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Finance and Constitution Committee

Wednesday 23 November 2016

Session 5



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FINANCE AND CONSTITUTION COMMITTEE

13th 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:

Caroline Gardner (Auditor General for Scotland)

Mark Taylor (Audit Scotland)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Finance and Constitution Committee

Wednesday 23 November 2016

[The Convener opened the meeting at 10:00]

Decision on Taking Business in Private

The Convener (Bruce Crawford): Good morning and welcome to the Finance and Constitution Committee's 13th meeting in session 5. We have apologies from Neil Bibby.

Agenda item 1 is a decision on taking business in private. Do members agree to take in private item 3, which is consideration of a draft report on the land and buildings transaction tax?

Members indicated agreement.

Fiscal Framework

10:00

The Convener: The next item is to take evidence from Audit Scotland on the fiscal framework. I welcome the Auditor General for Scotland, Caroline Gardner, and Mark Taylor, who is an assistant director at Audit Scotland. Does Caroline Gardner want to make an opening statement?

Caroline Gardner (Auditor General for Scotland): I would like to make a brief opening statement. Thank you for inviting us to meet the committee.

As members know, the Scottish Parliament's financial powers are changing substantially. As a result, more complexity, uncertainty and volatility will affect the Scottish public finances. The fiscal framework is vital to how the new powers will be used, as it sets out the agreed rules by which they will be managed.

As we know, that comes at a time of continuing pressure on the public finances together with uncertainty about the potential impact of the result of the European Union referendum. Some clarity may be provided by the Chancellor of the Exchequer's autumn statement this afternoon and I am sure that we all look forward to hearing what it contains.

It is clear that the wider system for Scottish public finances, including the budget process and financial reporting, will need to be further developed to reflect the increasing fiscal responsibility and financial risk. We should aim for world-class public financial management in Scotland. That will require Scotland-specific solutions that draw on experience, expertise and ways of working around the world but reflect our own fiscal and economic context.

There is plenty to work through on the best way forward as the new powers and the fiscal framework provisions come on stream. My colleagues and I are committed to working with the Parliament to help it to develop new arrangements that are fit for purpose. We will do that through informal commentary such as this with committees and others and through our formal audit reporting. I hope that members can see that in our submission.

Members will see from the submission that there are three important areas in public financial management for the committee to focus on. First, a more strategic approach to public financial management will be needed, with longer-term and more joined-up thinking and planning that are based on a good understanding of the economic

and fiscal situation in Scotland and much more widely.

Secondly, the Scottish Government will need to manage much more financial risk than ever before and make choices within the provisions of the fiscal framework. The Parliament will have a key role in understanding and challenging that as decisions are made.

Finally, I see a need for much more transparency in each component of the fiscal framework, in the overall picture of the public finances and in what is being achieved through public spending, which is important.

Mark Taylor and I are happy to do our best to answer the committee's questions on this important area.

The Convener: Thank you for coming to the meeting. Your "Scotland's new financial powers" report, which you produced earlier, and your summary are helpful to committee members.

You state in your submission that there is a need for

"a more strategic approach to public financial management",

as you outlined in your opening statement, and for

"an overarching medium-term financial strategy".

It would be useful if you could expand a bit on what you mean by that in practice. For instance, how might that differ from the publication of the comprehensive spending review? Are there any international examples that we could learn from and apply in Scotland to help to build the world-class system that you rightly outlined?

Caroline Gardner: Two elements make that approach important. First, the fiscal framework contains new powers for revenue borrowing, for the Scotland reserve and for thinking in the longer term about the impact of not just spending decisions but taxation decisions and the financial strategy for investing in infrastructure in ways that were not possible before. All those things need a longer-term view, and they all interact with each other. There are limits on the amount of money that can be transferred into the Scotland reserve in total and in an individual year. Having a line of sight through what might be possible is really important.

On the other side of the equation, the Scottish Government has pioneered the outcomes approach and embedded it in the Community Empowerment (Scotland) Act 2015. Thinking in the longer term about how to improve outcomes and particularly about the prevention agenda means that thinking about what public spending achieves needs to be over a longer term than the single-year budget or the overall fiscal thinking

that goes into the comprehensive spending review and the United Kingdom picture.

One international example that we have been examining closely is New Zealand, where a similar outcomes and output approach is taken. As well as the annual budget process, New Zealand has a longer-term financial strategy for the public finances and much more frequent reporting on progress towards them. That is not a template for us to use, but it is an interesting example that shows what can be done and how it can help to focus decision making at a more strategic level than asking how much spending on the health service will go up by next year.

The Convener: That is interesting, but you are really saying that the nuts and bolts for creating the medium-term financial strategy are already available and that it is a question of putting it together in the right package and making it all link up. Have I got that right?

Caroline Gardner: I think so. The fiscal framework makes the strategy more important and gives some of the mechanisms that enable us to create that. If Mark Taylor gave you more of a picture of what we think should be in a medium-term financial strategy, that might help to bring it to life.

The Convener: That would be helpful.

Mark Taylor (Audit Scotland): I will give a sense of what the medium-term financial strategy might look like, but decisions on what it will look like are for the Government and Parliament.

I guess that the strategy would be a multiyear document—it might be for a five to seven-year time horizon—and would include an analysis of the economic context, how it might change and what that might mean for predicted levels of funding and revenues through time. It would also include indicative spending levels and a sense of what the priorities and broad levels of spending are, as well as what that might mean for anticipated borrowing and reserves through time.

To answer your question about how that differs from the spending review, that is about the level of detail. The spending review is a three-year budget that is quite precise and detailed on each spending area. Of course that can change, but it is tied down at quite a specific level. For a medium-term financial strategy, we have in mind a picture of spending at a broader level and a sense of what that means for the overall public finances. That would provide the context for identifying issues that we face and for discussions about what our priorities are. You might envisage that the strategy would indicate how spending might shift—we have talked about how spending on, for example, the health service might shift over time to preventative

spending—and how that would be planned over time.

Such a strategy would give the Parliament, the committee and the public the ability to take part in the discussion about what issues we face and what they mean for the Scottish public finances and to have that conversation at a broader level. It would not be a substitute for a budget or a more detailed spending review when that was appropriate, but it would provide a high-level context for such conversations and allow them to take place not in a narrow period—the budget review period—but on a continuing basis with a sense of what the bigger picture is through time.

The Convener: I guess that that would allow us in Scotland to get away from discussing the numbers so much and to become much more involved in a discussion about what we are trying to achieve. I understand that. Would there be a role for the Scottish Fiscal Commission?

Caroline Gardner: The Fiscal Commission will play a significant role in forecasting the revenues from the devolved taxes, which is what it is set up to do, and in the consultation on the fiscal framework, as it will do the gross domestic product forecasts that will play into that.

There is an interesting question about where all that comes together. The committee will know that, increasingly, what the Fiscal Commission does looks like what the Office for Budget Responsibility does at a UK level. The one outstanding gap is in commenting on fiscal sustainability over the longer term. The OBR produces a fiscal sustainability report every couple of years, which gives us a picture of the public finances that is based on current policy commitments and demographic trends. We do not have provision for that to take place in Scotland, but such a report would inform the medium-term financial strategy that Mark Taylor outlined.

The Convener: The new parliamentary session began in May. If the medium-term strategy was for five to seven years, it would fit neatly into the system that we have for Holyrood, with a five-year parliamentary session. Where do you envisage the timescale sitting in relation to a new parliamentary session coming into being?

Caroline Gardner: You are right that the strategy would fit well with the five-year parliamentary session. The right timing might be relatively soon in the new session, probably soon after the programme for government was produced, to show how the Government intended to give effect to its proposals.

The strategy would not be set in stone for the next five years. I would expect it to be refreshed and updated in response to circumstances during

the life of the session and to inform the annual budgets that flow from that.

The Convener: That is helpful context. James Kelly's questions about the information that will be available to us fit in neatly here.

James Kelly (Glasgow) (Lab): The questions follow on. As Caroline Gardner said in her opening statement, to be able to comment and make decisions on the issues correctly, we need accurate financial reporting that aligns with them. The presentation of that reporting will be key, particularly with the new revenue raising and borrowing powers.

What key points does the Government need to address to ensure that information is presented not only accurately but in a format that helps Audit Scotland, us as parliamentarians, and the decision makers and stakeholders in the country to understand the figures better and the consequences of the decisions that are ahead of us?

Caroline Gardner: We see the budget as a cycle. The budget documents, including the longer-term financial strategy, the annual budget and the annual reporting, form a cycle that needs to be seen as a whole. We have a chance to make sure that it is better integrated in the future, so that we can see what happened against the plans that the Parliament agreed before the start of the financial year.

We have produced a couple of reports on where there are opportunities for financial reports for Scotland to be more complete. For example, at the UK level, we now have whole-of-Government accounts that pull together the whole public sector and provide a sense of the total public sector pension liabilities, total borrowing and total commitments to revenue-financed investment in ways in which we do not currently do that in Scotland.

There are other areas where there is room for such transparency—for example, on where the risks might sit with student loan financing and what might happen to the level of repayment. We have made proposals on how financial reporting could be developed further.

On the budget, the big win is for the committee and the Parliament as a whole to have a clearer picture of the overall public finances than they currently have. That is especially important with the new fiscal framework and with the new borrowing powers, the reserve and different sources of funding coming into the budget, in contrast to almost all of it having been funded by the Westminster block grant, as in the past.

Making a closer link between what the Government proposes to spend and what it wants

to achieve with that is important, which is the convener's point. What is the purpose of the spend and how will we know whether that purpose is being achieved so that we can take the appropriate action?

Mark Taylor may want to add to that.

Mark Taylor: There needs to be transparency about the detail and the big picture. Particularly in the early years, we will need the detail of how the fiscal framework operates and how each element of it relates to the others. We will also need the big picture of how those elements aggregate into the main totals in the budget and how they relate to each other, to show how total funding will be applied to total expenditure. For performance reporting on the outcomes, an opportunity to have a clearer sense of what the money will be spent on and the specifics of how that will contribute to outcomes would be helpful.

In both those areas, the Government has shared some material with the Public Audit and Post-legislative Scrutiny Committee and Audit Scotland and has indicated its direction of travel. We know that such thinking is going on.

Ultimately, clarity is needed on those issues to enable this committee to do its job and the public more generally to understand what is going on. That involves the process changing from one in which there is reasonable certainty about how much money there is and what the plans to spend it are to one in which there is more uncertainty that needs to be managed through the year.

Another area of transparency for you and us to think about is in how the Government reports on what it is doing through the year and how it has managed the position so that its decisions—the Government will have more choices—and the basis for them are clear.

10:15

James Kelly: Those points are well made—particularly on the need to have an overall picture of Scottish public finances. Another theme that you have identified is the link between revenue and expenditure, which will be crucial as we move ahead and particularly as the revenue-raising aspects will have an element of forecasting to them. What are the key measures on the reconciliations between revenue and expenditure that we need to have in place in order to properly scrutinise that as a committee?

Caroline Gardner: As Mark Taylor said, more frequent reporting will be needed than has been the case until now, when the Government has primarily been spending a block grant from Westminster. The reconciliations will happen after the financial year and, in the case of income tax,

that will be substantially after the end of the financial year—18 months after in some cases. The recognition of more volatility and risk, and the need for more thought about how that volatility will be managed, will therefore be important. It is not just the case that tax revenues will go up and down; it is quite likely that, if tax revenues go down, social security spending will go up at the same time. Thinking about the interactions therefore becomes really important, as does thinking—as part of the longer-term financial strategy—about what the response would be to changing economic circumstances.

We know that an economic forecast of tax revenues is never right—it cannot be right in that sense. Clarity about what the underlying assumptions are, what scenarios have been played into the budget and what action will be taken in better or worse circumstances than those in the central forecast is part of what the committee and the Parliament more widely will need to see from the Government and from the Fiscal Commission forecasts that are coming into that process.

The Convener: We were beginning to raise transparency issues, which I think that Maree Todd is interested in.

Maree Todd (Highlands and Islands) (SNP): Yes, I am interested in transparency, which is one of the most important issues for the Scottish Parliament—indeed, we take pride in our transparency and accountability.

In the past couple of years, getting late autumn statements from the Westminster Government has been an issue, and that has impacted on our ability to produce a timely budget and allow for scrutiny. Given all the constraints, difficulties and volatilities, what would transparency and accountability look like in a world-class system?

Caroline Gardner: That is a great question, which is at the heart of the work of the tripartite review group that the committee and the Government have put together and which I am pleased to be a member of.

First, a balance has to be struck between the time for scrutiny of a budget and the certainty about the figures—as far as they can ever be certain—that are in it. We have to recognise that that certainty will never be as strong as it was in the past, which probably moves the balance a bit further towards allowing time for scrutiny, rather than placing a premium on getting the right numbers into the process.

To return to the idea that it is a budget cycle rather than a budget event that is so important, if you have the medium-term financial strategy, there is time throughout that period to think about challenging and understanding elements and what

might be moving over time. If there is a clear line of sight between what the budget proposals were and what the outturn looked like in terms of the finances and what was achieved, this committee and the subject committees can drill into that at any point in the year—not just in the six weeks, the two weeks or whatever time there is in the formal budget cycle for the annual budget. The testing and the understanding of the assumptions will continue to build up over time.

As I said, we have some examples, such as the New Zealand Government's approach, where the sense of a process is absolutely there. There are great examples—some from the developing world—of citizens budgets, which provide information to members of the public, interest groups and civil society to allow them to drill down and understand what the budget means for their part of the country and area of interest. That allows them to become part of the debate in ways that will become critical, because we are talking about raising taxes, as well as spending money.

There is no single answer, but there are lots of pointers that we can draw on.

Maree Todd: Will you look at the behavioural response to taxation? A key element is that, if there is transparency and people understand the outcomes that are achieved by paying their taxes, they are more comfortable with paying taxes.

Caroline Gardner: I could not agree more. Recently, we have seen in America the idea that simply paying tax is bad, rather than the alternative view that it is the price that we pay for a civilised society and that we all get something for it. We can all do more on that broad argument.

The quid pro quo is that we need more transparency about and accountability for the raising and spending of the money. It is quite easy to get hung up on the narrow aspects of behavioural responses to taxation—the idea that we cannot announce one measure before another because people will change their behaviour. You are right that there is a much bigger issue for us. Scotland is at a great point in history to make the case for why good public finances and good public spending can help everybody in society and to demonstrate that we recognise the accountability that comes with that.

The Convener: I think that Patrick Harvie has a supplementary question on that area.

Patrick Harvie (Glasgow) (Green): Yes, thank you. Good morning. On that theme of transparency and accountability, a lot of what I see in your written submission today and in other Audit Scotland documents on the subject is about people understanding the basis on which decisions have been made. Your first answer to Maree Todd seemed to be moving more in the

direction of people taking part in those decisions and actually having a role. The Scottish Government says that it supports participatory budgeting

“as a tool for community engagement”

and as part of

“the wider development of participatory democracy in Scotland”.

What impact would a really innovative approach to more participatory budgeting in Scotland have on your role, as Auditor General? Is there any scope for that to happen at a national level? The Scottish Government places a lot of the expectation on that happening at local level, but is there scope for those principles to apply in national budget setting as well?

Caroline Gardner: To answer the last part of your question first, absolutely, I think that there is. The Community Empowerment (Scotland) Act 2015 contains a commitment to some participatory budgeting. The answer to lots of the really knotty problems facing public services is much better community engagement. That means not just consultation on budget or service proposals but involving people in why, for example, our health and social care services need to change. That is not just because money is tight but because it is a better way of meeting the needs of an ageing population.

That conversation is difficult to have and you cannot have it once and consider it finished. It is just as relevant in parts of Scotland where there are proposals to change services as it is at a national level where the parliamentary and media debate often becomes focused on one particular aspect of a much bigger and more complex system, to everybody's detriment.

One of the reasons that I feel so strongly about the opportunity that this point in devolution brings in Scotland is that it gives us the chance to think about what that looks like at a national level. What information do people need to have available in order to be able to think about, talk about and understand the choices that are in there? How do we build the case for a coherent and sustainable approach to taxation and to public finances so that people feel that they have a stake in them? It feels to me as though it has never been more important for Scotland or—looking round the world—generally to get that debate going. If we get that right, we can move Scotland a long way forward in terms of what is necessary and possible.

Patrick Harvie: At the moment, we are quite some way from having that opportunity for participation. Even Parliament is getting a couple of weeks to participate in the budget discussion this year. Do you see that as something involving in-year revisions to the budget or is it part of an

annual cycle? How do you see that working at a practical level?

Caroline Gardner: My sense is that it probably has to work at every level. The convener asked about the timing of a medium-term financial strategy. It seems to me that that flows very clearly from the manifestos of parties heading into an election and the programme for government that comes out of that—whether it is a single-party Government or, as in previous times, a coalition. There is that sense of what the priorities are for the Government for the next five years and, linking to that, how much money is likely to be available to do that and how it is intended to target that money. Making changes in public services generally means moving money around. What does that mean?

Therefore, at that level, there is a debate that Scotland is pretty well placed to be opening up. That can then be moved into the annual budgeting cycle and any changes that may be required in year. If it turns out that tax revenues are lower or higher than expected, how do we want to use that opportunity to move things around? As with participatory budgeting at a lower level, it is not something that we do once and then tick the box. It is a continuing process that we need to embed in how the Parliament and the Government do their business.

Patrick Harvie: Thank you.

The Convener: That leads neatly on to Ivan McKee, who has a question about the issues around forecasting and mid-year adjustments. The point has already been touched on a couple of times.

Ivan McKee (Glasgow Provan) (SNP): There are a couple of things that I want to go through. One is an issue that we talked about in an earlier session, which is that the revenue stream is unpredictable now that it is on the taxation side. However, monthly data is available. The formal process runs 18 months or more out before we really know what the hard and fast numbers are, but we are getting a very good 80 per cent indication of what the numbers are month by month from Her Majesty's Revenue and Customs tax-take data. Should we use that data to drive in-year changes to the budgeting process rather than wait 18 months or two years before we suddenly realise that we have a problem?

Caroline Gardner: That question is made more complicated because of the transition towards the new financial powers over the next couple of years. Mark Taylor will go into more detail on that.

Mark Taylor: The challenge is twofold. One is that there is more complexity in how all of that works. That therefore gives more opportunity to look at the data as it comes in and to begin to

make decisions about how to manage and move the budget on, based on that data. Also, a wider range of tools are available to Governments to decide what to do.

One of the questions that arises is how far through the year we need to be before we can be sure that tax is more or less than we expected it to be. It is about when that information comes through. Mr McKee is right that some of that information is published on an on-going basis. My expectation is that it will take a bit of time to get an understanding of the real patterns of tax and when those judgments can be made. To get some data about that in the meantime is obviously very helpful.

Ivan McKee: I have already said quite a bit about the next area that I want to focus on, which is an outcomes focus and preventative spend and the mechanisms behind that. To start with the terminology, can you tell me how you define the difference between an output and an outcome, because you talk about them as being different things?

Caroline Gardner: I think that outcomes are what we see in the Scottish Government's outcomes framework, in Scotland performs, and in the programme for Government—the things that the Government wants to do. For me, an output is one of the staging points on the way to an outcome. Sticking with the example of health and social care, it is about helping people to live longer, healthier lives, close to their own homes.

At the moment, we tend to measure inputs—the amount of money going into the health service or the number of nurses or doctors or whatever. Outputs are the things that we expect will be influencing the outcomes that we want to improve—for example, the number of older people who are enabled to stay in their homes rather than being in a revolving door of emergency admissions because they are not being supported well enough. The number of older people who feel that they are not lonely in their communities longer term would be a great outcome when we are thinking about some of that.

Ivan McKee: So they are both measurable.

Caroline Gardner: Absolutely. They are not easy to measure but they are measurable.

Ivan McKee: I am glad that you said that. I do not know whether you want to go through some of what is done in New Zealand or some of what the Government has perhaps shared with you around how to have that alignment between the money and the outcome and how you set that up and track it. In my experience of doing that in the private sector, it often leads to organisational changes, because you need to have the responsibility. I suppose that we have seen a step

down that road with integration joint boards. Do we need to see much more of that and, as I say, can you share what New Zealand has done?

Caroline Gardner: In a number of our performance audit reports over the years, we have reported that the outcome is often clear but the Government's plan for improving the outcome in a joined-up way is not always as clear. There is room for being more explicit, at a minimum, by saying that if the outcome that we want to improve is this, here is what we think will make a difference to it—whether that is putting in place integration authorities that do specific things or something else—and here is how we will measure what progress that is making.

In my reports on health and social care, I have been critical of the fact that the measures that get attention tend to be around acute care and spend rather than what is happening in community-based health and social care. If we pull it all together, we find a raft of measures that do not obviously join up at all towards what the outcome—the overall thing that we are trying to achieve—is.

The cabinet secretary has announced a review of targets, which I hope will help to join that up. For me, if there is an outcome that we want to change, the starting point is to be clear about the plan for doing it. That will be based on varying degrees and quality of evidence, but we should still have a plan that says, “We are going to do this because we think that it will work and this is how we will know that it is working.”

Some things will work and some will not. We need to know about the ones that do not work so that we can change course, and we need to know about the ones that work so that we can invest more in that way of working. It is not a terribly sophisticated approach, but it requires clarity of thinking and engagement with people about why we are doing what we are doing.

10:30

Ivan McKee: Thank you.

The Convener: Murdo Fraser wants to ask about borrowing and the reserve.

Murdo Fraser (Mid Scotland and Fife) (Con): Thank you and good morning. Your written submission has interesting comments about the new borrowing powers that are being introduced and their interaction with the Scotland reserve. How do you expect the borrowing powers to be utilised? In particular, what is the reporting mechanism so that Parliament and the committee are aware of when Government is using those powers?

Caroline Gardner: In the fiscal framework, there are three elements to what you have

described: the capital borrowing powers, the revenue borrowing powers, and the Scotland reserve. On top of that, we have a fairly significant commitment to revenue-financed investment through things such as public-private partnerships and the non-profit distribution model, and it is adding to what is already there at the Scottish Government level.

We do not yet know what the Government's plans for reporting on that will be, either in terms of the budget proposal or the in-year reporting on what has happened. Our starting point is that the Scottish Government's consolidated accounts do not give a clear picture of where all the borrowing is as we stand. As we add those new levels of complexity into the interactions between them, that question becomes all the more urgent and it is why we are raising the question about the importance for this committee, the Parliament and anybody with an interest to be able to see what the plans are and what the longer-term consequences of those plans might be.

Murdo Fraser: It is intended as a mechanism to smooth out the peaks and troughs in revenue borrowing. When there has been a forecast for tax revenues that has not been met, it allows the Government to balance out the shortfall. What is the expectation of paying back that revenue borrowing? Is it expected that it will be paid back within a short timescale?

Caroline Gardner: There are limits in the fiscal framework and Mark Taylor will talk you through the detail.

Mark Taylor: On that question specifically, the fiscal framework sets out that the Scottish ministers have discretion to determine the period to pay it back, between three and five years from the point at which the borrowing is made.

On the broader point, there are judgments to be made about how revenue borrowing, capital borrowing and the reserves interact with one another. One of the things that we say in our submission is that it is an opportunity for the Government to set out its principles and policy about that.

There are a number of things to manage. There is the balance between flexibility and the ability to say that we have landed in a particular place because of variability, so we can use reserves and borrowing in response to where we are and balance that with predictability and resilience. We have made a judgment that we need to put money into a reserve that allows us to have that resilience when something happens. Alternatively, we have made a judgment that, rather than take advantage of a revenue borrowing facility, we will look to cut expenditure to manage the situation.

There are therefore some judgments to be made about the overall interaction between each of the tools that are available and the Government's overall policy—we use the term “strategy” in our paper—for how it intends to go about those interactions. We do not have any firm views about what the right answers to those questions are, but it is important for the Government and Parliament to have the discussion.

Murdo Fraser: You expect the Government to be able to set out its approach to us in due course.

Mark Taylor: Yes.

The Convener: I want to understand a bit more about the area that Murdo Fraser asked about. Paragraph 12 in your submission says:

“Only in the case of a Scotland-specific shock will it be able to budget to borrow for resource purposes”.

Who decides what is a shock?

Caroline Gardner: There is some guidance in the fiscal framework on what a Scotland-specific fiscal shock is, and agreement on it will depend on agreement between the two Governments. That is why the intergovernmental machinery becomes so important in all this.

The Convener: We are really saying that we do not yet know what a Scotland-specific shock might look like and it has to be agreed between the Governments. Is that right?

Caroline Gardner: There is a description of what a Scotland-specific fiscal shock means in the fiscal framework. There are also some numbers for how big it needs to be to trigger the exception powers, but there will need to be agreement between the Scottish Government and the UK Government that any particular set of circumstances meets that definition and that the borrowing powers come into action.

The Convener: Rules are set out in the fiscal framework.

Mark Taylor: There are rules set out and defined in the fiscal framework. They are ultimately about the balance between UK GDP and Scottish GDP—either the actual GDP figures, where there is a difference set out in the framework, or the predicted difference. What sits behind that is the discussion that becomes an agreement across the piece; it is about how objective or otherwise that is in practice.

Just to clarify one point, the Government is able to borrow in response to a range of things, including forecasting errors and cash management purposes, but it can budget to borrow in advance only where there is a fiscal shock. For resource borrowing powers generally, it depends on what has happened through the year, and there is the

ability to use the resource borrowing powers, whereas from a budget perspective it is only in the case of a Scotland-specific shock that the Government can say up front, “We are expecting a Scotland-specific shock based on the figures and therefore we plan to borrow at these levels for resource purposes.”

The Convener: If there is a shock, that usually means that something significant has happened in the economy. Is three to five years long enough to be able to deal with the potential turbulence and the revenue hit?

Caroline Gardner: The answer is that none of us—nobody—yet knows. For example, David Bell, who has appeared before the committee on a number of occasions, has done some work to look at whether, as far as one can tell, the provisions in the fiscal framework would have been sufficient to deal with the fiscal circumstances over the past few years.

As we all know, in this year more than any other, past performance is not necessarily a guide to future returns. Over the past couple of weeks, it is clear that all bets are off on what might happen in future. We will have to build experience as the new powers come on stream and understand the underlying assumptions that inform the proposals and the subsequent decisions that are made by this Parliament. We then need to review what happens to learn from that. We will very much be learning from the framework as it is implemented.

Mark Taylor: I can add a wee bit to that. One of the specific provisions in the fiscal framework is that, where there is a Scotland-specific shock and the Governments agree that the existing limits under the powers are not big enough, there is an opportunity to agree a different approach, whether that involves a different timetable or different limits.

The Convener: Dean Crawford has a supplementary question on this area.

Dean Lockhart (Mid Scotland and Fife) (Con): Yes. You have covered most of it, convener, but I have one question on the Scotland-specific shock. In the past eight years, we have had quite a few shocks to the economy, including the financial crisis, which was not Scotland-specific but which—one could argue—had a greater impact in Scotland because of our financial sector. We have also experienced a downturn in the oil and gas sector, which I imagine could be classified as a Scotland-specific shock.

With regard to how such a shock would be identified, you mentioned the differential in GDP between Scotland and the rest of the UK. Would the amount of tax revenue that is collected as a result of the shock also be taken into account? As I understand it, Scotland's budget will be driven by

the divergence in the amount of tax that is raised—not necessarily the divergence in economic growth—between Scotland and the rest of the UK.

Caroline Gardner: I will let Mark Taylor take you through the detail of that.

Mark Taylor: The short answer is that the provisions that are set out in the fiscal framework are about GDP. There is obviously a link between GDP and tax collection, and that will be what drives the forecasts for tax collection, but the provisions are around relative levels of GDP, either measured levels or forecast levels. The framework defines what a shock will comprise.

Dean Lockhart: I have a related question on GDP relative to tax take. There is obviously a direct correlation between GDP growth and tax take. Is the correlation in Scotland more or less direct, or the same, as in the rest of the UK? Is that perhaps a question for another occasion?

Caroline Gardner: The answer is that it is complicated. We know, for example, that Scotland does not have nearly as many higher-rate taxpayers as there are in the UK as a whole, and in England in particular. As a result, there is not a simple one-for-one relationship between GDP and tax take across Scotland and the UK as a whole. Understanding that will be a key part of good tax policy and good tax setting for this Parliament.

The Convener: Talking of shocks, Ash Denham wants to raise some issues relating to Brexit.

Ash Denham (Edinburgh Eastern) (SNP): Yes—surprisingly. You spoke earlier about the need to plan more over the medium term; I think most people would agree that that would be a good thing. I am wondering how that fits in with the slightly wider context, looking at what is happening at UK level at present. The impact of spending decisions that the UK might make could affect Scotland's budget, and changes might be coming soon—we do not know when—as a consequence of Brexit. Does that present additional challenges with regard to the idea of planning further into the future?

Caroline Gardner: I think that it does, which makes it all the more important. I often give the same message to the boards of public bodies: that they need to think about longer-term financial planning. Their response is to say that they only get an annual budget allocation from the Government. However, when we start to explore that with them, we find that they know a lot about what is likely to happen to the demand for their services and what is happening to their costs; pulling that together gives them a sense of the scale of the challenge that they have to manage and starts the process of thinking about what their options are.

It is glib to say that it is the same question for the Scottish Government and the Scottish Parliament, but actually that is true. It is not about doing that planning because it gives us the right answer; doing the planning is a good way of building the conversation about what we need to deal with, what opportunities we have and what choices within that we want to make. That will probably lead to better decision making and it is also a great way of involving the people of Scotland in the discussion.

Ash Denham: Are there things that the Scottish Government could be doing to plan for what I suppose are unknown unknowns at the moment, if I can put it that way?

Caroline Gardner: Yes. It is simply about the Government being more explicit about what is on its radar. At a very straightforward level, we know that things like the impact of demographic change on health and social care, education and higher education could be set out more transparently. We know where there are commitments that are hard to get out of in the short term, whether it is revenue payments for the non-profit-distributing model of investment or salaries and wages in a no compulsory redundancy context. The question for the Government is what is it committed to and what discretion it can use. It is about starting to think through explicitly how much Scotland depends on EU funding at the moment—not just agricultural funding, but structural and regional development funds. It is about asking what would happen in different scenarios if that money was returned to Scotland in full or if another amount was returned.

There is a range of things for which there is no right answer, but it is about having clarity about what the known unknowns are, if I can put it that way. That would leave us better prepared to deal with the unknown unknowns as they emerge, which they are bound to.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): Good morning, Auditor General. When I served on the Public Audit Committee in the previous parliamentary session, there was discussion about the nature of the relationship between Audit Scotland and the National Audit Office in relation to tax powers and so on. Where are we with that? Is there now a reciprocal arrangement in place so that Audit Scotland can give evidence to a Westminster committee and the National Audit Office can give evidence to Scottish Parliament committees?

Caroline Gardner: That is an important question and I am grateful for the committee's interest in the matter, because it is obviously not of interest to many people. Our starting point is that when the Scottish Parliament was established in 1999, there was a pretty clear division between

the UK's public finances and Scotland's public finances, and between what the National Audit Office did and what Audit Scotland did. Over time, that clear edge has increasingly become ragged and we are now in a position where HMRC is collecting the Scottish rate of income tax for the 2016-17 budget on behalf of the Scottish Government. We have arrangements in place for some joint working to make sure that this committee gets the assurance that it needs about that. However, from next year, the money raised will go from a small amount to a very significant amount through the devolution of all non-savings, non-dividend income tax. In addition, in the next two or three years, the interaction with the Department for Work and Pensions will become increasingly important.

We have a starting point in place for that to work well, which is based on the National Audit Office continuing to audit those two UK agencies—HMRC and the DWP—and my team staying close to what it is doing so that we can influence the work that it does, if we think that that is needed, and provide assurance back to the Scottish Parliament that Scotland's interests are being taken care of. We will need to revisit those arrangements in due course as the amounts of money that are collected by HMRC increase very significantly and as the DWP also comes into the picture for at least some of the social security responsibilities.

Willie Coffey: Has any step been taken yet for Audit Scotland to appear at Westminster committees, or for the National Audit Office to appear here?

Caroline Gardner: I have not yet been invited to appear before a Westminster committee. As you know, my counterpart, the Comptroller and Auditor General, has appeared before Scottish Parliament committees.

10:45

Willie Coffey: You talked about developing new arrangements at Audit Scotland in which there would be informal reporting, an example of which you have given us already, as well as your formal reports to Parliament. Do you see Audit Scotland's role changing in recognition of the new powers coming to Scotland, given that you might have much more of a role in the process itself instead of looking back at performance at the end of the process, as has been Audit Scotland's historical role hitherto?

Caroline Gardner: I think that I would probably distinguish between this period in which the new arrangements are developing, when we have an important perspective to play into the deliberations of the Government and the Parliament with regard

to what is needed, and the period when the arrangements are in place. After all, this is our core business; we report on accountability and transparency, and we can help to shape arrangements that really are world class and fit for purpose.

In the longer term, once the arrangements are in place, I suspect that we will probably pull back again to report on the information that the Government itself makes available. At the heart of that will be its annual accounts, which I hope will be more comprehensive and transparent than they are, and the link back into the budget process, but I think that once we reach a steady state—if that phrase still makes sense in today's world—we will step back from seeking to influence the way in which things are done.

Adam Tomkins (Glasgow) (Con): On the back of Willie Coffey's questions, I point out that, as the Finance and Constitution Committee, we are interested in the constitutional arrangements of what I would call shared rule as well as the financial concerns. I wonder whether I can push you a little bit more on this. I do not know whether you will agree, but it seems to me that the Smith commission agreement, the Scotland Act 2016 and, most of all, the fiscal framework itself have kind of done away with the old distinction that we have run with for 16 years or more that a power is either reserved or devolved. We now have a situation in which some powers are still clearly reserved or devolved but there is also quite a lot of shared responsibility and shared power, particularly in the field of social security but also in taxation.

Thinking constitutionally about this, I wonder whether you can say what kind of institutional architecture we have to hold to account, robustly and transparently, the exercise of shared power. I am not just talking about your keeping close tabs, as it were, on what the National Audit Office is doing in its audit of the DWP but about joint auditing by Audit Scotland and the NAO of the joint working between the DWP and the new Scottish social security agency, assuming that it comes on stream. Can you push that issue a little bit more?

Caroline Gardner: I am happy to do so, but in the recognition that there is still a lot of uncertainty about how that will unfold.

With regard to HMRC, I actually do not think that there is a need for very much more than we currently have. A lot of how that will unfold will be about the interaction between the Comptroller and Auditor General and this Parliament and between HMRC and this Parliament, but it will remain the case under the current settlement that all devolved income tax will be collected by HMRC as part of its UK-wide income tax collection exercise. What the

Parliament will need assurance on is whether Scottish taxpayers have been properly identified, whether the collection rates that apply to them are in line with collection rates across the UK and whether customer service levels are as good for Scottish taxpayers as they are for anybody else. I am not sure that, in that respect, there would be much added value in the kind of joint audit work that you have described, because it is still quite a self-contained and well-established exercise.

VAT might be a bit more difficult, given what we know about the data challenges that underlie the assignment of VAT revenues. There are some really important questions that need to be resolved; we are closely watching how the issue develops, but it is still too soon to say what it will mean for the audit work that will be needed on behalf of the Scottish Parliament.

Again, the uncertainty about social security benefits is a very significant issue. We know that the Government has committed to establishing a Scottish social security agency, which will provide a thing that we will audit. Equally, it is very clear that that agency will need to have a lot of interaction with the DWP, not least around universal credit, which is intended to be a very joined-up approach to social security. As that unfolds, there might be changes that will mean that, as Mr Coffey has suggested, our role will move on and there will be a need for much more joint work—not least to provide assurance to both Parliaments that that joined-up package of support to people is being managed properly. Of course, we will not know that until we see it.

Possibly more immediate is the need for progress on the ministerial mechanisms for joint working between not just those two Governments but the other devolved Governments in the UK. That was a clear recommendation of the Smith commission and a headline in the fiscal framework, but we have not seen much more about the mechanics of it. It seems to me that that is a priority. As we head into the land of things such as block grant adjustments, indexation and Scotland-specific fiscal shocks, we need robust mechanisms for managing those in practice.

Adam Tomkins: Thank you.

Patrick Harvie: I want to follow up on Willie Coffey's question as well, but I want to go in a slightly different direction from Adam Tomkins. He talked about the shared power between the Governments within these islands, but there is also a sharing of power between the Parliament and the Government here in the decisions that have to be taken.

Let us imagine that, later today, we hear from the UK Government that there is going to be some extra capital spending. That will have an impact on

the choices that Derek Mackay might have available over the next few weeks. Some people will lobby for shovel-ready projects in their areas while others might argue for investment in energy efficiency or childcare, arguing that those are jobs rich. We have to make those decisions in a way that is informed not just by what is gained in terms of public benefit from that spending, but by what impact it will have on future income tax revenues.

What is your role, not just this year but on an on-going basis, in providing the tools, the modelling or the information to enable us in Parliament to be informed about all the future impacts of those decisions, particularly when the Government does not have a majority and cannot simply push through its own plans but needs to gain agreement across the Parliament?

Caroline Gardner: The most important role that we have to play is in helping you and the Parliament and Government to shape a process that means that you are not making those decisions in the next six weeks—after the autumn statement and before the Government's budget is put up for agreement—but that there has been a process of discussion that is informed by a good understanding of the economic context, the public finances and the Government's priorities.

In future, there may be a majority Government, a coalition or a minority Government, and the process needs to be fit for all those circumstances. In my view, it also needs to provide scope for people to have their say, and that is a continuing and long-term thing.

My priority at present is to think about how we shape a system that does that. Within that system, there will be different players that provide different bits of information. A lot of the information has to come from Government, and how firm that can be will shift in different political contexts.

The Scottish Fiscal Commission has a role—and will have a greater role in future—around the GDP forecasts that are needed, and I have also mentioned the need for reporting on fiscal sustainability. We are seeing more commentary coming from groups such as the Fraser of Allander institute about the choices that exist and the opportunities and constraints around some of that. That is all very healthy. The budget process that we have at present cannot possibly squeeze all of that into a short six-week period and we need to move to having a continuing thing.

Patrick Harvie: That brings us back to the roles of the different organisations. In this kind of process, it will not be adequate for everybody to rely on information from the Scottish Government when it is one of the political forces that are involved in a political discussion about choices.

Caroline Gardner: I would disagree with that in the sense that, if we get a system that looks across the whole budget cycle, it will not be possible—in a hypothetical sense—for a Government just to produce a set of numbers and say, “This is the picture.” This committee and the subject committees will all have a chance to drill down and understand more what is happening in terms of financial pressures, demographic pressures and the commitments that are already baked into the budget; to think about what the options are; and to have a prioritised sense of how we would propose to use the money if there is a shift and we have more tax revenue or more of a stimulus from the UK Government.

The Government’s information has to be a starting point. In the brave new world that I am talking about, greater financial reporting would give you more assurance from the audit work that we do about things such as the commitments to revenue-financed investment. There would be more certainty across the piece about what the numbers mean, and that could be played into the decision making.

I do not think that we have a role in costing policy proposals, as that would drag us right into the politics in ways that would limit our usefulness to you. The real win is in getting more of that information routinely into the public domain with the stamp of assurance that good, independent public audit can bring.

Patrick Harvie: Thank you.

The Convener: I want to make sure that everybody got a chance to ask all their questions. Dean, did you ask all the questions that you wanted to ask on productivity?

Dean Lockhart: Yes, thank you.

The Convener: Does anyone have anything else that they want to raise?

Patrick Harvie: The other thing that I want to mention is the equality assessment of the budget. Again, this might be an area in which you do not feel that there is currently a core part of your role that is relevant, but I wonder whether that is worth considering again.

I do not think that either of you were part of the Scottish Government’s equality and budget advisory group. It recommended that

“Equality considerations should be an integral part of the core budget and spending review process”

and argued that that should be relevant to all Government agencies. Do you have a view on the scope for Audit Scotland to have a role in the process of looking at the equality impacts of the choices that have been made in the past or the options that are available in the future?

Caroline Gardner: We have done some of that work on choices that have been made in the past, and there is probably scope to do more. For example, the performance audit work that Audit Scotland did on behalf of the Accounts Commission on educational attainment contained an element on the equalities and inequalities dimension of that. We also looked at health inequalities in a very significant piece of work, and we will continue to do that, particularly as tackling such inequalities is such a headline priority of the Government.

However, the core responsibility for setting out information on budget proposals and specific policy proposals lies with the Government. Given its focus on reducing inequality, it seems to me that the committee and the Parliament should expect from the Government a good assessment of how what it is planning to do will affect inequalities. We will certainly be looking for that, as we have done in relation to other reform agendas.

Patrick Harvie: Okay. Thank you.

The Convener: I thank the Auditor General and Mark Taylor for coming along and giving us such a helpful and constructive perspective this morning. I have certainly found it very useful and educational in relation to how we might take things forward. Thank you very much.

With that, I move the meeting into private session.

10:57

Meeting continued in private until 11:39.

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