OFFICIAL REPORT
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Finance and Constitution Committee

Wednesday 11 January 2017

Session 5

The Scottish Parliament
Pàrlamaid na h-Alba

Wednesday 11 January 2017

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FINANCE AND CONSTITUTION COMMITTEE
1st Meeting 2017, 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:

Robert Chote (Office for Budget Responsibility)
Simon Fuller (Scottish Government)
Derek Mackay (Cabinet Secretary for Finance and the Constitution)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Finance and Constitution Committee

Wednesday 11 January 2017

[The Convener opened the meeting at 09:32]

Decision on Taking Business in Private

The Convener (Bruce Crawford): Good morning, colleagues, and welcome to the first meeting in 2017 of the Finance and Constitution Committee. I wish all my colleagues, the clerking team and Robert Chote from the Office for Budget Responsibility a happy new year. We have received apologies from Adam Tomkins.

Agenda item 1 is to decide whether to take item 4 in private. Do members agree to do so?

Members *indicated agreement.*

Draft Budget 2017-18

09:33

The Convener: Item 2 is to take evidence from the Office for Budget Responsibility on its "Economic and fiscal outlook" and its "Devolved taxes forecast", both of which were published alongside the United Kingdom autumn statement in November. We are joined by the chairman of the OBR, Robert Chote, whom I warmly welcome to the meeting.

If you would like to make a short opening statement, please feel free.

Robert Chote (Office for Budget Responsibility): Thank you very much indeed, convener. It is a great pleasure to be here.

By way of introduction, I note that, as you said, the most recent set of forecasts, details of which I know the clerks have circulated, were published alongside the autumn statement on 23 November. The next set of forecasts that we produce will appear alongside the UK budget on 6 March, so we have not done any updates of the material since November.

Needless to say, if we look at the differences between the forecasts that we published in March last year and those that we produced back in November, we find that the big-picture story of an outlook of relatively steady but—certainly by the standards of periods of growth after previous recessions—unspectacular growth remains in place. The continuing major uncertainty around those forecasts, which applies to the work of anybody who is doing an economic forecast over a period of five years or so, is the outlook for productivity. The defining puzzle of the present economic recovery has been that productivity, which is the amount of output from every hour that an individual works, has grown much less quickly than has historically been the case. That situation, which is not unique to the UK but is probably more pronounced in the UK than elsewhere, has led to a greater sense of pessimism about the medium to long-term growth prospects of the economy.

The most newsworthy thing that happened between March and November was, of course, the referendum vote for the UK to leave the European Union, which creates its own set of uncertainties around the forecasts as regards both the on-going response to the vote and what will eventually emerge from the negotiations. It is important to remember that the uncertainty surrounding Brexit has not displaced or replaced the existing uncertainty about the outlook for productivity and the outlook for the global economy; it has come on top of that. It is easy to forget the underlying sense of uncertainty by focusing too much on Brexit.

Over the coming years and decades, the long-term growth performance and productivity performance of the economy will surprise people on either the upside or the downside, and interminable PhD theses will be written on whether that was to do with Brexit or with the resolution or evolution of the underlying productivity puzzle. It is important to remember that.

People are very focused on what the flow of new economic data that is coming in tells us about the immediate response to the no vote and whether the economy is holding up. There is a great temptation for people to fixate on the weak bits of data or the strong bits of data depending on whether that supports their argument, but at this stage I would be extremely cautious about placing too much weight on the monthly and quarterly numbers that we get from the Office for National Statistics on the performance of the economy. We are dealing with very early drafts of economic history, and experience shows that they can be substantially rewritten.

Over the next few quarters, there will be a particular focus on the performance of business investment. If we look back to 2009, we see that there were huge variations in not merely the forecasts for business investment but the estimates of what actually happened after the event. In the second quarter of 2009, the estimates of the change in business investment on the previous quarter ranged from an increase of 1 to a decrease of 11 or 12. The figure is now put at -5, which gives you some sense of the changes there.

It is occasionally tempting to treat economic forecasting as a spot-the-ball competition, but it is not like that—or, if it is, it is a spot-the-ball competition in which you have to be prepared for the judges to change their minds repeatedly about where the ball is, often many years after the closing date of the competition. Therefore, it is necessary to have a sense of wariness.

I would like to make one remark on the devolved taxes forecast before we move to questions. We produced our forecast in November, and it has now been possible to compare it with the forecast that the Scottish Government produced in December in the draft budget. If we look at the largest of the devolved taxes, which is income tax, the differences between our forecast and the Scottish Government's forecast are small in comparison with the uncertainty surrounding either of those forecasts over the horizon that we are looking at. I would not regard those differences as being significant or worrying. They will reflect things such as differences in the modelling approaches, differences in some of the information that people have been able to take on board and different assumptions about the performance of growth and earnings over the next few years.

There are rather larger differences on land and buildings transaction tax, but that is only to be expected given the nature of that tax. The same is true for the equivalent in the rest of the UK. It is by its nature a much more volatile tax as there are bigger movements in housing transactions and housing prices than we get in wages and salaries. From our point of view—I know that we share this objective with the Scottish Fiscal Commission—the key thing is to be able to look at the numbers and highlight for people why there might be differences in them. As I said, one must expect such differences; they are not something to worry about. They are simply another symptom or manifestation of the uncertainty around economic and fiscal forecasting that I mentioned earlier.

The Convener: I was going to ask you to talk about how difficult the science of forecasting is and what that means for the committee, but you explored that issue well in your reference to a spot-the-ball competition. However, whether it is about a spot-the-ball competition or putting a finger in the air to work out what is going on, the issue for us in Scotland is what the variables are going to be and the difference between the rest of the UK and Scotland. Given the uncertainty around what the numbers mean, I am not sure whether you can provide us with any insight regarding where you think the challenges are for us and the potential variables with regard to the difference between the UK performance and the Scottish performance.

Robert Chote: I return to the fact that any uncertainties about the differences in performance between Scotland and the rest of the UK are probably dwarfed by the uncertainties around the performance of either in isolation. Returning to the productivity issue, I add that the biggest and perhaps most important uncertainty for us, the Scottish Government and the Fiscal Commission in producing future forecasts is the outlook for productivity growth and what that implies for growth in average earnings, which is a key driver of the income tax forecast.

As I said, we have had a period of weak productivity performance since the financial crisis. We are assuming that productivity growth and growth in the economy as a whole will pick up over the next five years but will not get back to their historical average rates at the end of that period. Nonetheless, our forecast is that the pick-up in the economy will be sufficient to get average earnings growth year on year in the UK up to 3.75 per cent by 2020 or thereabouts. I think that the Scottish Government's figure for Scotland is slightly above 4 per cent. I am not sure whether that is a genuine difference or just a difference in exactly which year-on-year or month-on-month comparison is used. However, we are both engaged, in part, in an act of faith that we will get back to something more like the performance of the past, rather than the recent weak performance being the new normal. If that is the new normal, that will be bad news for wages, living standards and the public finances, so that is a key issue.

The Scottish Government's approach to forecasting is, in essence, to take our forecasts for the UK as a whole for average earnings and then to use its own modelling techniques to try to discern whether there are any differences that are important for Scotland. That seems a sensible approach. The Fiscal Commission will have decisions to make about how much of a forecasting exercise it undertakes on its own on the macroeconomic side, but average earnings growth is the major underlying uncertainty.

On the differences between the modelling approaches, the Scottish Government has taken an interesting approach in its income tax forecasts in that it sort of disaggregates by different ages. We are more troubled in both the income tax forecast and the LBTT forecast by the difference between London, which has relatively high-end properties and income movements, and the rest of the UK, than by the "Scotland versus the rest of the UK" story. That is one reason why we have different techniques, although the latter issue will be important as well.

If I had to underline one key uncertainty in relation to performance in Scotland and the UK and any differences, it would be that of earnings growth and productivity growth.

The Convener: There are clear similarities between the OBR's forecast and the Scottish Government's forecast. They are more optimistic than those from some renowned companies and organisations, which seem to be projecting lower growth than either the Scottish Government or the OBR. Do you have a sense of why that might be?

Robert Chote: Yes. In our forecasts for gross domestic product growth this year and over the next five years, we are somewhat more optimistic than the Bank of England was in its most recent forecast back in November, and than the average of outside forecasters polled by the Treasury. Nonetheless, some people are arguing that we are nowhere near optimistic enough and that great opportunities present themselves that will result in a much stronger growth performance. It partly depends on when those forecasts were made. If we average a lot of outside forecasts, some of them will be relatively old and some will be relatively new.

09:45

If we consider the particular impact of Brexit on the potential performance of the economy over the nearish term—in the next couple of years or so—we have basically made the judgment that we will see some slowdown in the economy. That partly reflects the impacts of uncertainty on business investment—business is likely to cancel or delay some projects—but also the fact that we have seen a sharp fall in the pound since the referendum. That pushes up import prices and would therefore be expected to squeeze consumer budgets, particularly through this year and into next year. That means that, even if consumers continue to spend in cash terms what they were going to spend anyway, it will make less of a contribution to real GDP growth, because they will be buying less stuff with every pound that they spend.

In addition, some of the more pessimistic forecasts have assumed that there will be a hit to business and consumer confidence that is sufficient for consumers to increase their precautionary saving—that is, to tighten their belts out of a sense of anxiety—and that in some cases firms will engage in more aggressive job shedding because of the potential impact of Brexit. We have not taken that view. We have focused more on some delay in or cancellation of investment projects and the squeeze via higher prices. Some of the gloomier views—this is certainly true of some that were published ahead of the referendum—have assumed more aggressive reactions by consumers and businesses than we have assumed and than the evidence today suggests there have been.

The Convener: That is helpful.

Ash Denham (Edinburgh Eastern) (SNP): You have partly answered my question, which is about the assumptions around productivity growth. You say in your report that that is the most important uncertainty. I saw a tweet by Danny Blanchflower in which he said that the OBR really must explain its assumptions around why it thinks that the productivity puzzle will be solved in the next five years, and I note your comments on Brexit. It seems to me that in the relatively short term—over the next five years—we will have a lot of impacts around Brexit. We are not yet sure about some of them, but we have already seen that business investment is down. Do you not think that that will play into productivity? Why have you made the assumption that productivity growth will return in the short term?

Robert Chote: We have taken the forecast for productivity growth down over the next five years, partly as a result of the Brexit vote. The link that we emphasise in our most recent report is that, if there is less business investment, less capital is provided to businesses, and that in itself leads to weaker productivity growth. We have that chain operating.

The Treasury, in its analysis ahead of the referendum, also emphasised that it assumed that, if we have a less trade-intensive economy—most people are assuming that that will be the case, at least over the time horizon that we are discussing, although maybe not over a much longer one—we will get fewer imports and exports than we would otherwise have got as we move to a new trade regime, and that in itself will mean less innovation and less productivity growth. That is another potential channel.

Going back to the broader question of why we assume that productivity growth will pick up at all—Danny Blanchflower's question, which, as it were, precedes the referendum anyway—I think that the challenge for forecasters is that we are looking at two very different periods of history: a period of decades in which productivity growth was relatively strong, and a period of very weak performance since the financial crisis. As I have said, that is not unique to the UK.

On forecasting for the next few years, I think that, essentially, everybody has to wait. It depends how important the much longer period of relatively strong performance and the shorter subsequent period of relatively weak performance are as a guide to where we are going to be in future. Perhaps not entirely surprisingly, we fall somewhere between the two; we assume that things will not remain as weak as they have been since 2008-09, but that they will not get back to the productivity growth rates that we saw previously.

I dispute the notion that we are assuming that the productivity puzzle will be solved. We assume that there will be some return towards the improvement rates that we have seen in the past. Part of the reason for that in-between judgment is that there is considerable uncertainty over the explanations for the productivity puzzle. If we knew why productivity has been so weak, we could make a much more definitive judgment about whether the next few years are likely to be different.

The range of alternative views out there include that we are not measuring these things properly, that the puzzle is caused by the weakness in business investment, that it is something to do with the buoyancy of trade at a global level and that it is to do with the fact that there are simply fewer good, potentially profitable ideas out there for people to invest in. The Bank of England in particular has thrown a lot of person power at the question and it has concluded that there is no single defining explanation for the productivity puzzle but that lots of individual factors can explain parts of it.

Our view is that it is too pessimistic to assume that we will never get back to anything like the 2 per cent productivity growth that we have had in the past. What is the evidence for that? There is a judgment to be made somewhere between the two positions. What we do in the report is to show the implications for the public finances if the recent past is the new normal and the implications if we return to the performance of the past. Not entirely surprisingly, if the recent past is the new normal, it will not be good news for growth in tax receipts or for the public finances, and it will make it much harder for the Government to meet the fiscal rules that it has set itself.

As I said in my opening remarks, it remains, to some degree, a matter of faith that we will get back to something more like normality. However, we are certainly not assuming that we will regain the productivity level that we would have expected prior to the crisis and, over the horizon that we are looking at, we are not even assuming that we will regain the growth rate.

Ash Denham: Thank you.

Dean Lockhart (Mid Scotland and Fife) (Con): Your last answer covered a number of issues that I was going to touch on. I understand that there are variations in productivity across the UK, with the level in London being higher. There are also variations in productivity across sectors. Do your forecasts break down productivity levels on a regional or a sectoral basis? If they do not go into that detail, can you give us a flavour of your view on productivity levels in different parts of the UK and in different sectors?

Robert Chote: I am afraid that I will have to leave that to others. We produce a macroeconomic forecast only in order to produce a forecast for the UK-wide public finances, which is supplemented by devolved tax forecasts for Scotland and Wales. We therefore do not produce a forecast that is disaggregated by region—within England, for example—by nation or by sector. I could give you only armchair theorising and would prefer to leave it to people who have looked at it in more detail. That is not to say that it is not an important policy issue, but we are looking at aggregate tax receipts and aggregate spending for the UK public finances as a whole and it is not something that we work on specifically.

Patrick Harvie (Glasgow) (Green): Good morning. I am interested in what you have said about jobs. You say in your executive summary:

> "We do not, at this stage, forecast that Brexit-related uncertainty will prompt more aggressive job-shedding."

Can you explain why you have not looked at the possible implications of that uncertainty? One of the documents that we have been using to inform our discussions over recent months is the Fraser of Allander institute's report, which suggests that, even if we stayed in the European Economic Area but came out of the EU, the impact would be around 40,000 jobs lost in Scotland and a drop of £1,000 in the average wage. The consequence of that would not be people being cautious and saving more; it would be their not having enough money for the things that they need at the moment. Why have you not included any scenarios relating to the employment impact of Brexit and the different paths that we might commit to?

Robert Chote: In the approach that we have taken to Brexit policy as a whole and in the assumptions that we have made, we have been constrained by the remit that we have been given and the legislation that has been set out for us. We are required to produce forecasts on the basis of current Government policy—we are not allowed to look at different policy options.

Patrick Harvie: Current Government policy is to come out of the European Union.

Robert Chote: It is—exactly. That is why, in advance of the referendum, we did not produce a forecast of what would happen if there were to be a no vote. Subsequently, we had to decide whether we would try to predict the precise outcome of the negotiations and use that as a definition of current Government policy, and base the forecast on that.

Clearly, as you say, some institutions have produced different forecasts for different potential trade regimes. Whether any of those particular models will be one that the UK ends up with or whether the UK has one that is "bespoke" or different from everyone else's, only time will tell. The decision that we took was that, rather than pretending that we could predict exactly where this was going to end up, we would make some relatively broad-brush assumptions consistent with what external studies suggest would be true of a wide variety of the outturns.

That is basically to say that, over the five-year horizon that we are looking at, there would be less trade; somewhat less inward migration; and less investment than would otherwise be the case. That is what we have explained clearly in the report, and that is how we have proceeded. As things get clearer, we can change our position. How quickly things will get clear enough for us to change it is a matter of debate.

In terms of unemployment and the labour market specifically, we have unemployment rising relative to what would have been the case in the previous forecast. That is partly because, as I said, there is a weakness in business investment and a squeeze on consumers, which means that some spare capacity will open up in the economy. There will be some additional unemployment as a result of that, which is typical of when an output gap, as it is referred to, in the economy opens up, but we would expect that to close down.

Over the longer term, we are assuming that there will be weaker productivity performance than there would otherwise have been and that that will pull down GDP, which will be potentially weaker.

The statement that Patrick Harvie quoted, in which we say that have not assumed more aggressive job cutting, is, in a sense, tautologous. We have made an assumption, and we obviously have not made the assumption that is more aggressive than that. Crucially, in the scenarios that we have put in, we have focused on what happens if we end up with a weaker productivity performance, which has considerable implications for public finances but, more importantly, for wages and for living standards.

Patrick Harvie: You are required to operate under the assumption of current UK Government policy. Does that also apply to its immigration policy? The UK Government's policy is to bring net migration down to the tens of thousands. Some of us think that that is a bad idea—and probably unachievable as well—but are you assuming that that will happen and what the economic consequences of that will be?

Robert Chote: Obviously, we do not know what migration regime the UK Government is going to choose or emerge from negotiations with, so, again, we have made a relatively—

Patrick Harvie: But you know what its stated policy objective is.

Robert Chote: We know what its policy objective is, and that has obviously been there for some time. Although our forecasts have taken the objective on board, we have never assumed that the UK Government would succeed in getting migration down to that sort of level anyway. We continue not to assume that in the projections that we have made in this forecast. We have net inward migration settling down at around 185,000 a year, rather than the high tens of thousands.

Patrick Harvie: So, basically, on both those aspects, if the UK Government achieves what it intends to achieve, there are two more big heaps of bad to work into the figures.

Robert Chote: One point to bear in mind is that how bad we think the implications for the economy are depends on whether we look at GDP for the economy as a whole or GDP per capita. Obviously, the effect on GDP per capita is smaller because the economy would be smaller if there were fewer people contributing to it but the size of the economy per person in it would not be affected to quite the same degree. It is conventional—certainly in the analysis that we have produced and we see the same thing in analysis in the United States by the Congressional Budget Office—that, over a near, but quite long, time horizon, lower net inward migration is bad news for the public finances, primarily because net inward migrants are more likely to be of working age than the rest of the population. If we run that on, as those people get older eventually—well, all the time—[*Laughter*.]

Patrick Harvie: Sooner rather than later.

10:00

Robert Chote: —the fiscal implications will evolve over time.

Generally speaking—we again show the variants here—if you have low net inward migration, the outlook for the public finances is less good. However, it is not our job to say what migration policy will be. Obviously, Governments set migration policy not only with an eye to what it means for the public finances and if they want to take a view that has negative implications for the public finances, they can take other tax and policy spending decisions to offset that. We are not saying that you need this particular level of net inward migration to deliver a particular outcome for the public finances, nor are we saying that we do not believe that you should get net inward migration down to the high tens of thousands—that sort of policy advice is beyond our scope. We are just trying to say what we think the most likely outcome will be under those different circumstances.

Patrick Harvie: Thank you very much.

The Convener: Ivan McKee has a supplementary.

Ivan McKee (Glasgow Provan) (SNP): Thanks, convener. I wish to follow up on some of the stuff that Patrick Harvie spoke about on population. You kind of answered my question—you are using the figure of 185,000. In the data that we have seen—I do not know whether it is the same data that you are using—the ONS population forecasts are that the population will grow by more than 400,000 a year over the next five years. The vast majority of that growth is going to be from inward migration—maybe about 75 per cent of it. I think that that is consistent with what has happened over the past number of years.

I assume that your 185,000 number is some kind of step down from that. You have a line in your forecast that projects the public sector finance impact of that lower migration, which gets up to about a £6 billion difference by 2021, so the impact is obviously significant even with that step down.

I want to drill into that some more. You talked about GDP versus GDP per capita but, as you also rightly said, at the end of the day, it is the GDP number that drives the public sector finances, not the per capita number. Have you done any modelling at all on the assumption that the Government has any chance of hitting its stated objective? It seems a bit strange that, although we are led to believe that 17 million people voted for lower immigration and it is a stated Government policy, you are saying that neither of those points matter because there is no chance in hell of that happening, so you are just going to ignore it.

Robert Chote: I leave it to you to say whether that is what 17 million people voted for. There are different views anyway among the people who voted the way they did in the referendum on what the level of migration ought to be as distinct from its composition and the degree of control that the Government can exercise over it.

More generally, the approach that we take—basically to make the forecast tractable—is, as you imply, to pick among the variant population projections that are produced by the Office for National Statistics. We try to pick the projection that we think looks most consistent with current stated Government policy and with external and other influences on migration flows. At the moment, we are using the ONS's principal population projection variant, which assumes that net inward migration starts at around the levels that you have seen in recent years and then moves over five years towards a more long-term average.

When the ONS produces its population projections, it is not doing a detailed study of whether it thinks that the regime will deliver particular outcomes. It is a more mechanistic approach that basically says that the most recent past is the best guide to the near future and the longer history is perhaps a better guide further on. We take that on board.

As we said in the report, in the absence of the Brexit vote, we would probably have moved to a higher net inward migration variant from the ONS, simply because the most recent inflow rates have continued to be relatively high. The decision not to do that partly reflects the assumption of most external studies that the outcome of the negotiations will be that we move to something different and—given what the Government has said—it is more likely to be a tighter migration policy than a looser one. In addition, and perhaps more important in the nearer term, we assume that the pull factor—the degree to which people are attracted to come to the UK—will be less than it otherwise would have been because the economy will be weaker.

Therefore, the fact that we have taken a lower net inward migration assumption than we otherwise would have done is not simply or mainly a judgment based on the assumption that a particular migration control regime that will let fewer people in is going to be introduced. It is based on the fact that we will likely see a smaller inflow anyway because of the relative performance of the economy.

Ivan McKee: So you are saying that the best way to reduce immigration is to crash the economy, because then nobody will want to come here.

Robert Chote: Those are not words that we would use.

Ivan McKee: To follow through on that point, you are basically saying that the ONS assumption has, in effect, ignored Brexit because it has said, "This is what has happened in the past, and we believe that that is the best guide to what is going to happen in the future." That goes back to my question: have you done any number crunching on the assumption that immigration will be in the tens of thousands, and what does that look like?

Robert Chote: In the economic and fiscal outlook that we produced in March, we presented a set of different scenarios that were based on different outcomes for net inward migration. That was not done specifically on the basis of different policy regimes. The ONS produces different population projection variants for different migration rates simply by taking the principal rate and then saying, for example, "Let us assume that the end point is 60,000 higher or lower." The line is then drawn line differently, and the new result comes out. We have been able to use that technique to show some of the differences. The analysis that we published in March was basically deployed again in this forecast to illustrate the potential impact of not moving to the higher migration point.

As I have said, generally speaking, if you assume lower net inward migration, the mechanical effect on the public finances is that they are weaker because of the—

Ivan McKee: The number that you use is still 185,000. It is not a number in the low tens of thousands.

Robert Chote: No, and if it is lower than that, you can see from the March forecast the sorts of difference that that makes.

Ivan McKee: So that forecast does have a lower number.

Robert Chote: Yes. You can look above and below.

Ivan McKee: Thank you.

Murdo Fraser (Mid Scotland and Fife) (Con): Good morning. I want to ask a couple of questions about your projections for income tax, particularly in relation to the devolved taxes, which, as you will imagine, are of great interest to the committee, given that the budget that we are about to scrutinise will contain for the first time the full devolution of income tax to Scotland. The Office for Budget Responsibility has published its assumptions. It is expecting the Scottish share of UK income tax revenues to increase, albeit fractionally; that is, it is expecting a relatively higher growth in Scottish income tax compared to the rest of the UK. Do you have a view on whether the OBR is correct in that assumption?

Robert Chote: We would not have made it otherwise—that is the assumption that we have made. The share is relatively stable over this period. We look at whether there are particular sets of policy measures that are likely to have an asymmetric effect on Scotland and the rest of the UK that is likely to move that share. Generally speaking, if there are policy measures that affect either the top end or the bottom end of income distribution to a greater degree, they will have a different impact in Scotland than in the rest of the UK, simply because of the differences in income distribution. A measure that changes the personal allowance and takes people out of the bottom end is going to have a proportionately higher impact on receipts here than in the rest of the UK. If taxation is reduced at the top, it is going to take proportionately more out of receipts in the rest of the UK than here. There are those sorts of adjustments. However, as we can see from the report, those differences are relatively small over time.

Another thing that we can do in our forecast is make different assumptions about whether earnings growth is going to be higher for people on relatively high incomes versus those on relatively low incomes or the other way around. Again because of the differences in income distribution, that can have an impact as well.

As I understand the specific plans that have been put out in the draft budget, you are talking about raising the higher-rate threshold less quickly and raising the personal allowance—in effect, a zero band—more quickly than would be the case under current UK policy. That will have offsetting effects on revenues. Not raising the higher-rate threshold as quickly will bring more in; raising the personal allowance by more will bring less in.

When we produced our November forecast, that was not firmly Scottish Government policy at that stage. When we produce our March forecast, we will be able to incorporate that, and we will produce an explicit estimate of the net effect on receipts of making that change relative to sticking with the UK policy line. My guess at this point is that the numbers are not enormous, and there are offsetting effects at the top and the bottom. We will consider that more carefully when we get to the next forecast in March.

Murdo Fraser: I wish to follow that up. I have heard everything that you have had to say, but your forecasts are suggesting that, although the difference is marginal, Scottish income tax revenues will grow faster than the income tax revenues of the rest of the UK, relatively. Are you therefore saying that you think that income tax revenues per capita in Scotland will grow faster than those in the rest of the UK?

Robert Chote: I am not sure what the answer to that question would be. I can get back to you on it. I do not know what is happening to the relative population growths over this period. If I can dig that information out, I can get back to you.

Murdo Fraser: Thank you—that would be useful. One of the challenges that we have is that we know that, relative to the UK economy, the Scottish economy has not been performing as well in terms of GDP growth over recent years. Unemployment in Scotland is relatively higher, and employment is relatively lower than it is in the rest of the UK. That is why suggestions of a faster income tax growth in Scotland relative to the rest of the UK seem out of kilter with what is happening elsewhere in the economy.

Robert Chote: We can make comparisons with Wales. Although Scotland’s performance versus that of the rest of the UK when it comes to unemployment rates is not that different from Wales’s, the performances of Scotland and Wales are rather more different for employment rates. The employment rate is lower in Wales because of lower activity rates, whereas the rate in Scotland is not that different from that of the UK as a whole. The rates bounce around but, if you look at page 10 of our devolved taxes publication, you see that there is a lot more similarity between Scotland and the rest of the UK than there is between Wales and the rest of the UK.

Murdo Fraser: Perhaps we have an ambition to be better than Wales, at least.

On that point, have you done any work to consider what improvement there would be in the income tax take in Scotland if the Scottish economy grew at the same rate as the average for the UK, or if employment and unemployment rates in Scotland matched the UK average?

Robert Chote: No, we have not. That would be outside the scope of what we do. You might be able to infer some of that from the data that we have published, but our approach generally involves having a UK forecast and then considering the share and whether there are reasons to expect that share to move.

The Scottish Government’s approach involves a different sort of bottom-up forecast. It takes into consideration the different sources of income and differentiates by age. From its point of view, it might be possible to take its own forecast and to say that, if we shifted the particular assumed employment or activity rates at different ages, we could do that comparison. I suspect that it would be slightly harder with the methodology that we use, but I am saying that off the top of my head.

James Kelly (Glasgow) (Lab): As we have been discussing, economic growth is always important, particularly as it relates to productivity. In this committee, we are particularly interested in the changes to the devolved taxes and the block grant adjustment and in how differential growth rates can affect that.

It is interesting to look ahead. Although the growth rate in Scotland is lower, the trend is broadly similar in your forecast over 2017-18 and 2018-19, but when we get to 2019-20, the Scottish Government is forecasting a small increase of 0.1 per cent on the previous year, whereas the OBR is forecasting an increase of 0.4 per cent, which rises to 2.1 per cent in 2019-20—

Robert Chote: Sorry, which number are you referring to when you talk about 2.1 per cent?

James Kelly: The UK growth rate forecast for 2019-20.

Robert Chote: Right.

James Kelly: What I am interested in is the jump of 1.7 per cent from 2018-19 to 2.1 per cent. What has driven you to make that forecast?

10:15

Robert Chote: At UK level, it comes back to the assumption that in the near term there will be a weakening in activity in the economy because of the squeeze on consumers and the weakness of business investment, although there is significant uncertainty about both the size and the timing of that effect. If that happens, a greater margin of spare capacity in the economy will be opened up—that is, there is potential that could be used up before the Bank of England would worry about the inflationary implications of having the economy motoring at that sort of rate.

In a situation in which a bit of a hole has been created in the economy, we end up with a period of stronger long-term growth as the hole is filled in. Such a story would normally be quite dramatically illustrated in the wake of a recession—let us say that the economy normally chugs along at 2 per cent a year but there is then a recession; it is then not unusual for the economy to grow by 3 or 4 per cent a year for a couple of years, as it climbs out of the hole on the far side. What has been very unusual about this recovery is that there has not been such a period of 3 to 4 per cent growth; instead, we have just got back to the previous trend. In other words, the whole potential path of the economy appears to have shifted downwards. However, in microcosm, what is going on is that the economy is able to pick up a bit because, in the nearer term, greater spare capacity has been created by the short-term downturn.

You asked about the difference between our forecast and whatever the Scottish Government is assuming on growth in the Scottish economy. I do not know precisely what the Scottish Government is assuming, but as I understand it, it has a bespoke version of the National Institute of Economic and Social Research's economic model, into which it feeds our assumptions about what is happening in the UK as a whole to generate some Scotland-specific numbers.

You would have to ask the Scottish Government about the mechanics of that and whether its numbers would be systematically lower than the UK numbers that we provide in the first place or whether there are other, specific elements in that regard. Basically, we produce a forecast for growth across the UK as a whole, and the Scottish Government takes that—the same is true of earnings growth—and sticks it into its model to generate a Scottish number. As I said, I do not know about the mechanics of the differences between the two models.

James Kelly: Of course, the Scottish Government forecast is a matter for the Scottish Government. I am not asking you to speculate on why there is a difference. I was just interested in the trend that you forecast. You described the situation—

Robert Chote: The big picture is basically that, when the economy gets into something of a hole, there is a period of above-trend growth while it climbs out of it.

James Kelly: Okay.

The Convener: If I recall correctly, the OBR commented in its report on the growth in incorporations. If there is such growth, the UK still gets a tax take, although incorporation impacts on the income tax take and there will be a negative outcome in that regard. I suspect that if the trend is the same in Scotland, things will be somewhat different, given that there will be an impact on our income tax take and it will be the Treasury that might get some gain—perversely. Do you have a view on the impact of incorporation in Scotland compared with the rest of the United Kingdom, given that we have a smaller number of higher tax payers?

Robert Chote: It is not something that we have distinguished to that level. The forecast that we produce of Scottish income tax receipts is based on a share of the UK forecast, and one of the reasons why we have revised down the UK forecast is that we have looked again at the trend in incorporations, which, as you said, seems to be rising more quickly than we previously assumed. There is a debate about how much of that is to do with the particular tax advantage for people of being companies as distinct from employees or self-employed and how much of it is to do with more underlying structural trends, in that there are certain industries in which it is just more efficient to organise oneself in that way, whatever the tax arrangements happen to be.

We have taken account of the trend in the UK forecast, so that will feed into the Scottish forecast. There is an offset in the UK corporation tax forecast. Clearly, there is a loss to the Exchequer overall; we assume that there is such a degree of incorporation because people know that they will be paying less in corporation tax than they would have been paying in income tax. As you say, part of the loss of income tax receipts is offset by corporation tax receipts. We do not know to what degree that matters to Scotland, which is seeing the hit on the income tax side—although presumably the impact on the corporation tax side would in some way feed through into the block grant adjustment, from which we steer very clear, as those are deep waters. We have not looked at the Scotland-specific implications, but our Scottish income tax forecasts reflect the judgments that we have made on incorporations in the UK forecast.

The Convener: It is a pity that you said that you steer clear of the BGA, because that is obviously where the question needs to go. There was an agreement on no detriment in the fiscal framework and we have a situation in which the UK Government has introduced policy levers that are encouraging people to choose incorporation to avoid paying income tax—if that is what is going on. The UK Government gets some gain but loses more on income tax, but Scotland loses entirely, because people are moving out of income tax. I wonder—this might be for our adviser to think about—whether that is a fiscal framework issue in the context of the no-detriment principle.

Robert Chote: As I say, judging that is not for us, although I can see why that would be an interesting issue. You would come back to the question of how much of the trend in incorporation is a response to changes in policy, and how much of it is due to the fact that there has always been a differential in the relative tax treatments. What is relevant to the no-detriment debate is whether that is the impact of the underlying policy difference or the impact of the way in which the difference in the relative tax advantage has changed since a particular date, and how much of the underlying trend in incorporation is down to the fact that it is a lot easier for people who work in business services, the media and so on to arrange their affairs in that sort of way. I can imagine hours of entertaining debate on that very subject.

The Convener: It is too complex for me to even think about. I do not know why I went down that road.

Your OBR tax forecasts do not model the UK Government's commitment to raise the personal allowance to £12,500 and the higher-rate threshold to £50,000 by the end of the UK Parliament. What impact will those things have on the forecast for the block grant adjustment and, therefore, the Scottish budget?

Robert Chote: We are constrained by the fact that we produce the forecast on the basis of currently defined Government policy. We have an issue here for the UK, as indeed we do with Scotland, which we need to keep under review: when do we regard a policy as being firm enough to include it in our forecast? We have always taken the view that we need to have a very clear statement of exactly what the Government is intending to do and when it intends to do it. In the UK context, we take those things on board when they appear in the Treasury budget document, not when ministers stand up and say that they have an aspiration to end up here or there. We take them on board when they are concretely put into a budget. What matters is the path towards a particular objective for some year in the future, not just where we end up. Occasionally, we can provide numbers that illustrate what difference it would make if we reached a given end point, and we have done that on the income tax commitment. We have a section in our forecast on policy risks, which I think includes that.

For every forecast that we do, we specifically ask the Treasury, "Is this firm policy? Are you including it in your scorecard of measures?" If it says no, we highlight the point that that commitment has been made, but we do not include it in the forecast.

There is an issue for us here. In the November forecast, we did not take on board any potential Scottish Government decisions on the de facto personal allowance or the higher-rate threshold. There is an issue about when such a decision becomes firm policy. Our view is that, if it is in the draft budget, that is a strong enough commitment to enable us to put it in when we come to do our next forecast in March. Maybe that is not the right thing to be doing—you are greater experts than I am on how firm such things are at different points in the Scottish legislative process, so tell me if it is not. Basically, that is the approach that we are taking.

The Convener: I am not sure that the legislative process is the issue. The real issue is whether a policy can be achieved, given that we have a minority Government.

Robert Chote: A policy sometimes appears in a UK budget but is then dropped afterwards because there is not parliamentary support for it. We put it in when the Government makes a firm commitment and take it out when the Government firmly commits not to implement it.

The Convener: You talked earlier about the productivity conundrum. Does the OBR have any views on what the Scottish Government or, indeed, the UK Government could do? Both are responsible for helping to grow the productivity level in Scotland. Does the OBR have any particular view on how that might be achieved, or is that something that you tend not to comment on?

Robert Chote: Again, it is beyond our remit to give advice on that, but you can look at the sort of things that other people have suggested. I presume that, when the UK Government announced increased support for infrastructure spending in the autumn statement, that was done partly with an eye on the implications that that could have for productivity growth. There are issues about whether the financial system functions well enough to ensure that capital is reallocated effectively away from what can otherwise become zombie firms to firms that have the potential for greater innovation and productivity. Some of the explanations that people had for why productivity performance was so weak over the period immediately following the financial crisis were to do with the dysfunction in the financial system and the fact that we were not seeing the reallocation of capital that we might have expected, and policy measures that would help on that score were mentioned at the time. There is a long list of things that people have suggested around education, training and so on, but it is not our role to comment on that.

I caution that the issue appears to be, in part, a global phenomenon. That should be borne in mind when thinking about what potential domestic policy could do. If the global trend is for less investment opportunity or if the particular type of technological progress that we have seen is not as conducive to investment and GDP growth as it might have been, there may be bigger-picture stories that might not be particularly amenable to domestic policy.

The Convener: That is a helpful note of caution.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): You kindly came to the committee's away day in August, when we were all pretty much in the dark. I have listened to the discussion, and it sounds as though we are still pretty much in the dark. I loved your analogy of the spot-the-ball competition. However, to me, it seems more that you are being asked to fill in a crossword puzzle without being given any of the clues.

Robert Chote: That might be easier rather than more difficult.

Willie Coffey: On page 9 of your executive summary, you say:

> "We have been given no information about the Government's goals and expectations ... And we would not in any event wish to base our forecast on assumptions we could not be transparent about."

Given that we are dealing with the early drafts of economic history that you mentioned in your opening remarks, is there not a challenge for your organisation? If the Government is not going to tell you the detail of its policy plans, will you have to make best-case and worst-case assumptions? I take it that there must always be something to work on. Is there a challenge for you in doing that?

Robert Chote: Yes. Particularly ahead of the referendum, a number of other forecasting outfits tried to imagine a variety of different trade regimes and came up with different sets of assumptions. However, partly because we are required to reach a judgment on whether, under the existing policy, the Government has a better than 50 per cent chance of hitting its fiscal targets, we must have a central forecast. We cannot just say, "It depends on which of a variety of outcomes you end up with." We are constrained by that, and we do what we can to show sensitivity. It is not clear whether it would be consistent with our legislation—and I am not sure how informative it would be—for us to make precisely calibrated estimates of what difference it would make if the outcome of the negotiations was EEA membership rather than some different trade regime. The uncertainty surrounding either of those outcomes would be large relative to the significance of the difference that you might see between the two of them.

10:30

One point to bear in mind is that we felt that it was important to formally ask the Government when we did the forecast whether there was anything additional that it wished to tell us about its goals and expectations for the negotiations. It chose not to and pointed us to some things that it had already said. As you pointed out in your question, I would have felt uncomfortable if the Government had said that it would like us to take three things into account but that we could not share those things publicly. We want to produce our forecast on the basis of assumptions that we can explain to you and to everybody else, so it was really a question for the Government whether it wished to say more to everybody, not just to us. However, even if it had said in much more detail what it was aiming for, given that it is a negotiation, that would not necessarily have been a good guide to what the outcome is going to be.

Partly as a result of the fact that the policy objectives and expectations were not set out in great detail, entirely understandably, plus the fact that that would not necessarily be a good guide to where we ended up, we were led to stick with this relatively broad-brush view. I do not think that we are likely to fine-tune it forecast by forecast, depending on the latest tweak that appears in speeches about where things might or might not go. We will keep that under review as we go along.

Willie Coffey: Is there time for one more question, convener? It is on the pound.

The Convener: On you go.

Willie Coffey: You also mentioned the impact of the falling value of the pound. Your paper says that the depreciation of sterling will boost net trade in the short term. What about the impact on importers? I know a company in Ayrshire that is facing huge import costs. It mainly imports electronics. On balance, what is the effect? Does the falling pound have a more beneficial effect or will it be a short-term benefit only? What can we expect to see in the medium to long term if the pound stays where it is?

Robert Chote: It is a short-term benefit in the sense of boosting net trade. Over the longer term, if we look at the pattern of our share of world markets and so on, we have the short-term exchange rate effect and then the assumption that we have made in the longer term that growth in imports and exports is likely to be weaker over the time horizon that we are looking at than it would otherwise have been because of the transition to new trading arrangements, whatever those end up being.

There is a net boost to economic activity in terms of the volume contribution to GDP growth in the near term. That helps to partially offset the impact of weaker business investment and the squeeze on consumers. Over the longer term, the trade picture is more affected by the assumption—and it is a broad assumption—that import growth and export growth are weaker, and we assume that they are weaker in parallel. The net difference between the two is not changed, but we end up with a less trade-intensive economy that we otherwise would have done over the current time horizon. The story could be different over a much longer time horizon.

The Convener: Thank you very much for coming along today. It has been a helpful and informative session. Thank you for being so candid; that has been helpful to the committee. You said that you would follow up on a couple of things, particularly in regard to the question that Murdo Fraser asked you.

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

10:33

Meeting suspended.

10:37

On resuming—

The Convener: Welcome back, colleagues. Item 3 is evidence on the Scottish Government's draft budget for 2017-18 from Derek Mackay, the Cabinet Secretary for Finance and the Constitution.

I will outline for the record the committee's approach to the draft budget process. Until 2016-17, our predecessor committee's scrutiny of the draft budget tended to focus on the expenditure side of the budget, and all elements of the draft budget were covered in a single evidence session with the cabinet secretary. However, as a result of the increased powers over taxation that have been devolved to the Scottish Parliament, it has been agreed that the scrutiny of the draft budget will take place over two separate oral evidence sessions, with one considering the revenue side and the other considering expenditure. We will therefore focus this morning on the revenue side of the budget; we will have the chance to ask questions of the cabinet secretary on expenditure at our next meeting, which will be on Monday 16 January.

I welcome the Scottish Government officials joining Mr Mackay: Aidan Grisewood is deputy director of the fiscal responsibility division; James McLellan is the fiscal adjustment team leader; and Simon Fuller is acting deputy director of the office of the chief economic adviser.

Do you wish to make an opening statement, cabinet secretary?

The Cabinet Secretary for Finance and the Constitution (Derek Mackay): I will make some brief remarks, convener. Thank you for the invitation to speak to the committee on taxation specifically. This is obviously a significant draft budget, given that our spending plans relate to revenue generation under the new powers.

We all want to ensure that Scotland remains attractive to live, work and invest in, and that we have resources to sustain our public services.

With regard to our tax proposition, we hold true to our principles on certainty, convenience, efficiency and ability to pay. Having outlined a forecasting methodology and many of the assumptions that we have made, our position is transparent. I appreciate the work and effort of the Scottish Fiscal Commission, which has worked through our forecasts. The draft budget document outlines the position on the fiscal framework, and there is a chapter on tax, which includes a look at a number of the assumptions that were made. We all know that the new budget process under the fiscal framework is complex, but I hope that it is accessible.

Our key decisions include our proposals to freeze income tax rates and to increase the higher rate threshold in line with inflation, which we believe—as with all our taxation positions—is a responsible, balanced and progressive approach. On business rates, I have not insisted on a revenue-neutral revaluation. That has implications, but I have proposed to cut the poundage and to raise the threshold for both the large business supplement and the small business bonus. Although this is not necessarily a matter for the budget, the position on the council tax is clear. I have listened to this and other committees on their positions on council tax and attainment. We will maintain the rates and bands for the land and buildings transaction tax. Landfill tax rates have been uprated in line with the retail prices index.

Those are the key points from the position that I have set out to Parliament. I am happy to take questions.

The Convener: This is an historic budget, cabinet secretary, as you are the first Scottish minister to have the privilege—if that is the right word—to propose rates and bands for Scottish income tax. With that privilege comes challenge and responsibility, because it means that the budget is now much more dependent on the performance of the Scottish economy relative to the performance of the UK economy. Can you give the committee some insight into how that has changed the way that the Scottish Government has approached this year's budget process, the draft budget and plans for future years? In particular, to what extent does the budget process need to focus more on longer-term macroeconomic issues such as productivity growth, which this committee has taken a fair bit of evidence on over the course of the past few weeks?

Derek Mackay: That is a fair question. I am sure that all parliamentarians were always interested in sustainable economic growth and all the related factors and determinants. However, because we are largely no longer just a spending Parliament, the relationship between tax and spending is more significant. Ministers—and all parliamentarians—have had to think more deeply about that relationship and about the decisions that we take on tax powers, as well as on spending. Ministers have had to consider their portfolio decisions and how to stimulate the economy and how to support it, our population and public services. We have to ensure that we arrive at the right decisions to deliver sustainable economic growth.

A focus on the population and all the other factors that the Government now has to consider when arriving at policy decisions is also important, as is understanding the drivers and forecasts that inform that work. We are highly dependent on forecasts, but what matters even more are the outturn figures. Although we work to forecasts, it is the outturn figures that are assessed to determine what the Government receives after all the adjustments take place. I hope that we all understand the complex nature of that.

The key point is that ministers and the Government are minded to look at all the issues when considering how we grow the economy. We have to ensure that there is a positive cycle of return and that we have resources to spend on public services, rather than diminishing resources.

The Convener: In terms of productivity, the Scottish economy outgrew the UK economy for many years. That has not been the case in the past couple of years, particularly due to the impact of the North Sea oil downturn. The issue for us in the future—it is an issue of particular interest to the committee—is relative growth in the UK and in Scotland. What additional measures has the Government introduced to grow GDP in Scotland?

10:45

Derek Mackay: The economy is still a shared issue: the UK Government has control over a great number of economic levers, while the Scottish Government can also do certain things. We are taking action across a range of portfolios. On business rates, for example, I have described our competitive regime around the small business bonus scheme and changing the thresholds in the large business supplement, cutting the poundage and reducing the level for everyone. Therefore, we have a supportive package on business rates and non-domestic rates; the commercial side of land and buildings transaction tax is very competitive, too.

There are other elements of support to the business community, such as the Scottish growth scheme or—and this is an approach that the Government might not have taken in the past—specific Government interventions to support individual areas, such as steel or shipbuilding. Those are just two examples.

We are also focusing on the enterprise agenda. We have an economic strategy on exports and the growth opportunities that exist there. We are also supporting our significant and growing tourism market.

In all our portfolio areas, we are trying to support economic growth to try to improve our position, to realise the economic opportunities that exist and to grow the tax receipts. Of course, there are vulnerabilities. You have touched on oil and gas, and the situation in that sector has had a profound impact on tax receipts and the economic growth forecasts. There is also the productivity challenge. Since devolution, there have been improvements relative to the rest of the UK, but there is much more to be done in that area, too.

We are taking specific business interventions. We are also trying to support the economy through research and development, by attracting foreign direct investment and by ensuring that Scotland is an attractive place to live, work and invest in through every measure that we can.

The Convener: Unfortunately, Adam Tomkins is not so well today, but if he were here, he would probably want to ask about city deals, which he has raised with a number of people. I have an interest in that issue from a Stirling perspective. I want to ask about the Government’s approach to city deals. How important can city deals be in helping to drive forward the Scottish economy?

Derek Mackay: I would describe city deals as being organic, because there is no set formula on what proportion those involved pay or how such deals have emerged by way of numbers. As well as engaging with the appropriate partnership or local authority, the UK and Scottish Governments work together to arrive at a deal. The deals differ from area to area.

City deals are quite potent in delivering and unlocking economic growth. The first big city deal, which, of course, was Glasgow and Clyde, was largely about infrastructure, although it had employability strands, too. I was involved as the then Minister for Local Government and Planning. There was good partnership working and local leadership. The deal largely consisted of locally led projects supported by finance, with all the necessary checks and balances, including the assurance framework between the UK and the Scottish Governments.

Arguably, city deals have unlocked resources from the UK and Scottish Governments and put them into projects that should make a difference. They have a methodology, particularly for the most advanced deal, around how we assess their economic benefits. I think that they can deliver sustained economic growth, and we are encouraging further talks on all the other proposed city deals.

Budget provision materialises when the deal is done and we then factor in when resources are programmed to be released.

The Convener: This is my final question on GDP issues. You have said that GDP is a joint responsibility between the UK and the Scottish Governments. You have outlined the Scottish Government's approach. Do you have any particular asks of the UK Government in terms of useful measures to boost the economy and GDP in Scotland?

Derek Mackay: In debates, we have touched on some of the work in the oil and gas sector—specifically around tax relief, incentives for further exploration and support for decommissioning. There are a range of things that could be done just in that sector. There is also a wider debate about the appropriate use of borrowing to support capital investment.

I welcome the UK Government's change of heart on further capital investment. I believe that capital investment has sustained large parts of the Scottish economy through a very difficult period, and we have plans for on-going capital investment in infrastructure and so on.

The UK Government could take a wider look at the appropriate use of borrowing. We have a position on the current budget balance, specifically on oil and gas; support could be given for that sector. We have engaged with the chancellor on those points.

The Convener: Does anyone else want to pick up on productivity issues before we move on to wider tax issues?

Ash Denham: Yes, I do. As the convener mentioned, we had the OBR in this morning, and we explored with Robert Chote the productivity growth rate, given that it is such an important assumption that underpins the growth forecasts. The OBR is assuming a return to productivity growth of 2 per cent in five years, and I believe that the Scottish Government forecasts follow that.

As the convener said, a few years ago productivity was growing at a higher rate in Scotland in comparison with the UK. Do you have any comments on where you think the Scottish productivity rate is going? Will it mirror the UK rate, or will it be behind or maybe even ahead?

Derek Mackay: Our experience is that the oil and gas sector specifically has impacted on the Scottish economy the most. The forecasts are saying different things because we are using different methodology with different drivers and determinants. That is not necessarily a reflection of the Scottish economy—it is in part a result of the different forecasting methods, models and determinants that are used.

We would all want to drive up productivity. Some of that comes down not just to the number of jobs or the number of people in employment but to the quality of jobs and the need to improve in areas such as research and development and foreign direct investment. All that will help to improve the overall structure and distribution of employment. It will produce more efficiency, and further expand the sectors that can help to contribute towards productivity.

The Convener: James Kelly has a related question.

James Kelly: I think that we all agree that promoting economic growth is very important. I am interested in some of the forecast figures. As Ash Denham mentioned, we had the OBR in earlier. The OBR forecasts that growth will rise by 0.3 per cent from 2017-18 to 2018-19, and by 0.4 per cent from 2018-19 to 2019-20, to 2.1 per cent. Between 2017-18 and 2018-19, the Scottish Government forecast goes up from 1.3 per cent to 1.6 per cent, which is quite similar to the OBR increase. However, between 2018-19 and 2019-20, the Scottish Government forecasts an increase of only 0.1 per cent, whereas the OBR forecasts an increase of 0.4 per cent. Why is growth tailing off at that point?

Derek Mackay: I believe that it is largely due to the methodology rather than to any major event. I have my forecasters here with me, so they can explain some of the detail around the difference. We are not suggesting that economic growth would in itself necessarily be slower or less successful; it is about the assumptions and methodology that are used to arrive at the different figures. Simon Fuller can probably assist with that.

I watched the committee's evidence session with Robert Chote this morning, which I think was a helpful session. He helpfully pointed out the fact that we use different models. Of course, the figures are all forecasts. Perhaps Simon Fuller can assist you in understanding that.

Simon Fuller (Scottish Government): To add to what the cabinet secretary has said, when we do our forecasts, from approximately 2018-19 onwards, we assume that Scotland's economy will gradually return to its trend rate of growth of approximately 2 per cent. It will rise from about 1.6 per cent in 2018-19 up to about 2 per cent, which is about the long-run average, by the end of the forecast period in 2021-22.

There are a number of judgments that underpin that forecast with regard to some of the short-term effects unwinding and our return to longer-term trend levels of growth, productivity, wages and such like.

As the cabinet secretary said, the model that we use is different from the OBR's model. The underpinning assumptions are different, and the manner in which the model itself operates is slightly different. A combination of the differences in the underlying model and framework, and some of the different judgments that the OBR has made in its longer-term forecasts, explain the overall difference.

I would not want to put words in the OBR's mouth with regard to why it has assumed larger growth in future years, but we have essentially assumed a gradual return to our long-term trend from 2018-19 onwards.

James Kelly: I understand that different models will give you different results and that there are different assumptions.

Earlier, it was explained to us that the UK economy, which has some holes in parts, would slowly start to grow. The OBR's forecast shows steady growth from 2017-18 to 2020-21. I was particularly interested in the figures for 2018-19 and 2019-20, which show the UK figure growing by 0.4 per cent and the Scottish figure growing by 0.1 per cent. I am not clear about the modelling and the assumptions, even after your explanation. You said that, overall, the figure would grow to 2 per cent. However, why does growth seem to become somewhat stunted in 2018-19 to 2019-20?

Simon Fuller: I can explain why we have assumed a gradual level of growth throughout that period. When we go from 2016-17 to 2018-19, we have a relatively fast increase in growth—we assume that growth increases from 1 per cent to 1.6 per cent, which is faster than the OBR assumes at the UK level. That is the period during which we think some of the output gaps in Scotland will close and the spare capacity in Scotland will be dealt with. After that, we think that the rate will gradually slow down to a longer-term average. That is what we have been assuming. It may simply be that the time period over which we think that that change will occur differs from the period that the OBR has in mind. For example, I suspect that if you look over a slightly longer period—for example, from 2016-17 to 2020-21—the overall evolution might be similar over both forecasts, although there will be slight differences in the time periods when it is assumed that various events will occur.

Obviously, there is a lot of value in looking at changes from year to year, but it is sometimes quite difficult to point to one single event that drives a difference in forecasts from one year to another. It is sometimes easier and more informative to look at the longer-term change over a three or four-year period, which will be driven more by the fundamentals.

The Convener: Dean Lockhart had a question on productivity.

Dean Lockhart: Actually, it was on income tax forecasts—it was a supplementary question to James Kelly's question. Do you want me to leave that to later?

The Convener: Yes, if it is to do with income tax. I will let Murdo Fraser in at this stage.

Murdo Fraser: Cabinet secretary, I was taken by what you said earlier about the need to recognise the underlying performance of the Scottish economy as a key driver for the tax take going forward, which involves a change from where we have been historically. In this budget, you have taken the decision to create a tax differential with the rest of the United Kingdom in terms of income tax, and you will be aware of concerns that have been raised by business organisations, among others, that that sends out a message that Scotland is the highest-taxed part of the United Kingdom, which might have an impact on our ability to attract investment, for example. However, I do not want to get into the politics of that—

Derek Mackay: You just did.

Murdo Fraser: Yes, but what I want to do is look at the context of that decision.

The Scottish Parliament information centre has told us that, next year, your budget will be up by £501 million in real terms on the current year. Do you agree with that figure?

Derek Mackay: In this one year there is a real-terms increase as a consequence of the decisions from March last year, in terms of resource, and the decisions about capital that were announced by the chancellor in his autumn statement. There is a real-terms increase for one year, but that must be looked at in the context of a 10-year period of real-terms reductions, which represent a 9.2 per cent real-terms reduction over that period. I just mention that for completeness, Mr Fraser.

Murdo Fraser: I was just going to get on to that subject, but thank you for accepting that you have got an extra half a billion pounds in next year's budget that you do not have in the current year.

As you mention the historical context, let me take you to a helpful table in your budget document that gives the total Scottish Government budget from 2010-11 to 2017-18—it is an extremely long table in annex G that takes us from page 169 to a summary on page 172.

That table shows that, in 2010-11—the starting point—the Scottish Government's total budget was £34.2 billion in rough terms. It dips a bit, then it comes back up. Your draft budget for 2017-18 has a figure of £37.95 billion. It does not look to me like there is a cut there.

11:00

Derek Mackay: In the total period since the Tories came into office, there has been a real-terms reduction.

Murdo Fraser: With respect, that is not what the table shows.

Derek Mackay: There is a real-terms reduction in our discretionary spend.

Murdo Fraser: With respect, the table in your budget document shows that, in the period that you are talking about, from 2010-11 to 2017-18, the budget goes up from £34.2 billion to £37.9 billion. Where is the cut?

Derek Mackay: I say to you again, Mr Fraser, that there is a real-terms reduction in our actual real-terms spend when it comes to the financial power that we have.

Murdo Fraser: So why is your budget document telling me something completely different?

Derek Mackay: It is not. Those figures are accurate in terms of the outturn.

Murdo Fraser: Hold on a second. This is your budget document, which you have published. There is a table in it that tells me that, in 2010-11, the Scottish Government's total budget was £34.2 billion, and your draft budget for 2017-18 shows a figure of £37.9 billion. How is there a cut? Have you got your sums wrong?

Derek Mackay: No, I have not. There is a real-terms reduction over the period from when the Tories entered office of about 9.2 per cent in terms of our spend.

Murdo Fraser: You have said that three times, but that is not what the table demonstrates.

Derek Mackay: I am telling you what the overall reduction is in the real-terms spend.

Murdo Fraser: How can we believe anything in your budget document if there is such a fundamental error in the presentation of the figures?

Derek Mackay: It is not a fundamental error. Those are the DEL figures as we have expressed them to you.

Murdo Fraser: Where are they in the table?

Derek Mackay: The departmental expenditure limits are covered within the position that I have outlined in the draft budget.

Murdo Fraser: As you will be well aware, departmental expenditure limits are only a part of your budget. The figures contained in the table are the total budget figures, which show a substantial increase in your spending power since 2010-11. Is that not the case?

Derek Mackay: I have covered the point around the total managed expenditure and how the spending power of the Scottish Government has been reduced in real terms since the Tories entered office.

Murdo Fraser: That is not what your budget document says. It says quite the opposite.

Derek Mackay: I covered that in the statement to Parliament. That is the position: we have had a reduced settlement over a 10-year period from 2010-11. I have explained the point that, between the resource and the capital, there is a real-terms increase for the forthcoming financial year, but that is set in the context of reductions since 2010-11.

Murdo Fraser: Could any of your officials help?

The Convener: I think we have had enough ping-pong here. The cabinet secretary has made his point, and you have made your point. I call Patrick Harvie.

Derek Mackay: I thought that Mr Fraser was touching on the income tax position. It is important that Mr Fraser mentioned divergence in terms of tax. He has put out quite a negative message about the position on tax.

Our position—that we are not passing on the tax cut for some of the richest in society in terms of the higher-rate threshold—is the right thing to do. Given current income levels, 99 per cent of adults will pay no more tax than in 2016-17.

The Conservatives have put out the message that Scotland is high tax. I think that that is unhelpful, given that in fact it is the wider package that is important when it comes to taxation and to quality of life in Scotland. Perhaps the Conservatives should not put out that message. Scotland continues to be a good place in which to live, work, invest and do business.

The Convener: There is an inevitability about the process at this stage.

Patrick Harvie: I will talk about tax as well, but perhaps from a slightly different perspective from that of Mr Fraser. What are the objectives of the Scottish Government's income tax policy?

Derek Mackay: We arrived at our tax position by considering expenditure, the policies that we wish to achieve, delivery of the manifesto and the new tax powers that we have to help to balance the position. We have taken a fair and reasonable approach on taxation that uses our powers responsibly.

We do not believe that it is right to pass on the Tory tax cut with regard to the higher-rate threshold; rather, we want to have certainty and stability on rates. At this time of uncertainty, we are providing continuity on the rates and bands while ensuring that we will generate more income by adopting a different tax position from that of the UK Government. Following the block grant adjustment, that will generate around £79 million.

Patrick Harvie: I am not really interested in the UK Government's income tax policy for its jurisdiction; I am interested in the Scottish Government's income tax policy for Scotland.

You mentioned as an objective raising enough revenue for your manifesto commitments and you talked about stability, but you did not say anything about progressive taxation and closing the inequality gap. Is that part of the objective of your Government's income tax policy? Is progressive taxation Scottish National Party policy? Does the zero-change position on income tax rates and bands reflect the fact that your view is that income tax policy is sufficiently progressive at present?

Derek Mackay: What we have put through is what we included in our manifesto, on which we were elected. That is our current proposition, but decisions on our income tax policy are, of course, taken year to year. In my opening remarks, I covered the principles that we follow, one of which is proportionality to people's ability to pay, and progressivity is part of that.

Patrick Harvie: Your zero-change position implies that you think that income tax is sufficiently progressive at present.

Derek Mackay: I said that our position on income tax remains under review. For example, we have said that we will look at the evidence, the assumptions and the analysis on the additional rate to ensure that, if we took a different approach to it, we would not lose any income. The position that we are putting forward is the one that we outlined in the draft budget, which comes from our manifesto for the election.

Mr Harvie said that he is not particularly interested in what the UK Government does, but there is a relationship between that and the block grant adjustment. We need to make sure that what we do raises revenue and that we do not take an unnecessary risk. However, I repeat that progressivity is certainly part of the mix and that our position will remain under review.

Patrick Harvie: Why is it a good idea, for example, for there to be only one income tax rate between the personal allowance and £43,000?

Derek Mackay: We are not proposing to change the bands and rates at this time. I do not believe that the structure that we inherited—which the Government can change—is absolutely perfect, but I think that the public and taxpayers face a lot of uncertainty at the moment. The principles of certainty, convenience, efficiency and progressivity in terms of the ability to pay are all important. We can have further discussions about what the income tax structure ought to look like, but we believe that what we have proposed commands the support of the people through the election.

Patrick Harvie: I recognise that, as you put it, you inherited the current system, but the proposals in the budget are your policy proposals. We are talking about the rates and bands that your Government is proposing. Why is it a good idea for only one rate to exist between the personal allowance and the high-income threshold? Why would it not be a more progressive idea to reduce income tax for low or even average earners and to increase it modestly for those who are on higher incomes up to the high-income threshold?

Derek Mackay: I know that Mr Harvie's party has different proposals on income tax, as do the other parties. Among those proposals is the proposal to raise the basic rate. We are not proposing to do that; we are proposing to freeze the rates. We feel that that is fair at this time and that our proposition gives us and taxpayers certainty and reliability in relation to income.

It is true that the Parliament has been empowered to change the rates, the bands and the thresholds if it so chooses, but what we have put forward provides stability and certainty. We are not passing on the tax cut through the change to the higher-rate threshold that the Conservatives have proposed, and that is the right balance to strike at this stage.

Patrick Harvie: You keep using the phrase "passing on", but no passing on is involved; there is the setting of Scottish income tax policy by your Government and by a rate resolution that will be passed by the Scottish Parliament. That will be set here in Scotland; it is not about passing anything on.

You have talked about increasing the threshold for the higher rate by the inflation rate, but that is the maximum of what your manifesto said was to be considered. It said that the higher-rate threshold would increase

"by a maximum of inflation."

Why are you doing the maximum of what you set out in your manifesto as worth considering?

Derek Mackay: We are making the change in line with inflation. As I said, we will take tax decisions year on year—that is the position that we have put across at the moment.

Patrick Harvie: The question is why.

Derek Mackay: The figure is to be in line with inflation. That feels like the right thing to do in a balanced way.

Patrick Harvie: Why?

Derek Mackay: Because it feels like the right thing to do.

Patrick Harvie: It feels like the right thing.

Derek Mackay: That is our judgment of what is fair and balanced. Mr Harvie has a different view on the structure of income tax, but we feel that what we have set out fits with our manifesto commitment, commands the support of the people, is fair and gives certainty at this time.

Patrick Harvie: Why increase the higher-rate threshold by inflation but not the additional-rate threshold? If a principle was involved in sticking to inflation, surely you would do both rather than do one but not the other.

Derek Mackay: We did not have in our manifesto a commitment to changing the additional-rate threshold. I am delivering the manifesto commitment that I was elected on.

Patrick Harvie: With respect, I am asking for reasons why rather than references.

Derek Mackay: One of the reasons why is that a change to the threshold for the higher rate generates more income than a change to the threshold for the additional rate, because of the number of people who are paying that.

Patrick Harvie: Are you saying that increasing the threshold increases the revenue? Surely it decreases the revenue.

Derek Mackay: The point is in terms of the block grant adjustment position relative to the rest of the UK. What we do is relative to what the UK Government does on tax policy.

Patrick Harvie: I am sorry, but are you saying that increasing the higher-rate threshold by inflation will increase the revenue from higher-rate taxpayers? Surely the opposite is true.

Derek Mackay: I am saying that, because of the block grant adjustment, what we do is relative to what the UK Government does, so the figure that we arrive at is in relation to the UK figure. That is why I have used the language of not passing on the Tory tax reduction, which will change the higher-rate threshold to a higher level than will be the case in Scotland. That is what generates the difference.

Patrick Harvie: Do you accept that freezing the threshold would generate more revenue than your policy proposal of increasing it by inflation will?

Derek Mackay: Yes.

Patrick Harvie: Finally, I will talk about higher-rate taxpayers. Of course, we all have an interest to declare, because we are higher-rate taxpayers. We are all better off because of the UK Government's decision to increase the personal allowance. The poorest people in society gain nothing from that, but everybody up to the £100,000 mark, which is where the effect of the personal allowance starts to decline, is better off because of the change in the allowance. There have also been pay settlements since your manifesto was written, and higher-rate taxpayers, including us, are seeing their incomes increase by inflation or above. They will be better off again if we increase the higher-rate threshold by anything at all. Why do we need to look after higher-rate taxpayers in that way, when we are not giving a tax reduction to low earners?

Derek Mackay: To be frank, we believe that we are supporting low earners through our position on freezing the basic rate. I know that Patrick Harvie has a view about what the UK Government is doing on that, but our position is not to increase the basic rate in Scotland. As for the higher rate, I have set out our position on the thresholds.

Patrick Harvie: Your budget document states that the

> "increase in the higher rate of income tax threshold, when combined with the increase in the personal allowance, means that low and middle income taxpayers will be protected".

How on earth are low and middle-income taxpayers protected by an increase in the higher-rate threshold? They are not at all affected by it.

Derek Mackay: We are not putting the basic rate up—that is my point. Other parties proposed—

Patrick Harvie: The sentence that I quoted from your budget document is not about the basic rate. You said:

> "This increase in the higher rate of income tax threshold, when combined with the increase in the personal allowance, means that low and middle income taxpayers will be protected".

Such taxpayers are not in any way affected by the higher-rate threshold.

11:15

The Convener: Patrick, I have been pretty kind to you in giving you space to ask your questions, but—

Patrick Harvie: I appreciate that.

The Convener: That was your final question, and this will be the final answer to you.

Derek Mackay: Let me put it simply. Basic-rate taxpayers are protected, in that we are not putting up the basic rate of tax, as was proposed by other parties but not by the Government.

Ash Denham: Some of what I will raise might have been touched on. You decided not to increase the additional rate in this budget, at a time when public finances are under pressure. Will you talk about the factors that fed into that decision?

Derek Mackay: The key issue is whether raising the additional rate would generate more income and bring us the benefit of an increased tax take. Albeit that the income would come from the richest in our society, the point of the approach would be to raise income, and the analysis was that there was a risk, in that a movement of as much as 5 per cent among Scottish taxpayers, through whatever mechanism, would mean that we no longer raised the income, so the policy would be counterproductive. That assessment led the Government to the opinion that it was not appropriate to increase the additional rate at this time.

However, the policy remains under review. We will ask the Council of Economic Advisers to look at the assumptions and consider what would mitigate the risks, so that we are in a position in the future to make a judgment on what an increase might generate.

Neil Bibby (West Scotland) (Lab): The Government and the First Minister have said that they support an additional rate of 50p but are not proposing such an increase this year, for the reasons to do with behavioural impact and negative effect that you have just set out. As things stand, for you to support a 50p additional tax rate in Scotland, would it require the chancellor to propose a 50p additional rate for the whole UK?

Derek Mackay: I first make the point that all members have to understand the block grant adjustment and the outcome of the fiscal framework, which is that decisions are no longer taken in isolation in Scotland and it is not just a case of what we decide to do about tax equalling what we spend—everything relates to what happens in the UK in terms of tax and the block grant adjustment. If the chancellor were to make a different decision on the additional rate—although what you propose does not look like a decision that Philip Hammond will make any time soon—we would have to look at our position, given that tax decisions must be taken from year to year and in the context of what the UK Government is doing.

We have to ensure that we will actually raise revenue. There is a political judgment to be made about what is acceptable and what is required to fund public services. In the past, my colleagues in Westminster opposed the reduction in the additional rate. We will keep the position under review in the context of the Scottish budget, based on an analysis of what an increase would generate.

I am not dismissing the issue when I say that what we do on income tax must take account of what the UK Government is doing and that, if the UK Government decides to put up the additional rate, we must take our decision in that context. However, I do not think that the current UK Government will make that its first tax option.

Neil Bibby: A number of experts have said that it is difficult accurately to quantify the behavioural effects of a tax change without introducing the change. You have said that you will not introduce a 50p tax rate this year for the 17,000 richest people in Scotland, but you have not ruled out doing so in this parliamentary session. There is a suspicion that you have no intention of raising the additional rate at any point in this session.

A 50p tax rate could raise up to £100 million. You have said that it could raise £50 million or cost the Scottish Government £30 million. You said that you are waiting for more analysis of and evidence on the effects. What exactly are you waiting for? What has to change in the analysis that you have to lead you to support a 50p tax rate for people who earn more than £150,000 a year?

Derek Mackay: Any reasonable person would want an assurance that such a rate would actually generate income and more certainty about the level of income.

Decisions on tax, including income tax, will be taken year to year. In our manifesto, we made it clear that the position on the additional rate will remain under review, and it will. We will bear in mind all the advice that we receive on scenarios and the certainty of tax collection, and the best analysis on tax behaviours and minimising tax avoidance, and we will ensure through Her Majesty's Revenue and Customs that we have assurances about residency and that we do not have taxpayers moving elsewhere to avoid any increase in the Scottish rate of income tax.

The first position is certainty about how much the tax will raise and whether it is positive for Scotland. All the other issues that are taken into account when determining a tax policy are about what we spend and what is required to balance the books.

Neil Bibby: Will you clarify something? You said in response to Ash Denham that, if there was a 5 per cent reduction in additional rate taxpayers in Scotland because they were paying tax in the rest of the UK or wherever, that would reduce revenue to the Scottish Government.

Derek Mackay: Yes.

Neil Bibby: My understanding was that you modelled two things and that a 5 per cent reduction would actually result in a £50 million increase in revenue.

Derek Mackay: The information that I have is that the analysis that was published in March showed that, for 2017-18, losing only 1,000 or around 5 per cent of additional rate taxpayers would mean that the 50p additional rate raised no extra revenue.

James Kelly: You said at the start that you have taken progressive decisions. Is it not the case that, because you have shied away from using the Parliament's new tax powers progressively, councils will have less money and will therefore need to make cuts, which will affect local jobs and services?

Derek Mackay: Local government has had a fair settlement, which I will continue to engage with the Convention of Scottish Local Authorities on. I have also written to ask each local authority whether it has accepted the offer, and the deadline for responding to that is 20 January. The total package for local government services is strong and fair.

Like other public services, local government will have to deal with a financial situation that means increased pressure on services and with all the extra pressures that come along, such as the UK Government's decision on the apprenticeship levy. The local government settlement is good and strong and we have got the balance right. If it was such a bad deal for local government, I am sure that COSLA would have rejected it.

James Kelly: I will not go through the local government expenditure issues, because we will have a separate session on that. This meeting is about revenues and you have made certain tax choices, based on which you have had to map out your budget. Because you have limited how much you will look to raise through taxation, there will be cuts. Even SNP politicians have acknowledged that councils will have less money to spend. As a consequence of your taxation decisions, there will be cuts in local government's budget and people in communities will suffer because of that. Do you recognise that?

Derek Mackay: There are more resources for local government services and, when we get into talking about expenditure, I will be happy to cover that authority by authority, if Mr Kelly so wishes. I will be able to show how the package of support to local authorities is fair and how it will support local services. Between non-domestic rates, council tax and the Government settlement, along with extra support through initiatives such as the attainment fund and its targeting of education, the settlement package is fair and will be supported by local communities. There will be more resources for local government services as a consequence of the draft budget.

James Kelly: Let me put it another way. What drove you to reach your taxation decisions, which will raise an amount of money that I argue is limited, although you argue that it is adequate? What was the thinking behind the taxation policy, given that it has consequences for the rest of the budget?

Derek Mackay: A Government's first point of reference is surely the manifesto on which it was elected. Of course, we are a minority Government and any budget will have to get Parliament's support, but our first position is to look at the manifesto. That is covered through the programme for government and delivering on the commitments and policies.

In doing that, we look at our tax position and what we put it to the people that we would do on revenue. We work on that simultaneously to produce a budget that considers our commitments and our policies for revenue and taxation. We ensure that there is enough resource to adequately fund our public services and meet our commitments and we undertake taxation in a fair way that ensures that Scotland is competitive and attractive, so that we deliver a fairer country.

James Kelly: You did not stand on a manifesto of cuts to local jobs and services, so surely you should set your tax plans accordingly.

Derek Mackay: I have described how we have put more resources into local government services, and I am happy to describe that in more detail when we cover expenditure. That includes the work in the integration joint partnerships on health and social care integration, which I assume that there is support in Parliament for.

We are putting in more resources through the changes that we have made on council tax and through the ability to raise council tax by 3 per cent. All of that will mean real money—real cash support—for local government services. I say again that local government has had a good, fair and strong deal from the draft budget.

I do not dismiss the fact that there are challenges in the public sector—we all face challenges in these difficult economic times—but the settlement is a strong one in which we have looked at the issues before us and given local government a large degree of protection.

The Convener: There are a couple of supplementaries on this area.

Willie Coffey: Cabinet secretary, will you outline for us some of the other ways in which taxes in Scotland across the board are actually less than in the rest of the UK? I am thinking about things like the council tax, for example, which is 12 per cent lower in Scotland than it is in England; in Wales, it is apparently 32 per cent higher—things like that. Tuition fees are effectively a tax, business rates are lower in Scotland and prescription charges are effectively a tax, so the notion that Scotland is the highest taxed part of the UK is really nonsense when we look across the broad horizon of elements that impact on the money that is in people's pockets.

Derek Mackay: I would even point out that the income tax proportion for higher-rate earners is 10 per cent, so I do not accept the charge that Scotland is the highest taxed part of the UK, certainly in the context of everything else—the quality-of-life policies and social contract issues, some of which Mr Coffey touched upon. People are not more highly taxed if they need free personal care, want to go through university or happen to be sick and need a prescription.

On council tax, even after the changes that the Parliament supported around the multipliers and potential council tax increases, on average it will still be less than it is in England. That shows that Scotland remains attractive.

Looking at the totality of our tax and spend policies, I think that we have struck the right balance. We believe in a social contract whereby people contribute to society but get certain social benefits at the point of need.

The Convener: Does Dean Lockhart want to come in on this area?

Dean Lockhart: My question is on income tax forecasting, if this is the right time for that.

The Convener: Ivan McKee, is your supplementary directly related to what has just been going on?

Ivan McKee: I was going to talk about what Willie Coffey covered and touch on some of the stuff from earlier as well.

The Convener: We will come back to Dean Lockhart after Ivan McKee.

11:30

Ivan McKee: I thank the cabinet secretary for coming to the meeting. I want to ask about support for business, but before I get to that, I want to clarify stuff that was talked about earlier on, when Murdo Fraser was talking about cuts to the budget.

If I am not mistaken—it is important that we clarify this—Murdo Fraser talked about table 4 in the draft budget, which includes total Government spend. That is not just the settlement from the Treasury; it also includes borrowing and tax revenue, for example. Obviously, the table is in cash, not real terms. Even when we take the numbers in that table over the seven-year period, they demonstrate a cut in real terms. However, the important number, which we are talking about, is the settlement from Her Majesty's Treasury. Table 1.01 shows that that has gone from £29.6 billion in 2010-11 to £30.9 billion in 2017-18, which I think is only a 4 per cent increase in cash terms. Table 1.02 lays out very clearly the real-terms change in the DEL settlement from HMT which, over the seven years to 2017-18, is a 7.4 per cent reduction. As the cabinet secretary correctly said, there is a 9.2 per cent reduction over the years to 2019-20. Is that a fair summary of the reality of the situation?

Derek Mackay: Yes, it is, but I do not think that Mr Fraser is happy with that answer.

Murdo Fraser: I will come back in, if I may.

Ivan McKee: I just wanted to clarify that for the record.

Murdo Fraser: Could—

The Convener: Let the cabinet secretary respond first. I will then let you ask your question.

Derek Mackay: Yes, the tables cover the points that Mr McKee raised, and I covered them in the statement in which I gave more information on the total discretionary budget. We can argue about the relative cuts to Scotland's budget and what we have received.

Murdo Fraser: Mr McKee said that if we look at the real-terms figures, we can see that there is a real-terms cut, but I do not believe that that is correct. SPICe very helpfully gave us comparative real-terms figures—in 2016-17 prices—for looking at the total Scottish Government budget. Those show us that, in 2010-11—this is in 2016-17 prices—the outturn was £37.229 billion in real terms and in the draft budget, the figure for total spend is £37.401 billion in real terms. Therefore, the total budget is up on that for 2010-11 in real terms. That reinforces my point that your claims about austerity and cuts are somewhat lacking in evidence.

Derek Mackay: Well, I—

The Convener: I would like that to be clarified. That is the same figure that is in the table on page 172, is it not? It includes annually managed expenditure, over which you have no discretion.

Derek Mackay: Yes. There is no discretion over AME. It is needs based and is drawn down—

Murdo Fraser: But it is still part of your budget.

Derek Mackay: It is needs based and is quite different from the discretionary spend that the Government has at its disposal. Mr Fraser knows the difference.

Murdo Fraser: Yes, but that is still part of your total budget.

Derek Mackay: It is quite different from the discretionary—

Murdo Fraser: The total budget has gone up in real terms.

Derek Mackay: That is quite different from the discretionary spend that the Government has at its disposal.

The Convener: This is groundhog day.

Derek Mackay: I know that Mr Fraser is trying to level the argument that the benevolent UK Government has always been kind to Scotland and we deserve no more resource, but I would argue quite differently.

Murdo Fraser: I am simply demonstrating what the evidence shows us, cabinet secretary.

The Convener: Did Ivan McKee finish his question?

Ivan McKee: No. I had not even started it. [*Laughter*.]

The Convener: On you go.

Ivan McKee: That is the point that I was making. The total budget is not the issue; the settlement from HMT is the issue, which is a completely different number. The Scottish Government has managed to keep things on a level keel in real terms over the period because of what it has done in other areas to generate revenue. There has been a significant cut in what has come from Westminster.

My main point is about productivity and growth, which is obviously a key issue. Will the cabinet secretary go into a bit more detail—the issue has already been touched on—on support for business relative to that in the rest of the UK and on making Scotland the most attractive place in which to do business, whether through business rates, the small business bonus or the land and buildings transaction tax from a non-residential point of view?

Derek Mackay: I was able to cover some of the business rates decisions around cutting the poundage overall. Not insisting on a revenue-neutral revaluation comes at cost, but it is the right thing to do in terms of that poundage reduction. There is the increase in the thresholds for eligibility for the small business bonus. It is anticipated that that will take 100,000 properties out of rates altogether. I know that others wanted me to go further with changes to the large business supplement, but I was not able to do that. The changes include increasing the threshold to £51,000. Matching that will ensure that around 8,000 properties are taken out of it. That is a comprehensive package on business rates.

I described separately the initiatives around the Scottish growth scheme, a focus on attracting further investment and a focus on recalibrating our economic strategy to target growth opportunities.

On-going capital investment has made a difference in difficult years, particularly through infrastructure spend. That very much continues, and some of the major projects are coming to completion.

We have touched on the city deal work and there are financial mechanisms that I want to continue with and that I want to explore, such as tax increment financing and growth accelerator models. Other things include guarantees that the Government has been able to provide, which have supported specific interventions.

As I said, there will be further work to support our productivity, such as work from the enterprise agencies on digital and bespoke packages for companies. We have a particular direction of travel on the business pledge, part of which is about quality, the living wage, accreditation and so on. A range of measures will support productivity.

A major impact that we have discussed at this committee has been that on oil and gas. We should not leave the decommissioning opportunities to someone else, for example, but should try to ensure that we have a strong part to play in them.

Dean Lockhart: One of the key things that we need to do on economic growth is to encourage companies to scale up, but the large business supplement acts as a disincentive for companies to grow beyond a certain size. Even after increasing the threshold, 20,000 businesses in Scotland are still subject to the large business supplement, which, for companies of that size, makes Scotland the highest-taxed part of the UK. Is not changing the threshold nine months after the policy was introduced a recognition that the tax has failed and is damaging business, as the Scottish Retail Consortium said?

Derek Mackay: Mr Lockhart has helpfully changed the language of the Tory position: he says that Scotland is not the highest-taxed part of the UK but is the highest-taxed part of the UK just for properties of—

Dean Lockhart: I was speaking in the context of this tax.

Derek Mackay: Fair enough, Mr Lockhart, but I know that your language was more accurate when you were saying that it was just for properties of that size—apart from the fact, of course, that the poundage for those properties comes down, because the overall poundage comes down, which benefits every ratepayer who is paying non-domestic rates.

In an ideal world, I would not have a higher level of large business supplement, but that would come at a cost. I would put the question back to the Conservatives and ask them what they would replace it with. Removing it would come at a cost and would require resources to come from elsewhere in the budget or in tax to pay for it.

I believe that the package that I have come up with is fair and proportionate: it has protected small businesses and it will lift more businesses out of taxation. There is a poundage reduction for everyone, and fewer people will pay the large business supplement. Of course, those paying it would rather not have the differential rate, but the overall package is very competitive and good for Scotland.

Dean Lockhart: Do you recognise that the higher rate could act as a disincentive for companies to expand beyond a certain level? It might not make good economic or business sense to scale up if they would expand beyond a certain level. I return to your economic case on the vital need for our companies to scale up. Last year, 13 organisations wrote a letter to you, saying that the tax is damaging business. Is there not a recognition on the Government side that the tax is damaging the expansion of business in Scotland?

Derek Mackay: First, business rates would be only part of a company's decision either to upscale or to move, so I do not think that it will be a major impediment to business growth—especially as, generally speaking, it is less expensive to do business in Scotland than it is in England. It has to be taken within that context, along with all the other issues that will be taken into account when a business decides to grow.

Of course, many of the organisations that signed the letter on the large business supplement will welcome the change in the threshold that is part of this budget. I wonder whether the Conservatives will be voting against the change in the threshold, because I think that it has been welcome, as have some of the other measures in relation to business rates in my budget. I do not think that the large business supplement is a major impediment to growth; it has been collected and, within the wider context, there is a very competitive business rates position—I am reducing the overall poundage and there are all the other measures that I have spoken about.

However, I have reflected on the views that the business community has given me, which is why I am proposing a change to the threshold. To go further would mean a tax rise elsewhere or a reduction in public expenditure, and I am interested in what the Conservatives think those should be.

Dean Lockhart: The SRC said that this budget has

"fumbled the opportunity to ... reverse"

the

"doubling of the Large Business Rates Supplement",

which it says is damaging business. That is the latest feedback from business on its reaction to even the increased threshold.

What was the rationale behind choosing £51,000 as the increased threshold? Was there a particular reason why £51,000 was chosen?

Derek Mackay: As it happens, the £51,000 figure matches the threshold in England, so it feels like an appropriate figure. That is the reason why I chose that figure.

On the SRC's opinion on the wider package of business rates, if you look at its view on the overall approach to taxation, you will find support for some if not all of the policies in the draft budget.

The Convener: Willie Coffey wants to come in. Is your question a supplementary on this before we move on to borrowing?

Willie Coffey: No, it is on growth schemes.

Maree Todd (Highlands and Islands) (SNP): I had some questions on borrowing.

The Convener: We will start with Willie because that is still about productivity issues and then we will move to Maree on issues to do with borrowing.

Maree Todd: I also have a supplementary on small businesses.

The Convener: Okay—I will let Willie go first, then you can come in with a supplementary on small businesses and move on to borrowing.

Willie Coffey: Cabinet secretary, there was a discussion earlier about growth schemes and the impact that they could have on regenerating local economies. As you know, the Ayrshire economy lags behind the Scottish economy on a number of factors. There has been support from the Scottish

Government for the Ayrshire growth deal but, as I understand it, there has been no equivalent statement of support for the Ayrshire growth deal from the UK Government—there was certainly nothing in the autumn statement.

Is that the current position as you understand it, and will you give me an assurance that you will continue to press the case for Ayrshire and press the UK Government to match the commitment that you have already demonstrated?

Derek Mackay: I appreciate that Mr Coffey is probably advancing a constituency interest there but in fairness, convener, I think that you mentioned a Stirling growth scheme city deal—

The Convener: I do not think that I actually used the word "Stirling" but I am glad that you did.

Derek Mackay: Talks about the Ayrshire growth scheme are on-going. The Scottish Government is engaged in that process. I did not see anything in the chancellor's autumn statement, although of course he pointed out to me that it is a statement, not necessarily a full budget, and this year there will be two budgets—maybe there will be a mention of it in that. We continue to work on it.

I described the scheme earlier as organic and quite bespoke and I think that it will be another example of a bespoke arrangement. We are continuing to engage as a Government, particularly my colleague who has the lead on it: Keith Brown, the economy secretary.

Maree Todd: I welcome the protection that you have introduced for small businesses. What impact do you expect the relief measures for rural and renewables businesses to have on growing the economy?

Derek Mackay: I wanted to ensure that on rural relief and digital, we could at least match what the UK Government was doing so that we were not at any disadvantage. The UK Government needs to provide further clarity on exactly how it will work but certainly the policy intention is to match it. Of course, that is in addition to all the other measures that I described earlier.

Maree Todd: Thank you.

11:45

The Convener: Do you want to ask about borrowing as well?

Maree Todd: Yes. We will talk next week about our new borrowing powers and what we want to spend. Do you intend to use the new borrowing powers that are available to the Scottish Government?

Derek Mackay: Yes, we intend to use them—we will use our new powers from the Scotland Act 2016 to the max. Our proposal is to set out further spending plans around borrowing and we fully anticipate using the powers to the cap of £450 million. We are also mindful of the aggregate borrowing cap of £3 billion. We intend to use them over the course of the year.

The Convener: As colleagues have no more questions, I thank the cabinet secretary for coming to give evidence this morning. We look forward to seeing you again on Monday. We now move into private session.

11:46

Meeting continued in private until 11:54.

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