OFFICIAL REPORT
AITHISG OIFIGEIL

Finance and Constitution Committee

Wednesday 14 June 2017

Session 5

The Scottish Parliament
Pàrlamaid na h-Alba

Wednesday 14 June 2017

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FINANCE AND CONSTITUTION COMMITTEE
17th 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)
*Liam Kerr (North East Scotland) (Con)
*Ivan McKee (Glasgow Provan) (SNP)
*Maree Todd (Highlands and Islands) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Rachel England (Scottish Government)
Brad Gilbert (Scottish Government)
Nathan Goode (Scottish Government)
Professor Charlie Jeffery (University of Edinburgh)
Professor Michael Keating (University of Aberdeen)
Professor Aileen McHarg (University of Strathclyde)
Kevin Stewart (Minister for Local Government and Housing)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Finance and Constitution Committee

Wednesday 14 June 2017

[The Convener opened the meeting at 09:00]

Decision on Taking Business in Private

The Convener (Bruce Crawford): Welcome to the 17th meeting of the Finance and Constitution Committee in 2017. I ask those with mobile phones to put them into a mode that will not interfere with proceedings.

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

Members *indicated agreement.*

Proposed Contingent Liability

09:00

The Convener: Item 2 is to take evidence from Kevin Stewart, the Minister for Local Government and Housing, on the proposed contingent liability. He is joined by Scottish Government officials Brad Gilbert, who is head of the financial innovation unit, Nathan Goode from the financial innovation unit and Rachel England from the finance programme management division.

Members have received copies of the letter from the minister setting out the background to the request. I welcome our witnesses and invite the minister to make an opening statement.

The Minister for Local Government and Housing (Kevin Stewart): Thank you, convener. I apologise that there is unfortunately an error in paragraph 21 of my letter, which is referenced in paragraph 11 of the committee's paper 1. The figure should read "£2 million".

The Convener: I clarify that paragraph 21 says £2.6 million.

Kevin Stewart: It is paragraph 21 of my letter and paragraph 11 in the committee's paper 1.

The Convener: Thank you.

Kevin Stewart: I seek the committee's approval for a contingent liability on the Scottish Government budget for the rental income guarantee scheme. The scheme—RIGS for short—is designed to help to attract new institutional investment to the emerging build-to-rent market in Scotland. It will help to deliver, at scale, new high-quality private rented homes that are modern, energy efficient and professionally managed.

Growing the build-to-rent sector is in line with the aims of the Scottish Government strategy for the private rented sector and is one part of the delivery of our overall more homes Scotland approach, which aims to increase housing supply across all tenures. It will make an important contribution to our broader economic strategy by boosting investment and house building.

Build to rent is a rapidly developing market, which has so far mainly been focused in London and English regional cities, such as Manchester. There have been some notable early investments in Scotland, and RIGS is designed to further boost the growth of that emerging market. Pension funds and other institutions have shown considerable enthusiasm for the sector and have set aside substantial capital for investment, which Homes for Scotland has estimated at £10 billion. I want

Scotland to have a share in that investment and RIGS is a key initiative to unlock it.

RIGS has been developed through close engagement with the industry, which has told us that a rental income guarantee scheme is the appropriate financial stimulus for the Scottish market. That is because a new market brings with it uncertainty, which increases the risk for investors and can stall investment. Under the scheme, investors will still be the primary risk takers and must cover the first 5 per cent of their rental income before the guarantee comes into play. After that, the Scottish Government will take only half of the rental income risk, and only to the extent that the rental income generated by the development remains at least 75 per cent of the original projections. In that way, the Scottish Government will ensure good commercial practice by retaining incentives for investors to let those homes.

Extensive work has been done to ensure state-aid compliance. The scheme needs to be a commercially viable initiative where investors pay a fee to participate. The costs of the scheme will depend on the nature of the proposals that are accepted and supported and how many calls are made under the guarantee. Extensive modelling has been done on the Scottish Government's exposure; the maximum projected exposure for a contingent liability will be around £15 million. That would arise only if all the developments in the scheme systematically underperform. My officials have estimated that the maximum probable cost will be about £2.6 million. We believe that, in return, Scotland could attract investment of about £500 million to build 2,500 new homes, with the associated additional construction work and wider economic benefits. Given that significant leverage, that represents excellent value for money.

The Convener: Is the £2.6 million that you mentioned the number that we have just corrected in the letter? Have I got that wrong?

Brad Gilbert (Scottish Government): The £2.6 million relates to the £2 million for potential calls on the guarantee plus the £600,000 that is the cost of running the scheme.

The Convener: Okay. It is explained in paragraphs 21 and 22 taken together—I understand that.

In the paper attached to the minister's letter, the last sentence of paragraph 10 says that RIGS aims to

"significantly boost new institutional investment in Scotland to build more homes, by reducing some of the risk that investors see in this emerging market".

I did not see much comment in the letter or the annex about what those risks are that investors see. It would be good to have an explanation, minister, as that will underpin why you have brought the proposal to the committee.

Kevin Stewart: We operate in a challenging economic environment, particularly post the European Union referendum. The message from the industry has been clear that investment to support the growth of the sector and reduce risk is needed more than ever.

The Scottish Government has, over the piece, made public its exploration of RIGS and the intention to introduce such a scheme. We market tested it and received a positive response, and we worked closely with industry to develop and refine the scheme further to create positivity in the industry. If we were not to progress the scheme, we would expect significant stakeholder backlash, particularly given the extensive time and effort that was put into involving stakeholders in the proposal. It would send a negative signal about Scotland as a place to invest and do business.

The Convener: My initial reaction is that the industry would say that, wouldn't it, because this sort of scheme would be helpful for it. You have heard that from stakeholders and others who are involved, but what information has the Government gathered from other sources to show that it is not just the house building sector that says that there is a need and that the risk is real?

Kevin Stewart: We have done extensive work, including putting in place a private rented sector champion. Officials and the industry have a PRS working group, and we have tried to create a balance. We recognise that industry will always say that there are risks and that Government should intervene, but there have been difficulties out there for institutional investment, particularly since the EU referendum.

RIGS is designed to give early movers in the purpose-built PRS market greater certainty of income in the early years of letting by providing a limited Scottish Government guarantee. The market in Scotland is so limited that a proven investment would give investors the confidence to back early development in Scotland.

I will bring in Mr Gilbert, who has been at the forefront of discussions between industry and Government in the PRS working group and other fora.

Brad Gilbert: There has been considerable discussion with all the market players—investors, developers and local government stakeholders—in the private rented sector working group. There is agreement about the potential demand for BTR in Scotland of between 7,000 and 10,000 homes. However, realising that potential requires us to ensure that we put in place the right conditions and support to achieve it. A range of measures has been put in place, of which RIGS is one

element. As the minister says, it is about trying to provide support for the sector, which is the only tenure sector that does not currently receive some form of intervention from Government.

Kevin Stewart: I will give the committee an example from Manchester, where a housing investment fund was introduced to deliver housing for sale and rent. Although it is relatively small scale, as it is delivering 119 new PRS homes, it has sent a positive signal to the market that PRS development is encouraged. Subject to launch, RIGS will send a similar signal to the market in Scotland.

The Convener: You explained that, if everything was to fail at once, the maximum cost would be £15 million but, from the paper that I have seen, it seems that the reality is that it would cost more like £2 million if there was a problem. You estimate that, as a result of putting that up as a potential guarantee to be drawn on, the scheme could draw in up to £500 million of new investment in the sector in Scotland, which seems on the face of it to be a good deal. What level of confidence do you have in that number of £500 million and why do you have that level of confidence?

Kevin Stewart: A huge amount of modelling work has gone on. The £500 million figure and the associated jobs are part of that modelling. We have had not only Scottish Government officials but the Scottish Futures Trust, Scott-Moncrieff and, of course, the PRS working group consider it. A pretty significant amount of work has gone on in that regard over the past 18 months.

Mr Gilbert might want to add to that.

Brad Gilbert: The figure of £500 million of new investment is based on an estimated £200,000 per unit for each of 2,500 units that could be supported through the guarantee. That is an estimate of the number of units that the scheme could cover and it is judged that that is the appropriate level of support to help to establish the market for build-to-rent housing at scale in Scotland.

The Convener: I have strayed into modelling. Adam Tomkins will deal with that.

Adam Tomkins (Glasgow) (Con): If the figure of £500 million is based on the 2,500 units figure, how robust is the latter figure?

Brad Gilbert: I will shortly bring in my colleague Nathan Goode, who has done a lot of the modelling in the RIGS work. We have considered what would be a reasonable level of exposure, and the judgment in the modelling is that 2,500 units would be the appropriate number to accommodate.

09:15

Adam Tomkins: With respect, this is beginning to sound a little bit circular. The amount of money to which you are prepared to expose the taxpayer is dependent on the number of new homes that you want to build—or the number of new homes that you want to build is dependent on the exposure to the taxpayer. Where is the starting point?

Kevin Stewart: The key thing is that we want more than those 2,500 homes to be built. We have indicated that that number is basically a starting block, which will entice future development. I return to my point about the investment that Manchester made in a small number of PRS homes, which allowed the sector in Manchester to grow once there was confidence in the area.

Adam Tomkins: Is the Manchester scheme, to which you have referred a few times, a UK central Government scheme, or is it a greater Manchester local government scheme?

Kevin Stewart: There is a UK Government scheme that provides a guarantee on borrowing. The Manchester scheme has its own housing investment fund, as far as I am aware.

Adam Tomkins: Why do we need to do it through central Government in Scotland, rather than through Glasgow City Council, for example?

Kevin Stewart: As regards waiting for others to do it, it is right that the Scottish Government takes the lead. As we have already said, the measures could lead to £500 million of investment. It is right that, as a Government, we show willing and get on with the job of enticing folk to see Scotland as a good investment, and build the houses.

Nathan Goode (Scottish Government): To return to the question of how we decided on 2,500 units, I will underline what the minister said: our estimate of the total potential build-to-rent number is 7,000 to 10,000 units, based on the work that we have done with the PRS working group. We think that a subset of that is appropriate for the level of support that is required to entice in the investment in the sector overall.

James Kelly (Glasgow) (Lab): Is the £600,000 figure that has been quoted part of the contingent liability, or is it separate from the continent liability?

Brad Gilbert: That amount is separate from the continent liability—it is the cost of using the delivery partner to implement the scheme to administer the applications for and assessments of guarantees, and the implementation of individual guarantee offers.

James Kelly: That cost will be drawn from this year's budget. What budget line will it be allocated against?

Kevin Stewart: I will correct you on that. That cost will not be allocated from the departmental expenditure limit budget per se. According to the accounting term for this, the cost can be covered by using the income from the guaranteed fees, because they are classified differently. That is from the annually managed expenditure budget, rather than from the DEL budget.

Do you want to add to that, Mr Gilbert?

Brad Gilbert: No. That was an accurate description.

James Kelly: So, are you trying to say that there is an income line that that sum will be set against?

Brad Gilbert: Yes. Basically, there are two elements. One is the provision that comes from the DEL budget to cover the cost of administering the scheme, and the other is the calls on the guarantee.

James Kelly: I am sorry, but I am not clear on where the £600,000 will come from. It is £600,000 that will have to be spent if the scheme goes ahead—I understand that, but I am not clear where it will come from.

Brad Gilbert: It will come from the directorate's resource budget and it has been factored into forward budget planning.

James Kelly: Okay—so it is from the resource budget.

Kevin Stewart: Ms England will provide a full explanation of how that will work, over the piece.

Rachel England (Scottish Government): The £600,000 is the administrative cost of making the scheme work over the lifetime of the guarantee; it is not the total cost in one year. It is spread over the whole term for which the guarantee will operate and it covers the cost of the work that is to be undertaken by the delivery partner. It will be a DEL cost from the resource budget, but it will be over several years.

James Kelly: How many years will that be?

Brad Gilbert: We expect to pay roughly £175,000 in each of the first two years and we expect that the cost will reduce as the scheme becomes established.

James Kelly: The minister's opening statement outlined that there will be a call on the contingent liability only if there is underperformance in the scheme. What would cause underperformance?

Kevin Stewart: Underperformance would be caused if investors were unable to find tenants to rent the properties. However, a number of safeguards are in place to reduce that risk, including chartered surveyors going in to look at local rent levels to see whether they would entice renters, as well as looking at the local market as a whole to see what the element of risk is.

James Kelly: Has your modelling covered what appropriate rent levels would be to attract people to rent the properties?

Kevin Stewart: Again, that comes down to chartered surveyors going to look at the market in particular areas and coming up with realistic rent levels that could be garnered there. That safeguard is in place to reduce the exposure and the possibility of a call on the guarantee scheme.

James Kelly: I am sorry, but I am not clear on that. Has there been appropriate modelling covering different scenarios on rent levels?

Kevin Stewart: I will pass to Mr Gilbert to talk about the modelling.

Brad Gilbert: The answer is yes. Perhaps I will invite my colleague Nathan Goode to say a little bit more on that front.

Nathan Goode: To work out the overall potential exposure for the Government, we needed to make assumptions about the rent levels that would apply to those units. It is a Scotland-wide scheme so, in practice, the rent levels could vary significantly, depending on where projects are located. To analyse that further, we looked at void rates in areas to assess potential exposure and how it might vary between locations according to local market conditions.

As the minister said, when it comes to considering applications in practice, we will have a mechanism in place in which chartered surveyors will give a view on whether the proposed rent levels for the project are consistent with local market conditions.

Ash Denham (Edinburgh Eastern) (SNP): I am interested to know how the Scottish Government has estimated demand for the RIGS scheme.

Kevin Stewart: As I said earlier, there have been numerous discussions over the piece with the PRS champion, through the PRS working group and with the industry, and there seems to be a great appetite out there for such a scheme. Investors believe that it would help them to enter the market; once some investors have entered the market, more will follow suit. From my perspective and from the communications that I have had, it is fair to say that the appetite out there is substantial. The demand is industry led; Homes for Scotland has estimated that there will be demand for 7,000 to 10,000 homes over the next five years.

Ash Denham: We are currently in a fairly unstable economic situation. Do you estimate that demand will be fairly steady, or will it be influenced by a change in the economic situation caused by Brexit or something of that sort?

Kevin Stewart: As I said earlier, since the referendum on the EU a certain amount of instability has been created for investors. We can attract investors if we have something such as RIGS in place. We know that there is demand for housing, including for housing in the private rented sector. We have already seen a small amount of builds in Aberdeen, for example, and there have been proposals in Edinburgh. What we are proposing would mean that building will increase. It is fair to say that the likelihood is that the vast bulk of demand and investment will be in the four main cities, first of all.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): Mr Gilbert said that build to rent is the only sector that does not receive any interventions from Government. If we do not proceed with RIGS, what model would we need to fund and deliver the 7,000 to 10,000 houses?

Kevin Stewart: If the scheme does not come to fruition, we are likely to see less investment in Scotland. At the moment, the vast bulk of institutional investment in such housing has been in London, the south-east of England and the major English regional cities. There have been some small developments in Scotland: Dandara has built 292 units in Aberdeen and there have been some recent moves in Fountainbridge in Edinburgh. It has been pretty slow in Scotland compared to other areas; the RIGS is designed to create attraction and to pump-prime further growth.

The conversations that we have had over the piece suggest that the scheme will balance risk between the Government and industry to get the sector into a much healthier state than it is in Scotland by attracting the investment that is currently going elsewhere—that £500 million—and by creating jobs in the construction industry.

Willie Coffey: To clarify a point about the liability that you are asking for from the committee today, how many units do we get for that potential investment?

Kevin Stewart: The maximum number of units is 2,500.

09:30

Willie Coffey: If that is successful, would it be your intention to come back at a future date for another opportunity to do something like this, to support up to between 7,000 and 10,000 additional units?

Kevin Stewart: I hope that the scheme will be successful enough to attract investors who will not feel the need in the future for a rental income guarantee scheme. It is to show investors that the market here in Scotland is healthy; the great hope is that we attract additional investment in the sector in the future without the need for the scheme.

Ivan McKee (Glasgow Provan) (SNP): I draw the committee's attention to my entry in the register of members' interests with respect to rental property.

I thank the panel for coming along to give evidence. There are a few things that I want to touch on, but first I want to clarify a couple of the numbers that have been mentioned. I thank the minister for clarifying the point about the £2.6 million versus the £2 million, with reference to paragraph 21.

I would also like to compare paragraphs 15 and 22. In paragraph 15, you state:

"the scheme is expected to be financially neutral with a fee income of £1.4 million being balanced against the expected calls ... and administration costs."

In paragraph 22, however, you talk about a likely guarantee cost of £2 million, plus the £600,000 of fees on top of that. Is there a disconnect there? I would like to tidy up those numbers to start with.

Kevin Stewart: I will bring in Mr Gilbert.

Brad Gilbert: To clarify, we talked about paying out £600,000 in administration to run the scheme, and we have talked about a range of predicted calls between £200,000 and £2 million. The base case is in the middle.

Ivan McKee: So if that comes in at £800,000, you are balanced.

Brad Gilbert: Yes.

Ivan McKee: It is essential to be clear on that.

Brad Gilbert: The modelling is based on assumptions, and the reality may be a little bit different.

Ivan McKee: That is fine. In general, the concept is great, because it is an intelligent intervention to focus on the gap in the investors' concept and to give them a reassurance that it is derisking for them. What you say about the void seems to include underoccupancy as well as shortfall in rent. As I understand it, you are combining both of those to estimate what the rental income will be, and it could be made up of either one of those components. Is that correct?

Kevin Stewart: A substantiated level of void rates in line with the local market conditions will be factored into the independently verified rental

projections, so any call on the guarantee would come into effect only at that point. Is that helpful?

Ivan McKee: You have said that you will assess a rental income for each set of units, depending on where it is, and that, if the actual income is 95 per cent or less, you will pay out the guarantee. Is that correct?

Kevin Stewart: The 95 per cent represents a 5 per cent buffer on top of what would be expected from normal void levels. That 5 per cent is borne by the beneficiary to act as an incentive to secure that regular rental income. Void rates as a whole are well below 5 per cent in Glasgow and Edinburgh, and we would expect build-to-rent properties to have lower void rates than that. If I remember rightly—I look to Mr Gilbert to correct me—the original proposal that was received from the PRS working group included, as might have been expected, a request that the Government take on 100 per cent of rental income risk within a smaller band. I hope that Mr Gilbert can correct me if I am slightly skew-whiff on that point.

Brad Gilbert: That is correct, minister. The original proposal from the industry was that the Government would take 100 per cent of the rental risk. Clearly, we deemed that that would not be acceptable, which is why we reached the current proposal, where there is 50:50 risk sharing between the defined bands at 95 per cent and 75 per cent. It is very much about finding the balance between commercial objectives and the Scottish Government's interests.

Ivan McKee: I am totally clear about that, and the concept is fine, but that is not the point—I am drilling down into the numbers. However, you have confused me a bit further by what you have just said. The way I read it was that a chartered surveyor would say that the market rent for a certain property was X, and you would say that, if it was rented out for 52 weeks of the year, the income would therefore be Y, and that would be the 100 per cent baseline. Then, if the figure fell below 95 per cent of that, the guarantee would kick in. However, if I understand what you have just said correctly, you will take what you expect to be the income over 52 weeks and then factor in an industry standard void rate and set that as the 100 per cent baseline. Is that correct, or was my original interpretation correct?

Brad Gilbert: I invite Nathan Goode to confirm that.

Ivan McKee: The issue is important, as it is about attractiveness to the market.

Brad Gilbert: Yes, it is important.

Nathan Goode: You are absolutely right, Mr McKee. The need to get that balance right is why we have spent so much time thinking about the issue. The way that you described the process the second time was correct. We expect an assumption about voids and bad debts to be plugged into the original baseline number that will then be used for assessing whether the actual outcome is 95 per cent of that target.

Ivan McKee: Okay. So the 100 per cent number on which you will base the deal with the investor is a net number that takes out risk and so on.

Nathan Goode: Correct—it is a net number.

Ivan McKee: My next question is about what happens on the upside. There are two parts to that, and I expect that Patrick Harvie will come in on some of the issues later. First, if the yield is 110 or 120 per cent, will the Scottish Government get some kind of clawback on that? Secondly, what implications are there for market rents? Do you envisage any kind of rent capping to deal with that situation? Will you say to investors that you think that the rent should be X, and it is unfair that they are charging X plus 10 or 20 per cent? Have you considered either of those aspects?

Nathan Goode: We considered those issues carefully with the working group and internally and we came to the conclusion that the proposal needs to be simple and straightforward for the market. Having landed on a 50:50 risk share—a situation where we are never fully indemnifying; we are taking on half of the risk at any point in time from the industry—we came to the view that we could not look for an upside clawback mechanism, because that was not consistent with the level of benefit that we were offering as part of the proposal.

Rent capping was also debated extensively. Brad Gilbert might want to pick up on the issue, but the conclusion was that there are other mechanisms to manage rent levels in Scotland's cities, and we should rely on those to deal with that issue.

Brad Gilbert: We have talked about the due diligence in RIGS, which will ensure that rents are in line with those in the local market. The Private Housing (Tenancies) (Scotland) Act 2016 will add protection for tenants against excessive rent increases in two ways. The landlord will be able to increase rents only once every 12 months, and tenants will have the right of appeal if that is considered to be unreasonable. There is also the facility for local authorities to exercise discretion to provide evidence to make the case that rent increases are excessive and to use the rent pressure zone mechanism. Those protections are built into that tenancy reform legislation.

Ivan McKee: On some of the mechanics, I assume that, if the investor sells the property on, the scheme moves with the property, and I assume that you have in place an audit process to

check that what you are being told about rental incomes and so on is verified.

Kevin Stewart: Yes, but Mr Goode can give you more detail about that.

Nathan Goode: One thing that we were concerned about was ensuring that there is no cherry picking. We do not want investors selling off property that they are having no difficulty letting and leaving others within the scheme and claiming within the guarantee. The structure will say that an investor either is part of the guarantee scheme or is not. The guarantee can transfer if the ownership of the entire scheme transfers, provided that the transfer is to an entity that the Scottish Government is comfortable with as a counter-party.

The Convener: The minister introduced the issue of state aid, and I know that Liam Kerr has questions about that.

Liam Kerr (North East Scotland) (Con): Before I turn to state aid, I would like to follow up on a couple of earlier questions. You have obviously done extensive modelling of the various scenarios, but I think that you do not intend to publish any of that modelling. Why not? It seems odd that a lot of what is going on is based on modelling that no one is able to see.

Kevin Stewart: There are areas of commercial sensitivity. Mr Goode can explain further why we feel that we cannot go fully public on all of them.

Nathan Goode: The essential point is that we are using the modelling to set a price for the guarantee, and we do not want the people who are going to be taking up the guarantee to have access to our workings. We are providing them with an offer, and it is for Government to determine what the appropriate balance of reward and risk is within that analysis. That is not information that is to be shared with our counter-parties.

Liam Kerr: You talk about the UK's guarantee support for the sector, but you say that feedback from the industry indicated that that was not what was needed in Scotland. Could you develop that point? What is different about Scotland, and did that approach work in the rest of the UK?

Kevin Stewart: I already pointed out that certain areas, including Manchester, went above the UK scheme. Potential investors have pointed out that the UK scheme is not the right thing for Scotland. Accordingly, we put together the PRS working group to come up with a mechanism that would ensure that the necessary investment was delivered. Mr Goode can give you more details.

Nathan Goode: The UK scheme is a debt guarantee scheme, so it provides lenders to projects with an underwriting. That is fundamentally different from what we are proposing, which is a rental guarantee scheme. Developments in Scotland can apply to be part of the UK debt guarantee scheme, and they have done so. The two schemes are potentially complementary.

You ask whether the UK scheme has worked. It has certainly been slow to take off, and there are a number of reasons for that, which we do not have time to go into today. The jury is out on the UK scheme.

The reason why it was felt that Scotland needed something different involves not a finance issue but one of visibility of future rental income. Because there is a lack of a track record in the build-to-rent sector in Scotland, there is little on which investors can base their investment assessment that is already in place in Scotland. That is discouraging people from deciding to invest in Scotland. Like everyone else, investors are often a bit parochial, so they tend to start with London and then move out to the English regions. What we are trying to do here is to find a way of helping Scotland to jump the queue, in effect, and become more attractive to the investors who would otherwise just play a waiting game with Scotland and not come here until quite a bit later. The fundamental idea of the scheme is to bridge that analytical gap for investors and to provide a tool for them to get over the line in relation to investability in Scotland.

09:45

Liam Kerr: That leads on quite nicely to state aid. You have designed it as a fee-based scheme in order to reduce the risk of an issue with state aid. I see that

"The State Aid Unit considers the risk of state aid being present in RIGS is low",

but a low risk is nevertheless a risk, so the question is what happens if the unit is wrong. What if it is state aid? What is the impact if it is judged to be state aid? Why is there no assurance? Is there no possibility to just go and find out whether it is state aid?

Kevin Stewart: We talked to the state aid unit and, as you rightly point out, it says that the risk is very low and that it is

"satisfied the charging of a fee to beneficiaries of the guarantee, which is linked to commercial considerations, addresses the risk of non-compliance".

As well as doing that—

Liam Kerr: Forgive me a second, minister—

The Convener: Let him finish.

Kevin Stewart: As well as doing that, we commissioned Scott-Moncrieff as independent

financial adviser to assess the approach to ensuring state aid compliance and to confirm that state aid principles have been followed appropriately.

Liam Kerr: I accept that. I just want to clarify something quickly. You said that the risk is "very low", which is slightly different from your letter, which just has it as a low risk. Can you clarify that? Also, what if that assessment is wrong? What is the practical implication of it being wrong?

Kevin Stewart: Mr Goode will comment on that.

Nathan Goode: The way that state aid works is that the risk arises as a result of a potential challenge from a party who feels that they have been unfairly treated as a result of the state intervention. The first question that arises is who would challenge and why they would do so. It is difficult to find a rationale for such a challenge, so we see the risk as being conceptually possible but largely theoretical.

The consequences of a challenge would in effect be for the value that beneficiaries have received and there is a provision in the guarantee documentation that will make sure that beneficiaries of the guarantee are aware of the state aid position. They will be stepping into the scheme knowing that that is the situation. We think that a challenge is highly unlikely and, as the minister said before, we have the appropriate assurance that we need.

Another point is that we could adapt the scheme very quickly if it appeared that some form of state aid challenge was likely.

Patrick Harvie (Glasgow) (Green): I want to follow up on one or two issues around the numbers and then go on to a wider issue. You cite the industry estimate of the build-to-rent potential as being in the range of 7,000 to 10,000 homes over the next four to five years, with an estimated 4,000 units in the pipeline. That includes

"projects already being built or with planning approval, and early stage opportunities with identified investor interest."

Am I right in assuming that those 4,000 units will not be eligible for the scheme given that they have got to where they are without support?

Brad Gilbert: The information is based on informal intelligence from the industry, and the developments in that pipeline are at different stages. Some developments, of which there are recent examples, are proceeding without Government support. RIGS is designed to accelerate developments by providing a bit of support, particularly for developments that would not otherwise proceed.

Patrick Harvie: I accept that that is the intention, but does that mean that your projected up to 2,500 homes are on top of the current 4,000 that are in the pipeline, or are they within that figure?

Brad Gilbert: Some of the homes could be within that figure. As was mentioned, the 2,500 are a subset of the overall 7,000 to 10,000 potential homes, and some of the developments that are in the pipeline may well seek guarantee support on the basis that the investment decisions have not yet been taken and may not be taken.

Patrick Harvie: Yes, but I presume that you do not want those who do not need the support to access the scheme.

Brad Gilbert: Absolutely.

Patrick Harvie: I am not sure where the cut-off is. Is eligibility to apply for the scheme based in some way on demonstrable need?

Kevin Stewart: Each application will be looked at intensely by officials here, Mr Harvie, to see whether RIGS should apply to a particular scheme. The development at Forbes Place in Aberdeen, where the units are already in place, is up and running and would not qualify for the scheme. However, in some cases where the development is in the pipeline, there may be a need for a call on RIGS to make the scheme a reality. Each case will be considered individually.

Patrick Harvie: The bulk of the 2,500—at the maximum—homes could still be within the 4,000 that are identified as being in the pipeline.

Kevin Stewart: They could be, but they may not be.

Patrick Harvie: How does the scheme connect to wider Scottish Government housing policy? In looking at the financial merits of the scheme, we should be looking at the value that is obtained. Is that value judged purely in numbers of units or in terms of the type of house building that is going on? We surely do not want the urban equivalent of gated communities, and we do not want investment to be speculative with only high-end properties being built. We want to build to meet the need that exists for housing that people can afford to live in.

You have cited London as an example of where the build-to-rent model has been more successful. Surely, I hope, we do not want to get to the point that London is about to reach, where private renting is the biggest tenure—or do we?

Kevin Stewart: The Government has said clearly that we want to see a mix of tenures. It is obviously not all about numbers; I want to see quality in all builds that take place in Scotland. The scheme will have no effect on the resources for the Government's ambition to deliver 50,000

affordable houses, including 35,000 for social rent, during this session of Parliament.

We know that private renting has grown over the piece—the number of properties in the private rented sector has tripled since the 1990s—and that, UK-wide, it is likely to hit 20 per cent of tenure by 2020. I do not want to restrict people's choice of tenure. I choose to stay at home with my folks at the age of 49—I choose that, but I do not know whether they choose that. I do not want to restrict anybody and prevent them from going into whatever tenure they want to go into. However, I also want homes, whatever the tenure, to be the best that they can be. This is not just a numbers game; it is about providing the right homes for people in the right places and under the tenure that they want.

Having visited the development in Aberdeen recently, I know that the quality of the product is very high indeed. If we can achieve that standard, we will be doing well.

Patrick Harvie: The scheme itself will set thresholds and standards. You say that it is not just a numbers game. The scheme will have standards for rent levels, integration with the wider community and the proportion of homes for social rent as we have for other developments.

Kevin Stewart: We will look at each of the developments individually. If the properties are not of the quality or standard that means that they can achieve the expected rent, that will make it difficult for us to say that that level of income is achievable. That, in itself, will restrict our making that guarantee.

I do not want to be too prescriptive about what we are looking for. In order for all of this to work properly, rental value must be achieved. If the properties are not right, their rental value will not be achieved.

Patrick Harvie: I take the point. It reinforces the idea that, if the public sector is taking half the risk, maybe the private sector keeping all the profit is not the right balance to strike.

How will we judge the success of the scheme as it goes forward? You said that the modelling will not be published, and you have given some reasons why you think that that is appropriate. I presume that details in respect of each application—such as the application of the scheme, the type of development that is able to access it, the extent to which the developments have drawn on the guarantee that has been provided to them and whether the fees match the cost of providing the guarantee and the calls on the guarantee—will be given to Parliament in due course so that we can judge whether the Government has achieved value for money.

Kevin Stewart: We will report to Parliament on the costs of the overall scheme if it goes ahead. Reporting on individual developments might cause some difficulty. I would like to clarify that and write to the committee about it.

Patrick Harvie: I am not sure how we will be able to judge the merits of the scheme until we have an answer to that question.

Kevin Stewart: I will need to check the possibility of reporting on individual developments. We can give you the overall numbers, but the cost of providing the scheme to individual developments might be commercially sensitive. I would like to get back to the committee on that point.

The Convener: You might have to get back to us confidentially.

Kevin Stewart: Absolutely.

The Convener: Neil Bibby, do you have some questions?

Neil Bibby (West Scotland) (Lab): No, I think that they have been covered.

The Convener: I thank the minister and his officials for their evidence. The committee will consider its response to the Government's request in private, later in the meeting, and we will write to the minister to confirm the committee's decision.

09:59

Meeting suspended.

10:03

On resuming—

Brexit (Implications for Devolution Settlement of UK Common Frameworks)

The Convener: The next item on our agenda is to take evidence on Brexit and the implications for the Scottish devolution settlement of any UK common frameworks, as discussed in the UK Government's white paper. We are joined for that purpose today by Professor Michael Keating from the University of Aberdeen; Professor Charlie Jeffery from the University of Edinburgh; and Professor Aileen McHarg from the University of Strathclyde. I warmly welcome our witnesses to the committee. I am aware that Professor Jeffery has another engagement to attend—he will be here until about 11.45, so we need to bear that in mind. If necessary, he will just have to go at the appropriate time.

We have received written submissions from all our witnesses, so we will go straight to questions. I will open the session with what is probably an impossible question for you to answer, but it is probably the right place to begin. We have seen the outcome of the UK general election. I would like you to give your take, as best you can, on what that might mean in terms of the likely impact on Brexit negotiations, in particular with regard to paragraph 11 of Professor Jeffery's paper, in which he observes that

"the Great Repeal Bill ... will be irrelevant in the event of"

an

"election outcome"

other than a Conservative majority. Before the meeting started, Professor Jeffery told me that he wrote that six days before the general election.

I ask you all to provide whatever clarity you can in the current context, as that would be incredibly useful. Professor Jeffery, given that I have quoted you, it is probably right that you start.

Professor Charlie Jeffery (University of Edinburgh): Thank you, convener—I wrote that the day before the general election.

The Convener: The day before—sorry.

Professor Jeffery: Clearly, the result of the election was a surprise to pretty much everybody except the clever people at YouGov, who used an elaborate forecasting model that got it just about right.

The point about the great repeal bill is pretty valid, because the Prime Minister is clearly weakened and very much dependent on building a different kind of coalition of support within and beyond her own party. In those circumstances, much of what we have talked about in the Brexit debate hitherto is now subject to question, including the great repeal bill and those provisions that appear to set a direction in relation to devolution.

What I identified as perhaps a rather more muscular approach to cross-UK co-ordination vis-à-vis the various devolved Administrations is one of the things that would need to be reflected on, given the relative political weakness of the Prime Minister now, in comparison with one week ago.

The Convener: Would Professor Keating or Professor McHarg like to contribute?

Professor Michael Keating (University of Aberdeen): Before the election, it appeared that the UK Government was going to pursue a course that it called a UK Brexit, but in which the decisions would be taken by the UK Government in consultation with the devolved Administrations and legislatures, rather than jointly with them. It was also clear that the UK Government was resisting any form of differentiation across the United Kingdom, possibly with the exception of the Irish border. That has now become much more difficult.

The UK Government is going to have to reach out in various directions in order to get the legislation through. It will have to pay more attention to Northern Ireland because of the proposed arrangement with the Democratic Unionist Party, whatever that turns out to be, and it cannot open up to Northern Ireland without also taking into consideration the distinct circumstances and expressions of interest in Scotland and Wales and indeed in London and the regions of England.

Professor Aileen McHarg (University of Strathclyde): I suppose the lesson of the general election is, "Don't make predictions about anything," but as you have asked us to do so I will say something. In response to Professor Jeffery's comment about the great repeal bill being irrelevant, I will make the qualification that I do not think that it will be irrelevant. The things that the great repeal bill purports to do must be done, whatever form Brexit takes. The question is how we do them.

The bill provides for continuity of laws and enables replacements where necessary. The only real question, as the other two panellists have said, is what degree of compromise there is likely to be and whether the UK Government is willing to concede. As they both said, it seems possible that there will be a more conciliatory and consultative approach; on the other hand, perhaps the DUP's involvement in maintaining the Government, if that

is what happens, will reinforce Irish exceptionalism—I do not know.

The Convener: That sets the scene. Adam Tomkins will go next.

Adam Tomkins: I will ask about common frameworks. The devolution arrangements in all three devolved nations were based on many assumptions, one of which was that the whole of the UK would continue to be a member state of the European Union. That is why it is incompetent for any of the devolved Parliaments or Assemblies or any of the devolved Administrations to act, or to make law, in a manner that is incompatible with EU law. Given that we voted to leave the EU, that clearly needs to be revisited.

As I understand it, what the UK Government is proposing—albeit that what is in the public domain on this is sketchy, at best—is that there will need to be some kind of pan-UK common frameworks that do the job in a post-Brexit UK that the requirement to act compatibly with EU law has been doing in the pre-Brexit UK. Roughly speaking, is that your understanding of the talk about common frameworks?

Professor Keating: Yes, although I might query your premise, which was that we voted to leave the EU. The result of the vote was very narrow, and different parts of the UK voted differently. I think that it is legitimate to take into account the need to reconcile both sides of the argument rather than to simply say that the pro-leave side will have its own way. That relates to the convener's earlier question.

It is widely accepted that there is a need for common frameworks. The Scottish Government has talked about cross-border frameworks. There are externalities and international obligations. The question is how far those frameworks should go, who should set them and what should be in them.

The UK Government has said that it will take over the common frameworks, which will revert to the UK. I think that that is a misleading interpretation—I think that the common frameworks must be built anew, from nothing. The question is how detailed they should be. We can look at the experience in other countries. Spain and Italy have framework laws that have been proved to be a centralising measure and which have generated interminable litigation in the constitutional court. In Germany, on the other hand—which still has framework laws, although they have been reduced—the framework laws are negotiated bilaterally and they pass through the Bundesrat, as the representative of the federal regions.

The question is not about the principle of frameworks; it is about how they are set, what is in them, how detailed they are and who has the last word in setting them. Will we have genuinely joint decision making or will it simply be decision making by the UK Parliament?

Professor Jeffery: I agree very much with Michael Keating. There is a real difference in substance and meaning between a framework that is imposed from the top down and one that is agreed from the bottom up by the contracting parties.

There is another question. The election result has brought into discussion a different conversation about the terms of departure from the EU. Some people are advocating continued membership of the single market and other EU frameworks. If those people win out in that conversation, there might well be rather less of a difference in the internal arrangements that are required to manage the relationship with the single market than there would be if we pursued a different kind of Brexit, which might require a very different approach. The conversation about whether to have a top-down or a bottom-up framework will also depend on the nature of Brexit, and I think that the likely nature of Brexit might have moved since last week.

Professor McHarg: We should be a bit wary of the argument that EU law provided us with UK common frameworks, so they must be replaced, as there is an element of post hoc rationalisation in that. EU law only partially provides common UK frameworks. There are various ways in which internal differentiation is still permissible, even in the context of EU law.

In some of these areas, to the extent that I understand them—such as agriculture—we did not have much in place prior to joining the EU and EU law provided us with the common framework.

I agree with the previous comments. We need to think about each area on its own merits and not simply assume that, because we have had an element of commonality, it has to be replaced.

10:15

Adam Tomkins: It seems that we all agree that we will need some sort of series of common frameworks, if I have understood your answers correctly. In which areas will we need them? Agriculture is often mentioned—I know that other members want to talk about that—but it is an umbrella term that covers a lot of different things. It covers landholdings and agricultural subsidies, and also a lot of consumer protection law and product safety law.

There has been some talk about the importance of the UK's internal market. In addition to agriculture, however you might want to define that, and the UK internal market, however you might

want to define that—I would be interested to know how you would define it—where else might we need pan-UK or perhaps pan-GB common frameworks post Brexit?

Professor Keating: There is the whole area of environmental policy. Again, it is difficult to draw boundaries and say what lies within that, but there are obvious externalities there, in that pollution does not respect borders between parts of the United Kingdom, and there are also international environmental obligations.

As Aileen McHarg points out in her submission, the UK internal market is a recent idea—nobody ever talked about it before Europe came in. However, it is to do with having a level playing field. It is about fair competition within markets and about controlling externalities, which could arise in relation to all sorts of things. State aid is an obvious example. That is not reserved—it is partially reserved. It is not a huge policy area these days but, as you know from your discussion under the previous agenda item, state aid issues can pop up in all sorts of places where we did not expect them.

UK competition policy will certainly have to be revised. The UK will need to have its own competition policy, because its existing policy complements the EU policy. That might apply within the UK as well—

Adam Tomkins: That is all reserved under the Scotland Act 1998, is it not? There is no devolved competence with regard to competition law.

Professor Keating: Yes, but competition issues may arise in relation to actions of Governments on, for example, state aid—that is really about competition—or environmental regulation that might be considered anti-competitive in various ways, or protectionist. We do not have a comprehensive UK competition law. That might need to be thought about now that we will no longer have EU law to rely on, because things come up that are devolved and are not necessarily covered by existing UK competition law.

Professor Jeffery: One thing that was suggested in the Conservative Party manifesto—again, it is now rather conditional, because we do not know the extent to which the manifesto will be a guide for the Government, given that the party has to negotiate policy with other partners following the election—was regional policy for EU structural funding, given the consequences of withdrawal from the EU. The manifesto contained a commitment to establish a shared prosperity fund that would, in so far as it was spelt out, replace EU structural policy in the UK, claiming therewith a UK-wide role for the UK Government and proposing a framework for delivering that policy.

That is probably a bit more contentious given that regional economic development is clearly understood to be a matter of devolved governance. The way in which the proposal was phrased was interesting, as it described the devolved Administrations as consultees in the development of whatever common framework might be introduced under the policy. I suspect that we might have moved away from that, but it shows the potential for thinking about the EU as a way of understanding differently how powers are exercised post Brexit.

Professor McHarg: To pick up on what Michael Keating said, state aid is devolved. There is no UK state-aid policy and there never has been, so that is an area where I expect that the UK Government will want to create some kind of replacement for EU law, not least because international trade law, once we are subject to it, will have state-aid implications. That is one thing.

More generally, we probably want to distinguish between two kinds of reasons for common frameworks. One is the level playing field argument. If businesses that are based in different parts of the UK are subject to different requirements, their business costs will be different and some will be less able to compete.

The other argument for common frameworks is policy effectiveness. For instance, although emissions policy would in principle be devolved, it probably does not make much sense for the Scottish Government to set up its own emissions trading schemes. Indeed, it does not make much sense for the UK to set up its own emissions trading schemes. That is an example of an area where, for reasons of policy effectiveness, doing things on a larger scale makes more sense. Another one is air quality, which has cross-border effects—you cannot keep air in one part of the country. Another example is animal health policy, for the same sorts of reasons. There is a risk of policies not being effective, quite apart from any single-market effects.

Adam Tomkins: That is very helpful—thank you.

I will go back to the question of state aid as an example. A number of the witnesses have suggested that you think that the UK Government might want to have a single, common, pan-UK state-aid law. Is it your judgement that it is in the national interest that there is only one UK state-aid law, or could we have four—or potentially more, if cities in England are taken seriously—different laws of state aid in the same country without disrupting whatever we mean by the “internal market” within that country?

Professor Keating: The experience in other countries where those sorts of things are not

controlled is of uncontrolled competition and subsidising industry. It is a terrible problem in the United States, where there is no way of regulating it. It is ineffective because those efforts cancel each other out. They waste a lot of public money because they give subsidies where they are not needed.

Another general comment is that many of the competences that the EU has in the fields of competition and environmental policy were never in the treaties. They were extended by the European Court of Justice on an ad hoc basis and then they became law.

Adam Tomkins: Yes, I know.

Professor Keating: The question then is what the UK frameworks would look like. Would they be flexible and open-ended in that way and entrusted to judges, or would we have something much more rigid?

State aid is a good example, because it pops up in all sorts of unexpected places. Environmental policy was never in the treaties until, I think, the Treaty of Amsterdam—it just came along as a result of the spillover effect from one policy area to another.

Professor Jeffery: I have one addendum, on the consequences of internal differences on brokering external trade agreements. State aids are non-tariff-related factors that can impact the terms of trade between different places. To the extent that the UK will need to negotiate international trade deals in the future—and that extent is currently not clear—there may be an external rationale for stronger internal co-ordination.

Professor McHarg: There is an ideological dimension to all this. Maintaining a single market within the UK and the extent of that single market—what sectors it extends to—are highly politically contentious questions.

Because of the effect of EU membership, we have got used to thinking about frameworks as normal and natural, but if we strip out that element of the UK constitution and go back to our own, very thin constitution, the idea of constitutionalising market principles becomes quite contentious and problematic.

Ash Denham: Professor Keating, you mentioned that, where framework laws and provisions exist in other European countries, they are often a major source of contention between the parties. It would be challenging to create and maintain such framework laws and provisions, even somewhere that had a well-developed set of intergovernmental relations that were working well. We probably do not have that here.

You mentioned that there are a couple of other countries in Europe that have models in which IGR is working better. Could you say a little bit about those? Could that work here?

Professor Keating: Intergovernmental relations do two things: one is to facilitate common working where there is a common perception of the problem and there is not a big political difference; the other is to deal with conflicts. Our system of intergovernmental committees—joint ministerial committees—does neither. When joint policy making is needed, it is done, but not through the joint ministerial committee mechanism. Where conflicts need to be resolved, they are solved politically, not through that mechanism. The only ministerial committee that meets regularly has been that on Europe, and there have been concerns about that, too.

There is a general question about whether we want to go in the direction of intergovernmental policy making. The tendency in most systems in recent years has been to move away from too much intergovernmentalism, because it is extremely costly, it does not encourage transparency or accountability, it sometimes makes policy making more complicated and it overburdens the system. Attempts to disentangle the layers never really work, but that is the general tendency. We should think very carefully about the implications before moving down that road.

If we are going to go for intergovernmental policy making, we need to address a question that has never been addressed in our system—that of power and where it lies. In Spain, there are sectoral conferences. They are quite active, and they make a lot of joint policy. There is a voting system. The delegates do not vote very often, but the fact that there is a voting system means that the central Government cannot always get its own way.

In other systems, there is a second chamber that represents the territories, as in Germany. Unless you think seriously about that power, the negotiations will never be among equals; they will involve the centre, in consultation with the other levels of government, imposing its own way. That is the experience of Spain and Italy, which do not have effective second chambers.

Professor Jeffery: I will add a bit more on Germany, on which I used to work quite a lot. Germany has moved away from framework laws, because neither side was particularly content with the way in which the system worked. There was a tendency to specify too much at the central level, which annoyed people at the regional level.

Nonetheless, there is a framework for enacting statewide legislation in areas that are, in principle, ones of regional competence. Broadly, that works

well, because there is agreement that certain conditions are good conditions to meet statewide. In Germany, that is partly expressed in economic terms—in single market terms, broadly—but it is also expressed in social terms. The phrase that is used in various parts of the constitution is "equality of living conditions" or—depending on the place—"equivalence of living conditions". It is an equity-based argument as well as a single market argument. Germany is a place that has general agreement on those economic and social dimensions of the purposes of central and regional governments working together. You have to have that to make intergovernmental relations work, and I am not sure that we have that in the UK.

10:30

Professor McHarg: Michael Keating is right about power. We have an asymmetrical system not simply in the differing devolution settlements in different parts of the country but in the asymmetry between the UK level and the devolved level. We are talking about potential constraints on devolved Governments, but there are no equivalent constraints on the UK Government. We have to bear in mind the fact that the background to all the talk about common frameworks is that the UK Parliament can impose them if it chooses to do so, subject only to the Sewel convention, which we now know is not legally enforceable. We are in a situation of significant imbalance.

Ash Denham: If I understand the witnesses correctly, they are saying that other European countries are moving away from such frameworks. Would that be fair to say? If so, what are they moving towards and how are they arranging matters differently?

Professor Keating: Charlie Jeffery knows about Germany, so I will leave that to him. Almost all the autonomous communities in Spain have reformed and updated their statutes. There is a binding of competences—they call it "blindaje competencial", which means an armouring of competences. That is the principle that the central Government cannot intervene—in the guise of co-ordination or whatever—in certain kinds of competence, so the autonomous communities are being strengthened and reinforced. The Italian system has been trying to do that too, although not quite as successfully. Recent Canadian reforms have also tried to make it clear that certain competences belong to the provinces alone and cannot be interfered with by the central Government in the guise of spending power, transversal legislation or whatever.

Professor Jeffery: In the German case, there was a move away from framework laws on which both levels of Government legislate—the central level legislates to set the framework and the regional level legislates to work within that framework—towards a concurrent power system, in which the central level is empowered to act if certain needs, such as single market needs or equity needs, are met. In effect, that led to a disentanglement of the areas that had been subject to framework laws, with some becoming the responsibility of the central level and others becoming the responsibility of the regional level but, in some cases, with the possibility of central legislation in areas of regional competence if particular needs or conditions were met.

I emphasise that that can work because there is a high degree of consensus across Germany about the purposes of government. I am not sure that we have that kind of consensus here.

The Convener: The witnesses have just told us that we have a system of intergovernmental relations that is creaky at best—it disnae work. There is an agreement that, if we are not going to remain in the single market, there will have to be some sort of common framework arrangements. We have talked about the areas that they might cover, but there is enormous potential for conflict between the various devolved bodies and the UK Government. The question at the back of my mind at this stage—this refers to some of the stuff on page 4 of Aileen McHarg's submission—is about how we could get a different type of common framework and what way of coming to that would best suit the devolved nations and the Scottish Parliament.

Aileen, you describe three different ways of doing that—an ad hoc way, permanent re-reservations and a new cross-cutting constraints process. I think that you suggest that the ad hoc way would be the best way forward for the devolved legislature of Scotland. Could you reflect more on that, because we will eventually reach that point in the discussions?

Professor McHarg: Yes. That would be my preference, partly for reasons of the preservation of devolved autonomy and partly for reasons of flexibility. There is nothing permanent about ad hoc solutions, but they do not achieve everything that the UK Government might want to achieve. If we want to comprehensively protect international trade deals or the UK single market—whatever that is—the most obvious way to do that would be by replacing the cross-cutting constraint of EU law with new cross-cutting constraints in relation to the single market and international trade.

That would be problematic for a number of reasons. First, the centralising impact would potentially be great and hard to predict. Secondly, there are severe questions about the constitutional appropriateness of that approach. The cross-cutting constraints that we have at the moment relate to convention rights and EU law, both of

which have a particular constitutional status and apply more or less symmetrically to the devolved Governments and the UK Parliament. Convention rights are slightly different in that they bite more tightly on the devolved Parliaments, but they still bite and constrain the UK Parliament as well.

I would be very concerned about the idea of the UK single market acting as a cross-cutting constraint on the devolved Parliaments when there is no equivalent for the UK Parliament and when the UK Parliament and the UK Government, in their English capacities, could undermine the single market through their actions—I think that Professor Jeffery made that point in his submission.

Anything that leads to asymmetrical constraints should be resisted. I prefer the ad hoc model, but that depends on the ability of the devolved and UK Governments to work together to reach agreements where necessary.

Professor Jeffery: I have a side comment to make. The territorial relationships that exist in the UK are not mediated simply through Governments. In our present situation, which echoes others in the past, a particular territorial interest has a certain amount of leverage over central Government and might well use it to extract territory-specific concessions, to put it in a polite way. In the US, that is called pork-barrel politics, and I suspect that we will be in a bit of a pork-barrel era, to the extent that the proposed alignment, which might be confirmed today, persists for some time.

That may also apply in part to Scotland. The Conservative Party in Scotland has said that it will act in coherence in the UK Parliament, and it has more votes than the DUP; that could be a route for it to extract concessions for Scotland that go beyond intergovernmental relationships, but which could have an impact. For example, the DUP has made it clear that it wishes to have a significant increase in public spending in Northern Ireland, which might well have implications for some of the state aid issues that we have discussed.

We are in an interesting situation in which the territorial politics of the UK will be mediated not only by the UK's territorial Governments, but by territorial lobbies—for want of a better word—that have considerable bargaining power at the moment.

Professor Keating: I agree with Aileen McHarg's comment about the transversal frameworks. Anyone could potentially fall foul of those, and it would be difficult to define what was within them and what was outside them.

Another question concerns international agreements. Some EU laws will lapse, but they will be replaced by existing international agreements on trade, the environment and all kinds of other things. At present, the devolved Administrations have some input into EU decision making. It might not be adequate, but they are part of the delegation to the Council of Ministers—they get the papers and so on. They do not have an input into international treaties, so there is a question about how the devolved territories could safeguard their interests in those areas once they become subject to international treaties rather than European laws.

The Convener: That leads neatly on to some of the areas that Patrick Harvie wants to look at.

Patrick Harvie: I am not sure that any of this is neat, convener. Sir Humphrey once said to Jim Hacker, "If you must do this damn silly thing, don't do it in this damn silly way," and I am afraid that that thought will stay with me for the foreseeable future. One of the traps that we need to avoid falling into is that of assuming that, if the UK completes the process and withdraws from the European Union, a unitary state that never existed in the first place will emerge.

On the question of the extent to which common frameworks are required, there is a tension between whether those decisions will be made at UK level by the UK Government or in a more collaborative, open and participative way. I want to ask about two aspects of that. One of them relates to the specific example of emissions trading that Professor McHarg raised. The UK has been an advocate of the EU emissions trading scheme, but it has had a lot of problems over the years. As the energy sectors in different parts of the UK continue to diverge, those problems will be experienced in different ways. Different jurisdictions in the UK might have different views about the relationship that we ought to have with the EU ETS in future. The jurisdictions in the UK also have their own legislation and domestic climate change targets that interact differently with the EU ETS.

Therefore, decisions have to be made about whether to continue to co-operate as part of the EU ETS and how to deal with the different problems that emerge in different parts of the UK; whether to have a separate emissions trading scheme in the UK, in which our different tensions and interests would need to be balanced; or whether to have an alternative to emissions trading, which would have to be based on tax, although, at present, the relevant taxes are reserved, not devolved. For that one specific example, of which there will be many others, there is a question of how to balance the different needs and expectations of the different parts of the UK based on their different circumstances.

The second aspect of the tension between the UK Government making the decisions about

common frameworks and there being a more open and participative approach relates to the Northern Ireland situation. Is it a reasonable interpretation of the new situation that the question of the UK Government making decisions about the extent of common frameworks is no longer possible, given that there is a difference in the devolved context between a Government having an excessive influence on the UK Government and an Opposition party having such an influence, especially when that party is on one side of the carefully balanced unionist-nationalist dividing line in Northern Ireland? Is it not clear that the idea of the UK Government having the practical ability to make and impose those decisions is dead?

The Convener: Wow!

Patrick Harvie: Or tell me that I am wrong.

The Convener: Gaun yersel, Michael.

Professor Keating: On Patrick Harvie's first comment, I agree that we should go into the process realising that the UK is not a unitary state. In many senses, Brexit was predicated—this is how it was promoted by some people—on the notion that the UK is a unitary state and that, when the power comes back, we can decide what to do with it. That is not the default position. The default position is that the devolved competences are devolved until such time as they are reserved; they will not automatically go to Westminster.

On Patrick Harvie's other point—I might be at risk of being a bit political here—there is a serious problem with the UK and Irish Governments assuming the role of honest brokers. In relation to the Irish question, successive UK Governments have said that they have no interest in either the union or Irish unification, as that is entirely up to the people of Northern Ireland. If the UK Government is in a parliamentary alliance of whatever form with a party on one side of that, that creates problems for its role as an honest broker.

Patrick Harvie: There is also a consequent problem with its ability to make decisions on the issue of common frameworks in a way that treats not only both sides in Northern Ireland, but all the nations of the UK, fairly.

Professor Keating: Indeed. We are used to seeing Northern Ireland as completely different and not setting a precedent for anywhere else, but we cannot do that any more. There are precedents that will be set in Northern Ireland that will then have to be applied, particularly if we have the notion of a UK framework, which would make it very difficult to say that we will differentiate for Northern Ireland, but not for anybody else.

Patrick Harvie: Yes.

10:45

Professor McHarg: I have a comment on the EU ETS point. The point of the EU ETS is to set a carbon price, but our carbon pricing system is set by multiple instruments—at the moment we have climate change levies, climate change agreements, a carbon price floor, emissions performance standards, renewables targets and so on. The whole area is quite a big mess. One might see Brexit as an opportunity to sort out that mess, but I doubt very much that achieving that is in any way a realistic aim.

Those are the sorts of things that we can start to think about rationally in five years. We have to get through the Brexit process before we can take advantage of the policy opportunities that Brexit gives us to sort out some things that we do not do so well.

Patrick Harvie: I raised that as an example of where tension between UK-wide decisions and a more open and flexible arrangement will be inevitable: we will come up against that. For example, one of the reasons why this week Scotland has been able to say that our emissions have gone up but we still met our target is because the target became easier because of changes in the ETS, not because of what we were doing domestically. In contrast, in other parts of the UK, the situation does not play out in the same way.

Professor McHarg: Yes—we are part of a complex multilevel governance system, so the removal of one level of governance will have interesting and differing impacts throughout the UK. That is an example of a bigger problem. We need ways to deal with issues that cut across boundaries, and we need to recognise that we are in a multilevel system and that taking out one level does not simply empower either the UK or the devolved Administration, but might affect both in ways that have to be managed.

Professor Jeffery: Mr Harvie and Aileen McHarg raised the point about the challenges of disentangling the policy responsibility for England for emissions trading and pretty much anything else, when thinking about common UK-wide frameworks, and about the role that the UK Government performs as the policy maker for England and as the guardian of the UK-wide framework. As we move towards a post-Brexit system of common frameworks in different areas, there will be a need for the UK Government to reflect carefully on the mix of responsibilities that it has that are UK-wide and those that are England only. Policies that are enacted for England inevitably have spill-over effects on the other parts of the UK, because of its large relative size. Securing a full appreciation of that dual role has barely happened since we entered the devolution

era; it could become all the more pressing in the new circumstances.

The Convener: I will ask a gentle question. You have introduced the implications around the English dimension, but what happens to English votes for English laws—EVEL—in all this? There are potential impacts in Scotland, if that begins to unravel.

Professor McHarg: If the Tories do a deal withy the DUP, they will not have an EVEL problem because they require a majority in England and a majority across the UK, and they will have both. Therefore, it is not a practical problem. Of course, if it were to be a problem, EVEL would be easily undone, because it is secured only by an amendment to the House of Commons standing orders, which can be quite easily changed, if necessary.

The Convener: Okay—so my question was tangential, and it did not matter, either.

Are you finished, Mr Harvie?

Patrick Harvie: I am finished for the moment, I guess.

Liam Kerr: If a free-trade agreement were to be concluded between the UK Government and the EU, what impact would that have on the EU common frameworks? Would some or many of them be ported in such that the Scottish Parliament would continue to be bound?

Professor Keating: That would depend on what was in the free-trade agreement. We have been talking about everything from a loose agreement to something like the agreements with Canada or Switzerland. There has been a lot of confusion about the single market. Both major parties in the UK say that we are withdrawing from the single market, but that we want to get back into bits of it. The question is how much they want to get back into. The Government said in its white paper that British firms might be bound by European product standards, which seems to me to be very likely. Most of those provisions are not devolved, although some in relation to food safety are. The closer we get to a deep partnership and something like the single market, the more those issues will come up, and some of the areas will be devolved.

Liam Kerr: So, it will be entirely a function of the negotiation.

Professor Keating: Yes.

Liam Kerr: If a free-trade agreement is made, what impact would that have on repatriation of powers from the EU? Is the answer to that similar to the answer to the previous question?

Professor Keating: That would fall into the category of the relationship of devolved competences to international agreements, because the agreements will cease to be EU ones and will become international. The devolved Administrations are bound by international agreements, whether or not they relate to devolved competences. That raises the question of what the devolved input would be to making those agreements, which gets us back to the question that I asked earlier about whether we need a mechanism to give the devolved Administrations some say in the making of international trade agreements, since those will become more and more important.

Professor McHarg: The devolved Governments are not bound by international agreements. We have a dualist system, in that we distinguish between things that are binding in international law and things that are binding in domestic law. International agreements are binding domestically only if, and to the extent that, they have been incorporated by statute. That may be acts of the UK Parliament or it might be acts of the devolved Parliament. At the moment, an act of the Scottish Parliament cannot be challenged on the basis that it conflicts with an unincorporated international agreement. There are provisions in the Scotland Act 1998 that enable the UK Government to try to secure compliance with international agreements. The Secretary of State for Scotland can veto a bill being sent for royal assent if it would breach international agreements, and there are powers of direction to require ministers to take action to implement trade agreements, but that is all.

There is no cross-cutting obligation to comply with international agreements in the way that there is a cross-cutting and comprehensive obligation to comply with EU law. That reflects the different constitutional status of EU law, as a sui generis form of supranational, rather than merely intergovernmental, co-operation.

Professor Jeffery: That raises a wider question about the extent to which devolved jurisdictions simply take the results of international negotiations or contribute to them. There are examples from elsewhere of that contributory element working.

Belgium is probably where that is most fully developed. The internal—the domestic—competence is externalised, so the Belgian regions and communities have the power to act in external affairs in the framework of their internal competencies. That does not mean that Belgium has several foreign policies; rather, it means that there is careful co-ordination between the two levels of government.

To return to the example of Germany, the German intergovernmental system has dark recesses, one of which is called the permanent treaty commission, which in effect co-ordinates

between regional and central Government in areas where international treaties touch on regional competencies.

There are frameworks that work in other places that could be used at the very least as prompts for thinking about some of the issues that Brexit will raise where trade agreements inevitably touch on devolved competencies.

The Convener: Maree is interested in this topic, too.

Maree Todd (Highlands and Islands) (SNP): Yes I am—although I am a little confused by all that. I will try to simplify matters. Are you saying that the UK Government cannot negotiate UK-wide international trade deals and that it must negotiate only English trade deals?

Professor McHarg: No. International relations are reserved, so only the UK Government can negotiate internationally on behalf of the UK. However, because of our legal system, there is a distinction between what is binding on us as a matter of international law and what is binding on us as a matter of domestic law. A good example of that is the European convention on human rights, which we have been a member of since the 1950s. Since 1966, we have been able to take cases to the European Court of Human Rights, but only after domestic incorporation of the convention via the Human Rights Act 1998 and the devolution statutes did it become possible to use or to rely directly on convention rights in the domestic courts. That important distinction underpins our entire legal system.

There is a difference between negotiating who has the competence to get us into international obligations and the enforcement, compliance with and implementation of those international obligations.

Professor Keating: Yes—Aileen McHarg is right on the strict legal position. My comments may have been misleading, because I was giving more of a political perspective, so I thank her for clarifying that legal point.

Maree Todd: International trade is going to be significantly more important after Brexit. Everyone is raising agriculture as an area of concern. I represent the Highlands and Islands, where agriculture is a significant part of the economy. Agricultural tends to be a thorny issue in international trade agreements because of the level of state subsidy and the ability, for example, to give farm payments and to make it a level playing field in international trade.

The pattern of agriculture in Scotland is very different from the pattern of agriculture in England. It is also a devolved issue. I imagine that in trading terms it is important—or worth more—to strike a UK-wide trade deal. How will we navigate that?

Professor McHarg: We have the options that were outlined earlier: we can have ad hoc legislation to implement particular trade deals, which could be negotiated or imposed; we could try to have cross-cutting mechanisms to ensure that the UK Government can make the devolved Governments comply with the terms of international trade; or we could forget about devolution of agriculture and re-reserve it to the UK.

I know from speaking to friends who are farmers that they are worried about the implications of future trade deals. A problem with the new era that we are about to enter is the lack of transparency and predictability.

One of the positive things about the EU is that it is an ordered system of governance. It operates on the basis of treaties—those treaties might change from time to time, but we know what the scope of competencies is. We can predict what the likely policy outcomes will be, and there is an open policy-making process that the devolved Governments can influence either through the UK Government or directly, because there are mechanisms at EU level that allow for consultation of regional Governments and so on. The system is a relatively ordered, relatively predictable and relatively transparent way of making decisions at international level.

11:00

We are about to go into a system of much more ad hoc trade deals with different countries and trading blocs, the terms of which might be different and the negotiation of which will take place between negotiating teams behind closed doors. It is much harder for the devolved Governments either to anticipate what will come out of those discussions or to influence them.

Maree Todd: In your paper, you mention that health is a non-marketised sector. That is the case in Scotland, but there is a significantly different picture south of the border. When the transatlantic trade and investment partnership was being negotiated, there was huge concern that the national health service might be vulnerable to international private interests. Is that likely to be a significant concern about Brexit? How can we protect the position of the NHS in Scotland, where the health sector is not marketised to the same extent as it is down south and we do not have anything like the same level of private provision?

Professor McHarg: I had TTIP in mind when I wrote that part of my paper. There are different views on how real that threat from TTIP was but, in principle, it was a concern.

The issue is not unique to international trade. For many countries—although not so much for the UK—EU law has been a route by which previously non-marketised sectors have become subject to competition. In sectors such as energy, telecommunications and transport, international-level free-market rules have been used to push the boundaries between the state and the market. Whether it is likely or not, the possibility remains that that could happen through international trade deals.

Willie Coffey: Let us return to the point that Patrick Harvie introduced in relation to Northern Ireland. Professor Keating, in your paper you talk about the Supreme Court ruling in the Miller case and so on. During that case, Scotland's constitutional argument was pretty much dismissed in a sentence or two, and it was confirmed that the Sewel convention is merely a political agreement. Now that the entire political situation has changed significantly and the UK Government is where the power lies, could the UK Government impose legislation in devolved competences in Northern Ireland, for example, without the devolved Administration's consent? If that is the case for Northern Ireland, does the same apply to Scotland?

Professor Keating: The British constitution works largely on the basis of convention, with some things being written down and some things having the status of ordinary laws—there is no single body of constitutional law. The Supreme Court said that the Sewel convention is not binding in law and, like other conventions, cannot be enforced by the courts. We knew that already. However, in a kind of obiter dictum, it went further and said that the Sewel convention is a merely political convention. To me, that betrayed a misunderstanding of what constitutional conventions do. They are neither laws that are justiciable in the courts nor political agreements; they are something else. I think that the point was missed there.

It also surprised me that the Supreme Court went out of its way to make that point, because it could have dismissed the Scottish Government's intervention by saying that the issue concerned the matter of foreign affairs and that, in any case, the situation was not a normal one. However, it chose to add that ground as well, at the invitation of the Advocate General of the UK Government. That has left a bit of a hole in our understanding of the constitution that really has to be filled. Hitherto, the UK Government has respected the Sewel convention and the process has worked well. If it is to be set aside this time, that will set a constitutional precedent.

That brings into question the whole basis of our constitution, which restrains the devolved Government but not the UK Government. That is very unusual. It means that we have not caught up with the federalising spirit that the devolution settlement seemed to have been taking on.

Therefore, although it can be said that, in one sense, the Supreme Court judgment was not surprising and told us what we already knew, it raised a lot of questions about our constitution, and Brexit is going to be a big test of those questions.

The Convener: Does anyone else have a comment to make?

Professor Jeffery: There is a point to be made about the level of exceptionality that would justify the UK Parliament overriding the views of the Scottish Parliament. The Miller ruling has opened up that debate beyond what was the practice hitherto, which, as Michael Keating says, had been working rather well.

There might be a sense in which, in a place like Scotland, the notion of a common framework—a more clearly specified set of understandings about the relationship between central and devolved Governments—might be perceived as a threat to devolved powers. However, there are circumstances in which it could be a protection, given the rather labile interpretation of the Sewel convention that we had from the Supreme Court.

Professor McHarg: In a sense, the Miller case told us what we already knew: that, notwithstanding the Scotland Act 2016, the Sewel convention was not enforceable. It was not inevitable that the convention was not justiciable; I think that it was open to the Supreme Court to determine, and, in a different, less high-profile context, the court might have been willing to say whether the Sewel convention would be engaged by the withdrawal bill. In fact, the court did say some things about whether it would be engaged but did not reach a conclusion.

The Supreme Court said that the intention of the 2016 act was to entrench the Sewel convention politically as a convention. What does that mean? How do you entrench something politically when there is no external enforcement machinery? It is difficult to understand what that could mean.

Interestingly, it has been suggested—I think by Paul Reed—that we should perhaps think of procedural mechanisms to give the Sewel convention greater bite. For instance, it could be required that, when ministers introduce a bill in the UK Parliament, they make a statement—equivalent to the statement that they have to make under the Human Rights Act 1998—on whether, in their view, the Sewel procedure applies. The bill could then be subject to scrutiny by a committee.

If the Sewel convention is to operate in a purely political realm, we probably need to think about how we can give it more political bite. At the moment, we can have a situation in which the Scottish Government takes one view on whether the Sewel procedure is engaged and the UK takes a different view. That has happened in relation to not just Brexit but certain bills. There is no mechanism whatever for adjudicating on those different interpretations, and the UK Government always wins because the Sewel convention is only a convention and not a legal rule.

The Convener: This question will boil it down in a simple way. When we leave the European Union, what would happen to the competences of the Scottish Parliament if there were no adjustment to the Scotland acts?

Professor McHarg: They would increase.

The Convener: Exactly.

Professor McHarg: Anything that is currently within devolved competence but is subject to EU law would fall to the competence of the Scottish Parliament.

The Convener: So, unless the UK Government takes an action, all the powers that currently lie with the EU—which I think are laid out quite neatly in paragraph 4 of Michael Keating's submission—would automatically become powers that would lie with the Scottish Parliament.

Professor McHarg: Yes, but they could be overridden by the UK Parliament, either on an ad hoc basis by enacting legislation on that topic or—more permanently—by changing the Scotland Act 1998.

The Convener: That would take us into the political realm. I leave hanging the question about what the political circumstances would be if the Scotland Act 1998 was changed. If the Scotland Act 1998 were not amended, one would immediately think that the Sewel convention was applicable and that the powers would come back to the Scottish Parliament.

Professor Keating: The one exception is that the funding would not revert to the Scottish Parliament. That is critical in agriculture.

The Convener: Yes, it is probably the main ingredient.

I am sorry, Willie—I interrupted you.

Willie Coffey: That gets to the heart of the issue that I want to explore. If a disagreement should emerge between the Northern Ireland Administration and the UK Government, it is unthinkable in the current political situation that the UK Government would retain some aspect of a devolved power against the will of the Northern Ireland Assembly. Do you think that we will see that effect in Scotland now, given the changing political circumstances?

Professor McHarg: There is an interesting complication with the Sewel convention in relation to Northern Ireland. Whereas in Wales and Scotland the Sewel convention has two elements—it applies to legislation that is within devolved competence and to legislation that shifts the boundaries of devolved competence—in Northern Ireland it applies only in the former situation. The practice there has been not to seek consent to changes to the boundaries of the devolution settlement. That reflects the situation as it existed in the earlier devolution settlement in Northern Ireland, which is where the origins of the Sewel convention lie. It was not invented in 1998; it was a prediction based on previous practice. I did not know that until the Miller case. I found it very interesting that what is apparently a foundational convention does not even apply in the same way to all the devolution settlements.

The other complication is that we might not have a devolved Government in Northern Ireland to give or withhold its consent to anything.

Willie Coffey: Yes, but the UK Government needs those 10 votes.

Professor Jeffery: Convener, you said that you are worried about straying into politics.

The Convener: I do not need to encourage you that much—please feel free.

Professor Jeffery: I will stray into politics a little.

At the UK level, we have a minority Government that is dependent on the support of a Northern Ireland party. I think that the capacities of that Government in managing the next stages of the Brexit process will be severely strained, and it would be a very unwise Government that, in those circumstances, took actions that would prompt conflict over matters of principle with fully functioning devolved Administrations such as the one here and the one in Wales. Of course, politicians sometimes do things that are not very wise.

That opens up an opportunity for the devolved Administrations to seek a more constructive conversation. I really do not think that the UK Government can afford lots of bust-ups.

The Convener: After the Scotland Act 2016 came into being, many of us got used to using the term "shared competences" in the context of the new relationship that developed between the UK Government and Scotland, but does the idea of shared competence make any sense in the light of the Brexit vote and everything that has flowed from it, given the UK Government's approach to sovereignty in the present circumstances?

11:15

Professor McHarg: At the moment, we have shared competence in relation to the implementation of EU law. I suppose that you could read across from that to the implementation of international trade deals. That would be a possibility. Again, though, the constitutional status of international trade and EU law is not the same. That is an important point to emphasise.

Professor Jeffery: A common framework could be a way of describing a shared competence. We will see what that means as the conversation evolves—it probably meant something different last week.

I quote from the Conservative manifesto, which might no longer be much of a guide:

> "We will protect the interest of Welsh farmers as we design our new UK farming policy".

It is not entirely clear who the "we" are who are designing the policy, but I certainly read the tenor of the document as being rather top-down in intent and I do not think that the current political situation would easily allow such a top-down approach. That suggests that we need the Welsh Government to help us to think through at the UK level what a UK-wide farming policy would be. Everybody recognises that there needs to be some kind of common framework around agriculture, and a wise Government might well look to establish those collaborative conversations.

Professor Keating: I still think that we must be wary of getting too many joint competences—there is a difference between those and overlapping competences—as that might be a problem.

Agriculture, for example, is tied up with environmental policy to the point that the ministerial responsibility in England, Wales and Scotland has been shared. Arrangements around agriculture might therefore spill over into environmental policy. You would have to look at having clusters of policies that would make it more difficult to say that the UK Government could just devolve little bits of agriculture while reserving other bits, because that would have knock-on effects. However we do it, we will need some kind of mechanism to deal with policy fields that spill over into other jurisdictions. We just do not have that at the moment.

The EU has solved a lot of those problems hitherto, but that mechanism will not be there.

The Convener: We have covered a lot of ground today. The witnesses are indicating that we have covered as much as we can until we are a bit clearer about the circumstances. I thank you for your evidence today. We will wait to see what the final picture looks like, although that might take some time.

11:18

Meeting continued in private until 11:28.

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