



**OFFICIAL REPORT**  
AITHISG OIFIGEIL

# Finance and Constitution Committee

**Wednesday 12 September 2018**

**Session 5**



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**Wednesday 12 September 2018**

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**FINANCE AND CONSTITUTION COMMITTEE**

**22<sup>nd</sup> Meeting 2018, Session 5**

**CONVENER**

\*Bruce Crawford (Stirling) (SNP)

**DEPUTY CONVENER**

\*Adam Tomkins (Glasgow) (Con)

**COMMITTEE MEMBERS**

Tom Arthur (Renfrewshire South) (SNP)

\*Neil Bibby (West Scotland) (Lab)

\*Alexander Burnett (Aberdeenshire West) (Con)

\*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)

\*Angela Constance (Almond Valley) (SNP)

\*Murdo Fraser (Mid Scotland and Fife) (Con)

\*Emma Harper (South Scotland) (SNP)

\*Patrick Harvie (Glasgow) (Green)

\*James Kelly (Glasgow) (Lab)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

George Adam (Paisley) (SNP) (Committee Substitute)

Gerald Byrne (Scottish Government)

John Ireland (Scottish Fiscal Commission)

Derek Mackay (Cabinet Secretary for Finance, Economy and Fair Work)

Will Quinn (Scottish Government)

Dame Susan Rice (Scottish Fiscal Commission)

Michael Russell (Cabinet Secretary for Government Business and Constitutional Relations)

Professor Alasdair Smith (Scottish Fiscal Commission)

Michael Walker (Scottish Government)

**CLERK TO THE COMMITTEE**

James Johnston

**LOCATION**

The Robert Burns Room (CR1)



**Scottish Parliament**  
**Finance and Constitution**  
**Committee**

*Wednesday 12 September 2018*

*[The Convener opened the meeting at 09:03]*

**Interests**

**The Convener (Bruce Crawford):** Good morning, colleagues, and welcome to the 22nd meeting in 2018 of the Finance and Constitution Committee. I have apologies from Tom Arthur, one of the new members of the committee. He is convening a private bill committee this morning. I welcome George Adam, who is attending as his substitute.

Under item 1, I welcome Angela Constance to the committee. I hope you enjoy your time on it. I invite you to declare any relevant interests.

**Angela Constance (Almond Valley) (SNP):** Thank you, convener. I am pleased to join the committee.

I refer members to my entry in the register of members' interests. I have no known interests that are relevant to the remit of the committee. However, in the interests of transparency around a later agenda item, I note that the Winchburgh development is not in my constituency but it is in the neighbouring West Lothian constituency, so I am very much aware of it.

**The Convener:** It is George Adam's first appearance as substitute at the committee, so I invite him to declare any relevant interests.

**George Adam (Paisley) (SNP):** Thank you, convener. I have just checked my published statement and I have no interests that affect the committee one way or another.

**The Convener:** There is nothing to do with St Mirren on the agenda today.

**George Adam:** No, I do not think so.

**The Convener:** I should have reminded people at the beginning to switch off their mobile phones or put them in a mode that will not interfere. I thank those who have just declared their interests.

**Decision on Taking Business in**  
**Private**

09:05

**The Convener:** Item 2 is for the committee to decide whether to take item 6 in private. Are we agreed?

**Members indicated agreement.**

## European Union (Withdrawal) Act 2018

09:05

**The Convener:** Item 3 is to take evidence on the European Union (Withdrawal) Act 2018 from the Cabinet Secretary for Government Business and Constitutional Relations. Today's session follows on from the evidence session that the committee held last week with the Secretary of State for Scotland. I welcome our witnesses to the meeting: Michael Russell, the Cabinet Secretary for Government Business and Constitutional Relations; Gerald Byrne, the team leader for constitutional policy; and Steven MacGregor, head of the parliamentary legislation unit in the Scottish Government.

Before we move to questions from the committee, I invite the cabinet secretary to make some short opening remarks, if he so wishes.

**Michael Russell (Cabinet Secretary for Government Business and Constitutional Relations):** Thank you, convener, and thank you for the invitation to be here today.

It is worth reminding ourselves at the outset of how central the Sewel convention is to the position of this Parliament in the constitutional arrangements of the United Kingdom. Essentially, for as long as Westminster claims unlimited parliamentary sovereignty, the existence of this Parliament and the Scottish Government is always contingent on Westminster's will. Westminster can legislate in devolved areas or change the powers of this Parliament or Scottish ministers without us being able to do anything about it legally.

Recognising that, the Sewel convention was established in 1998 as the original Scotland Bill was going through, to provide protection for the Scottish Parliament from Westminster undermining our legislation or interfering in our powers. Since 1999, the convention has operated impeccably, being observed by both Governments and Parliaments respecting devolved competence and devolved decision making. As David Mundell said last week, that has included matters on which there has been a good deal of controversy, not least the independence referendum. That has been the case until now.

We are all familiar with the events around the EU withdrawal bill. I want to emphasise two points, both of which appeared in the Secretary of State for Scotland's evidence last week.

First, in answer to a question from Mr Tomkins, Mr Mundell said that the Sewel convention had been "adhered to". For the avoidance of doubt, the Scottish Government does not believe that that is

the case. We believe that the Sewel convention was breached in the passage of the withdrawal act. Consent was properly sought. It was denied by this Parliament but the bill nevertheless proceeded. Nothing happened between the seeking of consent and its refusal to make those circumstances "not normal". By contrast, in Northern Ireland the UK Government made clear on the introduction of bills that circumstances were not normal, for reasons we understand. The difference is clear. The Sewel convention is of no value if the UK Government can decide at the end of the process that consent is not after all required, particularly if it is not forthcoming. The UK Government considered it was a legitimate approach that the withdrawal act should concern all of us.

Secondly, the secretary of state said that it was very clear back in 1998, when the convention emerged, that the Westminster Parliament would always be able to legislate on devolved matters. He said to the House of Commons in June this year:

"While the devolution settlements did not predict EU exit, they did explicitly provide that in situations of disagreement the UK Parliament may be required to legislate without the consent of devolved legislatures."—[*Official Report, House of Commons*, 14 June 2018; Vol 642, c 1122.]

In my view, those statements stand the Sewel convention on its head. The Scotland Act 1998 made clear the legal right of Westminster to legislate in devolved areas. It could not do anything else in our system. However, the point of the convention is that the legal right to legislate in devolved areas will not be used except with the consent of this Parliament, most decidedly not in situations of disagreement. There is grave cause for concern about the future of the Sewel convention under this UK Government. It appears to think it has adhered to the convention but only by emptying it of any meaning or value in protecting this Parliament. This is not an absolutist position, as the Secretary of State for Scotland contends. It is simple recognition of the purpose of the convention and practice over 20 years.

There is, therefore, a problem that needs to be fixed. That was also identified by the House of Commons Public Administration and Constitutional Affairs Committee in its report on these matters published in July.

The Scottish Government has made various suggestions to address the problem for discussion with the UK Government, including revisiting the statutory provisions in the Scotland Act 1998 that were extensively considered by past committees under Bruce Crawford as convener.

Today, I will write again to David Lidington to set such discussion in motion, and a copy of that letter will be provided to the committee. I hope that he

will respond positively to that request. I also look forward to discussing these matters with parties in the Parliament, both later today and subsequently.

In the meantime, as I said to the committee last week, the Government will work with the UK Government to develop Brexit legislation to ensure that Scottish interests are protected as far as we can, but we cannot, in all conscience, invite the Parliament to consider the issue of legislative consent if the UK Government reserves the right to set aside its view for all Brexit-related bills.

**The Convener:** Thank you, cabinet secretary. I had intended starting this morning's conversation with a question on common frameworks, but for understandable reasons you have concentrated on issues to do with Sewel and consent. Patrick Harvie has questions in that area, so he will go first on this occasion.

**Patrick Harvie (Glasgow) (Green):** Good morning. I also expected this to come up a little later. I have a question about the statement that you gave before the summer recess, in the second half of June 2018, when you said that, in relation to the embedding of the consent mechanism into legislation, you intended to

"provide ... detail of ... legislation at an early stage in the new session, and I expect that the ... legislative process ... will get under way shortly thereafter."—[*Official Report*, 19 June 2018; c 16.]

There was no suggestion of that in the programme for government. In fact, it suggested that the Scottish Government would wait until the end of the negotiations to set out our judgment on the best way forward at that time. Does that earlier intention to set out specific proposals still stand? When do we expect to hear back?

**Michael Russell:** Are you asking about proposals about Sewel?

**Patrick Harvie:** My understanding is that that was a comment about the embedding of the consent mechanism into legislation.

**Michael Russell:** We cannot embed it in our own legislation. This is a matter for legislation that will cover devolution as a whole. What I am saying today is that I am putting a set of ideas to David Lidington and to the UK Government about what change would free up this situation to allow us to operate the convention again.

As I indicated in my opening remarks, this essentially lies in the area of ensuring that there is clarity about what is being asked for and how it is being asked for. You cannot ask for legislative consent for any part of a bill, get to the stage at which that legislative consent is refused and then say, "It does not matter because we are going to do it anyway".

We need to embed in legislation a process that defines when legislative consent is required—and when it is not—and when it is required, make sure that it is binding, so that if consent is not given, that is final. That is the proposal that we are making and we hope to discuss that with parties here, including Patrick Harvie. As you know, we have a meeting this afternoon to look at some issues and I hope this will be one of them. I am in the process of writing to the United Kingdom and that letter will be provided today, and I hope to discuss that tomorrow.

**Patrick Harvie:** If Mr Lidington or the UK Government do not respond positively and do not intend to legislate on this in the near future, does the Scottish Government intend to publish legislation and seek the support of members of either house at Westminster to debate specific proposals?

**Michael Russell:** It is a good point. I am certainly prepared to consider that, but there is an on-going process of looking at intergovernmental relations. At the last joint ministerial committee plenary—I think that members of the committee know this and it has been referred to—there was an agreement that intergovernmental relations would be reviewed. That was agreed by the Prime Minister, so I find it surprising that there did not seem to be that indication from the Secretary of State for Scotland last week. Nothing much has happened, as the official who was with me last week at the JMC on European Union negotiations confirmed. Officials have met to discuss it once. We and the Welsh Government take the view that that needs to be given a push. The Welsh Government has published proposals. We have published proposals on devolution in "Scotland's Place in Europe" in December 2016 and we have more proposals here.

An issue that will undoubtedly arise tomorrow and will continue to arise is for the UK Government to put some urgency and push behind this, and the PACAC report pushes that as well. Let us try to see whether we can move on that, but I am entirely open to publishing or drawing up legislation if that is an effective way of moving forward.

**Adam Tomkins (Glasgow) (Con):** I am trying to understand exactly where we are with the disagreement between the two Governments about the extent to which the Sewel convention was adhered to in the passing of the withdrawal act. I understand that you are disappointed that the legislation was passed without the consent of the Scottish Parliament. I am also disappointed that the consent of this Parliament was not given to the passing of that legislation, but I do not yet really understand the constitutional and legal basis for your position that the Sewel convention was

not adhered to. Can I walk you through it so that I can perhaps begin to understand it?

**Michael Russell:** Yes.

**Adam Tomkins:** The starting point is section 28 of the Scotland Act 1998. Section 28(7) states:

“This section does not affect the power of the Parliament of the United Kingdom to make laws for Scotland.”

You referred to that in your opening remarks. Subsection (8) adds that it

“is recognised that the Parliament of the United Kingdom will not normally legislate with regard to devolved matters without the consent of the Scottish Parliament.”

That is the statutory recognition of what has been called the Sewel convention. I do not understand, I am afraid, what in the process of the enactment of the withdrawal act was not compliant with both the letter and the spirit of those statutory provisions, which are the statutory provisions that govern all of us.

09:15

**Michael Russell:** Let me give you an illustration of why I think that the Sewel convention was not adhered to. In the Northern Ireland Budget Bill, there was a declaration by the UK Government at the very start of the process that these were “not normal” circumstances and, therefore, it would legislate without the consent of the Northern Ireland Assembly.

If there had been, at the start of the withdrawal bill process, a declaration by the UK Government that it did not intend to seek legislative consent because these circumstances were not normal, I would reluctantly agree with you.

I think that this is one of these circumstances where a substantial re-examination is needed. For example, I heard Carwyn Jones say on Saturday that he thought the myth of Westminster parliamentary sovereignty should be set aside forever, so this is not a view held only by us.

However, what happened was that the Westminster Government decided that it would request consent, so quite clearly it believed these were normal circumstances, and only when that consent was refused did it say that these were not normal circumstances. It was the refusal of consent that created the lack of normality. That interpretation is very far from what any of us would have expected.

**Adam Tomkins:** Are you really saying to us that there were no intervening incidents? We are talking about legislation that took a year to be passed. The European Union (Withdrawal) Bill was published in late June 2017 and it was enacted in early June 2018. We are talking about a legislative process that took a year and during

the course of that year, a number of things happened.

One of the things that happened was that you introduced legislation into this Parliament that you then asked this Parliament to enact under emergency procedure. You said in your statement in the chamber seeking the support of the Parliament—which was given to you—to enact that legislation under emergency procedure that

“these are not normal times”.—[*Official Report*, 1 March 2018; c 29.]

There was a recognition by that point in the process that whatever one could say about the enactment of the legislation that is necessary in order to ensure that our statute books are coherent after exit day, this was no longer normal. You said yourself three times in that statement that these are not normal circumstances. This is what I do not understand. I do not understand how the position that you seem to be adopting now is that everything is normal unless the United Kingdom Government says at the beginning of the process that something is not normal, when we are talking about legislative processes that take months and months and in which there are many actors, including you. You said in this Parliament that these are not normal circumstances and we reluctantly agreed with you. They were not normal circumstances.

**Michael Russell:** You may have reluctantly agreed with me but, of course, the Secretary of State for Scotland, the Secretary of State for Exiting the European Union and the Chancellor of the Duchy of Lancaster did not agree with me because they did not use those words specifically about their own bill. The statute indicates that those words apply to the bill. If, at any stage, David Mundell or Damian Green and subsequently David Lidington or David Davis had said, “We now believe in the light of what Mr Russell has said”—and I did not know that I was that influential—“that the circumstances around the European Union (Withdrawal) Bill are not normal, and therefore, we are not seeking legislative consent; we are just going to do it,” that would have been understandable, but they did not do so. The fact that I said it about a different bill does not mean that it applies to the bill in question. That is a basic disagreement between us on that issue.

**Adam Tomkins:** This is the last question from me about this. Do you think that the process of enacting the withdrawal act and the UK Withdrawal from the European Union (Legal Continuity) (Scotland) Bill counts as normal legislative process?

**Michael Russell:** It does not matter at all what I think. You have quoted the Scotland Act 1998 and you have quoted it very accurately because you



have quoted the statute and what normality means is applied to that bill. That is what we are addressing in our proposal to David Lidington. You have to say in that piece of legislation, “We are not seeking legislative consent because these are not normal circumstances,” just as the UK Government did in the Northern Ireland Budget Bill, and that cannot be ignored. The UK Government did not do so; it did not attempt to do so. To do it at the end of the process was clearly wrong and did not observe the spirit or the letter of the Sewel process.

**Patrick Harvie:** Is it your position—looking forward, not just thinking back to the European Union (Withdrawal) Bill—that in the absence of that up-front comment that circumstances are not normal and consent will not be sought, the problem is that this Parliament will never know, when it is asked for consent, whether that consent will be respected?

**Michael Russell:** Of course, because the definition of consent, as you know, is given as including consent as we understand it, withholding consent or doing nothing at all, so we would be unable to know whether our position would be respected. There could be the mother and father of all disputes if the UK Government says at the outset, “We are not seeking legislative consent for this bill,” but that would be better than allowing the whole process to happen, at no stage indicating that there is any other intention—indeed, I believe that the Secretary of State for Scotland kept saying that he did not envisage circumstances in which the legislation would be overruled—and then overruling it. That is against the spirit of Sewel; I believe that it is against the letter of Sewel; and it goes against having democratic respect for the institutions.

**The Convener:** I know that Angela Constance wants to raise issues to do with intergovernmental relations, which the cabinet secretary has introduced into his narrative. Do you want to deal with that subject now, Angela?

**Angela Constance:** I think that it would be quite timely, convener. Good morning, cabinet secretary. I am very interested in intergovernmental relations and how they could be improved in a spirit of respect and reciprocity. You mentioned that the JMC has begun to at least moot this subject, although there is a need for further progress. You also mentioned the Public Administration and Constitutional Affairs Committee report that was published in July, which specifically said that after 20 years, Whitehall still does not understand devolution, which not only goes against the principle of devolution but, significantly, is also bad governance.

What is it that needs to change? You have mentioned aspects of the legislative consent motion process but what needs to change in terms of structures, cultures, intergovernmental agreements and perhaps even reciprocal political commitments?

**Michael Russell:** You would not disagree, I know, that the best relationship would be one of equality, which comes from independence. However, short of independence, we have to look for solutions. One of the barriers to those solutions is this view of absolute Westminster sovereignty, which needs to be challenged. However, even within that circumstance, we need to remember that there is no hierarchy of Governments in devolution; there is a hierarchy of Parliaments.

The UK Government must operate with the Scottish Government, the Welsh Government and the Northern Ireland Executive—when it is present—as equals and recognise the roles that they each have. Therefore, the frameworks are an anathema in those circumstances if they are imposed but quite understandable if they are negotiated and agreed.

There is that relationship of equality, but, as I have often said, the weight of Brexit on devolution has shown that there are deficiencies and difficulties that need to be addressed. We had a conversation last week about where devolution is going. The Welsh Government has published on this and we have published on this, in the original “Scotland’s Place in Europe” document at the end of 2016—in chapter 5, I think.

**Gerald Byrne (Scottish Government):** Chapter 4.

**Michael Russell:** Chapter 4. See, I do not keep it by my bed every night. In chapter 4, we look at a range of issues; they are really divided into three. People have a set of rights—employment rights, human rights, and environmental rights—that we want to protect; we are concerned that the UK Government may not protect them in future. We want to make sure that we have the ability to deal with those. We would need a number of powers in order to operate effectively in the new regime; trade is one, which we have outlined in the trade paper, but there are a range of others. There is a third area that has not been greatly discussed but needs to be thought of—legal personality. Ensuring that Scotland and the Scottish Parliament have legal personality would allow us to enter into agreements in a similar way to the devolved parliaments in Belgium, which have that responsibility.

We can put a range of proposals on the table. There is a range of ideas from Wales. Wales is very keen on the idea of a council of ministers—a council of equals—mirroring in a sense the

Council of Ministers that exists in the EU. Post-Brexit, this council of ministers would deal with the areas covered by frameworks. That idea is worth discussing. Wales goes into some detail about voting and qualified majority voting and ways to deal with it. What is concerning—and we have the PACAC report, saying that it does not work—is that there are no ideas coming from the UK, none whatsoever. The impetus for this is all coming from the devolved Administrations.

That indicates two things. One is that I think it is true what David Cameron said, that the UK Government devolved and forgot. There are whole swathes of the UK Government and whole groups of ministers who have never dealt with devolution and do not understand it. Some of us are long in the tooth. We grew up with the ideas; 21 years ago yesterday, there was the devolution referendum and we are still around and we understand how it works—we want to move on but we understand how it works. There are not very many people in the UK Government, and not many people in the civil service, who understand it and respect it. That needs to change.

The second thing that needs to happen is that there needs to be an understanding of equality. Four years ago, when the independence campaign was on, many assurances were given about powers, about equality and particularly about partnership. Those assurances need to be honoured; they are not being honoured at present.

**The Convener:** You mentioned common frameworks. The Secretary of State for Scotland gave evidence to this committee last week that despite a number of invitations to do so, he was unable to confirm that common frameworks would not be imposed on the Scottish Government or the Scottish Parliament. We would like to have your response to that for the record. Also, Mr Mundell indicated that good progress is being made on common frameworks. Again, for the record, can we have your response to that, please?

**Michael Russell:** Yes. I have made it very clear—I think I did it again at this committee last week—that on the basis of working together, we will work on frameworks; the work of the civil servants and the officials on both sides proceeds on those frameworks. There is clearly understanding of what needs to be done, but where there is imposition, we will not co-operate, because that does not respect the partnership; it assumes a hierarchy of devolution in terms of Governments that does not exist.

I am very happy to continue the discussions that are going on—I have made it absolutely clear that we will do so—but we cannot accept imposition. I am sorry that Mr Mundell could not commit himself on that matter but I am very clear about it—as long

as there is no imposition, the discussions will continue.

**The Convener:** The secretary of state also said that good progress is being made in discussions about common frameworks. What is your perspective on that?

**Michael Russell:** Yes, there is continued discussion and there is progress on frameworks and we are able to put frameworks in place as things go on. Where frameworks move into legislation, there will be greater difficulties. We are committed to not giving legislative consent, as you know, because of the circumstances that we are in. Issues will also arise as bills are published. The agriculture bill will be published today and issues have arisen there. However, we are continuing to try to make sure that the voluntary discussion works. All voluntary discussion works on the basis that nobody has a veto but everybody is trying to get a solution, and that is what we are trying to do.

**The Convener:** Thank you, cabinet secretary. Patrick Harvie, do you still have some outstanding questions on common frameworks?

**Patrick Harvie:** I have questions on one or two specifics. The cabinet secretary might want to write to us after the meeting if he is not able to give specific answers just now.

Environmental governance is one of the areas where common frameworks will be discussed and decisions need to be reached about the extent to which those matters are dealt with on a common basis across the UK and the extent to which they are dealt with separately. There have been calls, for example, for either a UK-wide regulator or environmental watchdog agency or for individual country-level bodies to be established within the countries of the UK to take on some of the functions that are currently held at European level.

There are also proposals for the UK to seek continued membership of the European Environment Agency, which includes some non-EU states. Can you give us an update on the extent to which agreement has been reached on those issues? I am aware of stakeholders in the field of environmental policy who are not yet seeing any clarity on that.

09:30

**Michael Russell:** It is appropriate that I seek information from the relevant officials and from the cabinet secretary, so I will write to you with the details on that. I will make one point, however, about membership of the European Environment Agency—and it is a general point not a specific point. We are interested in ensuring continued presence and continued involvement in a range of agencies as those opportunities arise. We are

taking a positive approach, but it would be far better to get the latest position on that and then write to the committee.

**The Convener:** We will exhaust as many issues as we can in relation to the bill and then we will go on to wider issues, cabinet secretary.

**Emma Harper (South Scotland) (SNP):** My question is about the protected geographical indication status of our produce in Scotland and, more widely, in the UK. Last week, the Minister of State for Trade Policy, George Hollingbery, said that some countries regard PGIs as non-tariff barriers to trade. He said there is no question but that Scotch whisky would carry some sort of PGI, because it is easily counterfeited and needs to be protected. He went on to talk about Japanese and South Korean markets, which was interesting because I was focusing on the EU PGI status that we currently have agreement on. He talked about market penetration, and it was interesting to hear that his information was different from that of David Mundell, who gave evidence to us the following day. Basically, he said the intention is that PGIs will remain exactly as they are and that we will have such arrangements in any future trade deals.

I am interested in the differing opinions, the information that is coming out and the reluctance of the UK Government to give assurances over the future of PGI status. What discussions have you had about protecting our PGI status?

**Michael Russell:** I was concerned when I saw the Minister of State for Trade Policy's evidence. He seemed very down on Ayrshire cheese, for example. Apparently, it is not penetrating the Japanese market enough. Speaking as someone who was brought up in Ayrshire, I regret that. I think the Japanese are missing out on a treat.

I was concerned about the dichotomy between those views. My understanding is that a strong commitment has been made to the food and drink industry and that PGI status will be maintained. However, I noted some concern yesterday from James Withers, the chief executive of Scotland Food and Drink, that that will not be the case. It is really important that PGI status is maintained, and the simplest way to do that—apart from staying in the EU, which would clearly still be the logical thing to do—would be to make sure that, in any exit agreement and future relationship agreement, there was an understanding of the continuation of a PGI scheme that worked for both sides. I hope that sense would prevail in that way.

The risks of getting this wrong are very great, and if the Minister of State for Trade Policy himself is not committed to PGI status across the board, I think we have a very serious problem. We will continue to argue for PGI status not just for Scotch

whisky, Scottish beef and Scottish lamb but for all the other things that are of extreme importance, such as the cheeses, Stornoway black pudding and Arbroath smokies, which are very important and need to be recognised. If the Minister of State for Trade Policy will not do that, we will.

**Emma Harper:** There is a PGI process taking place right now for Scottish wild venison. That process was begun in May, but I assume that it will be delayed because of the Brexit negotiations.

**Michael Russell:** I think that it is unlikely to be completed. I cannot speak with absolute veracity of whether that process will be completed, but it seems unlikely to me that it will be completed at this stage. It may well be completed, though, and I would commend Scottish wild venison. Argyll is a strong producer of wild venison and it is very important.

**The Convener:** We have strayed on to the Trade Bill. Someone has another question on that bill, and I am going to finish with Adam Tomkins asking about the European Union (Withdrawal) Act 2018 before we move on to the wider issues. I think that George Adam has a question on LCMs.

**George Adam:** We have moved on, convener.

**The Convener:** I apologise if I missed an opportunity to bring you in.

**Adam Tomkins:** Minister, what did you mean in your statement yesterday when you said of the European Union (Withdrawal) Act 2018 that

“this Government will have nothing to do with”—[*Official Report*, 11 September 2018; c 15.]

that legislation? You said that the Scottish Government will have nothing to do with the European Union (Withdrawal) Act 2018.

**Michael Russell:** I said, with reference to section 12—

**Adam Tomkins:** Can I ask the question? The European Union (Withdrawal) Act 2018 is the law of the land, whether we like it or not, so what did you mean when you said

“this Government will have nothing to do with”

the law of the land?

**Michael Russell:** I meant just what I have been saying about section 12. We will not co-operate with section 12 orders if they are operated, because we believe that frameworks should be voluntary and not enforced on us.

**Adam Tomkins:** In your view, is it normal for a Government in this country to say that it will have nothing to do with the law of the land?

**Michael Russell:** I think that, in the context of my statement, it was not only normal and

necessary but well understood—obviously with exceptions.

**Adam Tomkins:** I do not understand what that means. Can you clarify that, please?

**Michael Russell:** I think that it is clear what I mean.

**The Convener:** Let us move on to the impact on the budget, in general terms, of the UK's exit from the European Union.

**James Kelly (Glasgow) (Lab):** It is less than 200 days from exit day and from the start of the 2019-20 financial year, when the budget will kick in, yet we are weeks away from the publication of the Scottish budget. You have rightly warned, in a number of speeches and interventions, about the impact of Brexit on the Scottish economy and on public services. I will repeat the question that I asked you in the chamber yesterday. What assessment has the Scottish Government made of the impact of Brexit on the 2019-20 draft budget?

**Michael Russell:** Mr Kelly, I will repeat my answer more or less, but I will expand on it a little because I am not being difficult about this in any sense. I understand the question and I understand that Brexit will have such an impact. We have published figures that show the potential impact on the Scottish economy of the various types of Brexit—those figures are in the public domain, both in the first version of “Scotland's Place in Europe” and in the second version, which we published earlier this year. We will continue to update that document, which is a macro publication that indicates what the impact would be on Scotland and what we are doing.

However, there is also the issue of consequential to the budget for the additional costs that we are meeting, which I addressed in my statement yesterday. I gave a clear indication of where that money is being spent, and I indicated that further information will be forthcoming. We do not have knowledge of the future consequential but there would obviously be an impact.

Focusing on the narrower issue of the impact on the coming year's budget, I cannot say what the situation will be. That is properly for the Cabinet Secretary for Finance, Economy and Fair Work to say, and I give you an assurance that he is looking at that. The issue will be addressed in the budget.

Just as we are not yet absolutely clear about the legislative impact, there is a huge range of issues that would produce an impact from any scenario of Brexit. I will give you an example. If there were to be a no-deal Brexit, there would be a range of immediate costs that would be very difficult to quantify in the short term. If there were to be the softest of Brexits, with the customs union and the

single market, the costs would be very much reduced but there would still be an impact, because we would have to quantify how issues such as labour shortage would impact on the budget.

I give you a commitment that that work continues. It is very difficult to estimate those costs, but it continues. I also give you a commitment that the cabinet secretary will address the matter—in his budget, I presume, but also in his discussions with Opposition parties. I draw your attention to the published papers that contain information about the potential impact on Scotland.

**James Kelly:** Let us be clear. Are you saying that the Scottish Government has assessed the scenarios that you have outlined directly to gauge the impact on the Scottish budget in relation to revenues and spending?

**Michael Russell:** I am saying that the scenarios we have outlined are quantified in both “Scotland's Place in Europe” and in “Scotland's Place in Europe: People, Jobs and Investment”, which indicate what effects there would be. As time passes and we know what is going to take place, the Scottish Government will undoubtedly report on the impact on the budget.

**James Kelly:** Bearing in mind that the budget is going to be published before the end of the year, are you able to detail what work has been carried out directly on the impact on that budget and the various spending?

**Michael Russell:** I am sure that Mr Mackay will want to be as comprehensive as he can be about the work that is being done and the implications. I am not trying to avoid answering the question, but it is Mr Mackay's responsibility as the person who produces the budget. As a budget spokesperson, you will be in negotiation with him about such matters, and that is the right way to proceed. I cannot go into the details of the impacts on the budget here and now; that must be done by Mr Mackay.

**The Convener:** Let us move on to a different area. Willie Coffey wants to have a discussion about the Chequers deal.

**Willie Coffey (Kilmarnock and Irvine Valley) (SNP):** Last week, Mr Mundell told us that the Chequers deal was still on the table; yet, shortly after that, we heard Boris Johnson in his ranting describe it as “a suicide vest” the detonator for which we would hand to Brussels. Shortly after that, a former Brexit minister said that Mrs May faces a tremendous amount of political crisis and rupture if she does not ditch the Chequers plan. With that kind of loyal support within her own party, do you not think it is time that the Tories

stopped their civil war and started applying their attention to avoiding a no-deal Brexit scenario?

**Michael Russell:** To be charitable to all sides in the civil war, it has been going on for 40 years and it is not likely to come to an end this week. We are, in a sense, collateral damage in that civil war—everybody is—while it is going on. It is very damaging indeed, and very irresponsible.

We have to try to understand where the Chequers deal is now and where it might go. There are two conflicting views of the Chequers deal. The Prime Minister and various others who have spoken publicly about it believe that it is fully formed—that is it. It is on the table. It will be accepted and it is going to go ahead. However, nobody apart from the Prime Minister and those around her believe that that is the case. I have heard civil servants and others talk about the deal evolving.

The crucial question is whether the deal can seriously evolve into something that can produce a high-level agreement—a sort of blind Brexit. We must remember that this is about exit—it is not the end. It is not even the beginning of the end. It might be the end of the beginning, because, once the exit has been agreed, the future relationship will need to be decided, and that will be the hard thing. The really depressing thing I have to say this morning—Mr Tomkins accused me of spreading gloom in the chamber on 11 September—is that there are years of this ahead. We are trying to deal only with the exit just now. When we start to try to deal with the future relationship, it is going to be even worse.

Where we are at the moment is this: can Chequers produce the high-level, blind Brexit agreement that will let the present Tory Government off the hook even among its own supporters and get it through to next year? Can the Government move to that or will it be stopped by the Brexiteers, those people who presented a completely half-baked report yesterday in the House of Commons? We do not know, because the answer to that question lies in the internal Tory party shenanigans. It does not lie in anything to do with Brexit or anything to do with the negotiation; it lies in whether the Prime Minister is able to move. Last night, Robert Peston reported on a group of Tory MPs who were openly talking about getting rid of her, so how can we have any confidence in the process at all?

Yesterday afternoon, while I was delivering my statement, members of the Tory front bench were shouting about something that Michel Barnier is alleged to have said yesterday. Michel Barnier said something else last night. Clutching at straws is what most of the Tories are doing at present. What they should be doing—you are not wrong

about this—is sorting out their own house and being ashamed of the mess they have made of it.

**Willie Coffey:** Last week, Mr Mundell, too, said that Mr Barnier was not to be believed about dismissing the Chequers deal. In the past few days, he has said that a deal might be possible in six to eight weeks, but do we know whether he means the Chequers deal?

**Michael Russell:** Mr Barnier's number 2 said something quite fascinating last week in the middle of a row about what Mr Barnier had said to the Exiting the European Union Committee and the language in which he had said it. He indicated, rather interestingly, that the row told us not much about what Mr Barnier had said but a lot about the current state of British politics. There is a constant obsession with every statement, with swings one way and then swings the other way.

There just might have been a good way to do this. I do not think so, because I think leaving the EU is the wrong thing to do, but there might have been a good way to do it. However, this is the worst possible, most incompetent way you could imagine, and the responsibility for that lies fairly and squarely with the current UK Government and the Conservative Party.

**Murdo Fraser (Mid Scotland and Fife) (Con):** Maybe we can cut through the party politics and get back to talking about the business of Government.

Over the past few days, we have heard some commentary about the Chequers deal from various stakeholders. On Monday, NFU Scotland said:

“It is important that politicians of all parties put their shoulder to the wheel and secure something as close to the Chequers agreement as possible. If we step away from that, it will be detrimental to UK and Scotland.”

We heard similar comments about the Chequers deal last week from the Confederation of British Industry Scotland, and other stakeholders such as the Scottish Fishermen's Federation have been supportive of what the UK Government is trying to achieve. Why is the Scottish Government not listening to those important stakeholders in the Scottish economy and Scottish society and, instead, carrying on with the posturing that we have heard this morning?

09:45

**Michael Russell:** Let me start with the business of Government. With the greatest respect, Mr Fraser, if the UK Government was doing the business of Government, we would not be in this mess. On the issue of the Chequers agreement, the words “close to” are interesting. By the way, I am quite happy for people to read the CBI

president's statement of last week, which does not endorse the Chequers deal by any manner of means. On getting

"as close to the Chequers agreement as possible",

the closest that would be acceptable would be single market and customs union membership. Customs union membership is halfway in the deal; single market membership is not in it, except possibly in goods in a totally false split.

I want the best possible deal for Scotland, and that is what I will continue to argue for. I am not going to hide the fact that the Chequers agreement will not fly. We know that it will not fly, and NFU Scotland has not said that it will fly. How can it change to provide the basis for a solution? That is the issue: how can it change? Until there is agreement to change it in order to get agreement, there is no point in having this discussion. The deal has to change. Is it evolving or is it settled? That needs to be resolved, and the two sides are presently saying different things.

The internal warfare in the Tory party is creating enormous instability, and business after business is complaining. Last night, the chief executive of Jaguar Land Rover made an unequivocal statement about that. It behoves the Conservative Party to listen rather than to pretend that everything is fine, because it is not fine.

**Murdo Fraser:** If there is a vote on the Chequers deal in the House of Commons, what do you expect your Westminster colleagues to do? Will they vote it down?

**Michael Russell:** As I said yesterday in my statement—I am happy to repeat it—that is a false distinction.

**Murdo Fraser:** No, it is a very simple question, and it needs a yes or no answer.

**Michael Russell:** No, it does not, and it is not going to get a yes or no answer.

**Murdo Fraser:** If there is a vote on the Chequers deal in the House of Commons, will your SNP MPs support it or vote it down?

**Michael Russell:** You are not going to get a yes or no answer, because the reality is that there is a range of possible options. The much more likely vote will be between a blind Brexit, in which we do not know what is going to happen, a high-level statement that goes nowhere and the madness of just opting out. What everybody should be supporting—we will go on arguing for it, as my colleagues in the House of Commons have—is, at the very least, single market and customs union membership. We are not going to be put in the position—

**Murdo Fraser:** The Chequers deal does not support that.

**Michael Russell:** We are not going to be put in the position of backing a Prime Minister whose actions on these matters have been disgraceful, nor will we be put in the position of betraying the people of Scotland who voted to stay in the EU. In all circumstances, we will do the best thing for Scotland, which is not being the midwife for Brexit. Brexit is a disaster for Scotland. You know that, Mr Fraser, and it is about time you recognised it.

**Murdo Fraser:** You have answered my question, Mr Russell: you will vote it down. Thank you.

**Neil Bibby (West Scotland) (Lab):** Last week, the Secretary of State for Scotland was reluctant to share with the committee details of the specific sectors of the Scottish economy that the UK Government believes will be hit hardest by a no-deal Brexit. Has the UK Government provided those details to the Scottish Government?

**Michael Russell:** The information that has been published by the UK Government includes its analysis, which is similar to our analysis and is actually slightly gloomier. I do not know whether that information about specific areas of the economy exists, but it has certainly not been shared with us.

**Neil Bibby:** You mentioned a difference between the analyses of the Scottish Government and the UK Government. Yesterday, you referred to the no-deal technical notes. In what areas—if any—is there a difference of opinion between the Scottish Government and the UK Government on the details that are set out in the technical notes?

**Michael Russell:** The technical notes often deal with what you might call wishful thinking. There are whole areas in the technical notes that say, "This is what we would need to do, but it would be contingent on the EU saying that it would do this." The technical notes are often like small deals because there would be small deals within an overall no-deal scenario. An example is the rolling over of the aviation agreements. As you know, Dominic Raab got a bit of a tongue-lashing yesterday for having tried to set that up with all of the 27 member states without going through the negotiating process. A lot of the small-scale deals require European agreement and there is no such agreement; so, at the very least, we should be sceptical as to whether those deals can stick.

We have agreed that we will fact-check those technical notes against Scots law and any information that relates to Scotland, and we have tried to do so. We have not seen all of them, so we cannot fact-check them all, and we are not endorsing that policy view. We are passing it on, and we are saying that it is important that that stuff exists. However, I do not think anybody knows whether the arrangements would work. Some of

them might and some of them probably would not—that is the difficulty of the situation.

It needs to be understood that the no-deal scenario should be ruled out and could be ruled out in two different ways. It could be ruled out simply by saying that, in the event of a no-deal scenario, we will seek to continue single market and customs union membership for the foreseeable future. That is one way. The other way in which it could be ruled out is by seeking an extension of the article 50 process, making it an automatic trigger that, if the Government cannot come to a deal, it will say to the EU, “We want to suspend the article 50 process while we work this out.” Both approaches are legitimate and could be taken. I do not understand why they are not being taken. Instead, the Prime Minister keeps saying that a no-deal scenario would not be the end of the world or a disaster. Well, it would be. It would not be the end of the world, but it would result in a very difficult set of circumstances.

**Neil Bibby:** Further detail of the Scottish Government’s response to those technical notes, including the fact-checking and other comments, would be welcome.

**Michael Russell:** I note that, and I am not averse to providing that information.

**Neil Bibby:** That would be good. You said that you have published “Scotland’s Place in Europe” and other statements. For transparency, will you publish all papers that you have commissioned on the impact of Brexit and the preparations that have been made by the Scottish Government?

**Michael Russell:** I am not going to make a commitment to do that, because I am not sure what is on that list. We will publish what we write—we have prepared, I think, 16 papers of one sort or another. I will provide the list to you. We have published an extensive list of papers and will continue to do so. We plan to publish more papers in the weeks and months ahead.

**The Convener:** Thank you for giving evidence to us this morning, cabinet secretary. We are very grateful to you.

I suspend the meeting to change witnesses.

09:53

*Meeting suspended.*

09:57

*On resuming—*

## **Scottish Fiscal Commission (Forecast Evaluation Report)**

**The Convener:** The next item is evidence from the Scottish Fiscal Commission on the forecast evaluation report. This session forms part of our 2019-20 pre-budget scrutiny. I welcome to the meeting Dame Susan Rice, the chair of the Scottish Fiscal Commission, Professor Alasdair Smith, commissioner, and John Ireland, the chief executive. Thank you very much for sending us the report and the very useful summary that was with it. Before we move to questions, would Dame Susan Rice like to make any opening remarks?

**Dame Susan Rice (Scottish Fiscal Commission):** Convener, thank you very much. Good morning, and once again I thank the committee for inviting us. It feels like just yesterday that we were last here talking to you about our summer forecast. We hope that you have all had a good summer, as we have.

Last Wednesday we published three reports: “Forecast Evaluation Report”, which is an annual report; “Value Added Tax (VAT) Approach to Forecasting”; and “Statement of Data Needs”. Yesterday we also published our first costing to accompany the social security secondary legislation for the best start grant.

I will focus my comments on income tax, the economy forecast and our data needs. We are required by legislation to produce an annual evaluation of our forecasts. This is something that we do anyway because looking back at forecasts and how they performed against outturn data is one of the best ways in which forecasters can improve.

As we state in our report, there are many reasons for differences or errors. Forecasting is not an exact science. That is especially the case when we are dealing with economic statistics that are often revised and with some of the newly devolved taxes, where the tax authorities are still establishing the baselines for receipts. In Scotland, the position is even more dynamic as we observe data and trends often for the first time. Things are still forming here.

We have tried to be fair and self-critical of our work and transparent about the way in which we have evaluated it. We have also compared our own forecast errors with those of similar organisations, notably the Office for Budget Responsibility. We find that, overall, our forecast errors are within the ranges that we would expect, by looking at the track record of others.

10:00

This evaluation was the first opportunity to compare our own forecasts, produced in December last year and May this year, against the economic and fiscal data. The relatively short period since we produced the forecasts means that we are looking only at our in-year forecasts. That means that we are talking about forecasts for the fiscal year 2017-18. Next year we will be able to revisit those forecasts, looking at the track record for the current year, 2018-19, as well.

One exception to this timing, however, is income tax, because the most recent data, released in July, is for the earlier fiscal year of 2016-17; we have all had to keep that difference in mind. You may recall that there is an 18-month lag as a result of self-assessment. This is the first-ever release of Scottish non-savings, non-dividend income tax outturn data; it follows Her Majesty's Revenue and Customs Scottish taxpayer identification exercise and represents something of a milestone in the devolution story.

When we produced our forecasts in May, the survey of personal incomes was the best available source of information on income tax liabilities in Scotland. The survey is based on a sample of UK administrative records held by HMRC, with postal addresses used to infer who would be a Scottish taxpayer. The most recent version of the survey is for 2015-16. In our income forecast in May, we projected income tax liabilities from the fiscal year 2016-17 through to 2023-24.

Now that we have the new data that were released in July, we can see that our survey-based projection for 2016-17 had a £550 million overestimate of receipts. Our analysis suggests that that is primarily driven by the actual number of higher and additional-rate taxpayers being lower than the survey of personal incomes had suggested. As the numbers date from before any changes were made to Scottish income tax bands and rates, we believe that the differences are driven by data rather than by a behavioural response by taxpayers.

I know that the committee will be concerned about the potential impact of this new information on the Scottish Government's budget. The new receipts data refer to the fiscal year 2016-17, as I said. That is the baseline year under the fiscal framework; it will change the initial deduction for the block grant adjustment for income tax. Therefore, there should be no direct impact on the budget. We can discuss that more, if the committee would like to do so.

You will see that we have also evaluated our forecasts of the other taxes in our remit, including non-domestic rates, Scottish landfill tax and land

and buildings transaction tax. I will not say any more about those at this stage.

Turning next to our economic forecast, the official statistics were revised significantly following our May forecast. Economic growth for the fiscal year 2017-18 was revised up from 0.8 to 1.3 per cent, mainly due to some very large revisions in the estimates of construction activity.

Our May forecast of growth for the year 2017-18 was 0.7 per cent, which now looks too low. At that point we had three quarters of official data, which were quite consistent with each other and suggested only modest growth. While we were aware that revisions to those data were likely, we held the view that the statisticians in the Scottish Government, whose job it is to produce the statistics, were best placed to measure and revise their estimates of economic growth.

While the revised data show stronger growth in the year 2017-18 than was previously thought, the average growth since the beginning of the decade since 2010-11 and beyond has fallen slightly. Our view is that there is no evidence from this revision to suggest that we should change our underlying view of subdued trends in the economy.

I will finish by saying a few words about data more generally. Following its inquiry, the Economy, Energy and Fair Work Committee recommended earlier this year that we publish an annual statement of our data needs. As my comments illustrate, good data are fundamental to good forecasts. On balance, we have seen progress in the provision of data, although more can be done. We are concerned, though, about our access to data from the UK Department for Work and Pensions. We do not currently have an agreed way of obtaining access to the data that we require, and our most recent request for information, public body to public body, was treated as a freedom of information request. Although we received that information just in time for us to be able to examine it, we are placed in an uncertain situation with regard to future data requests.

I hope that that was a helpful overview of our work, which made for a busy as well as a good summer. We are very happy to answer any questions that committee members have. Thank you.

**The Convener:** Thank you very much for your opening statement. Can I pick up on the final point that you made, which was about not being able to secure data from the DWP? You said that the DWP treated your request as a freedom of information request. That seems somewhat surprising, given that you were trying to get the data to ensure that we have our own new social security system, and the payments for it, in as



secure a position as possible. Have you raised the matter with any other committee in the Scottish Parliament, such as the Social Security Committee, to make sure that it is aware of the quite significant challenge that you have just told us about?

**Dame Susan Rice:** It is and was a significant challenge. It happened in recent weeks, so I do not believe that that committee has met since then. We have, however, been very active in working with our colleagues in the Government and talking directly to others in the DWP, to help them to understand our needs. Our sense is that, like all big agencies, the DWP has more and more work to do and probably not more people to do it, and would prefer to take all requests from Scotland from the Scottish Government. The commission, as you all know, acts independently and we have both a right and a need to request our own data. We have raised this and we are in conversation, but we need to get the matter resolved. We need an agreement—a memorandum of understanding about how we work together—as we have with the other UK and Scottish agencies.

**The Convener:** The social security issue is not a primary responsibility for this committee, but this is unlike any other circumstance. I know that departments are busy, but we are talking about a primary requirement for the Scottish Government, the Scottish Parliament and the commission. It is not for me to tell you how to do your work, but I would have thought that a reasonable way forward would be for you to write to this Parliament's Social Security Committee, to let it know what is going on, and to the Scottish Government, to seek its help in securing an outcome as early as possible. I leave that with you. As I said, it is not a matter for this committee. Forgive me for straying into the area, but you did raise it.

Dame Susan, you explained that HMRC has now published its Scottish income tax outturn data for 2016-17, which are some £550 million below the Scottish Fiscal Commission forecast for 2016-17. You also said that that would have no impact on the budget. For the record, it would be useful for people to understand why the forecast number having changed will have no impact on the budget.

**Dame Susan Rice:** The year 2016-17 is the baseline within the fiscal framework, so that is the base from which we start. We hope that the new data are more accurate and reflective, and as we all incorporate the new data they will give us a new baseline, which will carry forward. Because it is the baseline, it is also the time when the initial block grant adjustment is made, so as one number changes the other number changes, and it nets out without an actual impact on the budget. Is that clear enough?

**The Convener:** Yes. It is useful to have that on the record from the beginning.

**Alexander Burnett (Aberdeenshire West) (Con):** I refer members to my entry in the register of members' interests.

Good morning, Dame Susan. I have a couple of questions, starting with one on construction. As you mentioned in your opening statement and in the report, there were significant revisions in construction industry activity, which were caused by problems in measuring that activity. You go on to say in the report that because those problems have by no means settled, we can expect that there might be further changes in that sector. That is symptomatic of a failure more broadly across Parliament to understand, in infrastructure projects and the like, the pipeline of the construction sector. Is your analysis of that sector improving and how might that analysis interact with other parliamentary analysis?

**Dame Susan Rice:** I have been talking, so Alasdair Smith can take this one.

**Professor Alasdair Smith (Scottish Fiscal Commission):** I am not sure that it is helpful to refer to our analysis of the construction sector data. We were aware, as were other forecasters and indeed the Scottish Government statisticians, that there were problems in the construction sector data, which were jumping around so much that it was hard to believe that they were accurate. Although there are some inherent difficulties in counting what is going on in that sector from quarter to quarter, it is really for the Scottish Government statisticians to do the best job that they can of producing the most accurate statistics. What we have seen in this quarter is that, having done that, the statisticians have decided that it is appropriate to have an unusually large revision to bring the statistics into better line with what they think is reality.

We have decided that even though we might have some doubts about the credibility of a set of statistics, it is not really for us to get into the business of second-guessing the Government statisticians and trying to do a job in parallel with them or do their job for them. It is sensible for us to take account of the uncertainties in the data, which indeed we did, in the sense that, in looking at our longer-run projections in our report last December, we decided to smooth the construction industry statistics so that their jumping around did not affect our long-run view. In doing our short-run forecasts we really had no better alternative than to take the statistics that we were given and make our best forecasts on that basis. Obviously we welcome the fact that there are now—hopefully—more reliable statistics. We will be taking those into account in our next forecast.

**Alexander Burnett:** When you see uncertainties in the statistics, which you cater for in providing your analysis, is there a process where you feed that back to the Government statisticians so that they can improve their statistics in future?

**Professor Smith:** I think that the Government statisticians and everyone concerned with the construction industry statistics knew that there were puzzles about the statistics, if only, as I have said, because they were jumping around in a way that was hard to understand. There was no need for us to tell the Scottish Government statisticians what they already knew.

**Alexander Burnett:** My second question concerns paragraph 3.39 in the report, in the section on non-domestic rates, and uncertainty about

“the resolution of appeals from revaluations that took place before 2017.”

I have a number of constituency cases in which appeals have been going on for longer than a year. Will you elaborate on your assessment of that uncertainty? Is it about the quantum of appeals or the quantum of results?

**Dame Susan Rice:** I am not sure that we have much to add beyond what is in the report, except that this is an area where the numbers are quite volatile. Things happen at different points in the year and a complicated suite of measures are fed in. It is not just about buoyancy; it is about a number of different things. Even in the old days of the non-statutory fiscal commission, numbers jumped around. They will always move a lot. I am not sure that there is a way to address that. There was a large wind farm where the basis changed, making a £3 million difference. The data are also affected by often a very small number of properties or entities that have a large value. John Ireland, I do not know if you want to add some detail to that.

**John Ireland (Scottish Fiscal Commission):** I think that that is as far as we can go on the nitty-gritty. We work very closely with the Scottish Government statisticians and the assessors who compile the roll. As Dame Susan said, during the course of the year there will be a number of appeals, which we track. We speak to the assessors to get their sense of where things are going. It is a very lumpy sort of process. We try to keep on top of it, but there are limits to what we can do.

10:15

**Professor Smith:** It is worth emphasising that although there are a number of inherently volatile elements in the non-domestic rates total and, as Dame Susan and John Ireland have just said,

there is a limit to what we can do to forecast—we just have to accept that those elements are a bit difficult to forecast—the overall total of non-domestic rates is a pretty stable number. We are talking about a bit of volatility on top of a very big number. Numerically it is not a huge forecasting issue.

**Willie Coffey:** I have a question about income tax, Dame Susan. Do you remember when, a couple of years ago, HMRC failed to identify about 400,000 Scottish taxpayers? That led to some debate, certainly at this committee and others, about the failure even to identify people who were liable to pay the Scottish rate of income tax. It has now emerged that there was quite a discrepancy between the two data sets, which led to the £500 million below-forecast issue. Who has the real data? How can we know which of the data sets is accurate?

**Dame Susan Rice:** The previous data set took UK-wide data and inferred, by address, that people must be Scottish-rate taxpayers. HMRC has now taken a different and, I suppose, more sophisticated look at who might make up that pool. That is the reason for the change now. It is a one-time change—it is not a number that will flip back next year or the year after. There is a completely different methodology now and HMRC has narrowed down who would be NSND—non-savings, non-dividend—income tax payers in Scotland. Some people will pay other kinds of tax and HMRC has narrowed that down.

**John Ireland:** The outturn data that is published in July is based on the S code. You will remember that, on your pay-as-you-earn code, you have a little “S”. In a sense that is the definitive data. The issue with the forecast evaluation was the mismatch between a statistical sampling of an earlier approach and that hard data about the S codes.

There is another issue, which is whether all Scottish taxpayers are correctly identified with S codes, but that is separate from the issue that we are talking about here.

**Willie Coffey:** How can the public get any sense of comfort about what you are dealing with? I do not envy your task here at all, but how on earth can we get any comfort that what we are dealing with is in any sense reliable? It seems that we are dealing with huge variations from time to time.

**Professor Smith:** I would emphasise what John Ireland said, which is that we are not looking at two competing sources of data that are to be treated equally. Until the new data came from HMRC, we and others were working with data derived from a survey of personal incomes. A survey is just a survey. The data that we now have

is HMRC's classification of taxpayers by S codes and that has a different kind of status.

As John Ireland said, the data may still contain some imperfections, but that is the definitive data. We are not jumping around between one and the other. The new data source is the one that we will be basing our forecasts on from now on. It is the one that the OBR will be using and it is the one that, as Susan Rice said, will underpin the block grant assessment. It is the definitive data source.

**Willie Coffey:** So we will not see any of these crazy fluctuations in future.

**Dame Susan Rice:** There will be some.

**Professor Smith:** The introduction of the new data source is a one-off step change in the availability of data. From the perspective of making good forecasts, it is a very welcome one-off change.

One of the reasons for the change in the income tax forecast is that quite a high proportion of income tax revenue comes from higher-rate taxpayers. For various reasons that are set out in our report, the survey of personal incomes is not very good at identifying accurately the number of higher-rate taxpayers in Scotland because, for confidentiality reasons, there has to be a bit of aggregation of higher-rate taxpayers in the survey data. On the other hand, the new source—the HMRC outturn data—identifies the higher-rate taxpayers with S codes. It is a more definitive source.

For the purposes of forecasting income tax revenue, it is particularly important that we have a good handle on the number of higher-rate taxpayers. We now have a much better handle on that.

**The Convener:** Representatives of HMRC are coming in front of the committee on 3 October, so we will have a chance to ask them in a bit more detail about how HMRC came to that final outturn data description. There is an interesting issue about the number of addresses identified in the survey process being much greater than the number of actual taxpayers. That is an issue for HMRC to pick up.

**James Kelly:** To an extent, I can understand how the discrepancies happened, because the survey data that you used was based on a very small sample of just 1 to 2 per cent. Obviously, HMRC has the actual outturn data based on all the data on its system. We have identified that there are nearly 30,000 fewer taxpayers than in the original forecast, and there is a lag until we will get the next HMRC outturn report, which is for 2017-18. In your forecasts later this year, how will you track changes in the number of taxpayers and forecast that?

**John Ireland:** We will take the outturn data from 2016-17, which gives us a clear handle on the taxpayers at that time, and project that forward. We will readjust our forecasting models so that they use that as a baseline. We will know more early next year when the survey of personal incomes is produced for the same year as the outturn data. We will get an even better handle then. However, for the December forecast, we will be rebasing the forecasts and the number of taxpayers using the outturn data for 2016-17, which should give us a far better and more accurate forecast.

**James Kelly:** You are going to take the number of taxpayers from the HMRC 2016-17 outturn report and fix that for 2017-18. You are not going to make any adjustments to it.

**John Ireland:** We will make some adjustments. We will try to project that forward. At the moment, we are working through the details of that. Our tax forecasting model has a detailed demographic split, and we are trying to work through how we will use the relatively limited data that we have from the outturn data, which is just by tax band, and how we will fix that and merge it with our fairly rich demographic modelling.

**James Kelly:** What would be your basis for making adjustments and changes? Obviously, the issue is sensitive, bearing in mind the discrepancies that there have been in the additional and higher-rate bands.

**John Ireland:** We will take those numbers and tax bands as a hard piece of data. We now just need to work through the quite intricate details of our modelling, which is broken down by gender and age band, and do our best to calibrate it that way. We will lean heavily on the taxpayer numbers in the outturn data, because that is the hard piece of information that we have. We will give it very high weight.

**Neil Bibby:** The SFC forecast of landfill tax revenues had an 8.1 per cent error, with the revenues being £11 million higher than forecast. The error was higher than the OBR's, which was 5.7 per cent, and the Scottish Government's error in 2016 of 0.5 per cent. Do you see any need to revise your approach to forecasting landfill tax?

**Dame Susan Rice:** Landfill tax is interesting. It involves considering a combination of how much waste is destined for landfill, with all the programmes encouraging other routes for a lot of waste, and the development of incineration capacity. We look at when we think incinerators will come online, what capacity they will have and so forth. All of the most up-to-date data feeds into our on-going forecasts and we will see where that comes out.

**John Ireland:** It is an in-year forecast. We had some available data for the first quarter and then we used the seasonal pattern in the previous four quarters to extrapolate that first quarter's data forward. Exactly as Neil Bibby says, we are going to have a look at that seasonal pattern and make sure that what we are using reflects the distribution between quarters as it currently is rather than as it was in the past. There is a bit of work for us to do there. We recognise that we got the seasonal pattern slightly wrong last year.

**Neil Bibby:** On LBTT, there was an overall forecast error of zero but, within that, there was a 5.1 per cent error on residential LBTT and a minus 5.3 per cent error for non-residential LBTT. With that in mind, are you planning to make any revisions to your forecast methodology for LBTT?

**John Ireland:** That was a similar but slightly different issue. Again, it was an in-year forecast and the principal forecast in residential was driven by the fact that transactions in the lower half of the market were much lower than we had estimated from the data. We are going to have another look at that and ensure that we are on top of that transactions data.

The housing market is trickier to forecast than landfill, in that it is not just about a mechanistic approach of applying a seasonal pattern. We need to look at some things and do a bit more digging on that. Again, the issue is the difficulty of doing an in-year forecast. It is about how we use the data for one quarter and extrapolate that forward.

**The Convener:** I know that Angela Constance wanted to raise issues about access to data. I hope that I did not get into some of your territory earlier.

**Angela Constance:** I am interested in the SFC's difficulties with the Department for Work and Pensions, which I say for the record I find truly shocking, given that, until Social Security Scotland is administering all the Scottish benefits, you will be particularly reliant on the DWP's data. The convener has covered that point adequately, and I look forward to reading your correspondence on it.

More broadly, I am interested in your experience with other UK Government departments and bodies. Are there examples of the relationship working well that could be replicated with the DWP? On a broader issue, I am aware, as other members will be, that the OBR has the right to access information and data from UK and Scottish bodies, whereas you have the right to access information only from Scottish bodies and not UK bodies. Will you share some of your experiences and reflections on that and any ideas that could rectify matters? I am sure that the committee would be willing to help if we could.

**Dame Susan Rice:** That is a good question, and we appreciate it. Because everything that we are doing is new, the landscape is necessarily evolving. The way that you explained our legal right to access is exactly correct. Things move on and can still move on. For example, with Revenue Scotland, we initially asked for data that it did not necessarily produce and publish, but it now produces and makes public some of the data that we require, so things have moved on. We have worked well with Revenue Scotland, and we have further interest in further developments there. It is not just about the UK and Scotland; it is about all the agencies and all of us learning what to do. Revenue Scotland uses different accounting bases for different numbers, and it would be helpful to have public clarification of that.

On UK bodies, from the beginning, we have had a very good working relationship with the OBR, but it is in a similar business to us, which is different from the other UK bodies. We have a memorandum of understanding with HMRC. Again, that has been a developing relationship and it needs to continue to develop, but we feel that good progress has been made. We are looking to enhance that memorandum of understanding, which reflects what we can expect from each other—what we can request and provide, when that happens and how we interact. It is helpful to have those guidelines laid out.

10:30

We understand from some of the UK agencies that, as I said, they have a lot of requests for information and they may feel that they do not have enough staff. Where we come in the pecking order is an issue. It is up to us to develop relationships. It is not just about a method; it is about working together with other bodies, and we are working hard to do that with all of them. I do not know whether Professor Smith or John Ireland wants to say more on that.

There is no particular cudgel that we can use to get what we need. We need people to fully understand who we are, what we are, that we are independent from the Scottish Government and therefore that we have a right to ask for the data. The fact that we are a public body in our own right needs to be respected.

**Angela Constance:** I fully understand that it is a two-way process, that it depends on relationships and that it is a journey that involves all partners and requires everybody to give and take. I understand that some of the UK departments are very big and have many demands on them. How will you increase the visibility of the commission to ensure that you are a bit higher up the pecking order? Is it just about a series of memorandums and agreements, or

should there be something more fundamental, such as a legislative right of access to information, which would diminish the need for layer upon layer of agreement?

**Dame Susan Rice:** With the DWP, we are working at lots of levels, through others and ourselves, to try to escalate the issue and enhance the department's understanding and responsiveness.

**Professor Smith:** It is helpful to think about the timing of different elements of devolution. As Susan Rice said, our relationship with HMRC has developed in a positive direction. There were things that we needed from HMRC and we developed a memorandum of understanding, as set out in our report. That relationship is currently developing in a way that is very positive for us.

The income tax story started sooner than the devolution of social security. So as not to be too negative, I point out that the DWP is coming to the devolution issues a bit later than HMRC did. It is not unduly surprising that a big UK agency, with its own administrative budget priorities and budget tightness, should be cautious about how it handles devolution, and the initial desire to work entirely through the Scottish Government is an understandable response.

To be positive, we hope that, as the devolution of social security expenditure evolves, the DWP will acquire the kind of understanding of the independence of the commission from the Scottish Government that HMRC has and will develop the kind of understanding of our needs that HMRC is developing.

At this stage, we should not be too negative. There are problems, as the convener has noted. It is sensible to try to work through those and hope that we will get the kind of evolution of relationship that we have had with HMRC.

**Dame Susan Rice:** To respond to the last part of Angela Constance's question, any interest in legislative agreements would be a matter for conversations between exchequers, in Scotland and the Treasury, so that is beyond us.

**Emma Harper:** I am interested in what you said in your opening statement about forecasts not being an exact science. Our briefing papers note that there were revisions to the estimate of GDP growth in August. That is just one example of revisions to GDP, and it is not unusual that revisions are made.

Given the uncertainties and errors around measuring GDP, and the weak and uncertain link between GDP and the size of the tax base in the short run, are the resources that you devote to forecasting GDP justifiable? Would it be better to focus on the fiscal forecasts?

**Professor Smith:** I would make a couple of different responses to that. Yes, there are inherent uncertainties about forecasting the economy. But the issue that we have had this year, with the construction industry data that we have already discussed, is of an unusual magnitude. This should not be taken as symptomatic of the kind of problem that we are going to face with every one of our forecasts.

Addressing your main question: no, I do not think that the right response would be to step back from attempting to do the best forecast of the economy that we can. The Government needs forecasts of the economy. We are the official forecaster for the Government. It is very hard for Government to make economic policy not just in the tax area, but across a wider range, without access to proper macroeconomic forecasts. Someone has to do it and it is our job to do it. We think that our evaluation report shows that, notwithstanding the challenges, we are doing a good job of it. We are not ready to hoist the white flag and say, "Sorry, this is just too difficult for us to do and you have to find someone else to pick it up".

There are important links between the economy forecast and the fiscal forecast. At the last meeting with you, we had a long discussion. I recall that virtually the whole of the hearing was devoted to changes in our income tax forecast that, incidentally, now seem like small beer compared with the revision of income taxes that we are talking about today.

That income tax forecast was driven by a change in the economy forecast. In forecasting income taxes and in forecasting VAT, which is a task that is coming onto our agenda now, you need a forecast of the economy, because you are not going to be able to produce good income tax forecasts without having as good a picture as you can have of what is going on in the broader economy.

**Dame Susan Rice:** I will talk around the issue. We have a formal legislative remit to do fiscal forecasting for devolved taxes. We are also now required to forecast assigned revenues, such as from VAT, looking at the cost of benefits, such as the social security benefits, which will come to Scotland. It is also a requirement that we forecast onshore GDP for Scotland. Alasdair Smith has given you good reasons why we would want to do those.

What we try to do is bring a Scotland lens to the examination of those areas, in relation to the economy and other forecasts, and to use Scottish data to determine what is happening here. Our economy is not just a twelfth or whatever the fraction is of the UK's. The economy forecasts always have revisions and there will be more

revisions to this one, but we are still in a better place because of the lens that we bring to it and the fact that we do that work ourselves.

**Emma Harper:** James Kelly asked about tax forecasts. To what extent do the errors associated with the GDP forecasts have knock-on implications for the accuracy of the tax forecasts?

**Dame Susan Rice:** One of the reasons for doing a forecast evaluation on an annual basis is to look back and see the source of errors. Forecasts all have errors. Even in the ones where the numbers match, you can see that, underneath, there are errors in this or that element. We use a constant iterative process. As we learn from how we approach things, decisions that we made in the past or new data that have come in, we bring that to bear on future forecasts. The job is not to let one error just sit there for ever and grow and grow in magnitude. We are constantly adapting.

**Professor Smith:** There is one very significant knock-on implication in the case of income tax. When the two Governments have income tax outturns for the fiscal year 2018-19, there will be a reconciliation of budget allocations that have been made for this year with the income tax and other tax outturns. It is desirable for everybody that those reconciliations, which happen two years down the line, are as small as possible, so that the initial budget allocations that are made to the Scottish Government are as close as possible to the final budget allocation. That is one reason why it is important to have income tax forecasts that are as accurate as possible, because you want those knock-on implications in the reconciliation two years down the line to be as small as possible.

**The Convener:** If it seems difficult getting forecasts right on income tax, just wait until we get to assignment of VAT. That is a going to be a really interesting situation, given that there is no definitive information available to make those forecasts on, but never mind that just now.

**Murdo Fraser:** I want to follow up Emma Harper's questions about your forecasts for GDP growth. The SFC says quite a lot in its paper around how the 2017-18 figure has been revised upwards, but you have revised downwards the figures for the previous years. There is also mention in your report about the forecast for the period after 2017-18 looking subdued—I think that that is the word that you used. Are you saying, therefore, that 2017-18 is a blip? Are we expecting longer-term GDP growth after 2017-18 to revert to where it was before that, which was below the UK-trend figure, or do we not know?

**Dame Susan Rice:** That is a good question, because it is one that a lot of people might ask. The 2017-18 change primarily related to a different understanding of the construction industry. It

affects that point in time; it is for the one year. As Alasdair Smith and, I think, John Ireland explained before, and as the report says, we knew that there was something funny about the construction data, so for 2017-18 we did not know what the new numbers would be but we thought that something might change. For the long-term forecast, a rough explanation is that our colleagues extracted the construction data because we just were not too comfortable with it. They looked at all of the other data, got the trends and averages, and then got some trends and averages from the construction data and merged it all back in—to use a term that was used when we were talking to a colleague yesterday, they stitched that back into all of the other information. The GDP forecast is made up of lots of elements.

For that reason, we can comfortably say that the 2017-18 numbers were, in essence, flattened out in our long-term view, and that the long-term view has not changed much. If anything it is slightly weaker than it was even a few months ago. “Subdued” is not a new word for us; it is one we have been using for a little while.

**Murdo Fraser:** To be clear, you expect that Scottish economic growth will lag behind UK economic growth.

**Professor Smith:** We have not made our new forecast; this is a forecast evaluation. It is not likely to change our long-run view because the changes in the data over the past three or four years give us a higher growth rate in the last year, but not a higher growth rate overall. It is unlikely, therefore, that, when we come to doing our next forecast in December, that that is going to change our view. As Susan Rice said, all the indications are that we will still have a subdued long-run forecast.

The other point to make in response to your question is that, yes, this past year's growth rate has been higher than we had anticipated. Is it a blip? We will consider such things properly in our December forecast.

10:45

A one-year growth rate of 1.3 per cent is not an exceptionally high number if you thought that the long-run growth rate was somewhere between 0.5 per cent and 1 per cent. One year's number of 1.3 per cent is not the kind of number that is going to knock you off a forecast because the long-run forecast is lower than 1.3 per cent but is not way above it. It is not an earth-shattering change.

**Murdo Fraser:** So we should not get too excited about it?

**The Convener:** The stitches are not going to come undone.

**Professor Smith:** That is what we are saying.

**Dame Susan Rice:** At this stage. Wait and see.

**Professor Smith:** Forecasters never get overexcited.

**James Kelly:** Dame Susan, you said that, if anything, you felt that the forecast going forward would be weaker than it was a few months ago. What led you to say that?

**Dame Susan Rice:** It will only be marginally weaker. As Alasdair Smith just said, we have not reforecast everything but we would ask ourselves the same question that we were just asked about the impact of the change in the 2017-18 number. We have given that some thought. On the basis of our whole methodology, we do not see that impacting very much.

John Ireland might be able to think of something that would cause us to be more conservative in the long term.

**John Ireland:** It is just a matter of a very small degree, and the remark is based on the fact that, in terms of the revised status since 2010, the growth rates are marginally lower than they were before the revisions.

**Professor Smith:** Figure 1 on page 9 of our summary report illustrates the issue in that the actual number is higher for 2017 than our forecast number but, if you look across the full range, the actuals are below the forecast numbers more of the time than they are above it. That is a slightly long-winded way of saying that the overall economic growth picture on the actuals is just slightly below what it was in the forecast, even though it is higher right at the end of the period.

**The Convener:** I thank our colleagues from the Scottish Fiscal Commission for coming along today. That concludes this evidence session. I now suspend the meeting.

10:47

*Meeting suspended.*

10:49

*On resuming—*

## Contingent Liability

**The Convener:** The last item of business is to take evidence from the Cabinet Secretary for Finance, Economy and Fair Work on the proposed contingent liability arising from a standby loan facility for a development site at Winchburgh. I welcome to the meeting Derek Mackay, the Cabinet Secretary for Finance, Economy and Fair Work; Will Quinn, guarantee schemes manager; and Michael Walker, finance business partner. Members have received copies of a letter from the cabinet secretary setting out the background to the request. Later in the meeting, the committee will consider in private the response to the request and we will then write to the cabinet secretary to confirm our decision. Before we move to questions, I invite the cabinet secretary to make a short opening statement.

**The Cabinet Secretary for Finance, Economy and Fair Work (Derek Mackay):** Thank you and good morning, convener. I am indeed here to invite the committee to approve a £15 million contingent liability to unlock major economic development in central Scotland at Winchburgh, West Lothian. That vitally important strategic site is on the point of stalling and urgent Scottish Government involvement is required. What I am asking you to consider is the minimum intervention required from Government to unlock the full development. The papers before you indicate the scale of economic activity on an active site that has reached a critical point. This proposal will allow the planning conditions to be met and the cap on construction to be lifted.

Your approval of this contingent liability will pave the way for new school provision, community facilities and essential transport infrastructure. All that will be alongside 3,450 new homes, 25 per cent of which will be for affordable rent, for an area with one of the highest rates of population growth in Scotland. This risk-sharing package has been subject to extensive due diligence and is the right type of intervention by Government, pitched at the right level, to demonstrate our commitment to provide an economic stimulus while limiting our exposure to financial risk. I ask the committee to consider the significant economic benefits that will be delivered to central Scotland through the approval of this essential contingent liability.

**The Convener:** Thank you, cabinet secretary. Your letter states that the developer has been unable to secure affordable market-rate finance to forward fund all the infrastructure needed to develop the site. It made me wonder why we have arrived at this situation. Why was it not anticipated

when the site development was initially financed—or was it anticipated?

**Derek Mackay:** I suppose that the answer to that is partly to do with the history and the changing costs, and partly to do with the recognition that a lot of front loading of capital investment is required and how, once that has been costed and considered, it is profiled in terms of the income that developers will get from the development and building of the units. I suppose that that involves a full understanding of the costs and the negotiation of what is required by way of planning consent, how the funding will ultimately be delivered and why this financial tool would be required. That is my understanding. My officials might be able to give you more of the history of what has changed since the development's inception.

**Will Quinn (Scottish Government):** That is correct. This comes down to the scale of the development and the infrastructure that is required up front. In terms of the package that is being asked for, the delivery of the school in question is a planning requirement and, as is stated in the papers, the developer is unable to secure affordable finance to front fund that. West Lothian Council is engaged in the wider infrastructure that is required and is carrying the maximum risk that is allowed under its governance arrangements.

**The Convener:** We are all quite grateful that the Scottish Government is able to help deliver this sort of output, but the question is: at the beginning of this process, was it anticipated that there would be a requirement for the Government to be involved, or did it think that West Lothian Council and the developer could put together the package that would release this site and make it work? How did we reach the point where the Government is getting involved?

**Will Quinn:** I think that the answer to that is that the developer and West Lothian Council have been engaged in negotiations for quite a number of years, so they have been developing how they might take this site forward, given the scale.

**The Convener:** Okay. It is an iterative process—is what you are saying? It is an evolving process and that is why the Government has been involved. I can understand that.

**Derek Mackay:** This is an exceptional situation because of the scale. It is a useful model to see whether we can find a financial tool with which to intervene to unlock development and help with infrastructure. Ordinarily, of course, developers would be negotiating with the planning authority, and if the negotiations did not work out, people would just walk away and the development would not happen. The council has been keen to see this through and it has looked at how it can be

innovative in delivering the infrastructure elements, because of the public benefits that it will bring. The units will have an economic benefit, but it is the infrastructure benefits of the schools and the public transport elements that have encouraged the council to try to find ways to ensure that the development happens, because it recognises the population demands in that area.

We have commissioned officials across Government to support sustainable economic growth, while limiting our exposure. Fundamentally, rather than see the development fall apart, our role is to put that final piece of the jigsaw in place so that the council and the developers can deliver the mutually agreed aims. Rather than our being involved at the start and saying, "How can we plan an intervention?", it been more a case of, "How can we help seal the deal?"

**The Convener:** That was a very helpful contribution.

**Alexander Burnett:** I note my interest in the development sector, which is in my entry in the register of members' interests.

I have a couple of questions. The first one follows on from the convener's question. Has this situation come about because banks are becoming more restricted in their ability to lend to different sectors—the development sector being one of them? If that is the case, is this going to be the first of several requests to the Scottish Government to act as a lender of last resort?

**Derek Mackay:** When I speak to the banks, they tell me that there is plenty of capital. When I speak to other business interests seeking financial support, they give me a slightly different perspective on things. This is simply about the up-front infrastructure spend that is required to unlock the rest of the development, which is welcome. It has planning approval.

That leads me to ask whether this is the kind of model that we would want to deploy. There is a range of measures in our toolbox to support appropriate development, such as tax increment financing, the growth accelerator model, financial transactions and infrastructure loan funds. There is a range of financial products that we can use to support development that is worthy of support.

The interesting element here is the use of contingent liability. We are offering that financial support to the local authority, which in itself is being quite innovative in how it is delivering the infrastructure investment to unlock the development because of all the benefits it brings. Although this situation feels exceptional because of scale and some of the factors involved, contingent liability is a useful financial tool that is at the disposal of the Government and—frankly,



because it requires your approval—the committee. You can ask, “Is this the right kind of intervention? Does the development have such support that it feels worthy of this intervention?” We hope, of course, the risk will never materialise for the Government, because there are many safeguards in place. However, the product gives that final security, in a sense, and supports the objectives of the development.

**Alexander Burnett:** My second question is about the detail. The committee papers talk about a commitment or arrangement fee. How much is that? They also say that any funds drawn down

“will be repayable with interest.”

What rate will that be?

One thing that has not been mentioned is overage. If the returns exceed the amount being financed, what will the Scottish Government recover? Sharing the risk is one thing, but if the reward is beyond what is expected, how will the Scottish Government, which will have facilitated the whole development, benefit from that?

**Derek Mackay:** Although the Government is always keen to get credit for things, this is a financial product that gives a backstop, in a sense. I would not want it to be portrayed as meaning that we will have a financial share in the overall development. That would be quite a different proposition.

On the detail of the interest rate, of course the product has to be state aid compliant. It has gone through all that due diligence. I ask Michael Walker whether we have further information on the arrangement fee.

**Michael Walker (Scottish Government):** The interest rate on the commitment fee is 2 per cent, and on top of any drawings it is 2 per cent plus a 1.1 per cent margin. As the cabinet secretary has mentioned, those rates have been scaled as a result of state aid due diligence. We had our advisers at Grant Thornton look at similar interventions in the market and compare how private sector providers would act in this scenario, and that is how they determined the appropriate rates.

11:00

**Angela Constance:** Good morning, cabinet secretary. I shared with colleagues earlier that I am aware of the Winchburgh proposition. It is not in my constituency, but it is in the neighbouring West Lothian constituency, and when it comes to fruition it will obviously have an impact locally in West Lothian in terms of economic development but also in the wider region. The area is part of the city deal, and the whole *raison d'être* of city deals is of course to promote economic development,

growth and house building, not just in the cities, but in the regions that surround the cities.

Given my local knowledge, I am conscious that identifying this project, in this area, for development would not have had its genesis with the Government; that would have rested with other partners, whether the local authority or the developer. It is important to understand more about the when and the why. Why did the Scottish Government get involved, what were the particular challenges, and are there any learning points? It is entirely appropriate that people should not just build houses without the infrastructure being in place, but it is obvious that, in this case, the planning consent process has been a barrier. Are there learning points for developers and local authorities when it comes to taking forward future projects of such magnitude?

**Derek Mackay:** Those were helpful comments—and helpful questions, too. I suppose that the financial element would have been negotiated between the council and the developer before they finally arrived at the proposition in the package. The question then became what the Government was willing to do as part of that. We have taken a proactive approach in trying to make sure that the development happens by offering our support. Essentially, as has been described, the council is using its borrowing regime to make sure that the infrastructure development happens and the development is unlocked. It will then get the return: it will get enhanced infrastructure for the area, but it will also get a financial return, which is based on the number of units that are developed.

It is not that this is the Scottish Government's role, but we have been participating to see what we can do to support the development, given that it has come this far. Our understanding is that this is the final financial element that will make it work. Although we are always co-operative, we try to minimise the risk to the public sector, including the risk to the Government. If the situation crystallises, the resources will still have to be returned to the Government.

I entirely take on board the comments about planning and the local authority's lead role in housing provision, which we are trying to support.

**Patrick Harvie:** Good morning. If the facility is ultimately drawn down, can you be clear that, ultimately, the taxpayer will bear no part of the developer's contribution as a result?

**Derek Mackay:** Yes. The developer is still absolutely liable for that. Can I explain how the impact on the Government might crystallise? I think that this is in members' papers, but if there was failure to the extent that the facility was called on, we have security over the land and there are other calls on resources before the issue finally

comes to the Government. We would have advance notice of that and would be able to plan it into a budget. It would not happen within a week or a month; it would be forecast at least a year in advance, so we would be able to build it into a budget. The maximum exposure would be up to about £850,000 a year, which would be manageable for us. However, the burden would still be on the developer to absolutely fulfil its condition obligations.

**Will Quinn:** Yes.

**Patrick Harvie:** You have set out that the basic reason why the facility is needed is that the developer is unable to access the finance that it hoped to access. What gives you confidence that it will have the money ultimately?

**Derek Mackay:** There would be the security over the land, and we would hold the developer to account for that, and there is income that is to derive from the units that are sold. The absolute worst-case scenario—it is almost unforeseeable—is that the units would not be developed, but liability would still rest with the developer.

**Michael Walker:** You ask how we can be comfortable that the developer has the financing required—in this case, to put towards school infrastructure. The council will be forward funding that, so the risk is taken away from the developer to that extent. However, the development contributions will still need to return to the council from the units that are sold. That is why we are comfortable that the financing is there.

**Adam Tomkins:** Cabinet secretary, in the papers that you provided to the committee, you identify that the Winchburgh development is identified in the Edinburgh city deal as a priority site for development. In your view, is such risk sharing, whether or not it involves contingent liabilities of the kind that we are discussing this morning, likely to become a feature of city and regional growth deals as they unfold and are developed across Scotland? We know that a number are still in various forms of negotiations in Stirling, Clackmannanshire, Tayside, Ayrshire and elsewhere in Scotland. Is it likely to become a feature of city and growth deals as we look forward?

**Derek Mackay:** For completeness, I should say to Mr Tomkins that I do not want to encroach on other cabinet secretaries' portfolios. Mr Matheson will lead on city deal negotiations as the infrastructure secretary. As finance secretary, I think that, if a deal is contributing to the economy, we should look at a range of financial tools at the Government's disposal to support sustainable economic growth.

Members of the committee will be well aware of other contingent liabilities in relation to which we

have set out how we are trying to be supportive of industry and the economy to help stimulate appropriate development. I think that this case is exceptional but that the model could be used in future arrangements in partnership with local authorities. A local authority might set out how it wants infrastructure to be delivered, and it might want to use the same or a similar model. We are open to that financially, but we would want to understand the business case on every occasion. The model could feature within city deals; equally, that could happen outwith city deals.

It so happens that, in terms of the overall Government support for the site and the region, this case was part of dialogue and engagement. It was supported by the local authority, the wider region and the Government; for that matter, given the nature of city deals, the UK Government would also have had an overall view. I will engage with the secretary of state on future city deals so that we can try to ensure that city deals cover the whole country.

Yes—this is the answer to the question—we are open to using this financial model, not exclusively in city deals but, where appropriate, to support development and put in place the necessary infrastructure that can unlock wider benefits.

**Adam Tomkins:** In last week's statement to Parliament on the programme for government, I recall the First Minister talking about new infrastructure funding. I hear what you say about Michael Matheson and his portfolio responsibilities, but as the cabinet secretary who will propose a budget to the Parliament in due course, do you foresee such risk-sharing arrangements being part of the Scottish Government's new investment in infrastructure in Scotland?

**Derek Mackay:** The model can be part of the infrastructure drive that we are trying to undertake, because it may well turn out to be a very useful financial tool. It is quite separate from the specific commitment that the First Minister gave on infrastructure spend as a proportion of GDP. That figure is about what we are able to invest by way of direct infrastructure spend, whereas this is about the contingent liability that we are creating because of the financial model that we are using in this instance.

The vision is absolutely clear, and of course we will return to Parliament with all the details on infrastructure spend. Let me be absolutely clear and give the most accurate answer possible to your question. This financial tool is different from the infrastructure announcement that the First Minister made as part of the programme for government.

**Adam Tomkins:** Thank you for that response. I am trying to understand the relationship between the various pots of money that are on the table. We have city deal money, we have last week's new announcements on infrastructure investment in the programme for government and we have contingent liabilities. I am trying to understand the relationship between contingent liability and the other two, broader pots of money, and your comments about that have been helpful.

**Derek Mackay:** All of us have to make sure that all of it is affordable, and understanding the liabilities that we are taking on is critical when it comes to affordability and understanding the risk. I am just being clear that the headline commitment is about actual spend, whereas this financial tool is about the risk that we are taking on to ensure that infrastructure spend happens.

**The Convener:** I thank the cabinet secretary and officials for coming today.

At the start of the meeting, the committee agreed to take the next item in private. The committee will meet again on 26 September to continue taking evidence as part of our 2019-20 pre-budget scrutiny inquiry. I now close the public part of the meeting.

11:10

*Meeting continued in private until 11:15.*



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.

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