OFFICIAL REPORT
AITHISG OIFIGEIL

Finance and Constitution Committee

Wednesday 23 May 2018

Session 5

The Scottish Parliament
Pàrlamaid na h-Alba

Wednesday 23 May 2018

CONTENTS

Col.

FINANCE AND CONSTITUTION COMMITTEE
17th Meeting 2018, Session 5

CONVENER

*Bruce Crawford (Stirling) (SNP)

DEPUTY CONVENER

*Adam Tomkins (Glasgow) (Con)

COMMITTEE MEMBERS

*Neil Bibby (West Scotland) (Lab)
*Alexander Burnett (Aberdeenshire West) (Con)
*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
*Ash Denham (Edinburgh Eastern) (SNP)
*Murdo Fraser (Mid Scotland and Fife) (Con)
*Emma Harper (South Scotland) (SNP)
*Patrick Harvie (Glasgow) (Green)
*James Kelly (Glasgow) (Lab)
*Ivan McKee (Glasgow Provan) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Andrew Chapman (Scottish Government)
Derek Mackay (Cabinet Secretary for Finance and the Constitution)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Finance and Constitution Committee

Wednesday 23 May 2018

[The Convener opened the meeting at 10:02]

Decision on Taking Business in Private

The Convener (Bruce Crawford): Good morning and welcome to the Finance and Constitution Committee's 17th meeting in 2018. As usual, I ask members and others who are attending to sort their mobile phones into proper order and, at least, to switch them to silent mode.

Agenda item 1 is a decision on whether to take item 3 in private. Do members agree to take that item in private?

Members *indicated agreement.*

Scotland Act 2012 and Scotland Act 2016 (Implementation Reports)

10:03

The Convener: Item 2 is evidence from the Cabinet Secretary for Finance and the Constitution on the implementation reports for the Scotland Act 2012 and the Scotland Act 2016. The United Kingdom and Scottish Governments are required to publish such reports annually, and we expect to discuss them with UK Treasury ministers later in the year.

The cabinet secretary is accompanied by two Scottish Government officials: Andrew Chapman, who is from the fiscal responsibility division, and Gerald Byrne, who is from the constitutional policy team. I warmly welcome our witnesses. Does the cabinet secretary wish to make an opening statement?

The Cabinet Secretary for Finance and the Constitution (Derek Mackay): I have a brief opening statement. I welcome the opportunity to discuss the latest implementation reports for the 2012 and 2016 acts. The reports focus on financial aspects of the acts, but it is worth noting that nearly every power that is in the 2016 act has been legally commenced.

Progress is being made on using the powers to deliver better outcomes for the people of Scotland. Naturally, some require considerable policy development work, some require extensive stakeholder consultation, and some require more primary legislation. The parts of the package of powers are at various stages of delivery.

Implementation of the most substantial and complex elements of the 2016 act powers—on tax and social security—is now well in train. Changes in income tax rates and bands were approved by the Scottish Parliament in the spring. My ministerial colleague Jeane Freeman leads on the new social security arrangements. We are committed to effective working with the UK Government to ensure responsible and seamless implementation of the 2016 act powers. The upcoming meeting of the joint exchequer committee this summer will be the next opportunity for us to review progress with the Treasury.

Parliamentary scrutiny has already proved to be crucial, and I fully recognise and welcome the important role that Parliament and its committees play. I look forward to the conclusions of the budget process review group in supporting Parliament in its role in scrutinising the Scottish budget and, most notably, to the first medium-term financial strategy that will be published shortly.

I am happy to take questions from the committee.

The Convener: Thank you, cabinet secretary. I am sure that, as members of the committee are, you will be concerned that Her Majesty's Revenue and Customs is able properly to identify people who are Scottish taxpayers. I am aware that at least two members of the Scottish Parliament have received correspondence from HMRC informing them that they had not lived in Scotland for the majority of the tax year. Apparently, that was because their addresses had been noted as being in Great Britain instead of in Scotland. If two MSPs have identified that to me, I suspect that, in Scotland generally, there will be a significant number of people who are in the same position. I wonder whether that will change unless they go back and challenge it. I am concerned about that. How confident are you about HMRC's ability properly to identify Scottish taxpayers? If that proves to be a more significant problem that affects more people than just our two MSP colleagues, what impact might that have on the Scottish budget?

Derek Mackay: If that is the case for two MSPs, it is quite unfortunate. I do not know all the details, so I cannot comment on the specifics, and I do not give tax advice to colleagues.

However, that is a serious issue. HMRC is expected to provide robust systems to identify Scottish rate taxpayers. We have a service level agreement, but that is its responsibility. HMRC is accountable to the committee and Parliament—and to me, as the finance secretary—and it is expected properly to identify taxpayers in Scotland.

On the examples that the convener has given, it strikes me that because all MSPs are resident in Scotland, they should all pay Scottish rate tax. I would expect them to do so, so further probing of those two cases would be helpful. HMRC has given my civil servants reassurance that it has programmes in place to enable it to identify, for our purposes, everyone who should pay tax. However, there is a project board that works through us and holds HMRC to account on its workstreams in that regard, and we will probe that further. Because the tax powers have been implemented from 2016-17 on, this summer we will have more data than we have had before. The information will be far more definitive than the forecasts that we have had in the past, so we will be able to probe HMRC more fully.

In the light of the examples that the convener has given me, I am slightly more concerned than I was before I entered the committee room. However, I have been assured by HMRC that it is doing everything possible and appropriate to identify taxpayers in Scotland. We will certainly pick up the matter, and I urge the committee to do the same in holding HMRC to account.

The Convener: Obviously, I will not disclose the two members' names unless they give me permission to do so.

How often do you receive updated information from HMRC on such administrative and tax collection issues?

Derek Mackay: We receive such information regularly. Andrew Chapman will cover our technical interactions with HMRC. I have to say that it has not been flagged up to me that there has been any systemic concern about there being large swathes of people who are not covered by the Scottish rate of income tax but who should be paying it. Such situations will be partly down to the individual circumstances of taxpayers, in which there might be dubiety about how much of their time is spent in Scotland, or other personal finance matters. I have been given enough information to reassure me that the figures are robust. However, there will be examples in which further probing requires to be done—such as you have just given us, convener. We have an assurance programme that gives us confidence that the figures are correct. However, the more definitive data we can get, the better.

I recall a question last year—from, I think, Willie Coffey—about differences between income tax numbers in our report and in the UK Government's report. There has been no such difference this year: there is closer alignment, as you would expect, as we roll out the new powers.

I did not fully answer the convener's other question. If HMRC was missing a lot of people, that would, of course, have a negative impact. Notwithstanding the complexities of the fiscal framework and the relative nature of it all, we want to ensure that every taxpayer who should pay tax in Scotland pays that tax so that it comes to us for investment in public services. I have no reason to believe that there is a substantial problem, but that is all the more reason to probe the matter, based on cases of people not being identified.

Andrew Chapman can speak about the more regular contact that we have with HMRC.

Andrew Chapman (Scottish Government): To reiterate what the cabinet secretary said, we have a joint project board with HMRC that meets quarterly. Part of that board's work is to ensure that there are in place rigorous data checks for the identification and continued maintenance of the system to identify Scottish income tax payers. However, we are in regular—almost daily—contact with HMRC to ensure that the work that we need it to do is carried out effectively and efficiently.

As the cabinet secretary mentioned, this summer we will get the HMRC trust statement, which will provide for the first time an outturn figure for 2016-17 Scottish rate of income tax receipts. As part of that report, we will also get for the first time a definitive published figure for how many Scottish income tax payers there are. Our current estimate, as included in chapter 2 of the implementation and operation reports, is that there are about 2.6 million.

James Kelly (Glasgow) (Lab): It goes without saying that it is important that everybody who is a Scottish taxpayer is recorded in the system and pays tax. A practical example would be someone who lives and works in Newcastle deciding, halfway through the year, to change their employment and moving to Glasgow to work for a Glasgow-based firm. How confident are you that HMRC has processes in place to track such changes and ensure that people pay their tax in Scotland and into the Scottish pool?

Derek Mackay: We are fairly confident that a person’s transferring in such a scenario would be picked up in real time. Of course, it will also depend on how the person is being paid, and whether they use the pay-as-you-earn system or do their own returns, which could affect the timescales. A person’s finances are not locked in from the start of the year for the whole financial year but should change as their circumstances change. Our processes and workstreams require HMRC to do that work. Therefore, I am as confident as I can be that such things are all taken into account.

James Kelly: I gave a fairly simple example. Is that something that has been identified in the HMRC workstreams?

Andrew Chapman: Yes. At the end of the day, it is for HMRC to ensure that the person pays the correct rate of income tax, whether it is the Scottish rate or the UK Government rate.

Committee members will be aware that there is a long lag between the end of the tax year and publication of outturn data. That is partly because Scottish income tax is calculated on a liabilities basis. Issues such as James Kelly referred to need to be picked up in calculating the outturn figure and addressed as part of that process. That is why publication takes a lot longer than for the other devolved taxes, such as the land and buildings transaction tax and landfill tax.

Derek Mackay: In essence, HMRC is expected proactively to identify whether it is appropriate for taxpayers to pay the Scottish rate of income tax even when there is a change of circumstances such as you described, Mr Kelly.

James Kelly: To give us a bit of assurance, will you write to the committee with the details of how HMRC will do that.

Derek Mackay: I make it clear that I am not HMRC. You want reassurance that the Scottish Government seeks reassurance from HMRC, so we will do that. However, there is a point to be made about the committee holding HMRC to account as well as holding us to account for our function.

James Kelly: I accept that. My concern is that I have raised a fairly simple example and, although both you and Mr Chapman have said that you are confident that it will be picked up, I did not really get any detail on how.

Derek Mackay: Convener, I am making the point that I am not HMRC. How it conducts its operational duties is for it to explain, and it is for us to ensure that we are assured by that.

10:15

The Convener: I understand that, cabinet secretary, but I think that James Kelly is raising a reasonable point. He has an expectation that the Government will also be doing its job to meet robustly with HMRC to ensure that it is going through a proper process to get the outcomes that we expect. There is nothing to prevent the committee from writing to HMRC, and I sense from where James Kelly is going that we will do that anyway, but he has raised a reasonable point for the Government to address.

Derek Mackay: I absolutely accept that and I will write to the committee with more on the information and assurance that we have from HMRC, as I think I said at the outset. I just want to make the point that we do not have operational control, but the accountability point is well made.

The Convener: James Kelly wanted to ask a question about borrowing. Please feel free to do that now.

James Kelly: Thank you, convener. Capital borrowing is covered in paragraphs 82 to 83 of the implementation report. It is noted that the interest rate for 2018-19 is 2 per cent, but I do not see anything about the rate for 2017-18 in relation to the draw down on the £450 million of borrowing. Do you have that information? Can you provide it to the committee?

Derek Mackay: In terms of—

The Convener: It is in paragraphs 82 and 83 of the Scottish Government report, I think, on the borrowing in Scotland reserve.

Derek Mackay: Is the question about the borrowing rate?

James Kelly: Yes. Paragraph 83 is specific that the borrowing rate for 2018-19 is 2 per cent. The previous paragraph discusses the borrowing for 2017-18, at £450 million, which is the same amount, but it does not say what the rate was.

Derek Mackay: It was 1.9 per cent.

James Kelly: Okay. On the repayment cycle, for 2017-18, repayment is over 25 years, and for 2018-19 it is over 10 years.

Derek Mackay: That is right.

James Kelly: Is there a particular reason for that difference?

Derek Mackay: The spirit of the agreement is in the fiscal framework, but there are two reasons why 25 years suited us, in that instance. The borrowing is to contribute to the whole capital programme rather than to specific projects. The projects in the capital programme include the Forth replacement crossing, trunk roads and other substantial pieces of infrastructure, for which the life cycle is 25 years or more. That cycle of borrowing fits the life cycle of the projects in the capital programme. Interest rates at the moment are low enough that it is in our interest to borrow over the longer period to lock those figures in.

James Kelly: For 2018-19, is the nature of the projects different and is that driving you towards a 10-year cycle?

Derek Mackay: We try to meet the spirit of the fiscal framework. We were able to agree the 25-year period with the Treasury. We generally make decisions on borrowing and how to draw that resource down, and set out the agreements, at the end of the financial year. We try to get as much flexibility from the Treasury as we can; Andrew Chapman can say more on that. The life cycles of projects, plus low interest rates, were the basis of our agreeing 25 years rather than 10 years. If we can lock in low interest rates, that is clearly in the Government's interest, in order to try to maximise its spending.

Andrew Chapman: Yes—that is precisely the reason. For 2017-18, we decided to borrow for 25 years based on two considerations. First, assets in the capital programme matched that term length, because those assets will have lives of 25 years and more. Secondly, as the cabinet secretary said, historically, interest rates are still quite low—1.9 per cent is a good rate—so we decided to borrow over 25 years to lock in that low interest rate.

For 2018-19, we included in the draft budget an assumption of repayment over 10 years because of the principle in the fiscal framework that the term length would usually be 10 years. However, when the lives of the assets justify the term length being shorter or longer, we can make the case to the Treasury to borrow over a longer or a shorter time. As the cabinet secretary said, later in the financial year, we will take a decision on what borrowing we would like draw down from the Treasury, and we will take into account the same considerations as we did last time, which are value for money and what assets we would like to borrow against as part of our capital programme.

James Kelly: When will you publish a list of assets that you will match the borrowing against?

Derek Mackay: Convener, in fairness, that is largely covered in the published infrastructure investment plan. I am happy to provide that to the committee as well as the context of the budget and some of the capital investment. A contribution to the pipeline of projects is in the infrastructure investment plan.

James Kelly: We can check that. I have one final question. Previously, there was an issue about a change in European Union accounting rules, which meant that certain capital projects needed to be included on the balance sheet in full, which restricted borrowing powers. Is that still a live issue in relation to the borrowing that we have just discussed?

Derek Mackay: That is a very good question. That is still a live and complex issue and there are a couple of strands to it. The accounting rules still apply. We deliver projects through the non-profit-distributing pipeline, and stand-alone projects and hub projects have different classifications and definitions, so they can be treated differently. We came to an arrangement with the Treasury in previous years about our borrowing capacity. A notional capital figure is drawn down rather than actual resources, or interest being tied up. The issue is still live, but I have described to the committee in the past how we have delivered NPD projects, in terms of how they are constructed. Any historical matter is accounted for in the Government's accounts. The fundamental issue about compliance with classifications in the NPD programme is still live, as has been explained to the committee.

James Kelly: The accounting convention is still in place but, if I have understood correctly, you are saying that you have found a way of reclassifying projects so that they do not fall foul of the accounting convention, and you are not required to include the full amount on the balance sheet.

Derek Mackay: That is correct. It is all done appropriately and legitimately, of course. Hub projects are treated differently from some of the larger stand-alone projects because of classification. However, we do not face some of the previous issues after our resolution with the Treasury. We have found a way forward.

Adam Tomkins (Glasgow) (Con): I have a follow-up question on the use of the Scottish

Government's credit card for funding infrastructure. You have maxed out the credit card; you have taken all £450 million to which you are entitled in the first year in which that power has been available. Have you done that in order to finance the construction of new infrastructure or to fund the maintenance of existing infrastructure, or both?

Derek Mackay: All borrowing and capital investment—the capital departmental expenditure limits and everything else—is going into the infrastructure investment plan. As I have said, that plan will cover everything, including new projects such as the Queensferry crossing, new national health service facilities, the roads programme and estate enhancement. There will be a mixture of new-build projects and facilities and the maintenance of existing infrastructure, and that mixture is the essence of any capital plan. The borrowing capacity—that £450 million—has contributed to the funding of the overall capital plan.

Adam Tomkins: Can you give any transparency on the relationship between how much of that money is being used to build new infrastructure and how much is being used to fund the maintenance of existing infrastructure?

Derek Mackay: I cannot disaggregate the £450 million from the overall capital budget, because it all contributes to that budget. It is widely regarded as a good thing that we are investing in infrastructure, in the economy, in NHS facilities and in transport infrastructure, which members ask us to invest in, but it would be an academic exercise for me to say which projects the borrowing capacity of £450 million was funding, because the budgeting arrangements mean that CDEL, borrowing and other financial tools are used for investment in the overall capital programme. I do not separate out the £450 million.

Adam Tomkins: I do not think that the exercise would be academic and, of course, I do not think that the word "academic" should be used in that pejorative sense anyway—[*Laughter*.]

Derek Mackay: I hold academics in the highest regard, professor.

Adam Tomkins: The exercise would not be academic because there is a material difference between Scotland investing in new infrastructure that we need to grow the economy and the Scottish Government using its new borrowing powers to maintain existing infrastructure. One activity is investment as properly understood, while the other is the use of capital borrowing to maintain existing roads and hospitals or whatever is being done with the money—we do not know what is being done with it, because you are not telling us.

For that reason, the exercise would be nothing like academic. It is important for the committee to understand at some level of detail and specificity what you as the Cabinet Secretary for Finance and the Constitution are doing with the borrowing powers, given that you are using 100 per cent of the borrowing that is available to you in the first year in which it is available to you.

The Convener: When the cabinet secretary answers the question, I ask him to tell us what the overall scale of the infrastructure programme amounts to. That will give us a perspective on where the £450 million lies.

Derek Mackay: Some of the information is expressed in the overall budget, which we have debated. I do not accept Mr Tomkins's suggestion that I was not treating academics with respect; I simply made the point that the exercise would be academic. It would involve assignment for a strange purpose and would mean saying that one input into the capital budget—the use of borrowing powers—was paying for particular projects, although all the input into capital investment contributes to all the capital projects, as I explained. We do not necessarily assign one funding stream to one project, although that is appropriate for revenue-financed capital projects that are in the NPD pipeline, as I described.

It is not the case that I have not explained the position to Parliament. The budget, the infrastructure investment plan, Government outturn reports and the Government's accounts explain how we use resources. All of that is transparent and up front.

The distinction between new build and maintenance is false. It is clear that we must maintain what we have. Whether that happens to be infrastructure in the estate, transport or housing, maintenance is singularly important—it is also good for the economy. When they are required, new projects—such as the substantial Forth crossing and hospital investment—are a success story. We commit to projects in the budget. The 2018-19 budget earmarked substantial multiyear investment in housing, the transition to a low-carbon economy and energy efficiency. On digital enhancement, we will in due course invest to the tune of £600 million in the procurement of digital connectivity. We have on-going transport programmes and plans to enhance the estate. All of that has been described to and debated in Parliament.

Given the economic cycle and the economic challenges that we face, it is important to invest in the economy through such infrastructure spend, which includes investment in the transition to a low-carbon economy. Such investment is necessary and is to be encouraged. Normally, all members—including Opposition members—

demand more, not less, from our capital spend, and they rarely make a distinction between investing in new build and investing in maintaining what we have, because both aspects are crucial to delivering the new infrastructure that the country requires, to preparing us for an even stronger future—as with digital investment—and to maintaining what we have. We recognise that we do have substantial legacy issues as well in terms of the condition of the estate and adaptation.

10:30

The overall figure for infrastructure spend is substantial. It is between £3 billion and £4 billion for the capital programme and the interventions that we make, so £450 million is a significant part of it; with the low interest rates, that has allowed us to do more in the economy and to deliver the Government's commitments, along with the budget process of Parliament. We are delivering that in a way that is prudent and balanced but is trying to stimulate the economy—on that, I thought that we were all agreed.

The Convener: Alexander Burnett will take us in a different direction with questions on air departure tax.

Alexander Burnett (Aberdeenshire West) (Con): Good morning, cabinet secretary. Paragraph 21 of the Scottish Government report mentions the deferral of ADT until issues "can be resolved", but the report does not say what progress has been made on resolving the issues, nor does it say whether an estimated date for ADT is available. Can you provide information on that?

Derek Mackay: That is a good question, because ADT is still a live issue. The report was accurate at the point when it was published. I still engage with Treasury ministers, but no resolution has yet been found. The principal issue, of course, is the Highlands and Islands exemption. As we have defective devolution, if we implemented ADT right now without resolving that issue, I do not believe that the no-detriment principle would apply, because it would be detrimental to the country. Passengers in the Highlands and Islands would have to pay the air passenger duty—the UK equivalent—for the first time. Highlands and Islands Airports Ltd has said that that would be calamitous for the Highlands and Islands as well as unhelpful administratively. However, there is no resolution yet to the exemption issue.

It is our view that we cannot proceed because devolution is defective. Only the UK Government can resolve the issue, because it is the EU member state and the issue is fundamentally to do with state aid compliance. The Scottish Parliament cannot act in a fashion that is contrary to EU law. The question that arises is over the UK Government's compliance as, ultimately, the UK is the member state. I have therefore worked with the Treasury on the issue. I think that I am on my third or fourth equivalent minister in the UK Government who deals with the issue. In fairness, I think that they want to find a resolution to the issue, but it is largely their responsibility to resolve it so that we can have the successful transfer of the power to Scotland and can enact the policies that the Parliament sees fit to make in that regard. Whenever ADT is introduced, Revenue Scotland will collect the tax.

It is clear that the sector wants certainty for the future, so I am making further efforts to get a resolution with the Treasury. I intend to update the committee in the next few weeks on whether I have established progress.

Alexander Burnett: Would you expect a resolution straight after the Brexit date?

Derek Mackay: That is also a good question. However, if Mr Burnett can explain to anyone what the arrangements are going to look like post-Brexit in spring 2019, he is in a better position than most of the UK Government, never mind anyone else. At this point, we cannot say what will happen, because we do not know what state aid compliance is going to look like or what the open-skies agreement might look like if we are not part of any European agreement. We want as much certainty as possible, and the committee is well versed on the Scottish Government's position in relation to the EU.

However, the position is not as simple as saying that leaving the EU in spring 2019 will resolve the problem, because there will still have to be some form of compliance in trade agreements and aviation agreements. Brexit is not the answer to this one, but clarity from the UK Government could very well be.

Alexander Burnett: I know that other colleagues want to come in on the subject, so I will let them do so.

The Convener: Has the subject been covered sufficiently, or does Ash Denham still want to come in on it?

Ash Denham (Edinburgh Eastern) (SNP): Yes, I will, please. Some of the ground that I wanted to cover has already been addressed. However, paragraph 22 of the Scottish Government's report states:

> "Revenue Scotland has conducted a programme closedown exercise and communicated a high-level 'start-up' plan to Scottish Government."

I am interested in the start-up plan. Is it publicly available?

Derek Mackay: When it became clear that there was a problem with air departure tax, there was no point in Revenue Scotland proceeding with preparations to collect the tax. I will ask Revenue Scotland to provide the committee with more information on that. Revenue Scotland will want as much warning as possible before the power is switched on. It is hard for me to give that clarity as it stands because we have not resolved the issue with the UK Government. In fairness, the sector will want certainty on the tax and Revenue Scotland will need proper notice in order to collect it. I will ask Revenue Scotland to provide the committee with further information on what its processes look like. I intend to come back to the committee with information if I do not make imminent progress with the UK Government.

Patrick Harvie (Glasgow) (Green): It is getting on for four years since it was agreed that ADT should be devolved, it is over two years since the legislation was passed and the snagging issues are still not resolved. Is it fair to assume that they will not be resolved this year?

Derek Mackay: In all honesty, I cannot answer that question because the resolution is not in my hands. I have committed to engage with the Treasury—as I have with successive Treasury ministers—as constructively as I can. I have set out the position of the Scottish Government and our expectations. I am taking further action by establishing a working group with key interests in Scotland to look further at the issue to see whether there can be any other resolutions in a Scottish context that can be delivered without compromising the devolution of powers. We will be doing further work, but it would require the UK Government to resolve the defective devolution before I could properly answer the question.

Patrick Harvie: Would it be reasonable to suggest that the Government could use the extended delay in implementing the devolution of the power to develop a policy that is based on an evidence base that does not fall over like the last one did?

Derek Mackay: Mr Harvie made a number of requests to the Government for independent assessments. I accepted those and the assessments were published. They show the environmental and economic impacts and are independent of those who have an interest in the tax rate. That was helpful for the purpose of Government and parliamentary scrutiny. We have provided far more substantial information.

There is the issue of how the Government chooses to use the power when we get it. The Government still supports the principle of air departure tax reduction. I accept that environmental mitigation would be required. We still believe that it would be good for the economy. However, I will not compromise the nature of the devolution agreement by taking the defectively devolved powers and introducing the tax in the Highlands and Islands for the first time. That would be a calamitous decision for that part of the economy, which is dependent on aviation and other forms of transport, and it would compromise the finances of that tax in trying to deliver a resolution.

I am working as constructively as I can with the sector, with affected communities and with the UK Government. However, the problem is one of the UK Government's making and I require it to provide a resolution.

Patrick Harvie: I want to move away from ADT specifically and ask two questions about uncertainty in general. One example of uncertainty is the potential for behavioural change in response to income tax policy. We have heard that the predictions or views on that range from the apocalyptic to ignoring the challenge and pretending that it will not be an issue at all. Is the Government collecting any data or undertaking any work to gauge the extent or nature of behavioural change, or is it leaving that entirely to the Scottish Fiscal Commission?

Derek Mackay: Of course we do work on that, including modelling. Our chief economic advisor carries out analysis, as you would expect. We also take advice from the Council of Economic Advisers.

By statute, we are guided by the numbers from the Scottish Fiscal Commission. The drawdown that I can have from the Treasury is dependent on the SFC's numbers, so I am bound to use those. However, there is constructive challenge. There are challenge meetings on methodology and on the figures that have been used so that the civil servants and economists can fully understand those. The SFC is independent, but there is that challenge so that we can be as well informed as possible in thinking about its forecasts. The position that we took on income tax was based on the SFC's work, because the drawdown is based on its forecasts and figures. Clearly, we will look closely at that. The forecasting issue is incredibly complex and difficult, but the outturn figures will tell us much more about what we need to know on the actuality. We will be able to do more probing of HMRC on the actual outturn and of the SFC's forecasting. Those figures will be able to tell us much more about what behavioural change actually happened rather than what people think might happen.

Patrick Harvie: Sure. The point that I am getting towards is about the commitment that you have made on several occasions in the chamber and elsewhere to return to multiyear budgeting and spending reviews that take a longer-term look.

The reconciliation between the income tax forecasts and the impact on the Scottish budget for future years is one area of uncertainty, and there are a range of other uncertainties. Those are unavoidable, and I am not criticising the fact that they exist, but to what extent is there a challenge, and how are you addressing it, in returning to multiyear budgeting—for which many people have made the case for a long time—when those new forms of uncertainty exist about the resources that will be available to the Scottish Government?

Derek Mackay: I am delighted that Mr Harvie is not criticising—

Patrick Harvie: Not on this occasion.

Derek Mackay: —and nor should he criticise. Neither should other members who were on the Smith commission and who gave me the fiscal framework within which I operate as finance secretary. It is a pleasure and a joy but, as we all understand, it is incredibly complex.

Adam Tomkins: You're welcome.

Derek Mackay: The question is a fair one. I actually agree with the desire to have multiyear funding, as much as we can. We have been able to do it with things such as early learning and childcare, housing investment and other capital projects, because it makes more sense to give multiyear certainty in that regard. That relates to capital, and we can do that partly because the UK Government spending review has given us longer sight of the capital period. With resource, we are going into the last year that is covered by the UK Government figures. The UK Government has committed to a multiyear spending review. It will set out the UK budget later in the year, and it should set out the spending review in spring next year. As the committee has asked me to do, I will set out more of the scenarios and the planning information in the medium-term financial strategy by the end of May.

In principle, I understand and agree with the desire to have multiyear settlements published, notwithstanding the complexity, the variability and the determinants that are subject to such change, including forecasts and other matters in the fiscal framework, the economy generally and Brexit uncertainty. With all those caveats, in principle, I would like us to be able to return to multiyear settlements. Of course, the not-insignificant matter of parliamentary arithmetic means that I still have to come to Parliament every year to secure consensus to pass a budget, which is another determinant in the mix. I will be able to say much more in the medium-term financial strategy, which will be published on 31 May.

Murdo Fraser (Mid Scotland and Fife) (Con): I want to ask about the concept of a "Scotland-specific economic shock", which has a very specific definition. As you will know, it is when Scottish onshore gross domestic product is below 1 per cent in absolute terms on a rolling four-quarter basis, and Scottish GDP is one percentage point below UK GDP growth over the same period. Under the fiscal framework, that has particular consequences and is known as a Scotland-specific economic shock, which unlocks additional borrowing powers for the Scottish Government.

As far as I can determine from the paper, the earliest trigger point for that has not yet been passed. However, if we look at the Scottish Government's published data, in the four quarters of 2017, Scottish GDP grew at 0.7535 per cent. The UK figure for the equivalent period was 1.7848 per cent, which means that there was a gap of more than 1 per cent. For the four quarters of 2017, Scottish GDP was below 1 per cent in absolute terms, which it appears would have generated a Scotland-specific economic shock. Is my analysis right?

10:45

Derek Mackay: I ask Andrew Chapman to cover that.

Andrew Chapman: An annex to our report covers that very question. First, as you will be aware, the borrowing powers—including the resource borrowing powers—were updated as part of the Scotland Act 2016. Those new powers commenced on 1 April 2017. At the minute, we do not have four rolling quarters of outturn data from April 2017 onwards, so we cannot access the additional flexibilities associated with the Scotland-specific economic shock borrowing powers.

Secondly, paragraph 66 of the fiscal framework provides that we would be able to borrow in the event of a forecast shortfall in tax receipts. We cannot use that power at the moment, however, because we do not have a forecast shortfall to borrow against: we are not in a Scotland-specific economic shock as defined in the annex of the report, but we will continue to monitor the situation closely.

Murdo Fraser: Thank you for that explanation. It confirms what I was driving at, which is that although the provisions do not technically apply yet, the historical data for the four quarters of 2017 would have met the criteria. Am I correct?

Andrew Chapman: Yes, and there have been other points in the past 20 years when that has been the case. That was used in formulating the provisions in the fiscal framework to account for situations in which the Scottish Government needs to manage increasing volatility with respect to tax receipts not being as expected.

Murdo Fraser: My next question is for the cabinet secretary. A few moments ago, you were discussing with Mr Tomkins the question of economic challenges. Clearly, it is an economic challenge for the Scottish economy to face something that is defined as a Scotland-specific economic shock. What does that say about your Government's stewardship of the Scottish economy?

Derek Mackay: I would pose this question: what does it say about both Governments' role in the economy of Scotland? I do not see why the UK Government gets to walk away from any responsibility for Scotland's economy, when the UK Government is mishandling the Brexit negotiations, is in control of migration policy—which is a key driver for population and productivity—and sets the block grant to Scotland. Even our tax powers, where we have some fiscal freedom, are all relative to what the UK Government chooses to do.

In addition, the UK Government manages macroeconomic policy. It has a role to play in industrial and economic interventions in Scotland and has played that role in part.

Clearly it is for both Governments to focus on economic success in Scotland, but that is not helped by the negative factors that I have mentioned. The Scottish Government has set out a range of economic strategies—I challenge Murdo Fraser to name which strategies we should no longer have—that reflect the nature of Scotland's economy and the interventions that we know we need to make.

Adam Tomkins asked about capital investment, and I touched on the fact that we have to prepare Scotland's economy for the future, which involves transport investment, digital investment, housing investment and our transition to being a low-carbon and high-tech economy. There are elements in the Scottish Government's budget to improve our economic position, for example through research and development, attracting more foreign direct investment, upskilling the workforce, investing in innovation, expanding on exports and on intelligent industrialisation—such as the new national manufacturing institute for Scotland—and incentivising new business and property growth through the business rates system, non-domestic rates and growth accelerator policies.

I could go on, but I see that Murdo Fraser does not want to hear me list our economic policies and interventions. However, we have expressed recognition of the challenge for Scotland's economy, and it is for both the Scottish Government and the UK Government to take that seriously. The UK Government has its responsibilities in that regard, and we will do everything that we can with regard to our responsibilities. Incidentally, that also means having a responsible and balanced tax regime that supports the economy, which is a key power that came from the Scotland Act 2016.

Some of the structural divergence has been down to issues such as the downturn in the oil and gas sector. Clearly, that industry is offshore, but it has an onshore impact. However, there are signs of recovery in the sector, which is all the more reason for allowing our economy to diversify, not least in terms of population growth, and to have the kind of impacts that we know will give us economic success. The Scottish Government does not control population growth in and migration to Scotland, and it is clear that the UK Government's actions are making things much harder in that regard. Although Brexit might be happening to the whole UK, it is having a disproportionate effect in Scotland. It is a serious threat to this country's economy, as we can see evidenced right now in the divergence in economic performance.

In the face of the UK Government's austerity, Brexit mishandling and inadequate measures in terms of the challenges that Scotland faces, the Scottish Government is doing all that it can to grow our economy and put us on a stronger financial footing. I hope that that answers the question.

Murdo Fraser: That, cabinet secretary, was a very lengthy answer completely absolving you of any responsibility for the Scottish economy.

Derek Mackay: Not in the slightest.

Murdo Fraser: What undermines your argument totally is the fact that the situation is described as a "Scotland-specific economic shock". If that was down to Brexit, we would see the impact applying across the whole United Kingdom. The fact that it is Scotland-specific suggests that there are problems being made at home here in Scotland that are the responsibility of your Government. Is not it time that you started taking responsibility, rather than passing the buck?

Derek Mackay: The Scottish Government is making the necessary financial interventions that are required to help to grow our economy and to make Scotland an attractive place to live, work and invest. In the face of Tory cuts, we have been investing more in resource and turning austerity into real-terms growth in Scotland's budget through responsible use of our tax powers. We are making the interventions. For example, the biggest increase in any Scottish Government portfolio in the budget year 2018-19 is in the economy portfolio, which had an increase of some 64 per cent, with substantial funding for higher and further education, innovation, business support and a range of schemes to support entrepreneurial culture.

However, in terms of Scotland's divergence, evidence from work that the Fraser of Allander institute and others have done shows that some of the most successful economies in the world are in countries that have population growth. The Scottish Government does not control the levers that are necessary to affect population growth positively.

In terms of Brexit's impact and threat, our analysis is that Brexit is disproportionately affecting Scotland in that regard. Leaked UK Government reports have vindicated what we have said on that impact of and threat from Brexit. I therefore argue, Mr Fraser, that both Governments have responsibility and that we are doing everything that we can to grow the economy in the face of Tory austerity, the mishandling of Brexit and the misunderstanding of the true economic nature of Scotland. The United Kingdom Government should accept its responsibility, as we accept ours, to do more for the Scottish economy.

The characterisation that compares Scotland with London and the south-east of England is not a fair one. When we look at all the data that exists, Scotland is performing relatively well compared to the other nations and regions of the United Kingdom.

Murdo Fraser: That is not true.

Derek Mackay: We therefore know that Scotland has strong economic foundations and that the UK Government needs to take some responsibility for its current handling of our economic position.

The Convener: We have had enough on that issue, so I am moving the discussion on. Ivan McKee has the next question.

Ivan McKee (Glasgow Provan) (SNP): I will make a slight change in direction.

Derek Mackay: Back to Scotland Act 2016 implementation, possibly?

Ivan McKee: I want to talk about VAT, just to clarify my understanding of what will happen when devolution of VAT assignment takes place.

Is the following correct? There will be a forecast of what we think VAT receipts in Scotland will be, but after the fact, there will not be an outturn number as such. An estimate of what we think VAT receipts in Scotland have been will be calculated using survey data, but no hard outturn data will be reported. Through the reconciliation process, we will compare what was forecast with an estimate of what the receipts amounted to.

Derek Mackay: That is a very fair characterisation. We will have a forecast, which will lead to the collection of survey data. I want to be open with the committee: I am not yet satisfied that we have the VAT proposition in the shape that we want. It has not yet been agreed to, and there is more work to be done before we can be totally satisfied that the methodology and the timescale are right for us.

I accept that it would be difficult and unwelcome for the business community to have a separate administrative system for VAT in Scotland. That was the option at one extreme. If we are to base our approach on surveys, we want those surveys to be as robust as possible. What is proposed is far more robust than what has previously existed. Forecasting is a complex business, but I want to make sure that we get the methodology right. Given that we are talking about assignment rather than a new power, I want to make sure that the process is absolutely right for Scotland before we sign up to it. Otherwise, it will become a self-defeating exercise.

Ivan McKee: That is interesting. There are two avenues that I want to explore. The first is to do with why you think that it would be difficult to collect real data. HMRC collects VAT returns from companies in Scotland and the rest of the UK. Those companies know whether the VAT on their input and their output comes from consumers or businesses in Scotland or in the rest of the UK. When a company does a VAT return, it has to identify separately how much of its revenue and spend are EU revenue and spend. There is already a framework.

Have you explored what the system would look like if we were to collect real Scottish VAT data from businesses? Cross-border businesses that sell to consumers or businesses across the UK are big enough and well-organised enough to gather that data anyway, because their business model relies on them understanding very well what they are selling, to whom, and for how much.

Derek Mackay: Sure. I am happy to say that I have been advised that the administration involved would not be welcomed by businesses. I totally get the point that, for some businesses, it is quite simple—they just pay the VAT and it would be for the administrator, in terms of UK Government agencies, to set that out, a. However, there would be many grey areas in which companies that operate in Scotland would not necessarily be sure about where to allocate that amount. "Government Expenditure and Revenue Scotland" is only an estimate in assignation.

That is partly why I say that I am not yet totally satisfied on the issue. I am a bit nervous about reconciling the forecasts and the survey data, but what I have seen so far suggests that if the information in question had to be separated out for Scottish businesses, that would add unwelcome complexity and cost. I am happy to come back to the committee with more information on this: it is a live issue.

There is a timescales for when the methodology should be produced and implemented. Of course, one year was a transitional year with no budget impact, leading to a year with impact. I want to be absolutely sure that we have got the foundations, the benchmarks and the methodology right so that we can reflect as accurately as possible what is really happening in the Scottish economy as regards VAT assignment.

It is frustrating that we are talking about assignment rather than a power to be able to vary the rate, as Parliament might want us to do for particular functions.

Ivan McKee: I understand that. That leads on to my second line of questioning, which you have partly answered. At least you have an open mind. For want of more defined language, we will be dancing around two made-up numbers. What is the value in the proposition if we will be comparing an estimate with an estimate, or a forecast with an estimate, and trying to reconcile in that space? Is there a cleaner way to do it that would not involve that pretendy process?

Derek Mackay: That is the joy of doing the Scottish budget on income tax, which is a substantial figure.

Ivan McKee: At least we will have outturn data on income tax.

Derek Mackay: You are absolutely correct to say that we get to a point at which we know what tax was actually paid in outturn, which is a position that we will never quite get to with the current proposition on VAT. I make it clear that, in my exploration of the issue, I do not propose a new complexity, a new cost or a new burden for business. I want to be assured that we can make the figures as accurate as possible, so that we truly reflect as best we can the VAT that has been accrued in Scotland and therefore what should appropriately come to the Scottish budget. More work is needed on that before we sign up.

11:00

The Convener: I will take that a bit further. You are giving a warning that the position is not where the Scottish Government wants to get to with the information that will be available through the survey process. I understand that, under the fiscal framework agreement, assignment is to be implemented in 2019-20, but there is to be a transition period. Has that period been agreed? If we have not got the system right, the period might have to last longer than was expected so that the numbers can be tested to ensure that we have robust figures before we implement anything that might be difficult.

Derek Mackay: That characterisation is fair. As the finance secretary, I am ensuring that the methodology, the numbers and the estimates are as accurate as possible. Because assignment is involved, it is important to get the system right. We cannot exercise a power—we are just signing up to the assignment of a figure for the Scottish budget, so I want to ensure that the figure is right and accurate for Scotland.

The timescales that the convener outlined are correct. We will agree the methodology, have a transitional year, assess the data and then implement the arrangements, which will have an impact on Scotland's budget. I will probe the matter further. I have a meeting with the joint exchequer committee in the summer, but I will not sign up until I am satisfied that the arrangements are right for Scotland.

The survey data is far better than what existed before. It has more information, covers more households and involves the right range of products. I am not challenging the essence of the methodology; I just want to be assured that it is robust enough to reflect accurately what is spent in Scotland and therefore what is accrued in VAT.

In relation to the Scotland Act 2016, the fiscal framework and subsequent engagement that I have had with the Treasury, there is agreement on a range of financial matters. If we have good reason to do so, we can revisit the technical agreements. If there is any question about the methodology, the estimates or the reconciliation, it is right to get the agreement correct at the outset rather than further down the line. That is why I am treading carefully.

The Convener: I understand that, but are you saying that, if there is no agreement, the transition period could be extended to ensure that all the data can be shown to be robust?

Derek Mackay: If I was not convinced, it would be reasonable to ask for the transition period to be extended so that we could get more data and get the system right, as opposed to implementing something that we were not satisfied with. If that transpired to be the approach, I assume that the committee would understand it.

The Convener: We have had a separate briefing on VAT from your officials, who will get back to us. We will also hear from the Treasury in September. Before we get there, we would like an update from the Government to enable us to construct the Treasury evidence session properly.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): The committee has considered a draft of the audit and accountability framework. Having a robust framework will be important to allowing us to scrutinise HMRC and others, particularly in relation to the identification of Scottish taxpayers, which has been raised. Where are we with the framework? Both implementation reports say that the framework will be agreed between Scottish and UK ministers. Will you assure us that the committee's wish for the process to be as simple as possible will be taken on board in the framework?

Derek Mackay: The framework has not been agreed by ministers for the simple reason that another committee has raised an issue. The Public Audit and Post-legislative Scrutiny Committee wants more access and, like you, it does not like the process of going through the Scottish Government to hold other agencies—particularly UK agencies—to account.

Members want direct accountability, and I agree with that proposition, so I have not signed up to the framework. That is not just my view—the Public Audit and Post-legislative Scrutiny Committee made that point and I think that it came to that conclusion at a meeting in February. I am trying to help parliamentary committees and to get more transparency, more ability to audit and more direct accountability of the agencies that deliver the powers that are being implemented under the acts. I am supporting committees and not signing up to the agreement until that is resolved. If it is resolved, I will sign up to the agreement.

Willie Coffey: Thank you.

Neil Bibby (West Scotland) (Lab): I want to ask about the transfer of the British Transport Police. The annual report from the Secretary of State for Scotland notes that the Scottish Government delayed the transfer of British Transport Police from 1 April 2019, but I did not see any mention of that in your report. You will be aware that the Justice Committee recently identified additional significant costs in relation to the merger and the transfer of staff. Given that it is not in your report, it would be helpful if you, as finance secretary, could tell us to what extent the Scottish Government believes that there are problems, including financial problems, with the transfer of British Transport Police.

Derek Mackay: It is fair to say that my report largely covers the financial provisions coming from the act. The Cabinet Secretary for Justice and the Minister for Transport and the Islands work on that issue between them, but it is my understanding that the joint programme board overseeing the integration agreed to review the timetable, on advice from Police Scotland and the British Transport Police Authority that operational aspects of integration would not be ready for April 2019. That will not have a financial impact that I can quantify until the review is complete and has taken into account what Parliament has said about the issue and all the engagement with stakeholders. I will be in a stronger position once we have that plan going forward, but the Government has clearly reviewed its position on integration in light of the views expressed.

Neil Bibby: Are the financial implications of the transfer being considered as part of that review?

Derek Mackay: They would be. Because of that review, I have not expressed that in the implementation report, because it talks about legal commencement and financial consequences, where that applies, but it has not applied yet.

Neil Bibby: It would be helpful to get more detail on that when it is appropriate.

Derek Mackay: It will be shaped by the plan, which is subject to consultation at the moment.

The Convener: I thank the witnesses for being here and for their contributions. The next item will be taken in private.

11:07

Meeting continued in private until 11:12.

This is the final edition of the *Official Report* of this meeting. It is part of the Scottish Parliament *Official Report* archive and has been sent for legal deposit.

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

All documents are available on
the Scottish Parliament website at:

www.parliament.scot

Information on non-endorsed print suppliers
is available here:

www.parliament.scot/documents

For information on the Scottish Parliament contact
Public Information on:

Telephone: 0131 348 5000
Textphone: 0800 092 7100
Email: sp.info@parliament.scot

The Scottish Parliament
Pàrlamaid na h-Alba