



OFFICIAL REPORT
AITHISG OIFIGEIL

Culture, Tourism, Europe and External Relations Committee

Thursday 9 February 2017

Session 5



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CULTURE, TOURISM, EUROPE AND EXTERNAL RELATIONS COMMITTEE
5th Meeting 2017, Session 5

CONVENER

*Joan McAlpine (South Scotland) (SNP)

DEPUTY CONVENER

*Lewis Macdonald (North East Scotland) (Lab)

COMMITTEE MEMBERS

- *Jackson Carlaw (Eastwood) (Con)
- *Ross Greer (West Scotland) (Green)
- *Rachael Hamilton (South Scotland) (Con)
- *Emma Harper (South Scotland) (SNP)
- *Richard Lochhead (Moray) (SNP)
- *Stuart McMillan (Greenock and Inverclyde) (SNP)
- *Tavish Scott (Shetland Islands) (LD)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Professor David Bell (University of Stirling)
Professor David Heald (University of Glasgow)

CLERK TO THE COMMITTEE

Katy Orr

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Culture, Tourism, Europe and External Relations Committee

Thursday 9 February 2017

[The Convener opened the meeting at 10:00]

European Union Referendum (Implications for Scotland)

The Convener (Joan McAlpine): Good morning and welcome to the fifth meeting in session 5 of the Culture, Tourism, Europe and External Relations Committee. I ask members and the public to turn off their mobile phones. Members who are using electronic devices to access committee papers should ensure that they are turned to silent.

Today we continue to take evidence on the implications for Scotland of the European Union referendum result. I welcome our witnesses to the meeting: Professor David Heald, professor of public sector accounting at the University of Glasgow; and Professor David Bell, professor of economics at the University of Stirling. Thank you for coming to give us evidence today. I invite Professor Bell to make an opening statement.

Professor David Bell (University of Stirling): Thank you for the opportunity to speak to the committee. In the past week or two, I have been taking an interest in the EU budget and what might happen after Brexit. Although the United Kingdom is a net contributor to the EU budget, a fair amount of money comes back to the UK. A large proportion of that is what I would call area based; in other words, it is tied to specific parts of the country. The main elements of that are things like agricultural payments, the European regional development fund and the European social fund. The amounts that are received are determined by different rules.

Post-Brexit, one question will be whether to retain those mechanisms. There are arguments for and against retaining them. Some argue that we should go down the New Zealand route as far as agriculture is concerned and effectively not protect our agriculture industry at all. Equally, others argue that the structural funds have not been effective in achieving the objectives that they were intended to achieve and that the case for retaining them is not strong. That argument is out there.

Let us suppose that those mechanisms are retained in some form or other. It seems to me that, in that case, a number of decisions would have to be made. First, who sets, and how, the

quantum for each of the policies? Would we expect to spend the same amount of money on support for agriculture as we have in the past? It is not entirely clear whether the amount of money that goes to the different funds is appropriate for the objectives that they set themselves.

Having set the amount of money, the question is how it would be divided between the four nations. In terms of the common agricultural policy, for example, the rule that was applied to the most recent budget round was simply to keep the same proportions as we had in the previous budget round. It did not really look at anything objective about the state of the agriculture industry in different parts of the UK; rather it was a line of least resistance—"Just do the same as you did before."

There is a question about doing that, because the EU allocates its other forms of area-based funding—the ERDF and the ESF—using quite strict criteria, namely the 75 per cent of average EU gross domestic product. Areas qualify for ERDF and ESF funding in different ways if their GDP is between 75 and 90 per cent of the EU average. The UK has nothing quite so objective in terms of rules about allocating money to different parts of the country.

A decision needs to be reached about that allocation, and the possibilities for that include passing the money through the Barnett formula, allowing the devolved Assemblies and Parliament to retain more tax revenue or having some objective metric that determines how much each part of the UK gets. Remember that, in the past 20 years or so, Scotland's economy has outperformed that of other parts of the UK. Now only west Wales and Cornwall qualify for the highest levels of support whereas, in the past and under the previous rules, the Highlands qualified.

If the money is divided, who sets the rules about how it will be distributed? The EU has worked with the devolved Assemblies and Parliament in some instances to, in effect, determine who gets what. Scotland has gone its own way on agriculture policy and so on. In the past, the devolved Administrations have had considerable sovereignty as far as the administration and general running of the area-based funding.

My basic conclusion is that a lot of decisions have to be made. It will be important to understand how the different levels of Government in the UK are negotiating the change in responsibilities, because there will be lots of opportunities for conflict.

The Convener: Thank you. As you have indicated, Scotland has punched above its weight on the allocation of EU funding that comes here. I note from our Scottish Parliament information

centre briefing, which is very useful, that we get 44 per cent of fisheries funding, 18 per cent of common agricultural policy pillar 2 funding and 16 per cent of pillar 1 funding. We also get 8 per cent of structural funds, which is equivalent to our population share. Overall, SPICe calculates that Scotland gets 14 per cent of the UK's EU funding, which is obviously considerably more than our proportion of the UK population level. What is the likelihood of us getting the equivalent of that 14 per cent back? If it is likely, how will it be delivered?

Professor David Heald (University of Glasgow): Whatever gets repatriated from the EU, the critical issue is the relationship between repatriated functions and how they are financed. If you look at the public expenditure statistical analysis on a per capita basis, you see that the index for Scotland is about three times the size of the index for England. There is significantly higher expenditure in Scotland on agriculture, fisheries and forestry than there is in the UK on average and it is particularly higher than the expenditure in England.

If the money that the UK will not send to Brussels sticks in the Treasury and Scotland is to get functions that were previously run by Europe, the question is how Scotland gets the money to finance those functions—that seems to be the critical, central issue.

The Convener: Obviously, you have observed for many years how the Treasury operates fiscally in its relationship with Scotland. Given your experience and expertise, what do you think the likelihood is of the funds being repatriated by the Treasury?

Professor Heald: We are in such strange times that I think that any kind of forecast is completely perilous. I think that, on balance, the Treasury has run the Barnett formula fairly honestly. Aside from specific issues such as the Carter review of prisons and the Olympics, the system has broadly run on an informal, non-statutory basis and the Treasury has largely kept to the rules. That has been enormously beneficial to the Scottish Parliament with regard to its discretion about its budget. However, we are now getting into areas of very deep politics because the whole agricultural policy was set at European Union level, so what we were talking about in the UK was delivery, which was largely done by the devolved Administrations for the devolved areas and by the UK Government for England.

The question will be whether the UK Government decides that there will be a common policy for the UK single market in agriculture as in other areas. There is a very big question around what the attitude will be. That point is separate from David Bell's point that there will probably be

big arguments about the nature of the British economy after Brexit. In that regard, he referred to the issue of New Zealand in the 1980s and the removal of agricultural subsidies, which was what some people on the leave side were arguing for in the run-up to the referendum. My view is that all bets are off about what the policies will look like.

The Convener: Many people on the leave side also said that Scotland would automatically get full control of EU competencies for agriculture, fisheries and the environment.

Professor Heald: I would rather not delve too deeply into the politics. People said an awful lot of things during the referendum that were fairly reprehensible.

The Convener: Professor Bell, do you want to come in again before I go to members for more questions?

Professor Bell: On areas such as fishing and farming, comparisons of amounts per head of the population are not necessarily useful. Scotland just does more farming because it has lots more area and it does more fishing because it has more abundant seas nearby. If the arguments about reducing agricultural support overall or reducing the kinds of support that are provided by the ERDF and the ESF prevail, Scotland will be particularly exposed in relation to farming but less exposed in relation to the ERDF and the ESF because, as has been said, Scotland's proportion relative to its population is not much different from its population share.

Tavish Scott (Shetland Islands) (LD): I thank David Bell for his paper on agriculture, which was really useful to read yesterday. If you were advising, on the one hand, the National Farmers Union of Scotland and, on the other hand, the Scottish Government, what would you say would be the best funding formula to achieve the current £400 million that we currently spend in Scottish agriculture? Put aside all policy issues on freedom to farm, supporting crofters or whatever. If you just go with the money, how could we best ensure that what we currently get in Scotland is delivered after whatever is going to happen in the future happens?

Professor Bell: Agriculture is in a particularly difficult position. That is partly because, as I pointed out, it is dependent on EU CAP subsidies for between a third and a half of its income. If that was to disappear, we would have to have very significant restructuring of the agriculture sector in Scotland, which would clearly be difficult for many communities.

10:15

Agriculture's main export markets are in Europe rather than the States, Australia or wherever, so, if it wants to compete on an even footing with European farmers, and CAP subsidies are reduced, that will inevitably force it into driving up prices, which means that it will lose competitive advantage against European producers.

On the other hand, if the UK goes into deals with third countries such as Canada or Australia, those countries will pressure the UK to reduce tariffs and income support for farmers. Agriculture is probably the most contested area of all in how trade between countries operates. The World Trade Organization has laboured long and hard to try to reduce tariffs and levels of protection for agriculture and has not been all that successful in doing so. As I have shown in the paper that I have provided, very significant tariffs protect European agriculture. Some are as high as 80 per cent.

The issue is difficult. My advice to the NFUS would be to try to retain as much of the status quo as possible, as that would mean income being retained and agriculture not being at a competitive disadvantage in relation to the European market, which is its main market. I do not know whether that is a feasible position because, in negotiations, the European Union might insist that that does not happen. It could reconsider the tariff barriers for agricultural products. That might hit some of the EU's own trade, but a trade-off between politics and economics is clearly going on in Europe just as much it is going on in the UK.

Tavish Scott: That is helpful. You would accept that the Barnett formula will never be the way to achieve the spend objectives in agriculture in Northern Ireland, Wales and Scotland. By any objective measure, what we would get for agricultural spending in Scotland through Barnett would be less than what we currently get.

Professor Heald: It depends on what you mean by the Barnett formula.

Tavish Scott: Broadly 9 per cent.

Professor Heald: The Barnett formula has become more complicated over time. It started off being really quite simple. Let us take the example of railways.

Tavish Scott: Can we stick with agriculture? I am not really interested in railways.

Professor Heald: Please let me finish my point. When the Scottish Parliament got responsibility for railways, there was a block transfer. The existing spending on rail in Scotland was moved into the block—it was transferred in—and the Barnett formula was applied to increments.

The obvious problem with that approach is that, given all the uncertainties, it would put farmers into competition with nurses in spending priorities. We cannot just say that Barnettising means that we will get only the population proportion. On past precedent, the existing spend would be moved into the Barnett formula—into the block—and then the Barnett formula would be used according to the fiscal framework for subsequent changes. The problem is that, because of all the uncertainties that we are talking about, agriculture would be quite unpredictable.

Tavish Scott: There is therefore an argument for not putting it into the Barnett formula and keeping it as a separate transfer to the devolved Governments.

Professor Heald: We have to think about the broader policy position. I started my comments by making the point that we need to think about the relationship between taking on the functions and getting the finance. Not making contributions to the European Union sticks as a benefit to the Treasury. There is then the question of who has policy control.

You can think of all sorts of arrangements whereby the UK Government had control of agriculture, fisheries and food in a policy framework sense, but where delivery was done by the devolved Administrations and by the Department for Environment, Food and Rural Affairs for England. There are many variants. For example, funding could be put into annually managed expenditure outside Barnett.

I have been arguing for devolution for 40 years and I have a track record of wanting to take as many functions as I can get, but we have to think about this territory carefully. I would only recommend taking on policy control of agriculture if the financial arrangements were to come at the same time. It could be quite dangerous were we to have that policy control without securing the financial arrangements.

Tavish Scott: Policy control in London would be a reverse of devolution.

Professor Heald: Policy control would be a reverse of devolution in that particular context, but we live in strange times.

Richard Lochhead (Moray) (SNP): In that discussion, there is an assumption of a relationship between the share of the budget post-Brexit and policy. Is it not the case that, on agriculture, the UK Government could simply divorce policy from the share of the budget that is allocated to Scotland? It could say that, although 14 per cent of the funding came from Europe, once we are out of the European Union, Scotland should get its population share irrespective of the budget, because agriculture is devolved, and that

the Scottish Government should just take the money and do what it wants with it. There is no relationship between policy and the share of the budget. Therefore, the UK Government can reduce dramatically the amount of money that goes towards agriculture.

Professor Bell: That does not chime with what has happened with the transfer of functions over time. For example, effectively, the Barnett formula has been adjusted downwards or, with the new tax powers, by the exact amount of tax that is being raised. It tends to operate on precedent rather than on the current population share.

I agree with David Heald's earlier point about the Barnett formula. Currently, £600 million or so is spent on the CAP in Scotland. If agriculture were put into the Barnett formula, the Barnett allocation to Scotland would increase by £600 million. In the following years, any changes to spending on agriculture in England would have an impact on Scotland. If, for example, spending went up by 2 per cent in England, there would implicitly be 2 per cent added to that £600 million for Scotland.

The problem is that agriculture is a much less important issue for England. Actually, it is not all that huge or an important issue for the Scottish economy, as it accounts for less than 1 per cent of Scotland's GDP. The figure is even smaller for England's GDP, and it may take the view that it does not matter so much. You could end up in a situation in which, if the money going to agriculture in England is not increasing but there are reasons to try to increase the amount of money going to agriculture in Scotland, you would be raiding other budgets in Scotland to make that happen.

Richard Lochhead: Agriculture underpins the food and drink sector, which is a much larger share of Scotland's GDP.

Professor Bell: Sure.

Richard Lochhead: The UK Government could take the decision that it does not want to support agriculture. That would impact negatively on the Scottish budget, irrespective of the policy that is adopted in Scotland.

Professor Heald: Yes. The whole fiscal framework since devolution in 1999 has been non-statutory.

Richard Lochhead: Exactly.

Professor Heald: As I said, all has been done relatively consensually. There have been arguments about specific points but, basically, precedent has been followed.

If there were separate policy control in the four jurisdictions and the UK Government decided that it was going to go down a free-market line and not

support agriculture, the policy risk would be the high budgetary costs if the Scottish Government decided that it wanted to continue to support agriculture.

Professor Bell: There is the clash of local control over agriculture and the role that agriculture plays in trade negotiations. Trade negotiations with the US could involve arguments that direct payments to farmers in the UK should be reduced—or eliminated, because they do not exist in the States. US farmers could say that competition would not be fair and ask that direct payments to farmers be reduced. That would have an effect on what could be done locally to develop agriculture policy in Scotland.

Richard Lochhead: My final question relates to transparency. The public in Scotland and the Scottish Parliament will want to know what the UK pays into and what comes back from Europe and whether Scotland will get its fair share post-Brexit. My experience of those issues is that there is a lot of smoke and mirrors. How easy will it be for Scotland to hold the UK Government to account on those figures?

Professor Bell: That will be quite tricky. You may not know that some local authorities in England took the UK Government to court—I think that it was about the ERDF allocations to different parts of the UK. They argued that Scotland, Wales and Northern Ireland were getting too much funding and that the EU's intention had been to provide more funding to the north of England than it had received. Their argument failed in court. That is an illustration of the arbitrary, informal or smoke-and-mirrors nature of what goes on.

The existing frameworks do not fill me with confidence that people will be happy about the information that they receive and their understanding of the process whereby big sums of money are allocated to different parts of the UK. There is a need to open that up.

Professor Heald: I know much less about the detail of agriculture than many people in the room. I found the SPICe briefing that came with the committee papers helpful in that regard.

When it comes to agricultural support, it is relatively clear what is coming into the Scottish budget. Other European payments have, obviously, been coming into other parts of the Scottish economy. I am not in a position to know how transparent those are.

Lewis Macdonald (North East Scotland)

(Lab): I want to move the focus a little further on to structural funding, because there are important issues in that area. First, David Bell said in his introduction that it is difficult to identify from the evidence that structural funds have achieved their objective. I suppose the one case that might be

offered against that in the Scottish context would be the Highlands and Islands, where the combination of Highlands and Islands Enterprise's efforts and the use of European funds has moved the Highlands and Islands from the bottom end of the European scale to somewhere nearer the middle. Is the case for structural funds contentious?

Secondly, given the north of England example that you cited, is it in the interest of those areas in Scotland that benefit from structural funds for them to be measured objectively on criteria that apply across the UK, or is it more likely to be advantageous if there were an allocation post-2020 that would then be addressed within Scotland alone?

Professor Bell: As a highlander, I probably agree with you that the EU has had a significant effect on the Highland economy. However, most of the evaluations that have been done are Europe-wide, although some have been UK-wide, and certain pockets of the European economy in particular—Portugal, some parts of Spain and some parts of Italy, for instance—seem to be resistant to improvement, so perhaps that has been an important context for the views that the structural funds have not achieved their objectives.

10:30

Of course, what the structural funds' objectives are is a further question. The one that most people would accept is the cohesion argument: the need to reduce spatial inequalities across the EU. Others have argued that the structural funds are important generators of overall national economic growth. That argument has been contested hotly in recent years by some who argue that the area-based funds are not that useful and that a more effective way to enhance national growth is to concentrate our money in cities because there we get what are called agglomeration economies.

We can see a clear line of that thinking into some of the policies that the UK Government is following, such as the cities approach. The northern powerhouse strategy is not about an area but is focused on particular cities. If that is part of the background thinking of the UK Government and Treasury, they may think that providing support to broad areas is money not well spent and that it is better to concentrate improving infrastructure and skills on cities or agglomerations of cities.

In principle, I am in favour of using objective criteria to determine who gets the money. Once we get into what end up being negotiations between local authorities and the Government, whether the Scottish Government or the UK Government, and provide support to one of the

city initiatives, it becomes difficult to understand why that initiative has it against some other potential candidate and difficult to evaluate it. At the end of the day, what were the objectives and what would have happened if the money had not been given? If we are implementing policy, we want to be able to evaluate it and determine whether it is a success so that we can put more money into the successful policies and not into the unsuccessful ones.

Lewis Macdonald: I deduce from that answer that there is no certainty that the UK Government or a future Scottish Government would accept the current model on which structural funding is based.

What about the short-term aspect of structural funding? Between now and 2020, the amount of money committed is less than, or just about, half of the money that is allocated to Scotland. Within that half, an even smaller proportion has actually been spent, so can we be confident that the further £400 million that has not yet arrived will arrive under the guarantee that the UK Government has given on structural funding? What are the implications for public bodies—local authorities, universities and others—in Scotland that have to raise match funding for that spending to go ahead? If there is a real difficulty in delivering the existing structures before Brexit, that will have significant implications for the future.

Professor Heald: My expectation is that nothing will change very quickly. On the whole, I would trust the UK Government to fulfil its guarantees about what will happen up until 2019-20. Given that all the talk is about Brexit, the issue will probably be around whether people lose heart about applying for EU funds. In particular, there is the issue of finding the match funding.

If one looks at the Institute for Fiscal Studies green budget, which was released earlier this week, we are talking about a period of about 15 years—three parliamentary sessions—of fiscal austerity in the UK. That is unprecedented in the past 100 years. There will be intense pressure on all public spending. One is seeing manifestations of that in the crisis around the national health service in England. There will be a period of intense pressure and there may well be an issue around persuading people to release the match funding and persuading them that applying for funds is worth the effort, as it is very resource intensive and there is substantial uncertainty about what will happen.

On balance—as in the earlier discussion about the Barnett formula—the Treasury has, on the whole, played the game fairly straight thus far. However, as I said earlier, we are in very strange times.

Lewis Macdonald: Is that your view as well, Professor Bell?

Professor Bell: Broadly, I would agree—in particular about expectations and how people change their behaviour, particularly in the run-up to 2020. There are more worrying signs in the scientific community about what the role of UK academics might be in future European projects.

The Convener: The structural funds are in euros. With the fall in sterling, does that put extra pressure on organisations that may be considering match funding? I understand that the value of the structural funds has increased because sterling has fallen.

Professor Heald: It means that there is more purchasing power from the European funding but the match funding is higher—yes.

The Convener: Thank you. This committee is quite unusual in that, completely randomly, we happen to have three members who are from the south of Scotland. There was a plan in the south of Scotland, which was quite well developed by local authorities and the Government, to create a new statistical European area under nomenclature of territorial units for statistics 2—NUTS 2. Presumably the motivation for that was that eventually the area would be in a good position to obtain additional structural funds. Where would that plan be now? I do not know whether you are aware of it. Is it underwater?

Professor Bell: There has been a rejigging of various boundaries in different parts of the UK over the years. I suspect that the UK Government will not feel constrained by European statistical conventions, which is worrying in itself but is particularly worrying in relation to how any area-based funding might be distributed in the future. The Government may go for something that relates more to the structure of government in different parts of the country, which might be local authorities or combinations of local authorities. I do not imagine that the NUTS conventions will survive Brexit for too long—I would be surprised if they did.

Professor Heald: There is a broader issue. One of the ways in which the UK Government is kept honest is the fact that Eurostat—the European Union's statistical agency—monitors the UK practices in national accounts and general Government finances, particularly in the context of the excessive deficit procedure.

You do not have to be a member of the European Union to follow the European system of accounts 2010, but Eurostat probably takes less interest in the countries that follow ESA 2010 and are not part of the European Union. For some time, I have been conscious of the fact that the Treasury, from time to time, puts pressure on the

Office for National Statistics about classification decisions. If I was running the ONS, I would say to the Treasury that it might press us but it would also have to get past Eurostat. However, when Eurostat is no longer as highly relevant, we may have significant difficulties on the statistical side.

Lewis Macdonald: I have one more question on structural funds. In responding to earlier questions, you made the point that, because agriculture will come into trade negotiations, the UK Government will have a direct interest in issues such as income support. Is there a conflict in the decision to support through structural funding either our less-developed regions or, alternatively, city regions? Is there an international or external aspect to that, which would be affected in the same way?

Professor Bell: You are coming close, but I do not think that there will be an impact on issues such as state aid and public procurement rules, which almost inevitably form part of trade negotiations. However, things such as the ESF and the ERDF tend to be a step back in terms of their being infrastructure support or general support for skills. A certain amount of ERDF funding goes into small and medium-sized enterprises, but I do not think that trade negotiations worry much about SMEs. Providing a big chunk of money to, say, a car company, which, in effect, subsidises it to compete with the country that you are trying to do a trade deal with is the sort of thing that really matters in trade negotiations.

Lewis Macdonald: So, it is not directly—

Professor Bell: No, I do not think so.

Ross Greer (West Scotland) (Green): You covered the subject substantially in your answers to Lewis Macdonald's questions, but I would like to pursue the point about structural funding and the need to match fund. As has been mentioned, around £400 million needs to be match funded over the next few years. However, our public finances in Scotland are now much more directly tied to the performance of the Scottish economy and we expect Brexit to have an impact on the Scottish economy in the next two years—before Brexit actually happens. What do you expect the Scottish Government to do about that?

Professor Bell: The impact would happen through differences in per capita tax revenues. The amount of money that the average income tax payer in Scotland pays to Her Majesty's Revenue and Customs compared with the equivalent south of the border determines what is called the block grant adjustment, which is where the issue of the relative performance of the Scottish economy matters. If Brexit pulls the whole British economy down, there will not be much effect on Scotland's

funding as such, because the block grant adjustment will fall, meaning that less will be taken out of the Scottish budget.

The question is whether Scotland will do differentially badly for whatever reason. In the past two or three years, we have seen Scotland do differentially badly largely because of the downturn in the oil industry, which is a shock that has hit Scotland more than it has hit the rest of the UK. My guess is that, in the period up to 2020, our finances will be very constrained—as David Heald has indicated—but we may not do massively differentially badly compared to the rest of the UK, because the amount of income tax collected per head may fall in both parts of the country.

It is a problem for the match funds, however, because those amounts have already been set and their value has increased. The same issue certainly applies in England, and it will apply even more in Wales, which gets far more per head in support from ERDF and ESF than Scotland does. I do not know what action the Welsh Government will take in that respect. I guess that I am saying that the situation is bad, but it is not catastrophic.

10:45

Professor Heald: Although I agree with David Bell's emphasis on the differential between per capita tax revenues in England and Scotland, there is also the absolute effect that, if the economy does worse, we are more likely to get more spending cuts passed through the Barnett formula. One of the striking things in the IFS green budget this week was that it said that, by 2019-20, the UK ratio of tax to GDP is forecast to be the highest since 1986-87. The IFS has talked about further public spending cuts, or further fiscal adjustment, of £40 billion. The differential between Scotland and England matters, but if Brexit has a very bad effect on the UK economy as a whole, there will be more fiscal adjustment at UK level, which will then feed through to the Scottish budget.

Ross Greer: At First Minister's question time a few weeks ago, a question was posed about what forecasting the Scottish Government should be doing on the impact on our public finances. As is the nature of FMQs, it was posed on the spot, so we would not necessarily expect a comprehensive answer at that moment. If you were in that position, what forecasting would you be doing for the short-term period of the next two to three years and for the five to 10 years that will come after Brexit?

Professor Bell: I am not sure that I would be forecasting because, as David Heald said, we live in very unusual times and the past is now not necessarily a good information basis on which to

project the future. However, I would be trying to get information on the issues that seem critical to me and that we have been discussing, such as whether the structural funds will continue and whether agricultural support will continue and, if so, how it will be organised and funded. That is the first set of questions. I would go through the Scottish economy sector by sector. Assuming that we will enter into trade negotiations with country X, I would consider what its strengths are and what it would expect from the bargaining, because there will be give and take—the UK will not just get what it wants. Going through the Scottish economy sector by sector is an important exercise to think about in the relatively short term.

Jackson Carlaw (Eastwood) (Con): I should have come in slightly earlier, because I want to go back to a point that was raised earlier, although the witnesses have touched on it again.

Professor Heald, in your discussion with, I think, Tavish Scott, you said that there will not be a retrospective application of Barnett and that the precedent suggests that existing funding will be transferred. However, you said that, if the Barnett formula is the mechanism that is used in relation to agriculture, there would actually be a progressive reduction in the overall support, although of course the Barnett formula is highly valued in respect of other sectors in Scotland. You then said to, I think, Ross Greer that this is one area that would need to be thrashed out and agreed. If the situation that you described happened—the precedent is applied and the sum is transferred across—what funding formula should the committee advocate to protect the sector if we were to progress on the current basis?

New Zealand has been mentioned several times, in passing. What happened to the New Zealand agriculture sector in the years subsequent to the removal of support?

Professor Heald: As I said, I am not a specialist in the field, but my understanding is that New Zealand did exceptionally well after that. Agriculture is obviously enormously important to the New Zealand economy—there are lots of sheep.

Let me come back to my area of expertise. I was explaining how the arrangements could be Barnettised, but before we think about the financial arrangements, we have to think about what the UK Government intends in relation to policy control. There is a long spectrum between going for a free market in agricultural products and broadly continuing the present level of spending on agricultural subsidy. We do not yet know whereabouts on the spectrum we will be, and then there is the question of the extent to which the devolved Administrations will get legislative control

and the extent to which they will continue to have a delivery responsibility.

If the UK Government wants a smaller public sector, it is obvious that all parts of public spending are going to have a very difficult future. One of the significant problems that the UK economy has—and many other economies have—is that tax revenues have done very badly since the 2008 global recession. It is not just a question of what the Government has done on tax; it is the fact that the recovery has been pretty weak and has not been very tax rich. There are complicated factors behind why that is, and all parts of the public sector face a difficult future.

Professor Bell: Speaking from my agricultural background as a potato inspector, the New Zealand agriculture sector has done very well. Of course, it had to restructure a lot. In addition, its neighbour—albeit not a close neighbour—east Asia, whose economy has thrived in the past 20 years and which has an enormous demand for food, has changed its eating habits quite a lot, which has been another part of New Zealand's success. It is not obvious that Scotland would have such opportunities.

Rachael Hamilton (South Scotland) (Con): My question is a supplementary to Ross Greer's question. It is clear that we need a strong economy. Would it be foolhardy to create a separate, Scottish system for CAP—and separate systems in the other devolved Administrations—when 85 per cent of Scotland's agricultural exports go to the domestic market? Would such an approach create barriers that would inhibit an important market on which Scottish agriculture relies?

Professor Bell: At the moment, the main element of CAP is the direct payment to farmers, which is not related to output. What you need to think about is whether that is an appropriate way to remunerate farmers and what you want farmers to do and not do. I guess that you do not want them to damage the environment and that you want them to help to sustain rural communities, ecological diversity and so on. I would start from those first principles when thinking about how to support agriculture.

The existing system, which is basically a direct payment for the number of acres that a farmer has, serves mainly to increase the price of land. It makes it more difficult for new entrants to get into farming, because the capital cost that they face is so much higher. Farmers, in general, are old.

If I was designing my own equivalent of the common agricultural policy, I would think very carefully about what it is that farmers do and would try to provide them with incentives to do the kind of things that we want them to do. I suspect

that we will end up with a restructuring of the industry. If farmers are to survive, they will have to be competitive, so they will reorganise themselves in such a way that they have structures that will allow them to continue to compete in domestic markets.

Professor Heald: It is striking that agricultural policy has not worked particularly well. There was a very critical Audit Scotland report last year, and an equally critical report from the European Court of Auditors. There are big problems around policy, objectives, implementation and enforcement. I do not know enough about the sector to have developed policy views on what to do.

The Convener: I have a supplementary. Eighty-six per cent of farming land in Scotland is classified as having less favoured area status. The Scottish Government has continued payments for less favoured areas. Do you think that, if there was a UK-wide approach, less favoured area status would continue in Scotland, given that it is currently being phased out in England?

Professor Bell: I am not an expert, but I have seen Scottish Government documents that indicate that payments per acre in Scotland are way lower than payments in other parts of the EU, given the way in which the overall moneys that come to the UK have changed over time and the way in which different areas are classified.

I suspect that, if we were starting with a blank slate, we would not go down that particular route. However, as I said in my previous answer, there is, in a sense, an opportunity for the UK as a whole. Perhaps Scotland—with good reason—will be able to set its own policy, because the farming circumstances here are quite different.

The Convener: I will press you on that. Eighty-six per cent is a pretty big figure for the proportion of land that has less favoured area status, so it is clear that there are different priorities for agriculture in Scotland and in England.

Professor Bell: That is true, and I would take it to the next level: what exactly is the priority? Is it to ensure that rural communities are able to continue? Is it to protect Scotland's scenery, or to protect biodiversity? I would start at that level and then go down to discuss whether some of the land should be classified as having less favoured area status. Much of Scotland's land is not very productive per acre, so we would, if we were going to provide support at an area level, have to put in place some sort of system for dealing with that.

I suppose that I am saying that, while Scotland may be disadvantaged at present, there is now an opportunity to think very carefully about what the whole system is trying to provide.

Professor Heald: Economists of a free-market disposition might be inclined to reply to the question by saying that agriculture should stop in those areas, but there are very big social and economic issues involved. Scotland makes up a much bigger proportion of the UK landmass than its proportion in population terms, so it is clear that there are big issues. Although agriculture is not a large part of the Scottish economy, it is of much greater political significance.

The Convener: I guess that that is what I am getting at. It is not that the system is perfect just now—as you have clearly said, that is not the case, and there is an opportunity to create a better system. What I am getting at is the question of where that should happen. We were reassured that responsibility for agriculture would remain with Scotland after Brexit, and it would seem that Scotland would be best placed to design a new system for Scottish farming.

11:00

Professor Heald: What the Scottish Parliament has at the moment is control of execution; control of policy lies with the EU. Post-1999, the Scottish Parliament and the Scottish Government got control of execution of a system that is set at a higher level. The big policy question is whether, in the future, policy will be set at UK level or at devolved level plus England. As David Bell has said, that will feed into the trade negotiations because—I suspect—there will be significant arguments between potential trade partners about state aid and subsidies. I find it impossible to believe that a significant part of the policy responsibility will not stay at UK level because of the importance that people are attaching to the trade negotiations. All sorts of issues will come up in the trade negotiations—among them will be things such as animal welfare and genetically modified crops.

The Convener: Emma, do you want to come in?

Emma Harper (South Scotland) (SNP): My question on LFAS has been covered.

The Convener: Okay. On trade negotiations, we have been told repeatedly—David Bell's paper more or less says this—that it is not possible to have a free trade arrangement and to subsidise farming—that that happens only in the EU's single market.

Professor Bell: That is not strictly true, but the point illustrates how strength in negotiations matters. I looked at a website that the Canadian equivalent of the NFU maintains. CETA—I have forgotten what it stands for—is the recent trade deal between Europe and Canada that brings down tariffs on food that is traded between

Canada and Europe, but the EU, which is the big negotiator in that negotiation, did not agree to cut the CAP. We would certainly have heard if that were the case. The EU will maintain payments to farmers. It said to the Canadians, "We'll take our tariffs off. Take it or leave it." The Canadian equivalent of the NFU argued that there was not that much in the agreement for its members, because although they are much more efficient producers, wheat from Saskatchewan would be competing with wheat from Italy, where the farmers get direct payments.

The question is whether the UK will be a strong party or a weak party in the negotiations. What will it be prepared to give up in order to have access to, for example, the other countries' car markets? That is why the Scottish Government must be in a position to understand what is going on.

Stuart McMillan (Greenock and Inverclyde) (SNP): A number of issues have been raised, and there has been quite a lot of discussion of agriculture and public procurement. CETA—the comprehensive economic and trade agreement—has just been mentioned. The CETA process became more interesting and more worthy of consideration when provincial procurement became an issue.

The UK's bargaining power is 65 million people compared with 440 million in the EU, or 318 million in the US. Is there, in trade negotiations, a negative opportunity to open up wider aspects of the public sector, including the NHS?

Professor Bell: I doubt that the NHS would be included, but such issues will probably become part of the debate. State aid is almost always part of trade negotiations. If I were an investor who was willing to invest in your country, I would want to be sure that you will not subsidise a competitor who would drive me out of business and cause me to lose my investment.

Public procurement also tends to be part of trade negotiations. In some countries, the state sector is very large. I would invest in your country only if I had free rein to tender in both the private and the public sector. The negotiations with Europe are unlikely to include the NHS because there is already a clear understanding of what state aid and public procurement mean. If we enter a deal with the EU—I hope that we will—we should not be surprised if the rules on state aid and public procurement do not change much.

Professor Heald: I will mention one thing that concerns me on the transparency front. One of the advantages of the Office for Budget Responsibility is that it is within the Government information perimeter, which means that it gets access to Government information. In the autumn statement, however, the Government refused to release to

the OBR the letter of comfort that it had given to Nissan. I suspect that we will see a lot of guarantees and letters of comfort. I am concerned about what those letters of comfort will say and what the potential fiscal cost will be. However, I think that other countries would ask such questions, too. A lot of what is currently up front in respect of state aid might start to vanish under the carpet.

Stuart McMillan: Would it be fair to assume that that would open up the issue of discussions about transparency between the devolved Parliaments and Assemblies, and the UK Government, through the joint ministerial committee?

Professor Heald: I am not sure that the UK Government will be terribly concerned about the devolved Administrations, in that context. It was the Conservative chancellor who set up the OBR in 2010: one has hit a particularly sensitive point when one starts denying information to institutions that one has set up.

Stuart McMillan: My final question goes back to whether everything will be on the table in the trade negotiations. Towards the end of the Prime Minister's speech at Lancaster house, she mentioned a number of areas, one of which was fishing. Is it legitimate to consider that fishing might once again be considered as a bargaining chip for the UK in order for it to get some type of trade deal, and that EU member states might be allowed access to fishing waters in Scotland and the rest of the UK?

Professor Bell: A trade deal is about all trade. There is trade in fish, in agricultural products and in manufacturing and services. The deal will probably cover in tortuous detail all potential aspects of trade between countries. There is also an issue about historical fishing rights that predate the setting up of the EU, so those will also have to be dealt with in what will be a very large agreement, if it happens: it will not be a short agreement.

Professor Heald: I will add only that I would have thought that a significant amount of the Scottish fishing industry's output goes to Europe. Judging by the number of lorries in Moray that are obviously European, a lot of seafood is going to Europe. The question of access to markets will be very important for the fishing industry, once it is outside the common fisheries policy.

Ross Greer: Stuart McMillan referred to the NHS and CETA with regard to trade deals. My understanding is that difficulties often arise with trade deals not from what is specifically included but from what is not specifically excluded. For example, the Scottish NHS is not specifically excluded from CETA and we are yet to see what

the consequences of that might be. There is an issue, in that the devolved Administrations in the UK do not have a role in the UK's trade negotiations. Does not the risk for public services come from their not being specifically excluded from a trade deal?

Professor Heald: I do not have sufficient knowledge to comment on that.

Professor Bell: I am not sure. For any such deals, there must always be an overarching body that arbitrates disputes—for example, in relation to the Scottish NHS. That is why taking back control in some areas is a bit of a problem. For any trade deal that one side does with a third party, a form of arbitration will have to be agreed in order to resolve disputes that might arise. In terms of just the number of disputes that are resolved, the European Court of Justice deals with more disputes, by a factor of at least 100, than the World Trade Organization does.

If a company in one country wants to object to another country's trade practices and both countries are members of the WTO, it must raise that with its Government, which must be willing to take that on and engage with the other country's Government, which will take a long time because the WTO does not deal with many disputes. However, in Europe, a company in one country can raise a dispute because of another company's practices—in France, Germany or wherever. There is a resolution mechanism in Europe. We have not talked about it much, but probably one of the most fundamental aspects of any trade deal is countries' agreement about how they will deal with trade disputes.

Lewis Macdonald: I want to follow up on what Stuart McMillan asked about fisheries. One thing that we have not touched on during the discussion is the European maritime and fisheries fund, which is the area payment from which Scotland gets greatest benefit. I think that we have established from the evidence today that agriculture is bound to be drawn into trade deals and that that will therefore have an impact on agricultural subsidy. Structural funds are much less likely to be drawn into trade deals, so much more can be determined autonomously here. Where does the fisheries fund fall in that spectrum? Is direct support for fisheries in terms of exports and restructuring likely to be part of a trade deal, or is that more likely to be domestically determined?

Professor Bell: I think that the deal that Norway has done to gain access through the European economic area to the single market specifically excludes fisheries and agriculture. That approach is therefore possible, but it means that there are fewer things to bargain with when making a deal.

In effect, that means that Norway has to accept what the EU does in respect of setting rules around trading and free movement of people, capital and services. I am not clear whether it would have got a different deal if it had put agriculture and fisheries into the pot. The EU probably thought that Norway was a relatively small country and that those issues did not matter all that much.

11:15

What will happen with fisheries here is pretty unpredictable because it will depend on the bargaining position that the UK Government will take. However, there is an argument that the communities that are concerned about the issue should have input to any debate around what is in and what is out.

The Convener: Professor Bell's paper says on page 9 something that could suggest that a lot of our conversation here about the transfer of funds and so on is rather immaterial. You suggest that the UK could choose to use the money that it will save to pay off the budget deficit. You said that the UK would gain £8 billion if it was

"no longer contributing to the EU budget"

and that there would be an argument for using that money to reduce the £59 billion budget deficit. How likely is that?

Professor Bell: I think that that is possibly less likely than it was before the referendum. However, as David Heald and the IFS have pointed out, the fiscal situation remains dire. It is not entirely clear, but I think that the UK Government is taking the view that it wants to be seen to be benefiting all parts of the country—I am thinking of northern England more than I am thinking of Scotland, Wales and Northern Ireland. One consequence of that could be retention of something like the structural funds and some form of agricultural payment—perhaps a reduced one—in order to maintain the argument that the economy should not be run just for south-east England.

The Convener: Do you have a comment to make, Professor Heald?

Professor Heald: I do not have anything to add.

The Convener: I thank you both for coming today and for your evidence.

11:17

Meeting continued in private until 11:39.

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