OFFICIAL REPORT
AITHISG OIFIGEIL

Finance and Constitution Committee

Wednesday 21 December 2016

Session 5

The Scottish Parliament
Pàrlamaid na h-Alba

Wednesday 21 December 2016

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FINANCE AND CONSTITUTION COMMITTEE
17th 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:

Colin Borland (Federation of Small Businesses Scotland)
Professor Campbell Leith (Scottish Fiscal Commission)
Claire Mack (Scottish Council for Development and Industry)
Dave Moxham (Scottish Trades Union Congress)
Sean Neill (Scottish Fiscal Commission)
Professor Charles Nolan (Scottish Fiscal Commission)
Peter Reekie (Scottish Futures Trust)
Lady Susan Rice (Scottish Fiscal Commission)
Barry White (Scottish Futures Trust)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Finance and Constitution Committee

Wednesday 21 December 2016

[The Convener opened the meeting at 09:30]

Decision on Taking Business in Private

The Convener (Bruce Crawford): Good morning and welcome to the seventeenth meeting in session 5—and the final meeting in 2016—of the Finance and Constitution Committee. I welcome the witnesses and those who are in the public gallery. As usual, I remind members to put their mobile phones into the appropriate mode.

The first item on the agenda is to decide whether to take item 5 in private. Are members agreed?

Members *indicated agreement.*

Draft Budget 2017-18

09:30

The Convener: The second item is to take evidence from the Scottish Fiscal Commission as part of our scrutiny of the draft budget for 2017-18. We are joined by Lady Susan Rice, who is the chair of the SFC, Professor Campbell Leith, who is a commissioner, Professor Charles Nolan, who is also a commissioner, and Sean Neill, who is the chief executive. I warmly welcome the witnesses to our proceedings, and I invite Lady Susan Rice to make an opening statement.

Lady Susan Rice (Scottish Fiscal Commission): Thank you very much, convener. Good morning to all of you and thank you for having us back. I will say a few words about the commission and then make a brief comment about each of the devolved taxes. I will canter through.

Since we last met in October, the commission has published its "Report on Draft Budget 2017-18", along with an accompanying non-technical summary. Following 11 scrutiny meetings, we independently concluded that the Government's forecasts were reasonable and, as is our wont, we also identified a number of areas for continued improvement in the forecast methodologies. As this is the final year in which we will scrutinise the Scottish Government's forecasts and make a judgment about whether they are reasonable before the commission takes on that responsibility for forecasting, those recommendations—those suggestions—are actually for us.

From next April, we will begin to produce our own independent forecasts of Scottish tax revenues and Scottish onshore gross domestic product. With that in mind, the work of the commission has evolved considerably over the past year. We were joined in the summer by a small team to manage the transition of the commission to a non-ministerial department. Sean Neill has been our interim chief executive since that time. I am pleased to report that, so far, the project is progressing pretty smoothly. It is a lot of work, but we are making progress as we anticipated. Permanent staff will begin to join the commission from January, and our way of working will develop further as we take on our new responsibilities.

The interim team has given us a lot of support in preparing the report for this year, but I have to call out the incredible amount of work that Professors Leith and Nolan did in creating the report, and I would like to thank them personally.

For this year's work, we started by developing a protocol with the Scottish Government to set out clearly how we would interact with it in this year's budget process. We really appreciated the high level of co-operation and transparency in our discussions with the Scottish Government, which greatly facilitated our ability to scrutinise properly and thoroughly the forecast methodologies.

In each case, the commission looked for evidence to support the approach that was adopted by the Scottish Government. As you know, it is not the role of the commission to determine how the Scottish Government produces its forecasts. That is up to the Scottish Government. However, where the commission felt that there might be a benefit from a different or additional perspective, we shared those ideas with the forecasters. In each case, the forecasters themselves choose whether to pursue or adopt those alternative approaches.

You will have seen that our report includes some sensitivity analyses—some "what-ifs", as I would call them—as a way to deepen understanding of some potentially important drivers of individual forecasts.

Last year, our report quadrupled in size from the first year. We should all be grateful that we showed some constraint this year and that the report has only doubled in size from last year. It has, however, become increasingly detailed and increasingly technical because the models have evolved, because we now have outturn data to consider, because we have added the Scottish rate of income tax into this year's report and because we have shared through example the nature of some of the approaches that we have taken and may take in the future to flex the forecast. In that sense, we are giving a bit of a preview.

Because of that increased complexity, we have tried at the same time to improve the accessibility of the report by publishing for the first time a non-technical summary and using additional media such as Twitter to communicate the work to a wider range of audiences. We will continue to take that approach and we are keen to learn from it, because we want our reports to be accessible as well as authoritative.

I turn to a brief overview of our main conclusions. This is the first year that we have been asked to provide independent scrutiny of the forecasts of income tax liabilities. Forecasting income tax liabilities is a complex task. The Scottish Government has developed a model that builds in demographic changes and growth in income. In reaching our assessment of the reasonableness of its forecasts, we focused in particular on its projections of earnings and employment growth. The commission considers the forecasts that the Government has produced to be reasonable.

We have identified a number of areas in which we feel that additional research and model development are required to improve the quality of the forecasts. A particular focus is judgments about behavioural effects or how people react to changes in tax policy. The evidence base in Scotland to inform such judgments is really limited, so it is not possible to be definitive on them. Looking ahead, it will be important to keep our understanding of those issues under review and to consider whether evidence exists or might be generated that could shed further light on them in a Scotland-specific setting. In future, we will be building a lot of data and observations on income tax.

The forecasts for residential land and buildings transaction tax revenues this year are lower than last year's, partly due to evidence that the housing market might be somewhat weaker than was previously expected, but mainly due to changes in forecasting methodology and changes to the base numbers that went into the forecasts.

In contrast, the forecasts for additional dwelling supplement revenues are higher than last year's, because we now have some outturn data available that has improved our understanding of the scale of additional homes in Scotland. However, information is still limited, especially on the refund rate. We will monitor that with interest.

Non-residential LBTT forecasting has not changed much since last year's budget process. We still feel that there may be scope to explore use of more Scotland-specific macroeconomic data to underpin the forecasts for that tax. Again, that is something that we intend to explore in future.

Scottish landfill tax, on the other hand, has seen a dramatic shift in forecasting methodology away from a simple target-based approach, which we challenged in the past, towards an approach that is centred on forecasting tonnages that will be sent to landfill. Initial work has been done to understand the link between the wider macroeconomy and waste arisings, and we can develop that further.

A couple of other areas that we will keep a close eye on are the development of incinerator capacity in Scotland—there are lots of plans for that, but they need to happen—and the policies that local authorities and waste management companies will adopt to ensure that the ban on biodegradable municipal waste going to landfill is successful when it is introduced. Both of those things will have an impact on the tonnages that are sent to landfill, and therefore on the revenue from the landfill tax.

From next year, we will also become responsible for non-domestic rates income forecasts. We plan to continue the Government's engagement with key stakeholders in the area to deepen our understanding of the main risks to the forecast, especially around large-scale development projects. In a smaller environment, large projects can lead to a certain amount of volatility.

Those are my opening comments. I close with a reminder that the Scottish Government has produced the forecasts and the commission has taken an independent view on their reasonableness. We have also begun to anticipate our new remit, and that is trailed in the report.

If our report has doubled in size since last year, I think that my opening remarks have done so as well. I thank you for your patience. I invite the convener and members of the Finance and Constitution Committee to give us any feedback that you have on the report and, obviously, to ask your questions. Thank you.

The Convener: Thank you. The paper growth may have slowed, but I guess that if the Scottish economy was growing at that level, we would all be a lot more excited.

Income tax forecasting is obviously germane, and it is important to know where we are. The forecasts for Scottish income tax to 2021-22 suggest a cumulative benefit to Scotland's budget of about £1.5 billion. Some of that will be a consequence of the policy decision to increase the 40p threshold only by inflation, but a number of growth forecasts that the committee has considered anticipate the Scottish economy growing more slowly than the United Kingdom economy. Given that, can you shed any light on why tax revenues in Scotland are forecast to be higher than the adjustment to the block grant, which is based on the per capita income tax revenue growth in the UK?

Professor Charles Nolan (Scottish Fiscal Commission): I will start with the first part of that question. What drives the forecasts of tax revenue on the macroeconomic front are the forecast paths for employment growth and aggregate earnings. Those are the two main macro inputs. The model works by forecasting employment growth, building that up from a breakdown of Her Majesty's Revenue and Customs data from the survey of personal incomes by age group, by income source and by sector. You are trying to build up the non-saving, non-dividend tax base, so you are trying to get a forecast of the number of taxpayers and their income, and for those of working age employment is the proxy for the number of taxpayers. That is about right because, in the 2013-14 SPI data, 97 per cent of taxpayers under 65 had income from employment, and of that income 95 per cent is non-saving, non-dividend income, so employment growth is the proxy for taxpayer growth. Most of the non-saving, non-dividend income for those over 65 is from pensions—that is about 80 per cent of their non-saving, non-dividend liabilities. In that way, knowledge of the taxpayers is built up from the bottom up in the Scottish Government's approach.

Forecasting employment consequently becomes important, because most of the liabilities come from taxpayers in employment. That is the first part of the connection of the income tax forecast with the wider macro picture. Given that you have some estimate of the number of taxpayers in employment, the key thing then is to look at how average earnings are growing, and there the forecast is driven by the Office for Budget Responsibility's forecast for earnings, which is incorporated in the Scottish Government's macroeconomic model to produce an average earnings profile. In effect, those two things are put together—there are lots of steps in between that I could talk about if you want—to give a distribution of income, to which you can then apply the tax code.

The Convener: There are obviously differences between what the Scottish Government is saying and what the OBR is saying in terms of forecasts. What is driving those differences?

Professor Nolan: There are two generic differences. One is that the models are different. The OBR's model of the Scottish non-saving, non-dividend tax liabilities is basically a share of the UK non-saving, non-dividend tax take. It is calculated using the Scottish share of the overall UK tax take, and that is sometimes described as a top-down approach. Our model is calculated using the same 2013-14 SPI data that the Scottish Government is using, and then various changes are made to account for demographic changes and any differential impacts between how tax changes would affect the rest of the UK and Scotland, but the share, which is around 7.3 per cent, has remained fairly constant through time. That is one difference. The models are slightly different, so they are liable to give you slightly different answers.

The second thing is that policies are slightly different now, so the higher-rate threshold for the forecast period will differ between Scotland and the rest of the UK, and those differences will be part of the data. The OBR did not include the Scottish Government's plans in its forecast, so the OBR's forecast for the tax take assumes that Scotland follows the UK Government's approach, and that is the other difference. Those would be the two reasons for the forecasts being different.

09:45

The Convener: I am sorry to get into such technical stuff so early, but that helps us to understand the overall position on how we got to where we are. Ash Denham might have some questions on income tax as well. Am I right?

Ash Denham (Edinburgh Eastern) (SNP): Yes. Good morning. At the moment, some clouds might be gathering over the UK economy as a result of matters relating to Brexit. The Scottish Government has made the decision not to pass on the tax cut for the top 10 per cent of earners. You mentioned the changes to the higher-rate threshold. As I understand it, 99 per cent of taxpayers will pay no more income tax this year, but revenue will actually be up. The Scottish Government has forecasted revenue of £79 million for next year. That will increase over the next few years and then, cumulatively, as Bruce Crawford mentioned earlier, it will be £1.5 billion by the end of 2021-22. You have said that you consider the methodology that has been used to come to those forecasts to be reasonable, so I believe that you have categories of reasonable or not reasonable. Are you able to give us a bit more detail on why you thought that the forecasts were reasonable?

Professor Nolan: Why is the income tax model reasonable? To answer that in a slightly generic sense, as Lady Susan Rice said in previous opening remarks, and as we write in our reports, we try to assess taxes and tax methodology by asking whether there is evidence for pursuing the approach that has been taken.

With the income tax model, the obvious alternative way to do that would be to make some kind of projection on income by deciles, as opposed to building it up by the age cohorts or age groups that I mentioned. Some work was done during the year—we discussed the issue in our challenge meetings—on whether that approach would be more accurate than building up the projection by age cohorts. The indications were that the age cohorts method was probably more accurate. Given some of the demographic differences between Scotland and RUK, the Scottish Government's judgment is that that modelling approach is probably more flexible for incorporating those effects, if and when they arise and become material to understanding the tax take or labour market behaviour.

We have to have a mixture of those kinds of discussions. We can say that we do not necessarily agree with everything, but the approach is reasonable, because it has a rationale and a justification, it can be defended and it produces numbers that look reasonable. There is a mixture of factors.

Lady Rice: Forecasts develop over time, as I signalled in my opening comments. This is the first year for the income tax liabilities, and we think that what the Scottish Government has done is reasonable. Reasonable is not a black and white judgment. It is what it is: it is within a spectrum. We fully expect the approach to evolve over time as we know more, do more and test more. Campbell, do you want to add to that?

Professor Campbell Leith (Scottish Fiscal Commission): Yes. As we have said repeatedly at previous meetings, we should imagine fan charts—which the Bank of England uses when it forecasts—around the forecasts. There is quite a range of uncertainty attached to them. One of the things that we have tried to do for almost all the taxes in the report this year is to undertake some kind of sensitivity analysis. What is it that generates those fan charts? What is it that generates the main likely sources of divergence from forecast that we will ultimately observe?

In the case of income tax, the key driver is nominal wage growth. We have spent a lot of time looking at what it would do to the forecast if that were a bit lower or a bit higher. Is the nominal wage growth forecast from the macro forecast a reasonable one to employ, because it is a key driver of income tax? Drilling down into what is materially important for driving the forecast and assessing whether we consider that to be a reasonable approach are what drive our assessment of reasonableness for the tax number that is ultimately generated.

Ash Denham: The Scottish Government has a new model, so it is constructing more detailed forecasts by age group, income source and sector. You alluded to that in your initial remarks. You said that it is important to further develop the economic modelling of the Scottish labour market, because you think that that will be important in forecasting in the future.

Some of the modelling is based on Office for National Statistics projections of population growth. Is that now a bit more complicated because of Brexit and possible changes to the free movement of people?

Professor Nolan: To go back to the modelling of taxpayers, calculating the population growth is the first step in calculating the future trajectory of the number of taxpayers. We apply a participation co-efficient, as not everyone will be working. A proportion will be working and a proportion will be unemployed, and what is left is the forecast for employment.

The OBR used the ONS principal population projections in its most recent forecast to accommodate the latest thinking on Brexit, and those projections are reflected in the principal projections for the Scottish population. The unfolding Brexit scenario is reflected in the same way as it is in the OBR forecasts.

Patrick Harvie (Glasgow) (Green): Good morning. I want to follow up on those questions. The range of impacts that we have been told could emerge from the various models that we could be living with post-Brexit—depending on whether the UK is inside or outside the single market and whether Scotland has the same arrangement as the rest of the UK or a differentiated arrangement—is really quite stark. The most damaging scenario was outlined a couple of months ago in the Fraser of Allander institute's report, which suggested that real wages would be down by 7 per cent and the number of people in employment would be down by 3 per cent, or approximately 80,000. It also suggested that there would be reductions in GDP, productivity and exports.

We must be working with some assumptions about the fundamental context in which the economy will be operating. Can you say what the assumptions are? When you take on the forecasting role from the Scottish Government, will you take the same approach or will you generate different predictions and forecasts based on different assumptions about the conditions in which we will be operating?

Professor Nolan: I will say something about how the Brexit situation is reflected in the current income tax forecasts. The earnings input to the income tax model follows the OBR wage projections, so the model reflects the OBR's assumptions in its modelling on the economic and fiscal outlook for the next five years, from 2017-18 onwards. That earnings profile is important for modelling the Scottish earnings profile, and Brexit is part of that. As I mentioned, the principal population projections are used, and the employment profile that is incorporated in the income tax forecasts is also very close to the OBR's profile.

In a sense, the macro forecasts that go into the income tax model are already starting to reflect how forecasters are trying to get to grips with what Brexit means—of course, at present, no one knows exactly what it means.

Patrick Harvie: Is the forecast based on a mid-point in the range of possibilities of economic harm that will come from Brexit or on an assumption that the market arrangements will be as they are at present—in other words, that we will be inside the single market? If that is not the case, will we have to revise all the projections dramatically downwards?

Professor Nolan: The projections are almost certainly going to be revised. I do not know whether they will be revised dramatically, but they will be revised.

At present, the way in which things are playing out in macroeconomic forecasts is that a couple of years down the line—assuming that Brexit happens—the OBR will be shifting down, in a net trade-neutral way, the path for imports and exports. Basically, there will be a level shift down in the path for imports and exports, which is meant to reflect a more difficult international trading environment in a couple of years' time and thereafter. However, the OBR is clear that the forecast is very rough and ready. It has no real sense of the detail of what the post-Brexit trade deal will look like, so that is—

Patrick Harvie: It is a finger in the air, really, is it not?

Professor Nolan: I will let Robert Chote speak to which finger is in the air. In the shorter term, Brexit has not happened and the trading rules have not changed.

On what is driving the short-term conjuncture or the short-term forces in the forecast, business investment is starting to look much softer now and next year, and a drop in the exchange rate is liable to push up inflation, so inflation expectations are starting to pick up. That will squeeze real earnings further down the line. Just when business investment starts to recover, household consumption starts to soften a bit. It looks like overall growth will soften in the next couple of years. Beyond that, it is clear that there is a very difficult judgment to make on how the situation will evolve. No one knows that.

Patrick Harvie: The second part of my question was about the approach that you intend to take when the commission takes on the forecasting function from the Scottish Government. Will you take the same broad approach of trying to produce a single central forecast, or will you try to produce a range of forecasts that are based on the different scenarios that we might face? That includes, for example, the range of different policy choices that the Scottish Government might make. I think that you referred to fan charts. The idea that income tax rates and bands will stay absolutely as they are until 2021 seems a bit far-fetched.

Professor Nolan: I do not want to tie anyone's hands, but I think that we will always want to look at scenarios. It is likely that, even in a couple of years' time, the future will not be particularly clear. Some things will have been resolved and new uncertainties will have emerged. We would want to try to take an evidence-based approach and consider which sectors of the Scottish economy are likely to be more affected by difficult changes in the trading environment, changes in international trading rules or differential regulations.

Will our big export industries be affected? A lot of the European Union tariffs are not that high, but they are high for some sectors. If certain sectors are forced to trade under World Trade Organization rules, that could be more difficult for them. It is difficult to say with any certainty how those things will play out, but I think that we will want to look at various scenarios. We can say what our central forecast is only if we know what the stuff round about it looks like, too.

Lady Rice: We will produce a forecast as required, but we are not working in that area now. We have our current remit, and we really have not plotted out exactly how we will approach the issue. We know that it is really important. We asked the Scottish Government in this round whether it had thought about Brexit, what it had thought and whether it incorporated its thinking into its forecasts this year. As Charles Nolan explained, it has drawn on the OBR approach, which is probably a reasonable thing to have done given where we are.

We will take Patrick Harvie's question away and discuss how we will approach the matter once we take on formal forecasting.

Professor Leith: I echo those comments. Essentially, the OBR's approach follows the consensus view of economists that Brexit will ultimately lead to a slowdown in the growth of trade. It looks likely that it will slow down the rate of growth of migration as well.

We do not yet know the exact balance between a soft Brexit, a hard Brexit and any other kind of Brexit. The OBR's forecasts acknowledge that huge uncertainty, and the OBR suggests that, ultimately, it will weigh on business investment, the depreciation in sterling will weigh on real wages, and that will subdue consumption growth. That is the basic approach that the OBR has taken.

However, as things evolve and uncertainties are resolved, we will be able to refine those forecasts. When we take over the job of forecasting, our remit will be to produce a single number to inform the budget, but we would also expect to do a sensitivity analysis around that central forecast.

10:00

The Convener: Given the methodology that was adopted in the fiscal framework—the per capita process that was agreed between the Scottish and UK Governments—if the economy and the tax take in the rest of the UK are softening at the same rate as the Scottish economy, Scotland will be no worse off than we would have been, because the block grant adjustment will not be as aggressive. Have I got that about right? It is not just about your forecast; it is about the impact of how the rest of the UK behaves.

Lady Rice: That relationship is indeed very important.

The Convener: If the Scottish economy softens at the same pace as the UK economy, because of the methodology adopted, there will be no impact on the block grant.

Professor Nolan: That is right. The indexation method changes.

Lady Rice: That is correct.

The Convener: I accept that there have to be the same conditions.

Professor Nolan: That is right.

Dean Lockhart (Mid Scotland and Fife) (Con): Looking at the importance of the dynamic between employment levels and average earnings for the overall income tax take, I noticed that the forecast for private sector earnings is 4.9 per cent by 2021. Will you remind me whether that is based on a Scotland derivation of OBR numbers?

Professor Nolan: In effect, it reflects the OBR forecast for average weekly earnings growth.

Professor Leith: It is slightly more complex than that.

Professor Nolan: Okay. It is put into the Scottish Government model and then there is a forecast for annual earnings. However, the forecast hours are relatively flat. The underlying driver of the number is the OBR wage forecast, but it reflects wider earnings growth.

Professor Leith: There is the public and private split, too.

Professor Nolan: We are talking about private sector earnings, the figure for which is 4.9 per cent. The average earnings figure—the average of the public and private sector—comes out of the computer and an assumption about public sector pay growth is deducted from that, which delivers the private sector profile.

Dean Lockhart: Is there any sort of bottom-up analysis? The earnings profile in Scotland is slightly different from that throughout the rest of the UK. If we use adjusted pro rata OBR top-down analysis, does that really reflect the earnings profile in Scotland?

Professor Nolan: You made a couple of points there. There is an annual survey of hours and earnings data that is also used in the income tax forecast model to plug the gap between the 2013-14 base and the 2017-18 forecast, and that reflects more of the fine grain in the split of earnings. However, the overall correlation between UK and Scottish wage changes is fairly close. There is probably not a huge issue there.

We did a sensitivity analysis and changed the earnings profile to see what that did. That is one of the reasons why we do sensitivity analyses. The assumptions are just that—they are assumptions and forecasts, so we want to test drive them a little bit, and that is one of the test driving scenarios that we use.

You are right. It is not a one-for-one movement between UK and Scottish wages, but it is quite close. When we test drove some alternative assumptions, they did not change the forecast liabilities too much in the near term. However, if that scenario is allowed to persist for a long time, has big effects.

Professor Leith: One of the things that we will be looking at is Scotland-specific modelling of the labour market. We highlight that in the report.

Dean Lockhart: Throughout the UK, we have seen an increasing tendency for people to move away from private employment and perhaps incorporate, thereby moving out of the personal income tax system and into the corporate tax system. The chancellor addressed the differential tax treatments between those two models of business in the autumn statement. Do you think that, because of the fiscal framework, that move towards incorporation might have an impact on the overall income tax take for Scotland?

Professor Nolan: Yes. There is an effect at present. After the basic forecast is produced, there are various off-model adjustments, the two principal ones being gift aid and incorporations. There is an assumption in the UK income tax forecast that has an effect on incorporations, and that is reflected in the Scottish income tax forecast, too. That effect is there and it follows a similar profile to the UK one.

James Kelly (Glasgow) (Lab): You have built up the methodology in which there is a link between employment earnings growth and tax levels. You have explained that there is a difference between public sector wage growth and private sector wage growth, and that private sector wage growth is 4.9 per cent while public sector wage growth has remained static at 2.3 per cent. What does that say about employment levels and employment growth in the public and private sectors?

Professor Nolan: The 2.2 per cent wage growth is the Scottish Government’s assumption based on earnings growth in the public sector during this period of austerity. It is meant to reflect the position that the next few years should be a lot like the previous few years in terms of overall public sector pay growth. As Campbell Leith reminded me, private sector wage growth comes out as a residual from overall earnings growth in the economy once we take into account the path for public sector earnings growth.

On what that says about relative employment levels in the public and private sectors, the assumption that drives the model is a forecast for overall employment. We can drill down into the income tax model and, presumably, get separate paths out for employment in those sectors. The Scottish Government has not published that and we have not looked at it but, in terms of employment, the key driver of the income tax forecast is overall employment growth.

James Kelly: Right. As an example, the forecast for employment growth in 2018-19 is 0.2 per cent. You can differentiate the growth in wage levels in the public and private sectors, but the model is not detailed enough to differentiate between employment levels in those sectors.

Professor Nolan: No—implicit in the model will be some trajectory for employment in the public and private sectors, although I have not looked at those detailed breakdowns.

James Kelly: You would agree that the figures seem to derive from the logic that employment in the private sector is growing at a faster rate than employment in the public sector. Bearing in mind the level of the figures, there might be a decline in employment in the public sector.

Professor Nolan: I will not guess what the underlying model implies about relative growth rates, but you are probably right. Fiscal restraint is driving the whole scenario of the assumption about the public sector. On what that means for the detailed forecast for overall employment, I do not have an answer or a number for you.

Professor Leith: One of the bits of sensitivity analysis that we did was to allow private and public sector wages to grow at the same rates and to not have the gap between them. That did not create a large difference in the tax forecasts, so it is not a material driver of them.

The way that the model works is that it extrapolates employment rates by age group. They are implicitly broken down by public and private sector, but we have not formally built them back up again to see what the aggregate forecast is. However, it will not be a huge driver of the tax forecast. What are huge drivers of the tax forecast are the aggregate level of employment growth and, more importantly, wage growth.

Neil Bibby (West Scotland) (Lab): Has any analysis been done of public sector employment rates in relation to public sector expenditure? The Government has put forward its overall spending plans in its budget, so it would be good to have an analysis of how that will affect public sector employment rates.

Professor Nolan: No. The model is focused on forecasting non-saving, non-dividend liabilities. As Campbell Leith said, if we change the assumptions on the public/private pay split, the employment path or the earnings path, does that change radically your forecast for non-saving, non-dividend liabilities? That is what we have been mandated to look at, so we have kept to that and have not really looked at the expenditure side of things, which you mentioned.

Neil Bibby: Is it possible to get the actual number for what has been forecast for public sector employment rates for next year?

Professor Nolan: You need to be slightly careful. The model has not been built or designed to forecast public sector employment rates. The Scottish Government, rather than us, would have to answer the question that you ask, but I suspect that it might say what I have just said.

Neil Bibby: What proportion of the forecast 0.3 per cent increase would be public sector growth?

Professor Nolan: I do not know the answer to that.

The Convener: Before we move on to LBTT, I just say that given the future role of the commission it is clear that we will have to invite you back to talk to us about how you are going to do forecasting and so on. I realise that we are not getting much chance to concentrate on how you will take things forward after this budget. I expect that we will invite you back in the next financial year and have another discussion with you at that time so that you can tell us a bit more about what your activity will be. I am afraid that, inevitably, today’s evidence session is based on the Scottish Government’s forecasting.

Murdo Fraser (Mid Scotland and Fife) (Con): Good morning. Lady Rice alluded to residential land and buildings transaction tax in her opening statement. The report states that the estimated outturn for the current financial year is £208 million, which is down £74 million on the forecast. That is a significant reduction and puts into context the report that this committee did on LBTT a few weeks ago. Perhaps even more serious is the fact that, as has been mentioned, there has been a significant—indeed, catastrophic—drop in the forecast for LBTT for the next three years, amounting to £833 million, or 46 per cent of the previous forecast total. How can we explain the size of that drop? What has been going on?

Lady Rice: Campbell Leith will give you technical details. As I said before, the drop is due partly to a change in forecasting methodology and partly to a change in the start point. LBTT is particularly sensitive to some remarkable things that happened in the housing market during the early years of the financial crisis, which is important in that where the start point is set has an effect on the numbers that come out at the end of the forecast.

Professor Leith: Table 16 on page 45 of the report does that reconciliation. It starts from the original forecast of £295 million, which was then downgraded to £282 million because of the ADS adjustment, and tries to reconcile that with what we seem to be observing in outturn data at the moment.

The first thing that would lead to the shortfall in the forecast is that the original forecasts were starting from 2014-15 outturn data for house prices, transactions and so on. Secondly, forecasts were based on a statistical model of average house price growth that tended towards long-term averages and tended to forecast quite robust house price growth.

10:15

Those two factors gave rise to fairly buoyant initial forecasts, and because of the progressivity of the tax, when house prices are forecast to grow strongly, more and more transactions are pushed into the £325,000 to £750,000 band, which generates lots and lots of revenue. The system is very highly geared: if there is a buoyant market, lots revenue will be generated. By the end of the forecasts in the previous budget, forecast residential LBTT was quite large, which to a large extent was based on transactions being dragged into the £325,000 to £750,000 bracket. Since then, outturn data for 2015-16 were not as favourable as had been forecast, and average prices in particular did not grow as well as median prices, which implies a shift away from the top end of the market. That could, to a large extent, have been due to forestalling activity, which would reduce the forecasts to £243 million, so it clearly does not go all the way in explaining current outturn numbers.

If we then sequentially replace the price and transactions forecasts from the 2016-17 budget with the ones that we now have in the 2017-18 budget and progressively drill down to see why the forecast has been revised, we see that the main thing is that prices in the market, both average and median, have not grown as expected.

Murdo Fraser: That was quite a technical answer. I think that I understood most of it.

How does what is happening in Scotland relate to what is happening elsewhere in the UK? I know that forecasts for stamp duty land tax in the rest of the UK have also been reduced, although not to the same extent. What is the knock-on effect of what is happening in the rest of the UK on the Scottish finances, through the fiscal framework?

Professor Leith: Our remit is to analyse residential LBTT in Scotland, and SDLT is in the rest of the UK, so we have not focused on it at all. Off the top of my head, I can observe first that residential LBTT in Scotland is, relatively, more progressive than the approach in the rest of the UK, so it is more geared towards changes in forecast house prices, and, secondly, that the OBR's forecasts for the housing market in the rest of the UK are slightly more buoyant than the Scottish Government is currently forecasting, given its new methodology. A combination of those factors might explain the difference.

Professor Nolan: The London end of the market often drives the UK forecast.

Murdo Fraser: In the context of the fiscal framework, what impact does the difference in projected tax take between LBTT and stamp duty land tax elsewhere in the UK have on the money that comes to the Scottish Government?

Professor Leith: As I said, we did not focus on block grant adjustments or SDLT forecast revenues. Our remit is to focus on LBTT revenues.

Ivan McKee (Glasgow Provan) (SNP): I want to explore the area in a wee bit more detail. There is clearly a disconnect between the forecast last year and the forecast this year. In chapter 5 of your report you say that the model is basically fine but there is an issue to do with the economic determinants. Table 16 unpacks that and explains what is going on. You drill down further and say that the key issue is not the number of transactions but the fact that the mean and the median are out of kilter, compared with forecasts. That is what is driving the biggest impact.

Professor Leith: Yes. In 2015-16, the mean and median were both subdued relative to forecast, but the mean was more subdued. This year, both are subdued relative to forecast, but there is no obvious additional shift in the mean relative to the median—they both seem to be growing relatively slowly.

Ivan McKee: Right—but transaction numbers is not the main issue.

Professor Leith: That is right.

Ivan McKee: We have seen that in the analysis that we did earlier in relation to trends and transactions.

Professor Leith: On the key driver for revenues, 60 per cent of them are generated by the £325,000 to £750,000 tax band. A buoyant market pushes more properties into that band, which generates more revenues. If that does not happen, revenues do not materialise.

Ivan McKee: Right. Got it.

The Convener: Let me make sure that I understand that. The number of transactions in the £325,000 to £750,000 bracket did not shift much, compared with the rest of the market.

Professor Leith: The £325,000 to £750,000 band has a relatively small proportion of transactions: less than 10 per cent of transactions are in that band, but it generates more than 60 per cent of revenues. If we look back at the buoyant forecasts in the previous budget, we see that they were driven by an increasing share of transactions going to the £325,000 to £750,000 band. To get those large revenues in would require going above a 10 per cent share of transactions going to that tax band. That has not quite materialised.

The Convener: Okay. I apologise. Ivan—please continue.

Ivan McKee: I will go on to talk about the bands. We have established that there is not an issue with the number of transactions. When the changes were made to introduce LBTT, the situation was made more favourable at the lower end—it was made cheaper and the tax was lowered. It was increased, however, at the higher end. We can see that in the shape of the lognormal.

If the higher tax had driven down the number of transactions at the higher end—we have already seen that the number of transactions has not changed—there would have been a differential impact across the bands. If we look at what we actually have in tables 18 and 19 and paragraph 5.22—if I am reading them right—and if we decompose all that information, we find that for all the bands up to £750,000 there is, in reality, basically the same drop-off in the number of transactions. That suggests that there has not been a differential impact as a consequence of the increase in LBTT in the £325,000 to £750,000 range. In fact, if we consider what has happened at £750,000-plus and £1 million-plus, we find that those bands have performed significantly better than was forecast, based on the lognormal that you originally used. Is that true?

Professor Leith: In the 2015-16 outturns, which I think we discussed in our previous outturn report, there was evidence of a clear episode of forestalling in the £325,000 to £750,000 band. The relatively low performance of that band might have persisted throughout the year. There were various reasons why that might have been the case.

For the 2016-17 outturn numbers that we have so far, it looks as though both mean and median prices have not been growing as expected, so there has been no tilting away from that band. In proportional terms, the forecast error is common across the top three bands in the table—that is, the bottom three bands—but, because the £325,000 to £750,000 band accounts for most of the revenues, that is where most of the forecast error shows up.

Ivan McKee: Sure, but it is absolutely not true to say that there has not been any change in the shape. You say yourself that there has been

"no major change in the shape of the distribution".

Professor Leith: Yes. In the 2016-17 outturn data that we have today, that is correct.

Ivan McKee: If the higher tax rate was driving a behavioural change in that range, we would have seen a change in that distribution.

Professor Leith: It could be that the change that was observed in 2015-16 has persisted into 2016-17.

Ivan McKee: You also talk about misallocation between the top bands. That ties in because, in the higher rate above £750,000, there has been a strengthening of the market.

Professor Leith: Yes. That relates to the fact that, even if we put in the outturn economic determinants, the model, in aggregate, forecasts quite well. However, particularly in the top two bands, it overpredicted revenues from the £325,000-plus band and underpredicted revenues from the band above £750,000.

If we then account for that using what we observed in 2015-16, it does not make a huge impact on aggregate revenues, and it makes a bit of an adjustment to what we would observe in the £325,000 to £750,000 band plus the top band. However, it is about a 5 per cent adjustment in that £325,000 to £750,000 band, so it is not a huge effect.

Ivan McKee: The adjustment is not huge. Okay.

The other impact is from the Aberdeen effect, which you discuss in table 22 and at paragraph 5.27. You are saying that it accounts for the balance of the difference of the stuff that you have not found. Clearly, the Aberdeen and Aberdeenshire market is way off the pace as a consequence of what has happened in the oil industry up there.

Professor Leith: We present that information as a highly speculative thought experiment. We do not actually have revenue outturn data for Aberdeen city or the Aberdeen area. One of the things that we hope to do when we meet Revenue Scotland in the new year is to consider whether we can obtain those data. Instead, we considered the state of the Aberdeen housing market in 2014-15 and the forecast for Scottish house prices that was made in the previous budget. We extrapolated that and, imagining that Aberdeen is expected to grow in line with the forecasts for the Scottish economy as a whole, considered what revenues that would be expected to generate. Then, looking at how the Aberdeen housing market actually performed, we considered what revenues that would be expected to generate, and we then looked at the difference between the two. That difference can account for about half the forecast error this year. However, it is a highly speculative exercise: we do not know whether the model fits Aberdeen.

Lady Rice: I will re-emphasise that point. The question that we started with was whether there are regional differences. Then, from that question, we considered where we might look. Aberdeen seemed a likely place to look at because of what is happening in housing activity there. That is all the exercise was. We do not really have evidence behind it yet, but it is the kind of exploration that we might do in the future.

Ivan McKee: I understand that there are caveats, but you have a calculation that gives a number that goes a long way towards explaining what was left of any drop-off in your forecast.

Professor Leith: At the previous committee meeting that we came to, we said that we would come at the data from any angle possible to try to explain it. That was one of the angles.

Ivan McKee: Sure. What I am hearing is that there are a number of reasons why the figures are off, against what was forecast, but none of them is anything to do with the fact that there are higher tax rates at the top end of the market. Can we talk a wee bit about the sensitivity analysis—[*Laughter*.]

Lady Rice: That is your reading.

Ivan McKee: I gave you plenty of opportunity to say that, and we talked about Aberdeen, the mean and median and the number of transactions.

Professor Leith: I said that there was a shift from average relative to median in 2015-16, which appears not to have worsened but has persisted into this year. That could be a behavioural response.

The Convener: Last question, Ivan. You have had a good go at this.

Ivan McKee: Clearly there has been a disconnect. Will you talk about the sensitivity analysis that you have done? We do not want to be in the same position next year in being significantly off against the forecast.

Professor Leith: The Scottish Government has adjusted the way it forecasts the economic determinants this year. In previous budgets, it had a small statistical model to forecast average house prices, which it then pasted on to an assumption that house prices would grow in line with some long-term average. It then assumed that median prices would grow alongside average prices in the same way and that transactions would tend towards some long-run turnover rate.

Now, following our recommendations, the Government has adopted statistical models for each of those elements individually. It has also attempted to differentiate between what was happening before the financial crisis and what has been happening after it. The previous forecasts tended to go to long-run averages that included the fairly buoyant period before the financial crisis, but the current forecasts tend to extrapolate to a greater extent the behaviour or the performance of the market that we have observed post the financial crisis, which tends to lead to a far more subdued forecast.

We looked at the same data and the same types of models, but we made little changes to assumptions about how to model things. Instead of using one type of statistical model, we used another; instead of looking at the turnover ratio, we looked at the rate of growth of transactions; and instead of looking of the ratio of median to mean prices, we looked at the rate of growth of median prices. We saw what forecasts those would throw out and whether the forecast would be materially affected by changing any of those elements. The conclusion that we reached is that average and median prices are the key driver of the forecasts—that is the thing that we need to get right in order to forecast accurately—but the various bits of analysis that we threw at it suggest that the Scottish Government's forecasts were reasonable. We could not find an obviously better way of doing things.

Ivan McKee: Thank you.

The Convener: Thank you. We have bored down to a fair bit of detail in the discussion today. I said to the clerk, "That's a lot of detail," and his response to me, in his ever-positive way, was, "That's good for the report."

We are grateful for your having come along today to give evidence. I am sure that the witnesses from the SFT, who are sitting behind you, are now looking forward to discussing matters to the same level of detail. Thank you again for coming along. I hope you have a good Christmas and new year.

I suspend the meeting for a short time to allow a change of witnesses.

10:30

Meeting suspended.

10:34

On resuming—

The Convener: I reconvene the meeting, colleagues. Agenda item 3 is an evidence-taking session with the Scottish Futures Trust as part of our scrutiny of the 2017-18 draft budget, and I welcome to the meeting Barry White, the trust's chief executive, and Peter Reekie, director of investment.

I wonder whether Barry White wants to make an opening statement.

Barry White (Scottish Futures Trust): Thank you for giving us the opportunity to come here today. Before we make our statements, we will, like last year, register a number of interests. We do not think that there is any conflict, but it is better to be clear.

I am the public interest director on the M8 project company and Peter Reekie is the public interest director on the Aberdeen western peripheral route project company. We also hold two charitable appointments, Peter with the Hub Community Foundation charity and me with the LAR Housing Trust. Those are roles that the SFT has asked us to fulfil, and they do not involve payment directly to us in any way; they are not personal interests but charities on which we represent the public sector.

We have provided a written document that highlights elements of our work and which includes a section on the call for evidence on our work last year and some helpful suggestions that people made. We have responded to those suggestions, and we hope that the information is useful to the committee.

At the meeting at which we last gave evidence, which was on 18 January in Pitlochry, we talked about the impact of changes in the European accounting rules on non-profit-distributing and hub programmes. At that stage, we had just reached financial close on Ayr academy under the hub programme, and we were pleased to get that done quickly on being given the go-ahead by the ONS after we had restructured the hub programme.

Since then, the ONS has, as we indicate in our written evidence, confirmed that the other NPD projects that reached financial close after the introduction of the European system of accounts 2010 will be publicly classified. Those projects are the AWPR, the status of which was already known; the Edinburgh sick children's hospital; Dumfries and Galloway royal infirmary; and the new Scottish National Blood Transfusion Service. The combined capital value of those projects is around £930 million.

Also since we last appeared before the committee, there have been two further updates to the guidance affecting ESA10, which is believed to have brought about a much more stable position for ESA10 classification almost two years after its introduction and after many iterations of the guidance, of which there have been two since January. Since the start of this year, we and our partners have closed 18 hub contracts for schools and community health investments totalling around £600 million. That positions us as one of the top three countries in Europe for additional investment.

I just want to add two very quick points. First, we are very pleased that one of our traditionally funded projects under the hub programme has trialled the project bank account initiative, which was formally introduced by the Government in October this year. For smaller businesses in the construction sector, being paid promptly is a key issue. Project bank accounts do not solve the issue entirely, but they are a useful step forward in smoothing the payment process. It is an issue that the Federation of Small Businesses feels very strongly about.

We have also seen significant progress on growth accelerator financing. Dundee just signed this month, and those of you who know Edinburgh will have seen the great progress that is being made on the demolition of the St James centre, which was catalysed by the Edinburgh growth accelerator deal. The increasing dynamism and confidence in Scotland's cities is a positive feature and is all the more important as Scotland's public services become more reliant on income from the Scottish economy.

Within the construction industry, people are talking about Brexit. As a recent Shepherd and Wedderburn report highlighted, there is concern about the workforce in particular, given the industry's reliance on foreign skilled and non-skilled workers. In the construction sector, 22 per cent of current workers are aged over 50 and 15 per cent are aged over 60, so there is a concern about the workforce going forward. Fortunately, I count as one of the 22 per cent aged over 50 rather than one of the 15 per cent aged over 60. I never thought of myself as an aged worker, but according to the Shepherd and Wedderburn report, that appears to be the case.

The Convener: Thanks, Barry. That makes me feel great.

Barry White: I am very happy to take questions about our work or about anything to do with the 2017-18 draft budget.

The Convener: I would like to get some stuff on the record about ESA10, which came out in September 2014. As you have described, a number of NPD projects had to be reclassified as on balance sheet. On page 5 of your submission, you describe the actions that SFT and the Scottish Government have taken since September 2014 to refocus activity—if that is the right terminology—in the light of ESA10. Can you give us a bit more detail on what you did to make sure that not as many of the projects that could have been classified as on balance sheet were classified in that way? It would be helpful if you could do that for the purposes of the record.

Barry White: Okay. I might ask Peter Reekie to comment specifically on the restructuring of the hub process.

Across Europe, people have had to deal with a change in a complex set of rules. That has affected a number of organisations, not least housing associations, which have recently come on balance sheet. Network Rail and the schools aggregator are examples at UK level.

Even a year after ESA10 was introduced, in September 2015, the European PPP Expertise Centre, which is hosted by the European Investment Bank, said at a presentation in Flanders that ESA10 was a "moving target" with a "continuous addition of interpretations". It said that there was a hardening of Eurostat rules and interpretation and that case opinions were increasingly important.

In the two years between the introduction of ESA10 and September 2016, a number of projects were scrutinised by classification bodies across Europe. Much clearer guidance emerged in September this year. I will ask Peter Reekie to comment on hub design, build, finance and maintain restructuring, but we now have much clearer guidance on how standalone projects—NPD projects were procured on a standalone basis—can be structured in the future. Across Europe, that is very much appreciated. Allianz, which submitted written evidence to your predecessor committee last year following its call for evidence on SFT, said that the lack of clarity was having the effect of stalling projects across Europe.

That is where we are now. The guidance is much clearer and more stable, but we still face a challenging issue. Now, it would probably take about a year to do a business case for a new project, and it could take 18 months to procure it. If we were to start a new project now, we would need to be clear about the UK Government's intention in the run-up to Brexit or post-Brexit, ignoring the politics of Brexit and so on. We would need to know its intention for the rules post March 2019, if that is to be the date on which the UK leaves the European Union. The belief is that those rules would be very much in line with the current Eurostat rules. In any case, there would need to be a set of rules of some sort, and others are suggesting that this would be a chance for the UK to do something different.

Looking forward, I think that ESA10 has stabilised, but it has stabilised within a time window limited by Brexit. We might be able to get reassurance from the ONS and the Treasury, and we will have discussions on what the regime is likely to be beyond that.

Peter, would you like to talk about our work to restructure the hub process?

Peter Reekie (Scottish Futures Trust): Certainly. The hub programme is a partnership arrangement between the public sector and the private sector that operates in five separate territories across Scotland. It is there to develop community infrastructure, and lots of schools and health centres are built through it with funding either from traditional capital budgets or from long-term revenue budgets under the design, build, finance and maintain route.

It is the DBFM projects that are affected by the ESA10 classification rules. In 2015, we spent a lot of time restructuring the partnership between the public sector and the private sector to retain a private classification for those projects and to allow us to pay for them out of long-term revenue budgets under the change in the rules.

10:45

The main change that we made to allow that to happen was the introduction of a charity called the Hub Community Foundation as a 20 per cent shareholder in the individual project companies that take forward the projects. That allows 20 per cent ownership and the returns from that ownership to be used for the public good without being classified to the public sector for national accounts purposes. Public sector ownership has reduced to 20 per cent, with 60 per cent retained, as it always has been, in the private sector. Ownership was originally 60 per cent private and 40 per cent public; it is now 60 per cent private, 20 per cent charity and 20 per cent public, and that restructuring has allowed us to maintain the balance between private profit and public good and to retain a private classification in the new rules. It also allowed John Swinney to state in November 2015 that the projects could go ahead. Since then, as Barry White said, we have closed 18 projects.

A further revision to the European guidance in March required us to make some small changes to the contract documentation but not the overall structure, and further changes in September required us to do the same. Through those two further changes, we have managed to maintain the pace of all the projects. You will need to stick with me here: we closed eight projects under the 2014 guidance, another seven under the March 2016 guidance and another three under the September guidance. We have had to work quickly with all our public and private sector partners to allow those projects to go ahead in the rapidly changing arena of guidance, which we hope is now stable and will allow the projects and the additionality that comes from them—more than £600 million of additional investment now—to keep going through the hub programme into the future.

The Convener: Can you tell me off the top of your head what the public sector element of the expenditure on those 18 projects amounts to?

Peter Reekie: Had they all been classified to the public sector, the £600 million would have counted against capital budgets this year and probably next year, as they are built over two years. That is not the case because we have retained the private sector classification and the projects can be paid for out of revenue budgets over their lives as they are used.

The Convener: I was keen to get that on the record because it shows that you are being fleet of foot in trying to deal with the issues and challenges that you face. In effect, you have secured an additional amount of expenditure that would have been hitting capital project costs.

Maree Todd (Highlands and Islands) (SNP): Forgive me for asking what might be a simple question, but am I correct in thinking that capital project costs are a lot bumpier, are less predictable and fluctuate a great deal more than revenue spend?

Peter Reekie: Yes.

Maree Todd: So it is almost impossible to make assumptions in that respect. Did some projects not have to be delayed because of the changing classification?

Peter Reekie: Yes. A number of projects in the hub programme were put on pause in late 2015, but they caught up again in the first quarter of 2016. Most of the 18 projects were closed in the first quarter, because we managed to get them going again.

Maree Todd: And nothing has not happened because of the change in accounting rules.

Peter Reekie: That is right. All the projects that were in the hub pipeline that faced that small delay have continued and are now in construction.

Maree Todd: So all we are seeing is a slightly different pattern.

Peter Reekie: Yes.

The Convener: I believe that Dean Lockhart, too, has some questions on classifications issues.

Dean Lockhart: Thank you for your paper and for explaining the background to ESA10. My understanding is that the trigger for bringing those projects on balance sheet was the degree of public control over the project—or over the special purpose vehicle controlling the project. In light of the restructuring that has taken place to bring about a private classification, what level of public control is still in place over the projects and how have you managed to achieve that without bringing the projects back on balance sheet?

Barry White: Again, I might ask Peter Reekie to speak to some of the specifics. All of our projects have a director on the board, and that is still the case. That move, which has been a big change in these projects, is key to transparency and is very helpful in the management of the projects.

Peter Reekie: There are two main ways to get control of what happens in these projects. The first and most important way is through the contract, which says that the company that is established to deliver a project must deliver it in the following way and in the following time, will be paid the following amounts of money and must maintain the project to the right standards. That contract, the way in which those standards are specified and the way in which the payments are made have been largely unchanged through all of this. That is what happens under any building contract; you will say, "This is what I want, and I'll pay you for it if it is done in the right way."

By setting up project companies to deal with this sort of project, we also had some corporate controls over them. Some of those controls have been relaxed as a result of the way in which the board works. Although, as Barry White has said, we now have transparency by having a director on the board, we are not able to do some things that we previously thought would be a great idea, such as stopping the company from changing its name and other such things that are done through the company's own constitution. That is less important than the overall control that we get through the contract, but the classifiers were particularly keen on the control of the project company, and that is why we have had to make some changes.

Dean Lockhart: Public sector shareholding has dropped to 20 per cent. Does that mean that you must still have a pro rata share of 20 per cent of the project costs or capital spend on the balance sheet, or is it all or nothing? Given that it is now deemed as private classification, is all of it now off balance sheet?

Peter Reekie: That brings us to the differences between budgeting and accounting, which is where things get a bit tricky. The goal of all of this was, in a way, to allow long-term revenue budgets to pay for the buildings as they were constructed instead of using capital departmental expenditure limits budgets. The European accounting rules and statistical treatments are what is relevant with regard to budgeting in the UK context. Every individual body that procures one of these assets will account for it under international financial reporting standards, which means that the way in which projects are accounted for is different from the way in which they are budgeted for.

In budgeting terms, the money will all come from long-term revenue budgets, whereas in accounting terms, it is likely that you would see the asset on the books of one of the health boards, for example, because the board has both a contract for and an interest in the project. The goal was a budgeting goal, and that is what has been achieved.

Barry White: I should clarify that that is at a UK level. The national accounts with ONS are the ones that align with the budgets; IFRS are used for the whole-of-government accounts. There are two different purposes for two different sets of accounts.

Dean Lockhart: On your point about Brexit, I take it that Brexit would impact on ESA10 but not on IFRS because, notwithstanding Brexit, IFRS will still apply within the UK to the ONS for accounting purposes.

Barry White: As part of the decisions on what we do post-Brexit, the ONS and the Treasury will have to decide how we do our national accounts. We will still have to declare national accounts that will be scrutinised by people who want to lend the UK money or whatever else.

ESA10 is underpinned by a United Nations accounting system, so anything that we do will probably be underpinned by that same accounting system. Whether we choose to keep ESA10 in broad terms or do something different will be a decision for the UK Government. I presume that ONS would become the ultimate arbiter on classification, because we would no longer be subject—I imagine—to Eurostat.

Dean Lockhart: I have one final question. Do you expect any further changes to the accounting standard or are you now at the final point?

Peter Reekie: Eurostat has said that it intends the final change, which is a substantial rewrite that has involved PPP experts from the European Investment Bank, and which means that the standard is now much easier for practitioners to interpret, to be stable for a period of time, although it reserves the right to make changes if necessary.

The Convener: We have started a hare running in this area, because four folk want to ask supplementaries, so I ask you to forgive me if we do not get into some of the other details of the excellent report that you have given us.

James Kelly: You describe a situation in which there was a tranche of 18 projects and you were able to classify those at least partly as public projects, which allowed you to smooth the expenditure against revenue budgets over a period of time. I want to ask about the four projects that have had to be classified as public. Mr White, you said at the start of this evidence session that the financial total for those projects was £930 million. What are the budgetary implications of that?

Barry White: I can comment on the budgetary implications, but the detail is more a matter for the Government because it decides how to budget for that.

I believe that a letter was sent to the committee that set out the fact that £283 million of borrowing powers had been used to cover that cost for 2015-16. I believe that, for 2016-17, the final decision on how the cost will be covered will be taken later in the year. We believe that to be the case, but we just supply the information to Government and it will decide on the precise budgeting for that.

James Kelly: I am not really clear about that. You mentioned the figure of £930 million, and reports in the media have suggested that that means that £930 million of money is lost to the Scottish budget. I do not endorse those reports, but I am anxious to establish the facts of the matter. How has that £930 million had to be dealt with in the Scottish Government's budget as a result of the new accounting rules?

Barry White: The cost of that £930 million was spread over a number of years. I will take 2015-16 as an example. In 2015-16, approximately £400 million of investment was off balance sheet and approximately £283 million of the four projects that we have talked about was on balance sheet. There was an agreement between the Treasury and the Scottish Government, and a letter was sent to the committee explaining that there was an agreement with the Treasury to use borrowing powers to cover that £283 million. That is how it was dealt with in that year.

In the year ahead—2017-18—the four non-profit-distributing projects that are on balance sheet amount to roughly £190 million, and the Scottish Government will decide what to do through the year. It is not for me to say what the Scottish Government will do, but it will liaise with the Treasury and decide the most effective way of addressing that. In the one year that I have talked about—2015-16—the effect was to use up some of the Government's borrowing powers.

11:00

James Kelly: You describe a situation in which you had a tranche of 18 projects and you were able to revenue fund them over a period of years. Is the effect of that that you are having to bring on more of the expenditure earlier? Is that the impact?

Barry White: Again, the precise details of the mechanics are more for the Scottish Government to explain. However, for 2015-16, which is the year that Mr Swinney wrote to the committee about, borrowing powers were used and there was a mechanism to pay over a period of time rather than up front and instead of borrowing from the national loans fund. I do not know the precise details of the agreement between the Scottish Government and the Treasury, but I understand that it still has the effect of spreading the cost over time.

The Convener: I understand from the clerks that the letter was received on 4 March, which was before the current committee came into being. We will ensure that it is circulated, so that everybody can see it. There are questions that we need to ask the Scottish Government in order to get a clearer perspective, from its end, of how it is bringing these things into book and the impact of that. For these guys, it is—

James Kelly: I appreciate that the witnesses have done their best to answer the question, but I am not clear about how this area is being accounted for.

The Convener: I accept that we need to make that clear.

Patrick Harvie: Good morning. I apologise in advance if this is a bit of a daft laddie question. Mr Reekie expressed the purpose of the arrangements as being to avoid the need for up-front capital expenditure by the Scottish Government through the ability to move things on to longer-term revenue budgets. If everything else was equal, that might be all very well, but figures that we have seen under freedom of information show that we are actually paying significantly higher interest rates than we would be paying under the national loans fund—in one case, we are paying more than 11 per cent compared with 1.6 per cent.

We have also seen that, in some cases, public sector bodies such as the national health service are paying three times the actual labour costs to have contractors undertake work. Contractors are charging for electrical work three times what it costs to pay the wages of an electrician. Why does it cost so much more to do things in that way?

Barry White: That is certainly not a daft laddie question. I presume that you are referring to the article in *The Guardian*, which contained some of those figures. The cost of finance differs depending on whether the Government is borrowing on a risk-free basis—whereby the

Government, as the borrower, must just pay the money back—or whether it is borrowing the money and transferring the risk at the same time. In comparing the costs of finance, there is a big difference between those two approaches.

The article was wrong about the cost of senior debt in those projects, which is the bulk of the finance that goes into them. The interest rate is actually about 3.5 per cent, which is more expensive than the national loans fund rate was when the projects began but less than the long-term average for the national loans fund for long-term borrowing. It is also less than the pooled rate at which local government assesses borrowing. I believe that lot of the pooled rates in local government are about 5 per cent.

The cost of the finance that is secured in such deals is much more competitive than the long-term average for borrowing and much more competitive than the historical private finance initiative deals, which were secured at much higher costs of finance, so—

Patrick Harvie: I appreciate that we are talking about lower interest rates than those for the early PFI schemes, but you have to accept that the cost is still significantly higher than public sector borrowing.

Barry White: Yes. The Government will pay a premium in order to transfer risk to the private sector and bring in private sector finance to bear risk. The transfer of that risk means that the Government does not have to pay for the asset unless it is properly maintained and looked after. There is a very strong contract in place that says that the asset must be looked after properly for its whole life, or for 25 years. That is an important element, because longevity and ensuring that something is properly maintained is a key aspect of preventing the money having to be spent in 25 years' time.

A big task for all of us in the public sector is to consider how we manage the historical contracts. There is work to be done to improve the performance standard of those older contracts under PPP and PFI, and we have deployed a team of people to work with health boards and local authorities to do that. They are making good inroads, but there is still more work to be done.

Patrick Harvie: What about the point about the public sector paying significantly more—in some cases three times as much—for trade work to be carried out than the tradespeople are being paid?

Barry White: NHS Lothian commented on that in the article in *The Guardian*, saying something along the lines that the figures do not include national insurance or the cost of employment. If you employ a plumber at your house, you do not pay the pure hourly rate that was set out in that article.

Patrick Harvie: Do you consider the costs of employment to be a factor of three?

Barry White: I can get back to you with the specific figures, but I would need to look at them first. There is a rate for a tradesman on site, which is not a simple reflection of the pure hourly rate. In general, when people quote for work, that is the rate that we see.

Patrick Harvie: If you could get back to us with some more detailed answers on those matters it would be helpful. If people are to have any confidence that the public sector is getting good value for money, some of those questions need to be answered in more detail.

Barry White: I can perhaps offer some more information. Having a pre-price schedule, which is one of the changes that have been made over the years, means that such costs can be assessed before contract signing and we can say that, if there are small changes, we want to avoid the exorbitant costs of the past. The pre-price schedule is there to manage some of the excesses of the past.

Patrick Harvie: Do you produce an overall figure—or even an estimate—of the proportion of what the public sector spends over the lifetime of each project that will be profit for the companies involved?

Barry White: We publish a number of figures. On the Government's website, we publish a clear flow of unitary charges as deals are signed. In all the contracts, we have moved to a presumption of publication after three years. Is that right, Peter?

Peter Reekie: It is two years post construction completion.

Barry White: Yes. We have moved on to a much more transparent basis, whereby the presumption is for publication two years after the facilities open. The details of how the models work for each project will be available as and when that date arrives.

Peter Reekie: It tends not to be the case—and it is not the case in any fixed-price procurement—that the construction contractor or facilities management contractor, as a company, has to declare whether an individual project made a profit or a loss. Most of the activity that takes place under the contracts is the same as the activity that takes place under individual stand-alone construction or facilities management contracts. Whether a company makes a profit or loss when it fixes a price for an individual contract tends to be a matter for the individual company.

The Convener: I let that discussion go on a bit, but we are beginning to stray from budget scrutiny. There is quite a bit of work to do around whether things are SFT home, invest, place or green, and if we carry on like that we will not get to them. A number of members want to come in, but I ask you all to keep questions as tightly focused on the budget as you can. This is our last chance to discuss the budget before we speak to the minister in the new year.

Ivan McKee: I will be brief, because Patrick Harvie has covered a lot of what I was going to cover. I understand that the figures are calculated as they are because that keeps the debt to GDP ratio at a level that is acceptable to the markets. Is that the bottom line? The Scottish Government has borrowing limits, but it is about the wider context of the Treasury.

Barry White: That is a fascinating question to which the simple answer is yes. However, because all the information is published anyway, the ratings agencies look at all the liabilities that the UK has as a whole. Because it is public information, they add that liability even though it is off balance sheet. They also look at the pension liabilities of the country. The ratings agencies look at the whole picture.

Ivan McKee: Therefore, it should come down to what Patrick Harvie spoke about in relation to what the cheapest method is. We are not going to get into that issue here, but the committee will probably want to look at that in the future.

The Convener: We can come back to that issue and look at it in greater detail later, if we wish.

Maree Todd: I have a quick supplementary question for Mr White. You were very clear about Brexit probably having an impact on infrastructure projects, given that there is a two-and-a-half-year run-in between the idea, the business case and procurement and the project actually happening. Brexit is likely to happen in less than two and a half years. Have I understood you correctly in saying that Brexit is likely to cause a pause?

Barry White: I would not say that. I was talking about wanting to build more project-financed infrastructure in Scotland, starting from now. The ESA10 rules are much more stable, but we would need to agree with the UK Government what it thought the regime would be in two and a half years' time. If it could tell us that now, that would give us stability looking forward. In the context of the whole Brexit debate, that is a very granular bit; however, it would be important to know the UK Government's intention. Brexit is not having an immediate impact, because there are no projects waiting to happen through project finance that are not happening. However, if we wanted to do more things in that way, on top of the £450 million borrowing powers, we would have to have discussions with the UK Government and the Office for National Statistics.

Peter Reekie: In the slow-moving world of infrastructure projects, any fast-moving rule change has the potential to disrupt things.

Maree Todd: Okay. Thank you.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): Your submission talks about digital infrastructure investment. How do you see relationships with the UK and the European Union developing in that regard, particularly in relation to mobile coverage? We know that the EU has a fairly extensive and developed digital single market strategy and agenda, part of which is about removing roaming charges—they will disappear next year. In my view, it would be ridiculous for that to happen only for the UK to leave the European Union, take back control and set its own roaming charges in 2019. I therefore imagine that we will stay within the digital single market if not within the single market itself. How do you see those relationships developing post Brexit, particularly with regard to digital infrastructure investment?

Barry White: I will talk about the UK relationship first. One of the most important relationships that we have is with Ofcom. Most of the investment in digital technology comes from the private sector, through fixed and mobile operators investing in the infrastructure. There are a number of key issues with Ofcom. Along with the Scottish Government, we made a submission to the digital communications review that said that putting Openreach at arm's length from the rest of BT exemplifies the most workable solution in the medium term for improving broadband roll-out in Scotland. That would have an impact on mobile technology as well, because mobile connectivity requires having the fibre around the countryside to plug mobile masts into.

A number of things are happening around mobile connectivity. First, there is the issue of how 5G is introduced at a UK level and how its coverage is regulated. At each iteration, both the geographic and the population coverage have improved a bit. As a new regime is introduced, the geographical coverage becomes really important, particularly for Scotland's remote areas. At the moment, we are working with the mobile operators on the Home Office emergency service contract, which is to put a 4G network in place for the emergency services that should cover all the major road networks in rural Scotland. We are building up a map of where mobile communications are unlikely to go without the market or the Home Office roll-out, looking at the more remote communities where the Government might need to get more comprehensive coverage.

Regulation at the UK level is the most important dynamic for how Scotland’s coverage and speed of communication in digital technology will be improved and made more accessible. I ask Peter Reekie to comment on the European side.

11:15

Peter Reekie: The SFT is not involved in the consumer marketplace for mobile communications; we are involved in thinking about the infrastructure that is required to allow all of that to happen.

There is a very big potential economic gain for Scotland in becoming world class not just in our digital infrastructure, but in our use of digital technology. The infrastructure elements that will support that technology will be fibre, which Barry White talked about; power to masts; ducts, including the way in which we tax and apply business rates to ducts; and how we allow those to be owned and operated. Other topics of the moment are internet exchanges, the spectrum and how that is managed—which is a UK priority, as we know—and the masts themselves. All those hard elements of delivering the service are the bits that we build, and they tend to be UK or Scottish controlled. We are not so involved in the overall European market.

Barry White: Let me give a simple example. We have fed into the on-going review of business and domestic rates on the issue of attaching business rates to what is called “dark fibre”, which is unused fibre. As companies lay one stretch of fibre, they may put in two or three other bits at the same time but not use it all immediately. If business rates are applied to that unused fibre, the likelihood of people putting in unused capacity is much reduced, whereas we think that it is quite a good idea that, if companies are putting in a pipe, they put in a bigger one even if they do not need all that capacity immediately. There is a series of things that we can do in Scotland to incentivise the private sector to invest in the sort of infrastructure that is needed to build that bigger picture.

We do not really have a locus in relation to the EU and roaming charges. Personally, I think that the work on EU roaming charges has been great progress. The cost of phone calls to people as they move around within Europe is much less now than it used to be, and it would be a shame to lose that progress on roaming charges. Who knows what will happen on that issue?

Neil Bibby: You have talked about Brexit and risks. Obviously, interest rates are pretty fundamental to borrowing to finance projects. To what extent is there a risk of interest rates going up over the next year to control inflation, and what impact would an increase in interest rates have on the budget?

Peter Reekie: We are in a world of uncertain and rapidly changing interest rates at the moment. We have had some projects that have been financed on very good terms since the Brexit decision was made, because the long-term rates have gone down and are now at a very, very low level, although they have bounced up a bit again since then.

For the long-term affordability of the programme, where projects do not have their long-term interest rate locked in, which happens on the day of the financial close, we include a significant buffer to allow for the potential for rates to go up. They are much more likely to go up than down from where they are now. All our long-term affordability modelling, which feeds into the Government’s overall affordability modelling, includes a margin for the potential for interest rates to go up. If we keep locking projects in at low levels, we will keep seeing the actual affordability being better than what we predicted.

Barry White: That is an important point. Interest rates now are well below the assumptions that were made in the programme at the outset. While the Bank of England rate has been very static and American rates have moved up a bit, the market rate for 20 to 25-year debt has been moving up and down. Affordability is good at the moment. Getting projects done in the early part of the year at low rates has been a fantastic opportunity to lock in that low cost for the next 25 years.

Ash Denham: I am interested in asking you about SFT invest and the growth accelerator schemes. In my patch, the project would be the St James centre in the east end of Edinburgh. You say that you use public sector investment to catalyse private sector development. In the case of the St James centre, there is £60 million of public sector investment for a £1 billion private sector development. Could you explain briefly how the model works? What sort of benefit does the public sector get? What return does it expect for its investment?

Peter Reekie: It is about the financial investment itself, but it is also about the confidence that comes from the public sector—in this case the City of Edinburgh Council and the Scottish Government—showing that we have confidence in the area and in our investment. The £60 million will enable infrastructure that will demonstrate commitment to the site and to the project, whether in the public realm or through other infrastructure elements around the site. The public sector agreement to invest has caused the private sector to make the decision to invest its funds there rather than to develop a different site. The private sector has pretty mobile capital and can deploy it wherever it wishes. The public sector putting the money in and showing long-term confidence in the site has drawn in £1 billion for about 1.7 million square feet of retail, leisure and residential development in the area.

The returns that will come to the public sector will be those that the public sector and the public as a whole will get from the economic growth that will come out of the development. There will be an increased taxation take from business rates, and from domestic rates if there is domestic development. There will also be jobs and quite substantial training on the site, both in the long term and in the short term as it is constructed. There is a whole series of wider ripples of benefits from the economic uplift that the site will bring.

Barry White: At the moment, the confidence that the cities are showing in attracting investment is key. Working with the cities, as well as rural areas, is important, as the cities draw in overseas investment. A Dutch pension fund has recently bought into 75 per cent of the investment in the St James centre, for example. That is because Scotland has been made an attractive place in which to invest. Sending a message to the market that we are serious about attracting investment through things such as city deals, the growth accelerator and tax increment funding is important. We have just launched two calls for TIF pilots. Those are important signals to send to the investment community, whether in the UK or abroad, that Scotland is a good place in which to invest.

The Convener: To widen that out a bit, you are involved in growth accelerator work in Dundee, but there are also city deals for Glasgow, Inverness, Aberdeen and—I declare an interest—the Stirling area. What involvement of the sort that you have had at the St James centre do you have with the other areas that have city deals to help them to make the additional impact that will bring private sector money in?

Barry White: The city deals in Scotland are a tripartite arrangement involving the city region and the UK and Scottish Governments. That is a crowded enough space. We support the Scottish Government in how the deal is structured, but the interface is led by the Scottish Government with the UK Government and the local authority group in the area. Our expertise goes into looking at the business plan’s robustness and what the capture mechanisms are to enable us to know whether it is having an effect. We feed that input into the Scottish Government.

Peter Reekie: In Aberdeen and Inverness, we have been involved in those elements of the programme where we have expertise, such as the digital elements, to help the local authority shape that investment in order to get the biggest boost from it. In Stirling and Clackmannanshire, we were probably involved at a slightly earlier stage in helping the authorities to develop their prioritised project list—they identified the projects—and to shape it to develop the maximum impact for a set of projects.

Adam Tomkins (Glasgow) (Con): I am encouraged to hear that. One of the puzzles that I have about the Glasgow city deal is that we have 20 or 22 projects that are at various stages of development. It is difficult to get any transparency on how those projects were evaluated and why they were selected—and what ones are still on the cutting room floor—to deliver the growth that the city deal is all about. Glasgow was the first city deal in Scotland. There have been others since, and others, such as Stirling and Edinburgh, are in the pipeline. Has there been any learning from one city deal to the next, particularly on the question of how you model the relationship between the infrastructure investment and the growth that you want to see as a result of that investment?

Peter Reekie: There will have been learning between the cities through the city alliance and other forums. We were not involved in the earlier deals. We have always had a view that, in the prioritisation of investment, it is more important to do the right things than it is to do the things that you are doing well.

We support the route that Stirling and Clackmannanshire are going down—and I hope that others will go down that route, too. They are trying to draw those direct lines between what their economic vision is for a city, a city region or, indeed, any region and whether there are any infrastructure barriers to that development or what infrastructure investments or other investments will support the vision. It is very hard to do that through an Excel spreadsheet or any form of model, but I agree with you that getting better at drawing the direct lines between the economic and social outcomes that we are looking for and the investment decisions that we make—with transparency around that—would be good progress.

The Convener: It is probably true to say that some of the original deals emanated from political agreements and did not necessarily have the business plans behind them. More recently, the city deals that have emerged have had well worked-up business plans. That has been my experience.

Barry White: I would describe it as a journey.

The Convener: You are perhaps being more subtle than I was.

Barry White: I subscribe to the view that the deals have made the cities much more outward facing to investors, with a city region having a much clearer story, vision and plan—or mooted plan—about how it is going to tackle some of the bottlenecks. If you are an investor looking at the situation, the story is positive. Delivery needs to follow behind the story and there needs to be rigour in the city deals. As I said, we were not involved in the Glasgow deal, but we have been involved in the subsequent ones.

The Convener: You said “mooted plan”. That interesting terminology says that you agree with me, I think.

Thank you for coming to give evidence. I am sorry that the session was not as broad ranging as it might have been, but lots of issues are going on and it is imperative that different members understand what those are. I hope that you have a happy festive period.

We will have a short suspension to allow for a changeover of witnesses.

Barry White: A very happy festive period to you all, too.

The Convener: Thank you.

11:30

Meeting suspended.

11:35

On resuming—

The Convener: Item 4 is to take evidence on the draft budget for 2017-18 from a panel of stakeholders. I welcome to the meeting Colin Borland, the senior head of external affairs for the Federation of Small Businesses Scotland; Claire Mack, director of policy and place for the Scottish Council for Development and Industry; and Dave Moxham, deputy general secretary of the Scottish Trades Union Congress.

We have received submissions from each of our witnesses. We will try to make this session as free flowing as we can. If a member asks a specific witness a question and other witnesses want to chip in, please feel free to do so.

Adam Tomkins: Good morning and welcome to the committee. Thank you for your written submissions, all of which were very helpful. I have a question about growth and the extent to which you think that this is a budget for growth—if at all.

I was struck by the FSB’s comment in its written submission that it is

“keen for the Scottish Government’s spending plans to focus on measures which grow the economy and encourage the creation, sustainability and growth of businesses.”

The SCDI, right at the beginning of its submission, talks about the

“underperformance in the Scottish economy,”

particularly as regards productivity and innovation. In its submission, the STUC also talks about the importance of growth policy.

Is this a budget for growth? If it is, is it a budget that adequately provides for growth in the Scottish economy? If it does not, what more would you have wanted to see?

Colin Borland (Federation of Small Businesses Scotland): We highlighted three things in our submission that we thought would be beneficial for growth. The first was maintaining a stable tax regime, as far as possible in line with the rest of the UK, and expanding the small business bonus scheme; the second was getting best value out of the money that is spent by ensuring more efficient, joined-up government with a particular focus on digital public services; and the third was a focus on local investment, particularly on local infrastructure.

If we look at the budget, I think that we have done okay. I know that arguments on tax were pretty finely balanced. At a time when weak consumer demand and sluggish economic growth are dominating business owners’ worries, it might make sense to put more money into customers’ pockets by using the tax powers and giving them a tax cut. On the other hand, at this time of economic fragility and political uncertainty, there is also merit in minimising uncertainty, disruption and extra administration for employers by keeping rates and thresholds the same as the rest of the UK.

In the absence of any compelling modelling on either side, we ended up advocating the latter position, simply because our position is always to simplify the tax system where we can rather than further complicate it and because we have not properly explored some of the practical consequences of having divergence from the rest of the UK.

Indeed, I noted that the Fraser of Allander institute’s commentary on the budget covered the issue of the upper earnings limit for national insurance and the fact that, if that stays the same when the upper threshold for income tax in Scotland moves, some people in Scotland could end up with a marginal rate of 52 per cent. I am sure that you have explored that issue in detail, so I will not detain you with it, but the fact that such things are emerging probably shows that it was right to try to keep everything as uniform as possible for the moment—while not ruling things out for the future, obviously. We welcome the fact that rates were maintained. It will be interesting to see how the differential in the higher threshold plays out.

The small business bonus threshold for 100 per cent relief has increased from £10,000 to £15,000. That is obviously good news, given the impact that the bonus has on businesses up and down the country, particularly in economically hard-pressed areas. We will talk about that more, so I will not go into too much detail. The extra money for broadband and mobile infrastructure was also good news.

We would have liked to have seen more on local roads infrastructure. That would have been good news. Most journeys and most delays happen on local roads, so that is where the productivity gains can be made.

It is probably not fair to expect this to be in a budget statement, but in the longer term we need to look at how we are delivering public services, particularly when times are tight, so that we get a little more value for the money that we spend, by addressing duplication and overlap in business support and elsewhere.

Claire Mack (Scottish Council for Development and Industry): As we said in our submission to the committee, growth is the key element. The growth rate of about 1 per cent this year is about a third of the UK rate, and closing the gap is critical to the country's economic health. Productivity is key to that—it is a difficult thing to unpack, but we have done some work on the issue.

We think that there is great support for infrastructure investment in the budget. That is absolutely key. We have expressed concern about support for the enterprise agencies at what we think is a critical time for the Scottish economy, given that the agencies are key drivers of productivity, innovation and internationalisation. We are keen that support mechanisms for the agencies should be as strong as possible.

We have argued in the past for a productivity commission for Scotland and we still think that such an approach would be useful. We are keen to do more work on that in the coming year.

I echo what Colin Borland said in the context of public services. Public services make up such a huge part of the Scottish economy, and we know that productivity in the area is slightly different from productivity in the private sector. We think that there is a way of reinvigorating and digitising public services, which could generate stronger growth and set us apart as a world leader in the area.

Dave Moxham (Scottish Trades Union Congress): There are points of agreement on infrastructure and digital, so I will not repeat what others have said.

To be frank, if productivity is the aim, there is a real contrast between the amount of scrutiny of the role of the enterprise agencies that is going on, in a somewhat rushed fashion, with a budget to match, and the complete lack of scrutiny of, for example—and I apologise to Colin Borland in advance—the small business bonus scheme, which is assumed to deliver many of the things that it claims to deliver, although that has never been tested or examined by the Scottish Government or anyone else, apart from the STUC. If we are going to invest that money, we have to show the same rigour on both investment pools as drivers of productivity. I still fail to see why the small business bonus scheme is seen as a particular contributor towards productivity.

As the committee would expect me to say, public services—the infrastructure and services that they provide—matter in the context of boosting productivity. This is not a great budget for local government, which is a significant problem. It is not a great budget for public service workers, either. If we are to have the public service improvement that Colin Borland talked about, we need a stable basis from which people can contribute towards developing public services, rather than suffer from their cuts.

11:45

Adam Tomkins: Thank you. There is a lot there to chew on and I am sure that colleagues will want to pick up on a lot of different aspects of what you have said. I want to drill down into one or two of those aspects.

First, on infrastructure investment, I think that all the panel members were in the public gallery to hear the conversation at the end of the previous panel about the relationship between infrastructure investment and growth. Some infrastructure investment leads to growth more quickly and directly. If growth is the priority, as at least two of you have said, do you have any reflections on the kind of infrastructure investment that we should be prioritising in this budget cycle?

Colin Borland: In our submission, we made the point that, if you are looking for bang for your buck, you want to be looking at local infrastructure investment. I was struck by the point that Stephen Boyle of RBS—

Adam Tomkins: I am sorry to interrupt, but can you explain want you mean by local infrastructure investment?

Colin Borland: To put it bluntly, I mean local roads. Sixty per cent of our members do almost all their business locally and a large proportion of them rely heavily on cars and vans, and local roads are where the delays occur.

I was struck by the point that Stephen Boyle of RBS made in an article earlier this year. He said that we know what sort of transport investments yield the highest returns: roads that unblock congestion and allow the network to flow more freely. People get held up on roads, and that is where the productivity losses occur. If you want to free up small businesses to do what they do best—make sales and get products delivered—rather than sitting in traffic jams wasting their time, that has got to be the way forward.

Audit Scotland cited figures that show that, for every £1 reduction in local road maintenance, there is a knock-on cost to the local economy of between £1.67 and £1.76. You would expect the converse to be true, with investment in our roads leading to productivity gains. That is why we want local infrastructure investment.

On the digital side, the debate about broadband is fascinating but we make the plea that mobile coverage should not be forgotten about. Mobile data in particular is really important for all sorts of business, but particularly for the tourism and hospitality businesses that rely on visitors to Scotland being able to get off the plane or train, look at Google Places on their phones and find out where they want to go that night. That is where we would like attention to be focused.

Claire Mack: We have acknowledged publicly that the Scottish Government has placed more emphasis on infrastructure investment than the UK Government has in successive budgets. We also acknowledge that that budget package has been declining.

Our thoughts on infrastructure are based more around the planning of infrastructure and trying to dovetail investments in different areas of the country to make sure that we get additional added value from them. To that end, we have suggested that some sort of national infrastructure commission for Scotland could be helpful. The SFT could have a role to play in that.

It is important to think about maintaining infrastructure as well as building it, and we know that there is a differential in terms of what each can do for growth. We are also keen on developments in low-carbon infrastructure. Scotland is globally recognised as holding a key strength in that area, and we are keen to see that that is maintained and supported.

We have been looking at transport infrastructure in some depth in the past year. We have a connectivity commission to look at roads, rail, freight and all sorts of other new and future developments in that area. We note the UK Government's support for developments in future transport options and we see that area as critically important going forward. It can offer lots of efficiencies and give us new and innovative ways of doing things.

In order for us to get to where we would like to be in that world-class space, digital infrastructure is critically important. It just feels like the no-regrets infrastructure spend. Energy supply and the security of the energy supply is also very important across the board for all our infrastructure spending.

Dave Moxham: I am fated to be last with the lists. I am just going to add housing.

The Convener: I want to ask Claire Mack about getting better value and the idea of a productivity commission. Can you bring that issue alive with examples of where we are not getting the best value that we should be getting?

Claire Mack: From a productivity perspective, the digital public services productivity issue is on the table in front of us. We know that, if we can increase that productivity, we will be able to get better value there a bit faster than we can from the private sector. A Deloitte report suggests that a certain amount of headcount reduction will happen through automation in the public sector, but we think that there is time that we can use to plan well. You only have to look at the recent television programme "The Council" to see that it is not that easy to automate and bring in robots to do human, front-facing jobs. However, transactional tasks and so on could potentially be automated, which would free people up to do more complex jobs and address the more complex needs of people in our society who rely on public services.

We are doing a little bit of work on digital public services, which we hope to publish in Q1 of next year, and we are keen to get the committee's views on that.

Ash Denham: Obviously, rates relief features in the draft budget. There will be a change in the threshold, which will mean that more businesses will benefit.

In its submission, the FSB said that it recently carried out a survey of its members on the small business bonus scheme. Will the FSB give us a flavour of the responses that it received?

Colin Borland: Yes. I would be delighted to do so. I put on the record that lots of people will be looking at the small business bonus scheme and its impact, including the FSB.

The most recent figures that we have are from this summer, when we asked 1,000 members about their experiences. Thirty-seven per cent of them said that receiving small business rates relief had let them invest in their business, and 19 per cent said that they had used that to invest in staff.

When we asked what would happen if that was withdrawn, 20 per cent said that that investment would be cancelled and 19 per cent said that they would have to close their business. If that does not demonstrate a clear business case for the scheme and illustrate its broader economic impact, I am not sure what does.

The scheme is not just about the jobs and businesses that it sustains; it is about what economists call the velocity of money—businesses spending, hiring, commissioning services, buying goods and investing in the business. That is the sort of economic activity that we are trying to generate.

The small business bonus scheme is about getting an element of proportionality or a redistributive element into the business tax system. People either agree or do not agree with tax thresholds. When we set income tax thresholds, we do not say that a person must spend the money that they save only on things that we approve of, so I am not entirely sure quite why we would do that with this particular property-based tax.

I am more than happy to robustly defend the impact of the scheme, which has, as we know, existed for around 13 years in one form or another.

Ash Denham: Your submission described the small business bonus scheme as “a key support mechanism”. I want to pick up on a point that Dave Moxham made earlier. Can you prove a link between what the small business bonus scheme is doing for small businesses throughout Scotland and growth? To pick up on the point about productivity, do you see a provable link there?

Colin Borland: The best evidence on that comes from people who are on the front line running businesses and who know what their margins are. You can ask them what the scheme has allowed them to do and where they would have found that money if the scheme did not exist. If a person’s annual turnover is £100,000 or so and they are operating on a margin of 2 or 3 per cent, a few thousand pounds can really make a difference.

However, it is almost impossible to attribute moves in the economy to any particular change, because an awful lot goes on, including employability initiatives, the employment allowance and a raft of measures that have been introduced. Economists can probably argue long into the night to try to prove a direct causal link between one initiative and a certain move in the economy, but we cannot see a better way of sourcing evidence than asking people who know what they are talking about—people who are running businesses on the front line—what impact the scheme has had on them and what would happen if it did not exist.

The Convener: I am sure that Dave Moxham has a different perspective on that and I suspect that Patrick Harvie’s question might lead to Dave being able to speak about that, as well.

Patrick Harvie: Good morning, everybody. I have no doubt that, if you ask people who have had a tax cut whether they like it, they will say that they do. I was interested that Colin Borland’s own figures suggested that the large majority of the people who he spoke to do not claim that the small business bonus has led to them investing or hiring additional staff.

Let us assume that we all agreed that the same amount of money could be ring-fenced for some kind of business rates relief scheme. Is it not reasonable to suggest that it could be designed better, so that the vast bulk of what the public purse pays for in a rates relief scheme would result in investment or in an increase in employment?

Colin Borland: I did not want to detain the committee, but I can go through exactly how it is being spent. There is another chunk if you add in the 37 per cent of businesses that have invested the money. Nineteen per cent have invested in staff, 37 per cent have invested in other aspects of the business and 35 per cent are using it to offset other increases in overheads, which is crucial to business viability. There is a lot in there to demonstrate that it is being well used.

Your point about targeting is interesting, because it is the sort of thing that sounds interesting—why would you not have a targeted tax cut? There are two points and the first is a practical one about who would administer that. We can talk in the language of the public giving money to businesses—it is not taking money from them, so it is not quite the same thing.

Patrick Harvie: A tax cut costs the public purse.

Colin Borland: Notionally. If the small business bonus and the small business rate were stopped tomorrow and everything else stayed the same—if nobody went out of business, nobody cancelled any investment and there was no knock-on effect on the rest of the public finances and the rest of the economy—we would be talking about £174 million. That is compared, incidentally, with a business rate take of £2.84 billion—it is about 6 per cent of that. Even if we got all that money, what would the cost be to define and administer that scheme? There are about 99,500 recipients this year and that number will increase next year. How would we go around all of them to ensure that they were the sort of businesses of which we approve and that we thought were deserving?

Patrick Harvie: I am sure that that would depend on the detail of the relief scheme that you wanted to design and on what you sought to achieve with it, instead of just cutting everybody's tax bill on a blanket basis. I wonder whether Dave Moxham could give a different perspective.

Colin Borland: I am sorry, but I have another point. My first was a practical point about how much would be eaten up by administration costs.

My second point is about fairness. We do not assess any other tax threshold against behaviour of which we happen to approve. That is not what the scheme is designed for; it is there to introduce an element of proportionality and of redistribution into a tax that is disproportionately difficult for smaller businesses and, in particular, for the smallest businesses that are operating in the toughest circumstances.

Dave Moxham: As Patrick Harvie implies, asking somebody who has just asked you for a bar of chocolate whether they like chocolate is probably not the perfect foundation. I know that Colin Borland has spoken to his members and I do not doubt some of the uses to which those resources have been put. I want to make it very clear: we are not anti-small business. However, when we hear about people using the money to pay overheads, one response is that that is keeping some good businesses alive; another response—to be frank—is that it is keeping some bad businesses alive, too. There is an awful lot of poor competition among small businesses that we do not necessarily want to sustain with what should be thought of as—I agree with Patrick Harvie—a public contribution.

I cannot design a new scheme off the top of my head, but I used to be involved with a future jobs fund. It used to ask a whole range of businesses and public sector organisations to come to it and it said, "We are prepared to give you some money to create jobs, so long as you are prepared to show us what you are going to use that job for."

That was not a particularly high-overhead scheme. The idea of designing something that people can apply for, with the intention of using it for the purpose of creating a good and decent job in the pursuit of a stable small business, does not seem to be beyond the wit.

12:00

To return to the point about the enterprise agencies, they are currently being examined in keen detail. Big questions are being asked about how they should be investing and whether or not they should be prepared to take risks. That level of scrutiny should be applied to the rebate, too.

Patrick Harvie: Did you want me to come to income tax later or now, convener?

The Convener: If you could do income tax now, please. Murdo Fraser is also interested in asking about that.

Patrick Harvie: I was interested in the Scottish Trades Union Congress's comments on income tax. You said that these were not the ideal circumstances at the moment and that the

"economic conditions ... for an increase in the basic and higher rates ... are not ideal".

I would certainly agree that an increase in the basic rate would impact on a great many people who are already struggling, particularly in the lower half of the income scale. The lowest four deciles of society are already being hit by difficult circumstances; they are looking at the prospect of inflation coming down the road and they are having their incomes reduced by choices that the UK Government has made.

It is not a requirement under the new legislation that we have only one basic rate. A more progressive approach could be used. Will you elaborate on why you think that it is the wrong time to be increasing the higher rate when high earners have had their incomes increased by the UK Government's choices? Is it not the right time to be reversing that?

Dave Moxham: I would need to hurriedly look through my notes. As far as I am concerned, we are saying that the conditions for doing that are difficult, but it should be done. If it does not say that in our submission, it really should. We advocate the use of the 50p rate and an increase in the basic rate by 1p. In the paper we recognise that that is not an easy decision to make in the current economic circumstances. I do not know whether that helps.

Patrick Harvie: That is certainly clearer. I would have argued that it is in fact very easy to make the case, given that high earners have had their incomes increased by the UK Government. It is pretty easy for me to make the case that the Scottish Government could do something that reverses that concentration of wealth. It is not just about fairness; it is about whether the wealth of the economy is going to be more concentrated in fewer hands and therefore less productive.

Dave Moxham: But we are agreeing about the use of the measure.

Patrick Harvie: Yes. Thank you.

Murdo Fraser: Perhaps I could ask the same question as Patrick Harvie but in a slightly different way and from a slightly different perspective.

Patrick Harvie: Really?

Murdo Fraser: I will start off with Claire Mack. In the SCDI submission, you make the point a number of times about the need for Scotland to

“remain competitive in order to attract investment and talent.”

We have seen a number of differential tax proposals from the Scottish Government in the draft budget and indeed in previous policy announcements. Derek Mackay has proposed that the increase in the threshold for the higher rate of tax will not be matched by the Scottish Government. LBTT rates in Scotland are higher than those south of the border. On business rates, there is the continuation of the large business supplement. Its reach has been reduced under the latest budget, but it will remain at double the UK rate. Do you have any view on what those measures mean for the competitiveness of the Scottish economy?

Claire Mack: We are looking at everything in a holistic pattern. We work with businesses and there is a consumer element to this, too. Focusing on businesses just now, however, there are a lot of things that businesses are expected to do and there are a lot of things that they do gladly. We do not find many businesses looking to shut up shop as a result of any of those measures, although some of our members are coming to us and explaining that they find that they are making it more difficult for them to do business.

We need to consider where the growth areas are, for instance in retail. Last year, 13 per cent of new firms were from the retail sector, and they are among our largest private sector employers. For them, the large business supplement is a very big issue.

The other issue is the behaviour linked to taxation. We need to be absolutely clear that we have good and strong data in Scotland about how these things are impacting particularly on businesses but also on individuals and households. We live close to our nearest neighbour, and people and capital are relatively mobile—that is one of the points to have come out in the report. We also need to be clear that, in our economy, we can see the real fluctuations between sectors very easily because of its current fragility. That is a global issue as well. We need to take good care when we make our decisions.

At the moment, we are still seeing growth supported by consumer spending, which is where income tax is interesting. There is a difficult decision to be made. I am not suggesting whether it is right or wrong but, when people are faced with a set of different things to think about, the higher rate of income tax always tends to grab the attention and is the one that takes the marginal rate hit. I would say that we need to be very clear about the behavioural impacts that could result through avoidance or, potentially, through migration of incomes or whatever.

We are doing some research on the consumer spending issue. In Scotland, we have a lower saving ratio and, with weak wage growth, we must be really clear about what the difficulties are with all of this. We need to be clear about the link between household disposable incomes and growth in our entire economy.

Patrick Harvie: Could I follow up with a very quick point on that?

The Convener: You can come back to it. I will let the others respond first.

Colin Borland: Someone—I cannot remember who—once said that economics is the art of telling everyone what is going to happen and then explaining why it did not.

I was struck by the point in the submission from the Fraser of Allander institute that the behavioural consequences of changes, particularly in a devolved set-up where the Government has control over some levers but not others, can be greater than might be expected. They can certainly be harder to establish. As I said in my first answer to Adam Tomkins, that is why, on balance, we came down on the side of saying that it is probably best if there is no change this year.

I take your point that putting more money in people’s pockets has got to be a good thing. However, given some of the anomalies—such as the national insurance issue that I mentioned earlier—that we are seeing emerge, given the fact that I did not see any robust modelling on either side of the argument to say that it would be a particularly good or bad thing to do, given everything else that is going on at the moment and given the fact that, where possible, I would like to simplify things rather than make them more complicated, on this occasion I believed that this was the correct thing to do.

Murdo Fraser: Sorry—what was the correct thing to do?

Colin Borland: Maintaining the rates in step with the rest of the UK. In an ideal world, we would have maintained income tax band thresholds as well, but we will see how that plays out in practice.

Dave Moxham: It is worth pointing out that reducing taxes and putting more money in people’s pockets does not increase the quantum of money in the economy; it just changes the way in which it is spent. We advocated modest increases in taxation because this is a particularly good time for the type of investments that we need in people that, frankly, the Government and local government are very good at and that show significant outflows in terms of benefits. None of this is about increasing the quantum—none of us have real anti-austerity tools at our disposal—but our considered view, even in the current economic climate, is that the transfer of resources towards equalisation and public investment is the best choice that we could make.

Patrick Harvie: I would like to clarify a point that Claire Mack made. You talked about the potential mobility of high-income individuals with the implication that revenues would go down. However, the committee has received evidence that there is a question mark over that at the additional rate band—the very highest earners. It is a question mark rather than absolute clarity, and a lot of the discussion ends up with the phrase, "We just don't know."

I am not aware of having seen any evidence that shows that that effect would happen at the higher rate rather than the additional rate. We are talking about a modest increase in the higher rate as one of the options. Are you aware of evidence that suggests that that kind of effect would happen at the higher rate rather than the additional rate?

Claire Mack: I have looked only at evidence that applies more broadly rather than just to Scotland. I do not have any evidence that suggests that there would be any particular Scottish element in that. What is known internationally, particularly in America—which I acknowledge has a taxation system that is different from ours—is that there would not necessarily be more mobility but there would be potential for avoidance. If people are able to book their income slightly differently and take advantage of tax relief, they potentially will do.

Patrick Harvie: That would not necessarily apply to someone who is in a salaried position and earns £45,000.

Claire Mack: No, not if they are on the pay-as-you-earn system.

Dave Moxham: It is worth pointing out the high density of the types of jobs to which Patrick Harvie refers. They cannot be carried around in a suitcase—they are Scottish jobs that will remain Scottish jobs.

Murdo Fraser: I have a slightly different question for Colin Borland, on business rates. The budget proposes to match the rest-of-UK business rate—which I am sure your members will welcome—but there is a revaluation due next year. I have already picked up concerns from my constituents, particularly in the hotel sector, about potential substantial rises in their rates bills as a result of the revaluation.

Have you had any sense from FSB Scotland members of their feelings about the overall burden of business rates? Obviously, those who are in the small business bonus scheme will not experience an impact, but many of your members—particularly those in retail and hospitality—will be operating at a scale beyond that. Do you have any sense of the level of rates bills that they are likely to be looking at after the revaluation?

Colin Borland: We have just seen the draft revaluations, which have been published on the assessor's website, and I imagine that people have not been rushing to queue up to have a look at them just yet. In the new year, we will be doing a lot of work to ensure that people are looking at them and that, if they think that the revaluations are wrong, they are doing something about it.

I think that you are right—some of the things that we have looked at suggest that there might be issues in particular sectors. At present, the Government and ministers have the advantage on us, because they have had the data for a while and they know what the impact will be. We have to take them at their word, therefore, when they say that something like a transitional relief scheme would not be appropriate, particularly as that would tend to be funded by the winners subsidising the losers.

Of course, all the other calculations about poundage and everything else will make a lot more sense when we get a feel for what the new rateable values will be. However, as is always the way with counter-cyclical taxes, it is unlikely that a lot of people will see their rateable values drop.

Murdo Fraser: Perhaps you can come back to the committee on that in the new year, once you have had a chance to look at the figures.

Colin Borland: It is almost certain that we will be looking at the figures in a lot of detail, so we will be more than happy to come back, if you let us know exactly what it is that you are looking for.

The Convener: Following the revaluation, there have been increases in some areas. Is that a big surprise? Not really. It always happens, does it not? There will be winners and losers.

Neil Bibby: We have talked about growth and productivity, and the impact on revenues; Adam Tomkins started that discussion. Colin Borland mentioned the importance of local roads and Dave Moxham mentioned housing.

Is it fair to say that we need to give greater consideration to the local government settlement? Rather than focusing on spending on services, we should consider the potential impact on investment in local roads and housing, and in turn how much productivity and growth can be generated locally.

Dave Moxham: Local authorities, as the drivers of local growth, are vitally important. I am slightly surprised that business gateway, for instance, was left out of the enterprise and skills review; I am interested to see where it sits. We are obviously concerned about the quantum of the local government settlement and I know that there have been a variety of views on how it should be interpreted.

The Scottish Government's budget has done some good things. For instance, we are clear that the investment in the living wage in social care for another year will help to drive equality as well as driving growth, as long as it is properly implemented. Overall, however, if you are asking whether we are concerned about the level of investment that local authorities will be able to make in their staff and services, the answer is yes.

12:15

Claire Mack: We are working with a number of local authorities on their city region deals and that kind of thing. The economic development functions in local government and the role of local authorities in addressing inequality are of key interest to us. We live in constrained times and we accept that the reductions to local government budgets could have an impact at that end.

Colin Borland: Economic development spending goes way beyond the traditional enterprise network. It includes everything from potholes to primary schools and an awful lot in between. The more that we look at where we have gone wrong with our economic development strategies in recent decades, the more that we are coming round to the view that a focus on the local, particularly local economies, is much more important than, for example, looking for the next grand design. Therefore, that economic regeneration game is a package deal that everyone has something to contribute to.

The Convener: I ask Claire Mack to say a bit more about what the SCDI is doing on the city deals. From the evidence that we heard earlier and from what Colin Borland and Dave Moxham have just said, they will be pretty important in driving forward our economy and increasing productivity. What has been the SCDI's role in that with the local authorities?

Claire Mack: We have mostly been working with the Ayrshire growth deal and we are doing some work to help the Tay cities deal to think about private sector investment, how to attract more businesses to their areas, and how to assess their strategic business cases to get as much additional value as possible. We have had somebody seconded directly into those projects to help with business engagement in the regions and to draw together a business view on what would help their employees and what would help them to grow their businesses as part of the city deal mechanism.

Dean Lockhart: My question is slightly different and relates to the role of the enterprise agencies. The enterprise budget has been cut by £85 million across Scottish Enterprise, Highlands and Islands Enterprise and, I think, the business gateway. Given the need to increase exports, productivity and internationalisation, if enterprise support is to be lower, what key areas should we prioritise and what should we ring fence in a tighter budgetary environment?

Claire Mack: We have identified that as one of the issues in the budget. By any calculation, there seems to be a 30 per cent reduction, so we question the ability of the agencies to deliver.

The prioritisation would be similar to what we proposed in our document "From fragile to agile: A blueprint for growth and prosperity". We will ask for it all and hope that it will all be there. The three key things that we think are important for the Scottish economy to grow are productivity, innovation and internationalisation. In particular, productivity will have an impact on wage growth, which is what we need and which will obviously feed through into taxation growth, which should help public sector revenues.

Colin Borland: As I said to Mr Bibby, economic development spending goes way beyond what goes to the enterprise network. As someone who has sat in front of this committee's predecessors and other committees for many years making the point that, because Scottish Enterprise in its current incarnation has a very specific remit that focuses on specific types of business and work it is of less direct relevance to our members, it would not be consistent for me to then say that a cut in its budget is somehow a disaster for us. However, if we are looking at ways in which money could be better spent, the enterprise review, and the Audit Scotland report that preceded it, are a pretty rich seam to mine. For example, they have identified that SE, HIE and the Scottish Government all have specialist growth teams that deliver very similar things.

For example, the Scottish Government spends £11 million a year delivering grants and activities for the food and drink sector. Although the three sector teams communicate and collaborate on specific pieces of work, there is duplication of effort, because they are all running about doing research and analysis and liaising with different organisations. The second stage of the enterprise review will probably show that there is significant potential to de-duplicate, streamline and focus those efforts.

The Convener: "De-duplicate" is a new word in the lexicon.

Does anyone have anything else to add?

Dave Moxham: No, I am happy to let it rest there.

Willie Coffey: I want to continue the line of questioning that I was pursuing with the previous panel.

From what has been said already, I understand that you all agree about the investment in digital public services. What do you think the consequences for Scotland might be of the UK pulling out of, for example, the digital single market? Are we inextricably linked to that in terms of technology and infrastructure investment? We should be asking ourselves how we can pull away from that. What would be the implications for Scotland's economy of that direction of travel?

Claire Mack: There is a lot in that question. I am a huge proponent of digital in terms of productivity. I was interested to hear what Barry White said about private sector investment, and it is true to say that it has given us a boost. The most recent Ofcom figures show phenomenal increases in some of our rural areas. We must remember that the commercial investment in those areas was, initially, zero, and that it was not until the public and private investment came in at the same time that something happened. That was very much about the EU framework and the EU thinking about digital aspirations.

Scotland needs to start thinking bigger about the digital economy, particularly with regard to the potential impacts of Brexit. We have focused on consumer-led roll-out and availability and skills, which is an absolutely valid approach. We need to get some good data on business connectivity and availability and think about how we can make sure that those elements are exactly as we need them to be for our businesses to successfully trade internationally. Opportunities for certain sectors are arising from the slightly different stance that Scotland has taken, and some of those sectors are particularly reliant on extremely good digital infrastructure.

The Convener: Does anyone else have something to add?

Dave Moxham: I cannot match that level of expertise, I am afraid.

Willie Coffey: We know about the huge digital divide that is faced by people who live in disadvantaged communities. However, new technology can help to bridge those gaps by helping people to access public services, work, or training online. Is that a crucial factor in taking forward Scotland's economy? What would be the implications of Scotland not being part of that European agenda?

Claire Mack: The issue is about our aspirations towards world-class status. Digital is a brilliant leveller in that regard. We are smaller and have to contend with a particular geography, but digital can help to level out all that. That is why it is important.

There is some scope for us to develop digitally. I agree 100 per cent that, handled correctly, and if there is equality of availability, new technology can have a massive impact on inequality. We are keen to see some really good data. We do not deny that there is already good data at the postcode level, but it would be great to see cuts of that data so that we can look at the business sector.

From a regulatory point of view, an innovative approach could be taken that is not necessarily reliant on population and geographic targets, which we know are incredibly difficult to achieve in Scotland. The way in which our population is dispersed means that we can hit UK-level targets and even Scotland-level targets and still leave a lot of areas unserved that we would like to be served.

Particularly in relation to mobile, and thinking particularly about upcoming mobile auctions, we are keen to see some innovative thinking either on how the spectrum is allocated or on some of the conditions that are placed on mobile operators. For us, the best option is the hard fibre. It has resilience and lots of capacity, so is a great investment from that point of view. Mobile is also critically important, particularly for small businesses who are very mobile, and for businesses that we want to see growing.

Colin Borland: On the specific question of e-government, you are right that there is massive potential for looking at what we could do and what resources we could free up and allocate elsewhere if we sorted out the e-governance side of Government. It is fair to say that we in Scotland have not really scratched the surface of what that is about. I will give an example by returning to business rates. Someone who has to check, appeal or pay a bill has to engage with about three different bits of Government. Why on earth could that not be put through a single portal where someone could go on and say, "Oh, yes. That looks about right. Right, I have paid it", and move on? Why is that so difficult?

Our experience of the situation is that, although we have all tried to cajole and encourage and, by appealing to people's better instincts, get them to co-operate a bit better and play towards the same agenda, it has been really difficult. I suggest that, if we do not see an improvement soon, the Scottish Parliament could be thinking about some sort of statutory duty on public bodies to play together and work towards that, and to cede a little bit of authority to each other to deliver on some of those common projects. As you say, when money is tight, and we need to get money to front-line services for the most vulnerable in our community, that has to be a prime candidate.

Dave Moxham: I am a bit worried about your statutory instruments on that, Colin. I would just like to add that there is a real point here, and this is a mantra that I have repeated at various committees: the staff who are involved in delivering at the front end must be properly involved in the process of doing the sort of things that Colin wants to happen. Too often, we lose the expertise of the people who are actually involved in doing the work on the front line, because middle managers provide blockages. I am very keen to see the front-line staff involved in that sort of discussion.

James Kelly: The Scottish Government wage forecasts over the period to 2021 are that the public sector wage position will remain static at 2.2 per cent, but that private sector wage growth will increase to a rate of 4.9 per cent. Is that a desirable policy outcome from the budget process?

Dave Moxham: Obviously we would like to see more wage growth in both sectors. It is absolutely vital that wages continue to grow in the private sector, particularly in those better-quality jobs that we are driving towards and that we require for more productivity. My fear is that, in the private sector, we will not see that sort of wage growth in services, partly because of poor employment regulation that allows that to happen, notwithstanding that the Scottish Government has limited powers to deal with it.

I turn to the public sector, which is a major concern. We believe that the public sector pay cap should have been lifted and that there will be two major outcomes. The first is suffering for our members; the second is a drawing of resources from the local communities that we talked about earlier.

We are significantly concerned that that is the trajectory. We recognise that a significant part of that is imposed on the Scottish Government by the UK Government and that the Scottish Government has limited room for manoeuvre. We would certainly argue for the lifting of the public sector pay cap and a slightly more generous offer to our members.

The Convener: I guess that the inevitable follow-up to that is, in terms of where we are in the public sector in general, the difference in approach between the Scottish Government and the UK Government around the issue of no compulsory redundancies is something that—

Dave Moxham: Yes, I would like to put a number of things on record. To repeat the point that I made earlier about the Scottish Government's living wage commitment and the additional commitment to care workers, the no compulsory redundancy guarantee has been important. To make the case that the Scottish Government is not motivated to do some good things for public service workers, or that it has a free hand to do anything it wants, would be entirely correct. However, we do believe, at this point, that the pay trajectory that James Kelly described is something that needs to be looked at very carefully.

The Convener: Okay. I have not had an indication from anyone else that they wish to contribute, so I wish our panellists a happy festive period and thank them very much for coming along today to give us evidence. We now move into private session. Thank you very much.

12:30

Meeting continued in private until 12:38.

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

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