ahead of them. [*Laughter.*]

Ivan McKee: It will be just the short version, then.

The Minister for UK Negotiations on Scotland's Place in Europe (Michael Russell): I will curtail what I was going to say.

The Convener: I understand that the Cabinet Secretary for Finance and the Constitution wants to make some opening remarks, to which the Minister for UK Negotiations on Scotland's Place in Europe might add.

The Cabinet Secretary for Finance and the Constitution (Derek Mackay): Thank you for the opportunity to give evidence with my colleague, who will indeed add to my opening remarks on intergovernmental relations.

The Smith report recommended that the current intergovernmental machinery between the UK Government and the devolved Administrations should be reformed. In December 2014, it was agreed at the meeting of the joint ministerial committee plenary—the JMC(P)—that the joint secretariat should develop proposals for revising the memorandum of understanding on devolution. As the committee will have noted from the communiqué following the meeting of the JMC(P) on 24 October, work has been proceeding on measures to make the JMC(P) a more effective forum for the management of intergovernmental issues.

However, the world has changed since the EU referendum. If the Prime Minister is to deliver on her commitment not to trigger article 50 until a UK approach and objectives for negotiations are agreed, the reviewed intergovernmental

machinery must enable the process that is being set up for EU negotiations to deliver meaningful engagement. That will include the JMC on European negotiations—the JMC(EN)—the forum at which the Minister for UK Negotiations on Scotland's Place in Europe represents the Scottish Government. The JMC(P) therefore remitted further work to the secretariat, to ensure that that will happen; it will return to the issue once the JMC(EN) is up and running in a satisfactory way.

The other Smith recommendation was that intergovernmental relations should be underpinned by stronger and more transparent parliamentary scrutiny. The session 4 Devolution (Further Powers) Committee's report, "Changing Relationships: Parliamentary Scrutiny of Intergovernmental Relations" led to the development of a written agreement on parliamentary oversight of intergovernmental relations, which was developed jointly between the Scottish Government and the Scottish Parliament, signed off by the Deputy First Minister and ratified by the committee in March.

The Scottish Government is committed to openness and transparency in our joint working, on a bilateral and multilateral basis. We are committed to complying with the written agreement, and we have made a good start during this session of Parliament, with relevant committees receiving information about the finance ministers' quadrilateral, the joint exchequer committee, the joint ministerial working group on welfare, the JMC(P) and the JMC(EN). We will continue to work with the Parliament to deliver on that commitment.

The Minister for UK Negotiations on Scotland's Place in Europe will update the committee on recent events, which have overtaken issues.

Michael Russell: It is a pleasure to be back at the committee, where I think that I first heard that the job that I now occupy was to be created—if I am remembering our away day properly.

I want to say two things about the structure that has been established. The first is to confirm the view that academics have given the committee—and the conclusion of parliamentary committees themselves—that many issues arise out of the joint ministerial structure that require to be resolved and that the structure has not operated efficiently or effectively for almost all the time that it has been in existence.

The purpose of having a revised MOU is to try to change that situation and the revised MOU, when it is eventually in place, may do so, but a bigger influence might be the establishment of the JMC(EN). That is because, for the first time in the JMC structure, there is a need for a group that can both agree actions and have oversight of those

actions. In other words, the JMC(EN) has to agree on what some elements of the UK negotiating position on Europe should be, given the interests of the devolved Administrations, and it then has to have the confidence that the UK Government is entering fully into that approach. That must be reported back so that the committee understands that the approach has been effective.

We will discover whether that can happen as the JMC(EN) continues in operation. It has had a single meeting, which was last week, and we have agreed to have monthly meetings. As time goes on, we will discover how that works. I am happy to discuss, in so far as I can, the detail of what has taken place at the meetings and what lies ahead.

The Convener: Thank you very much.

Adam Tomkins: Both of you alluded to the fact that numerous commissions and parliamentary committees and some academics, when they have studied the United Kingdom's joint ministerial machinery, have written that it is not fit for purpose. I confess to having written, or helped to write, some of those reports. Before we can understand whether that claim is correct, we need first to understand the purpose of the United Kingdom's joint ministerial machinery. What is the Scottish Government's view of what the purpose of the UK's joint ministerial machinery is and/or ought to be?

Derek Mackay: I would offer the view that its purpose is to help to ensure good governance and implementation in relation to issues that have been agreed. My closest interest has been around the finance ministers' quadrilateral, where all the devolved Administrations come together with the UK Government to discuss finance matters. That might include negotiations on issues that are of interest to all of us, joint working and implementation. It is a forum in which we can share issues and ideas, discuss implementation and proposals and show respect for all the Administrations and for governance.

The joint exchequer committee is a useful forum specifically for implementation of the Smith commission proposals. It relates to functions that have been devolved and other finance matters that are of interest.

My experience of both so far has been fairly positive. I have been able to raise issues, make progress and inform this committee of areas in which we have had agreement from the UK Government where we have sought it. So far, my experience as Cabinet Secretary for Finance and the Constitution is that the areas that have been servicing finance have had a better start. We meet more regularly and there is a helpful new rhythm of meetings, including of the JMC(P), in keeping with fiscal events. Those are helpful in my finance

brief, and they are taken seriously by the UK Government.

The most recent quadrilateral meeting was on the same day as the JMC(P) meeting in London. Civil servants advised me that the meetings might not always be as positive as that one was, but I thought that it was a good start for my first quadrilateral meeting. The machinery is there to serve good governance, in recognition of the UK Government's role and our role on matters that affect both Governments and their competencies.

Adam Tomkins: That is interesting. It is notable that, in speaking about what you think is the purpose of the quadrilateral and the joint exchequer committee, you did not mention joint policy making. Those bodies are about respect and sharing information and ideas, but they are not about joint policy making. Is that right?

Derek Mackay: We respect each other's competencies, although we might try to influence. We would obviously guard very closely rights around devolved issues, but some reserved matters and finance decisions impact on those devolved issues—I could give many examples of that. The finance meetings are generally not about joint policy; they are more about financial understanding, negotiation and perhaps resolving matters such as the block grant adjustment or implementation of a power. The joint exchequer committee and the quadrilateral meetings are not about determining new policy as such.

Mr Russell might want to add to that, on the wider issue of the JMC(P) and current European issues.

Michael Russell: We must distinguish between what the Scottish Government regards the meetings as being important for—what it would like to get out of them—and what the other participants regard them as being important for. It also depends on what the function of the meeting is.

I will illustrate that in two ways. The JMC on Europe—the JMS(E)—has always been the best attended of the JMC meetings. I was a member of it in 2009. I remember being at one meeting at which there were 20 UK ministers, as well as Rhodri Morgan and me, which was not exactly an equity of arms. The purpose of the JMC(E) was to brief ministers on what was on the upcoming Council agenda, so many UK ministers attended it in order to get a briefing from the United Kingdom permanent representation to the European Union—UKRep—about the European situation. In those circumstances, it was not really a joint ministerial meeting; it was a case of Scottish ministers being involved in a Whitehall structure, which happened to be the JMC(E) structure.

The JMC(EN) has clear terms of reference, which I think have been provided to the committee. Those terms of reference are to

“discuss each government's requirements of the future relationship with the EU; seek to agree a UK approach to, and objectives for, Article 50 negotiations; and provide oversight of negotiations with the EU, to ensure, as far as possible, that outcomes agreed by all four governments are secured from these negotiations; and discuss issues stemming from the negotiation process which may impact upon or have consequences for the UK Government, the Scottish Government, the Welsh Government or the Northern Ireland Executive.”

Therefore, there is some clarity on what we are trying to achieve in those meetings.

JMC(P) meetings are consultative and co-ordinating meetings between the Prime Minister and the First Ministers. The JMC(O) is the officials' meeting—it services what takes place in the other committees. There has been a JMC domestic process, but I think that it is formally in abeyance. There are no plans for a further meeting at this time, while the JMC(EN) is in operation.

It is a complex structure. The overall Government approach is clear. Each part of the structure has a different function, and one part of it—the JMC(EN)—now has clear terms of reference with regard to how it is to operate and what it is to achieve.

The Convener: That is a helpful overview of the position that we are in. I thank Mr Tomkins for teasing that out.

Ash Denham wants to ask about the improvements that could be made following Smith.

Ash Denham: Cabinet secretary, in your opening statement, you mentioned that the Smith commission recommended substantial reform. It said that the JMC structures should be “scaled up” and that there should be a new memorandum of understanding, especially in light of the further devolution that is coming. You said that some work has been done on that. How would you characterise the progress that has been made towards that goal?

Derek Mackay: There were negotiations to improve those structures. Our aspiration is to have parity of esteem, and to make sure that the machinery works well and that there are regular meetings. We would like improvements to be made in a range of areas, but that process has been overtaken. There have been elections and purdah periods since then. The whole improvement process has been overtaken by the European issue, which has become the focal point of intergovernmental relations. Mr Russell leads on that, and the First Minister is involved in the current negotiations on what a new memorandum of understanding might look like.

The Government continues to use the existing machinery to make sure that the joint exchequer committee and the finance ministers' quadrilateral continue to work, because that is how the powers that have been agreed are implemented. We are getting on with making sure that that process works well while the discussion continues on whether a new memorandum of understanding can be agreed.

Michael Russell: There is agreement that further discussions on the memorandum of understanding will proceed after the JMC(EN) structure is in place and operating. A commitment has been made to hold another JMC(P) before article 50 is triggered, and I suspect that the issue will be on the agenda then.

Ash Denham: If a further MOU is developed, to what extent do you think that it will incorporate the recommendations of the Smith commission? In what timeframe do you envisage that that might happen? If it does not happen—if the process is on hold, which I think is what I am picking up—how will that affect relationships between the two Governments in light of the further devolution that is to take place and the complexities over Brexit? Having a new structure in place would obviously help with those discussions.

Derek Mackay: I would say that the issues that were already in play around implementation of Smith are going fairly well. A pragmatic approach is being taken. The secretary of state and each relevant minister have oversight—I have some oversight of the implementation of policy and finance—and we are approaching matters in a very positive and constructive spirit and mood, and our civil servants are working together.

Of course, the Government would take a view around our constitutional position, but we are absolutely getting on with what has been agreed and making sure that the infrastructure is in place to achieve that. That all continues, and whether it is achieved through access to ministers or by officials, the work is on-going—I can assure you that it is happening. Intergovernmental relations are currently heavily dominated by the emerging agenda around Europe, because of its criticality and the state of politics in the UK at the moment.

11:00

The Convener: I want to unpick that a bit, in relation to the MOU and the changed dynamic because of Brexit. Can you explain what happened there a bit more? I think that there is a general understanding that we are on the road to signing off an MOU, but there may be stuff that you cannot say.

Derek Mackay: That is partly the issue. We can report to Parliament once negotiations around the

issues are concluded, but they are not concluded yet.

Good progress was being made on getting a new memorandum of understanding but, post-Brexit, the JMC process is focused more on the relationship that the Administrations have with one another and with the UK Government, and on any approach that the UK Government takes. We were getting there with a new agreement and, if the referendum had gone the other way or had not happened, the most recent JMC(P) session would probably have discussed the agreement, because the European issue would not have been dominant.

Those are the facts of the matter. My assumption would be that we would probably have had a new agreement in place because that would have been the main issue. However, we are where we are and the European issue is dominant—hence Mr Russell's involvement. Mr Russell attended the most recent meeting, rather than me, which signifies the importance of the issue, while we got on with other issues of cross-Government work.

The Convener: Okay.

Michael Russell: I do not think that many issues would worry us in the present situation; the agreement has just not been concluded yet. The fact that the last JMC(P) took place at the end of 2014 is perhaps indicative of the lack of urgency on the matter from the UK Government; it does not seem to have been at the top of agendas.

What has now focused minds on the JMC structure is the European situation. It is not simply a question of the European negotiation process being dominant in the relationship; it is that that has also drawn attention to the need for a JMC structure that is effective. That has resulted in a development of the JMC structure—we may see changes in the entire structure.

The Convener: Patrick Harvie has a supplementary question in this area.

Patrick Harvie: Good morning. I will stay away from the Brexit process, because I know that others have questions about that, but before the referendum result—before that was the context that everyone was thinking about—the Smith commission called for on-going work between the two Governments to arrive at an agreed position in relation to a number of its recommendations. Changes to allow victims of trafficking to be given a temporary right to remain in Scotland, some kind of replacement for the post-study work visa and agreements to allow asylum seekers to lodge a claim from within Scotland are all areas in which there was no hard and fast recommendation but there was a call for discussions to take place between the two Governments. Did the previous

intergovernmental machinery give any opportunities to progress such issues, and how will they be easier to resolve with the new machinery, once it is in place?

Derek Mackay: We do not really know about the new machinery because there is no agreement in place.

With the old machinery, we had an issue with the fact that if there was a dispute, it was ultimately the UK Government that would decide. The UK Government might have been the party that we were arguing with, but it then made the final decision if there was a dispute in intergovernmental relations. The Scottish ministers would raise matters of importance in any event, whether through communication meetings or the formal structure. However, if the matter was reserved to Westminster, the UK Government could just ignore it—potentially that meant that it would not even get back to the Scottish ministers in good time.

Patrick Harvie: Just so I understand the previous experience, is it the case that those kinds of issue were first put on the table by Smith, there was then some discussion between the two Governments and then the UK just said, “No, we’re not at all interested in doing that”? Is that what happened, or has the process been gummed up—delayed—by a lack of communication?

Derek Mackay: There might sometimes be a failure to respond to matters that the Scottish Government has raised because the UK Government does not want to respond. Therefore, to go back to the original question, we think that that element is not fit for purpose because it does not respect the nature of government in Scotland. I suppose that the UK Government would say that such a matter is within its competence, but that does not lead to healthy intergovernmental relations in areas in which there is a dispute. As I said, the current difficulty is that if there is a dispute on an issue, it is ultimately the UK Government that would decide on it. We believe that that is a weakness in the system in relation to areas that are outwith our competence.

It is also sometimes the case that UK decisions cut across devolved competences. For example, the apprenticeship levy is a tax that was imposed on Scotland without any proper consultation with anyone, and it cuts across devolved competences and responsibilities. That is the kind of issue that I raise through the current machinery and infrastructure. I have raised that issue with the UK Government and have written to the committee about it as well. However, it is still the case that the UK Government can ignore the protocol, and there is no mechanism to resolve that. Whether that will be resolved in any new memorandum of understanding remains to be seen.

Patrick Harvie: Does the Scottish Government believe that the additional issues that Smith identified are still on the table and must be progressed?

Derek Mackay: Yes. We would like to see much more happen so that we could have a totally harmonious position, with the Scottish Government able to express views that would be taken on board seriously and a more effective mechanism of resolution.

Michael Russell: If we analysed what has happened over the past two years, in hindsight we could describe it as having been focused on urgencies that have occurred. There were the Smith recommendations, but then there was the process of putting in place the fiscal framework, which took over the space available on both sides. Once that had been resolved, we were pretty quickly into the issue of Europe, which has now taken over the space that is available. All of that says something wider about the difficulty that exists in ensuring that the mechanism is fit for purpose and operates effectively. Carwyn Jones always says that we must remember that there is a joint process and that a joint commitment to get things done is required. I suppose that that gets particularly intensified when there is a considerable issue that requires resolved for both sides.

The Convener: Before we get into issues around Brexit and the JMC (European negotiations), Murdo Fraser wants to pick up on issues around the finance quad.

Murdo Fraser: Just before I do that, I have a quick follow-up question on Patrick Harvie’s last question. I am interested in the discussion around the Scottish Government bringing what are, in effect, reserved issues to the joint meetings. Do the ministers have experience of UK Government ministers raising devolved issues in relation to which they are critical of the Scottish Government’s stance?

Derek Mackay: The apprenticeship levy, as I said, is an example of a reserved issue that has cut across a devolved responsibility, and there is the prospect of a sugar levy, which would also impact on Scotland but on which there has been no engagement with us either. We would argue that those are devolved areas in which the UK Government has intervened.

Murdo Fraser: No, I am not talking about intervening. Obviously, you use the forums to make representations to the UK Government if you think that it has got policy wrong on a reserved issue. Is the UK Government doing the same to you the other way round?

Derek Mackay: Certainly, in finance quad meetings and in meetings of the joint exchequer

committee, the UK Government has been more focused on outlining its position than on listening to our requests. That has been the nature of the discussion at the meetings that I have been involved in, to be frank. Mr Russell might want to add to that.

Michael Russell: I was a member of the plenary, domestic and European joint ministerial committees in 2009, and I can remember what Mr Mackay described happening on many occasions and a particularly vitriolic attack by the then Secretary of State for Scotland, Mr Jim Murphy, on the First Minister. I can assure you, Mr Fraser, that they appeared to give as good as they got.

Murdo Fraser: Okay, thank you. I have a couple of questions on the finance quadrilateral meetings.

Mr Mackay, you wrote to the convener on 3 November with a summary of the latest meeting, which was on 24 October. You make reference in that letter to HM Treasury approval for annually managed expenditure cover for the Scottish growth scheme, which is welcome. You also narrate that the Treasury agreed to permit a budgetary carry-forward of up to 15 per cent for financial transactions, which was a change of approach. What does that represent in monetary terms for the Scottish Government?

Derek Mackay: It does not mean anything by way of new cash. For the Scottish growth scheme, it gives us budgetary cover to use AME if required. Over the period of the scheme, we can give loans and guarantees to companies whose growth can be supported by getting access to finance and, if there is default, that has a call upon our resources. There is no cash implication though.

Murdo Fraser: With respect, I think you misunderstood my question. It was not about the growth scheme; it was about the agreement on the 15 per cent budgetary carry-forward and what that represents in monetary terms.

Derek Mackay: It does not mean new money. It just gives us the flexibility to carry forward as used to be the case when there were higher levels of carry-forward for financial transactions. The limit was lowered quite drastically, which was an issue that other Administrations faced as well. Landing exactly on the line is very difficult to do, so a margin of flexibility is needed. It was felt that the reduction was too strict and too rigid. The devolved Administrations agreed that we needed further flexibility; it was maybe more of an issue for the other devolved Administrations but we were all sympathetic. It means simply having more flexibility for budget exchange, specifically on financial transactions, if required.

I am sure that Mr Fraser is aware of the nature of financial transactions; they can be issued and

get close to the line. Some of them—assistance for help to buy, for example—are not like a normal budget, where one can determine how much is spent, as they are demand led. For all of those reasons, further flexibility seemed like a reasonable request, and the Chief Secretary to the Treasury agreed and increased the limit at the request of all the devolved Administrations.

So there is no new cash; there is flexibility. That is a good example of joint discussion and of having flexibility in the arrangements, so that we are all able to deliver policy.

Murdo Fraser: I understand that. My question was simply whether you are able to put in monetary terms how much that represents. Maybe that is something that you need to write to the committee about.

Derek Mackay: Yes, I will write back with the quantum of current financial transactions.

Murdo Fraser: Thank you. That would be helpful.

My second question relates to current EU funding streams. Various constituents—I am sure this will be common across members—were in the process of applying for funds, such as LEADER funding or agri-environment schemes, and are concerned about whether their applications can go ahead.

On 3 October, the Chancellor of the Exchequer announced that such funding would be guaranteed for England and Wales. The Scottish Government did not make a parallel announcement for another month, until 2 November. What was the reason for the delay in the Scottish Government coming forward to confirm the position?

Derek Mackay: We sought absolute clarity on the resources that would be coming to Scotland—I can check the dates—so that I could pass on guarantees to stakeholders in Scotland. That was what I was subsequently able to do and have done. We still do not have clarity beyond that period, but I have passed on those guarantees. We needed clarity on the figures and all the information that we would require, and that pledge has been followed through.

Murdo Fraser: Are you aware of any reason why that clarity was not available from the Treasury when it made the announcement on 3 October?

Derek Mackay: There are sometimes follow-up letters. For example, we discussed the Scottish growth scheme at the quadrilateral meeting, but I like to have it in writing. I am happy to check the timescale, but there was no difficulty in principle. Obviously, the Government considers financial matters and so I was of the view that if we had the guarantees from the UK Government, we could

follow through on that in due course. I am delighted that we have been able to do that. It does have a call on resources but it is the right thing to do.

Murdo Fraser: Thank you.

The Convener: I am not entirely clear about the dispute mechanism in the existing processes to deal with any fall-out over fiscal framework issues.

11:15

Derek Mackay: So far things have worked fairly well with regard to implementation. There is cross-working between the secretary of state, the relevant departments and ministers, and there is an expectation that we will just get on with it. The joint exchequer committee looks at specific matters of negotiation, but so far we have not had a dispute.

I suppose that one of the differences between the joint exchequer committee and some of the other machinery that is in place is the very nature of the committee: the location changes; and there is a sense that ministers are almost co-chairing it. There is no sense of the Chief Secretary to the Treasury convening a meeting to have a discussion with me; there is a genuine joint arrangement that gives more of a feeling of parity of esteem and of the Administrations working together on an agreed format, which is the implementation of Smith. So far we have not had to trigger any dispute mechanism, because any implementation issue—whether about understanding figures, data or whatever—is worked through by getting access to officials. If a dispute were to arise, there would be an expectation that it would be resolved jointly, because we know what agreement we are working to.

The Convener: Even though the fiscal framework is a joint agreement, the relationship between the Scottish and UK Government might, for whatever reason, not always be as productive as you have just described. What, then, would be the process to deal with any such dispute that arose?

Derek Mackay: You are right that we have not had to use the process yet. My understanding is that a dispute would go through the JMC process, the fundamental problem with which is that the UK Government ultimately determines the outcome. That is why there is an expectation that matters will be resolved at the joint exchequer committee, where the relationship is between finance ministers and civil servants are just expected to get on with things. As I have said, if a data, finance or joint working issue arises in any policy area, we raise it and it should be taken on board and a resolution found. If that process fails and the

matter goes back into the JMC machinery, it is ultimately up to the UK Government to determine the dispute. That does not put us in the strongest position, but that is why we are trying to make the implementation of the fiscal framework with regard to Smith work to the letter.

The Convener: Let us move to a slightly different area, because I want to start to understand the issues around Brexit, the negotiations and so on. Before we get into the specifics of the JMC(EN), I believe that Maree Todd and Neil Bibby have some questions about general oversight, reporting-back mechanisms, differences between the UK Parliament and the Scottish Parliament and, indeed, what happens in the European Parliament.

Maree Todd: We have certainly learned over the past few months that there are significant differences between the UK and Scottish Parliaments with regard to transparency and accountability in our ways of working. Being transparent and accountable and allowing parliamentary scrutiny of what the Government is doing are very much at the core of the work of the Scottish Parliament. Will you comment on the opportunities to scrutinise what the UK Government is doing with regard to EU negotiations?

I have also been struck by how easy it is for the EU Parliament to scrutinise, comment on and feed into the process and how difficult it might be for us in the Scottish Parliament to do the same. You might also want to comment on how challenging that might be even for the UK Parliament.

Michael Russell: It will be very challenging for any Parliament. The European Parliament is probably in pole position on this, because it regards itself as a player and wishes to have information, and also because it has a vote at the very end of the process. The European Parliament has to vote by simple majority on the conclusion of the negotiations.

Having spoken in particular to Guy Verhofstadt, the European parliamentarian who has oversight of the process—he is not the negotiator—I know that his view, echoed by other views that I have heard in the European Parliament, is that that Parliament will take an active role in looking at what is taking place and in ensuring that constitutional due process is observed. That means that the committees of the Parliament will take evidence and there will be discussion of one sort or another.

I cannot speak for the UK Government but, clearly, it is presently involved in a legal action around the rights of Parliament with particular regard to the royal prerogative. The Scottish Government has indicated that it wishes to

participate in and join itself to that action, and the application to do so has been submitted by the Lord Advocate. It is the view of the Scottish Parliament that we should take a view on the article 50 process and that the Scottish Parliament should have a legislative consent motion, and we will argue for that.

That takes us up to the triggering of article 50. Beyond that point, the parliamentary process will be a reactive one. For example, the great repeal bill is promised for the next parliamentary session in Westminster. There are considerable issues arising from that for Scotland, and there would have to be an involvement from Scotland. Would that require a separate Scottish bill? If not, it should require a legislative consent motion. All of those issues will have to be dealt with.

It would be inconceivable if there were not also a process in which I was able to report to the Parliament on the progress that we are making, particularly with regard to the devolved issues, on securing a position in the UK Government's negotiating strategy. We do not know what that strategy is and we do not understand the higher principles that are guiding it, as I said yesterday in the debate. We are clear about the principles that guide the Scottish Government's strategy, and we raise them in debates regularly in the Scottish Parliament—some people do not seem to enjoy that as much as I do. They include issues around the single market, free movement and a range of other issues that we wish to be addressed—we will have more detail on those later.

The picture is emerging and mixed and changes fairly rapidly, but I hope that the process will be transparent. I do not mean that the terms of the day-to-day negotiations should be transparent—I accept that people do not negotiate in the full spotlight. However, those who negotiate have to be open about their principles and they have to offer reassurance to people. That reassurance must, in part, be public. The Nissan letter is an example of private reassurance, which rings alarm bells and makes people wonder whether they have been excluded rather than included, and whether, for example, there are implications for state-aid rules and the present Commission rules. There has to be a consideration of such matters.

In the wider context, early on, the Japanese sent a very cogent letter saying that one of the big issues at play was transparency—the letter specifically mentioned that issue.

We have to do our best to ensure that transparency is observed, excepting some issues around the negotiating process.

Maree Todd: We have talked a lot about the structures that are in place for intergovernmental relations. Do you have confidence that they work

well? Will the Scottish situation be reflected in negotiations? Will we be in a position to influence the discussions? Are we getting a sense of clarity?

Michael Russell: We are not getting a sense of clarity. We have entered the discussions in good faith, we continue to be part of them in good faith, we will bring our ideas to the table in good faith, and we will endeavour to make good progress. So far, we are moving very slowly—in some ways, with unsatisfactory slowness—but we are doing our very best.

The terms of reference that I read out are extremely important. We expect those terms of reference to be honoured and to guide and underpin what we are trying to do, and we will constantly return to them.

The Convener: We are starting to get into the JMC(EN) issue, which Ivan McKee wants to raise. Before we address that, Neil Bibby has a question.

Neil Bibby: With regard to parliamentary scrutiny, what is the Scottish Government's planned contact with EU institutions over the coming months, and what will the nature of the contact be?

Michael Russell: I should make it clear that that matter is being dealt with by my colleague, Fiona Hyslop. I work with her and Derek Mackay, and directly to the First Minister, via the Cabinet sub-committee and the other structures. She is working on a strategy of engagement, and I am sure that she will be happy to talk to the committee about it. She is meeting and talking to ambassadors and representatives at various levels of the member states. That is an on-going process and I am assisting with that, where it is helpful to do so. I am focused much more on the UK discussions, but I am engaging with European institutions, as is the Cabinet Secretary for Culture, Tourism and External Affairs.

We need to explain two things, I think. It will be helpful to understand them. The first is the constitutional due process, which is what the European states are looking to the UK to provide. That is between the European member states and the UK as a member state but, of course, the process has to include parts of those states that are part of the constitutional structure and settlement.

Monsieur Barnier, the representative of the Commission, has as the negotiator indicated that one of his negotiating priorities is the exceptions—he has mentioned Gibraltar and Northern Ireland in particular, but they include Scotland and Wales, clearly, and, I presume, London. All those areas have made and are making cases for being exceptions. We have to put our case and explain how that will work constitutionally. The JMC(EN) structure is now part of that constitutional make-

up, and there are terms of reference for the JMC(EN), which have to be known.

That is one part. The wider part is to make the situation in Scotland clear to the 27 member states. The situation in Scotland is that 62 per cent of people voted to stay, that a positive debate and dialogue is going on and that the Scottish Parliament is regularly considering and taking a view on issues to do with Europe, Brexit and the referendum. That is the democratic process in which we are engaged.

We are doing both those things openly and transparently. Our diaries are subject to publication and freedom of information requests, so people know where we are and what we are doing.

Neil Bibby: We have received letters from the Cabinet Secretary and the minister about discussions that you are having with the UK Government on a range of issues, but I think that it is fair to say that we have not been updated on the discussions that Fiona Hyslop is having with EU Governments or ambassadors. An update on that would be helpful.

Michael Russell: There is an external affairs brief and, obviously, evidence can be given. There is complete transparency about what we are trying to do and how we are trying to do it. Last night, I met the convener and deputy convener of the Culture, Tourism, Europe and External Relations Committee. I am happy to meet conveners and deputy conveners of committees and to talk to committees at their convenience.

The Convener: I think that the point that you are making is that, if letters are coming into the system, they are probably going to the Culture, Tourism, Europe and External Relations Committee—

Michael Russell: I would say so.

The Convener: I do not think that there is any reason why we should not be copied in to those, even if they are not directly within our remit.

Derek Mackay: That is fair and I am not resisting it at all, but thinking about compliance and the memorandum of understanding, I note that it is about the infrastructure of the Administrations and the UK Government. It does not say, "Every time you engage with any Government." I am not being a purist; I am just making the point that the agreement is specific. On intergovernmental relations in the UK, there is specific provision for how we engage with Europe.

Separately, I am sure that the cabinet secretary and the minister will be happy to come and explain to you their engagements to pursue policy, but we should not have crossed wires about the arrangements and wider transparency.

The Convener: The point that I was making is that that matter is not for us; it is for the Culture, Tourism, Europe and External Relations Committee.

Derek Mackay: Exactly.

Michael Russell: I add that there is transparency not only in parliamentary terms. I seem to remember that, this week, I saw a picture of Fiona Hyslop and the Polish ambassador being tweeted. There is publicity as well. Conversations are taking place and are being reported.

The Convener: Can we return to the JMC(EN)? I call Ivan McKee.

Ivan McKee: Thank you for coming along to talk to us this morning. I want to delve a wee bit more under the bonnet, if you like, of what happens at the JMC(EN). The devolved nations are involved in that. Are you given opportunities in those meetings to present the case in enough detail? Do you feel that you are being listened to? Given what is coming back, have you got any more clarity on the UK's position? What level of information are you getting back from the UK Government?

11:30

Michael Russell: It is early days. We have had only a single meeting of the JMC(EN). Everybody is there in good faith. A picture of the meeting was published on the internet last week, so who was present and was talking is open.

We will have to see as time goes on whether we believe that the structure that has been established works efficiently and effectively. I believe that there is an intention to discuss matters with us, but it is not a consultative meeting. That is an important point. We are not consultees in any sense nor can the Scottish Government be treated as just another stakeholder. It is a Government-to-Government relationship, so it must be conducted as a Government-to-Government relationship.

There are key issues of devolved competence that must be discussed openly. There are also issues that are not of devolved competence but which underpin issues that are, so they also need to be discussed. Free movement of persons is one such issue. There are matters that may currently be European competences but which should, were they to be returned to the UK, come directly to the Scottish Parliament. We are not into those yet, but they will need to be discussed.

We will see what comes out of the process. I repeat that we are entering it in good faith and with as much transparency as we can, and we are listening to what people and the Parliament are saying. The debates that are taking place here are useful in telling us members' views. I am doing a great deal of engagement work with communities

and organisations in order to listen to what they say and to try to fold that into the process, as well.

The process will be iterative and I hope that it will develop into a meaningful one. I suppose that the next big issue will be what is in the article 50 letter and what that letter says specifically about the Scottish situation. That will be the next test.

Ivan McKee: How often are the meetings planned to be? Is there a full schedule?

Michael Russell: The multilateral meetings are planned for every month, but there will be bilateral meetings as well. I have met David Davis on two occasions outside the multilateral meetings, including the multilateral at JMC plenary. I have also met the Welsh negotiator—the Cabinet Secretary for Finance and Local Government, Mark Drakeford. I will continue to have those bilateral meetings, which will be folded into the process, as well. There will not be only formal meetings of the JMC(EN); there will be other discussions. There is also, of course, the celebrated hotline, which I have used on one occasion and David Davis has used on one occasion to call from the other end. My speed of response was a little faster than his.

The Convener: You might not yet have the clarity that you seek from the discussions and the one meeting of the JMC(EN) that has taken place, but are you getting any level of information about what to expect?

Michael Russell: Yes, but I cannot go into detail. There is more information in the system now than there was a month ago. Whether it is the right information, whether we can draw conclusions from it and whether it can be, or is being, analysed in the way that I believe it should be analysed are other issues. The process has been moving more slowly than we wished it to move and it has been frustrating at times, but there is movement.

Adam Tomkins: I have a quick follow-up question about your understanding of the UK constitutional position. It seems to me that from time to time you are—as all of us are—capable of citing bits of the constitution and leaving to the side other bits of it that are perhaps less convenient. Is it not the job of the Scotland Office rather than the Scottish Government to feed into the United Kingdom Government what the views of Scottish stakeholders are with regard to reserved matters, including the United Kingdom's membership of the European Union, or is that a bit of the constitution that is not as important as the JMC(EN)'s terms of reference?

Michael Russell: In her first meeting with Nicola Sturgeon, the Prime Minister committed herself to engaging the Scottish Government fully. I regard representing a range of issues,

particularly the relationship of those issues to devolved matters, as full engagement.

It is sometimes difficult to define exactly what is and what is not a devolved matter. I have given the example of free movement of persons, which underpins some key devolved sectors of the Scottish economy. It would be very strange if I were to draw an artificial mental line between the aspects of devolved matters about which I could talk and those about which I could not talk.

Fortunately, a flexible approach is being taken to that matter by the Scotland Office as well—perhaps because it has different advisers now. It is working closely with us, and I am happy to say that David Mundell has been keen to have joint meetings with me in Scotland, which I am very happy to do. There is flexibility, but I will not go to the JMC(EN) and remain silent about matters that I think are important, no matter what their technical definition. I gave that commitment. Whether or not it is a commitment that Adam Tomkins likes, that will be the reality.

Adam Tomkins: That is very clear. Thank you.

Patrick Harvie: I am sure that your joint meetings with Mr Mundell are low key, quiet and calm affairs always.

Michael Russell: We have not had one yet, but we will invite you.

Patrick Harvie: My blood runs cold.

I want to pick up on one brief point for clarity. You talked about the importance of the article 50 letter referring to the Scottish situation. Is it an absolute requirement, from the perspective of the Scottish Government, that that letter sets out some level of detail on what arrangements are being sought for Scotland? What do you expect to see, and what do we need to see, in that letter that relates to the Scottish situation?

Michael Russell: I would not talk in terms of absolute requirements; that is not helpful at this stage. I will say that I think that an article 50 letter—whatever that is; as it has not been done before, that is a shorthand term for whatever the process will be—would have to refer to the special circumstances that Scotland finds itself in and the special requirements that it has. It is what would be called a differentiated position.

Whether there should be such a position has been much debated in the chamber, but I think that it is important that there is one. Whether that will be the case we do not know—it is very early days. We do not yet know whether there is to be a bill that will require parliamentary approval to trigger the article 50 process. The Prime Minister and David Davis have both said that the process of triggering will take place before the end of March. I think that a differentiated position is

important, therefore developing clarity about what we believe should be in the letter with regard to Scotland is important.

Patrick Harvie: Has that been communicated to the UK Government already?

Michael Russell: I do not think that there is any doubt. As our discussions go on, they will focus more and more on the need for differentiation.

However, it is difficult to know what we are differentiating from; that is an important issue. If the article 50 triggering letter is one line that says, "We're off," I am not sure that there will be grounds for a footnote. If there is more detail in it, I think that that would be required. We are in a situation in which we do not know. We might have expected to know some four months out from the process, but we do not know yet. It will be a developing situation.

Patrick Harvie: Thank you.

The Convener: Maree Todd talked earlier about the role of the European Parliament. A number of committees in this Parliament are taking evidence on Brexit, just as is going on in the House of Commons and the House of Lords. What do you think this committee can positively contribute to the process, from the perspective of the Scottish Government?

Michael Russell: The committee could do two things. One is to do with its finance role: it can provide clarity on some of the financial aspects of Brexit—in particular, Government financing. European finance and finance that comes from the UK to Scotland have already been raised. Secondly, the committee could, in its constitutional role, keep a watching brief on operation of the mechanism. The outcomes from the mechanism are of most interest to the Culture, Tourism, Europe and External Relations Committee, but its effective operation might be of most interest to this committee. That will be a matter for the committee, which will no doubt take a wide view of its remit—as committees, ministers and Governments do—but I think that doing those things will be particularly helpful.

The Convener: To use Ivan McKee's description, we want to get under the bonnet as much as we possibly can without getting our fingers dirty. Will you therefore give us a commitment, from your own perspective, to provide us with as much information as possible, as and when you can?

Michael Russell: I am absolutely happy to give that commitment. I shall look up in my greasy overalls from under the bonnet and try to give you as much information as I can on what is happening in there.

The Convener: I thank the minister and the cabinet secretary for coming along today and for engaging with the committee. I am very grateful for that. I also thank members.

Meeting closed at 11:39.

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