OFFICIAL REPORT
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Finance and Constitution Committee

Thursday 14 May 2020

Session 5

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CONTENTS

Col.
INTERESTS 1
PUBLIC FINANCES AND FISCAL FRAMEWORK (IMPACT OF COVID-19) 2

FINANCE AND CONSTITUTION COMMITTEE
10th Meeting 2020, Session 5

CONVENER

*Bruce Crawford (Stirling) (SNP)

DEPUTY CONVENER

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

COMMITTEE MEMBERS

*George Adam (Paisley) (SNP)
*Tom Arthur (Renfrewshire South) (SNP)
*Jackie Baillie (Dumbarton) (Lab)
*Alexander Burnett (Aberdeenshire West) (Con)
*Donald Cameron (Highlands and Islands) (Con)
*Angela Constance (Almond Valley) (SNP)
*Murdo Fraser (Mid Scotland and Fife) (Con)
*Patrick Harvie (Glasgow) (Green)
*John Mason (Glasgow Shettleston) (SNP)
Alex Rowley (Mid Scotland and Fife) (Lab)

*attended

THE FOLLOWING ALSO PARTICIPATED:

John Ireland (Scottish Fiscal Commission)
Claire Murdoch (Scottish Fiscal Commission)
Mairi Spowage (Fraser of Allander Institute)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

Virtual Meeting

Scottish Parliament

Finance and Constitution Committee

Thursday 14 May 2020

[The Convener opened the meeting at 10:30]

Interests

The Convener (Bruce Crawford): Good morning and welcome to the 10th meeting in 2020—and our first formal virtual meeting—of the Finance and Constitution Committee.

We have received apologies from Alex Rowley. I warmly welcome our new member, Jackie Baillie, and I thank Neil Bibby for his hard work and valuable contributions during his time as a member of the committee.

I invite Jackie Baillie to declare any relevant interests.

Jackie Baillie (Dumbarton) (Lab): Thank you convener. I very much look forward to being on the Finance and Constitution Committee.

I have no relevant interests to declare, although I refer members to my entry in the register of members' interests.

Public Finances and Fiscal Framework (Impact of Covid-19)

The Convener: In the second item on our agenda we will take evidence on the impact of Covid-19 on public finances and the fiscal framework. For the benefit of those who are watching, I say that we have also issued a call for written views, which closes on 29 May. You can find details of how to respond on the committee's page on the Scottish Parliament website.

Mairi Spowage, who is deputy director of the Fraser of Allander institute, joins us for the first item. You are very welcome. Would you make brief opening remarks?

Mairi Spowage (Fraser of Allander Institute): The institute has been trying to keep abreast of the economic and fiscal consequences of the crisis. At the start, we focused on the immediate impact that the economic shutdown was likely to have on our economy, including on the various regions of Scotland and sectors of its economy. We looked at how the crisis might impact on businesses, households and individuals. That work included analysis of the policy measures that have been announced by the United Kingdom and Scottish Governments, and how they have evolved throughout the crisis.

As we move past that short-term view, it is clear that the crisis will have long-term implications for our economy and finances. Despite how difficult it was to do, mothballing parts of our economy is the comparatively easy part: the decision to put large and expensive policy measures in place had to be taken in order to get businesses through the crisis. It was the right thing to do.

How we will restart the economy with measures including social distancing still being in place for some time to come is much more difficult; it is difficult to quantify the long-term economic and fiscal consequences of the crisis.

The policy measures that have been implemented—particularly, the job retention scheme, for example—are unprecedented in the UK context. The more difficult question is about how to deal with the long-term fiscal consequences of fantastically expensive policy measures, and with higher levels of long-term indebtedness.

The area of our analysis that I think will be of interest to the committee, and that members will want to talk about, is the differential impacts on sectors and regions, and how that might manifest itself in a different impact on Scotland overall. We have also been considering what the crisis might mean for the fiscal framework—how it operates and its future.

I am happy to take questions from members.

The Convener: There is the possibility that Covid-19 might have disproportionate fiscal and economic impacts on the four nations of the United Kingdom. Given the likely large-scale impact of that, what options are there within the current fiscal framework arrangements to deal with it?

Mairi Spowage: It is worth setting out what the difference in impacts might be in the Scottish context. There are some ways in which that could manifest itself.

First, if the sectors that are particularly impacted are more prevalent in Scotland, we might be more affected overall. There are a couple of key examples. The oil and gas sector has been severely impacted, and we have already seen announcements about many potential job losses. After recovering from the shock of 2015-16 and the sector getting back on its feet, this further crisis for it will have a significant impact on the economy of the north-east. We saw the effect of what happened in 2016 on the Scottish economy, as distinct from that of the UK as a whole. That is one boot through which there is likely to be a different impact on Scotland.

The other example is hospitality and tourism. The industries that support hospitality and tourism are more prevalent in Scotland than they are in the UK as a whole, so there is likely to be more of an impact here. More important is the fact that those industries are so key in particular areas. There are likely to be big regional impacts, particularly in the Highlands and Islands and other areas that rely heavily on tourism and hospitality related spending.

There is a third way in which differences could manifest themselves—how guidance has been implemented slightly differently in Scotland. We have heard from some businesses, including in construction, that they have been operating in the rest of the UK when they have not been able to do so in Scotland because of differences in what has come from the Governments. Regardless of whether it has been the right thing to do, there are certainly differences, so there might be different impacts. There might be further divergence over the next few weeks and months in terms of businesses getting back up and running. There could be different economic impacts.

Whether there are flexibilities or measures in the fiscal framework to manage the different impacts is a difficult question. There are not really many options in the fiscal framework to deal with differential impacts. Borrowing powers under the fiscal framework are fairly limited and many of them are for things such as forecast error, which we have seen manifesting itself already. The Scotland reserve could be used but, under the current budget, there is not very much money in that for managing the crisis.

Of course, the Scottish budget is not an insignificant amount of money. It is a large budget of £30 billion, so the Scottish Government might look at spending the money that it has differently in order to get through the crisis. However, we have fairly limited flexibilities for additional spending.

The Convener: Obviously, these are extraordinary circumstances. You mentioned the fiscal framework's limited borrowing powers for dealing with those circumstances. I am sure that there will be significant discussions between the UK and Scottish Governments about that. Is there, in your view, a need to expedite the forthcoming review of the fiscal framework in order to address scenarios that might arise from the impact of Covid-19 on public finances and the economies of the four nations? I think that the review was supposed to begin at the end of 2021. Is there an argument for bringing that forward to help to deal with the current unforeseen and unprecedented circumstances?

Mairi Spowage: There could be a case for doing that. We have previously talked at length about the fact that—even before the crisis—the flexibilities in the fiscal framework are not sufficient for the risk that the Scottish Parliament and budget bear, even with income tax powers. Flexibilities are required to manage that level of risk, and it is certainly true that it was already clear that the flexibilities are not sufficient. Add to that the current crisis and the necessity for responding to it, and there might be a case for saying that the aftermath of the crisis would be a good time to address whether the flexibilities are sufficient.

Quite early on in the crisis, the Institute for Fiscal Studies wrote about whether operation of the Barnett formula and the different fiscal frameworks in the nations of the UK were sufficient. The IFS did not say that Scotland, for example, needs more money than it gets through the Barnett formula; rather, it said that Barnett is a fairly blunt tool that does not necessarily look at the needs of the different parts of the UK. Some areas might get too much money, compared to what other areas get.

It is swings and roundabouts, depending on whether you look at the way that the whole system works or just at the flexibilities under the Scottish fiscal framework. However, even leaving aside the Covid-19 crisis, it is clear that the flexibilities are not sufficient to deal with the levels of risk that the Scottish budget is now bearing. I do not think that anyone would argue with that.

The Convener: I have a quick final question. If the fiscal framework review is not expedited, what short-term measures should the Scottish and UK Governments discuss to introduce flexibilities that might help us to get through the immediate crisis?

Mairi Spowage: It is possible for the UK Government to relax the current limits. It could do that. Obviously, it is built into the fiscal framework that, if there is a demonstrable Scotland-specific economic shock, the borrowing ability can be increased. However, that has never really been tested. It is not clear to me exactly how the calculations would be made to determine how much of the economic shock was due to a particular circumstance, or what additional borrowing would be released. There could be some flexibility to allow the Scottish Government to borrow.

However, as well as calling for the UK Government to be imaginative and to introduce new policy measures to support jobs in the coming period, the Scottish Government might also have to consider its spending priorities and whether to spend money differently, within its budget, in order to prioritise and support recovery. That would be as well as potentially getting more flexibility from the Treasury on the limits that are set in the fiscal framework.

The Convener: I am grateful for those answers.

Donald Cameron (Highlands and Islands) (Con): I want to follow up on the questions about the fiscal framework. In the Fraser of Allander institute blog that was published on 28 April 2020, the author went into some detail about the fiscal framework. The blog points to various pressures, including what the IFS said, which you have referenced already. At the end, it says that the framework

"seems to have performed reasonably resiliently since the virus took hold in the UK."

One reason that the blog gives for that is that the Scottish Government does not have to worry about funding deteriorations this year. Do you have any reflections on that? Might the framework operate resiliently in the short term but not in the long term?

Mairi Spowage: It is designed into the framework that, if there is a UK-wide economic shock that does not impact differentially in Scotland, the Scottish budget should not be any worse off. In that situation, in theory, the fiscal framework will ensure that, if income tax receipts per head in Scotland fall in the same way as they do in the rest of the UK, the Scottish budget will not be any worse off. The Scottish budget is protected from UK-wide economic shocks. The Scottish budget is set for this year, so there will be no immediate impact on it if the income tax receipts that are collected this year are less than it was first thought they would be.

The impact will come in a few years, in the form of reconciliations. Obviously, that will have to be dealt with at the time. There would not be an immediate impact on the Scottish Government's budget or spending power.

However, the fiscal framework operates a little differently for things such as social security. For example, additional payments might need to be made this year for social security, because many of the devolved benefit payments are linked to entitlement to universal credit, take-up of which has increased. Therefore, there are likely to be impacts on the amount of money that has to be found in-year to pay for those benefits.

It might also be the case that land and buildings transaction tax receipts, for example, are lower than we expect. That will probably come out in the wash in the autumn with the block-grant adjustment, but there might be some cash-management issues in the interim.

10:45

In general, the fiscal framework protects the position as regards the Scottish Government's spending power this year, but there are various issues that will have to be dealt with in future years. On social security, there might be some challenges in the year to come. Because so many of the payments were devolved only in April, we are in a new world when it comes to managing those pressures in the budget. We have not previously gone through the process, so we will have to wait and see how it works this year in the context of social security.

Donald Cameron: In the event of a Scotland-specific shock, there is provision in the fiscal framework to allow further borrowing. A Scotland-specific shock

"is defined as GDP growth in Scotland on a rolling four quarter basis being both below 1 per cent and 1 percentage point less than GDP growth in the UK."

I would like you to gaze into your crystal ball. Do you think that such a scenario is likely or possible?

Mairi Spowage: That definition was written when the fiscal framework was agreed. We then entered an era in which poor, muted or subdued growth of between 1 per cent and 1.5 per cent was forecast for the UK and Scotland for the foreseeable future; it was an era of unspectacular growth, compared with the 2 per cent that we were used to. Given the sluggish growth in the UK, the prospect of a Scotland-specific economic shock as defined in the fiscal framework appeared to be quite unlikely.

Now that we are in an era of a potential double-digit contraction over 2020, the prospect of growth in Scotland and growth in the UK being 1 percentage point apart is much more likely, because the economy is likely to be volatile over the next period and growth is likely to be poor. Therefore, in any one quarter, the criteria for a Scotland-specific shock could easily be met. We are talking about potential contraction of the economy in one quarter; it is quite likely that growth in Scotland and growth in the UK might be 1 percentage point apart on a four-quarters basis. Therefore, we need to think about what meeting the criteria would mean in relation to the extra borrowing provision that that would unlock for the Scottish Government.

Equally, because the data is so volatile, it might happen that the Scottish data is better for a period, but my understanding is that if the criteria are met at any point, the extra provision will be available.

Angela Constance (Almond Valley) (SNP): I hope that people can hear me. I know that they cannot see me, as we have had some technical issues.

You have said that, in theory, the Scottish budget should be protected from UK-wide economic shocks. We know that the mechanics of that are pretty clear, but is there any scope for the waters to be muddied—for good reason or bad—particularly in relation to the underlying causes of asymmetric shocks in tax revenue, which, as you have indicated, could be due to disproportionate impacts on different sectors of our economy or the provision, based on different scientific advice and judgments on the Covid pandemic, of different guidance to companies? How watertight is the commitment that the Scottish budget should be protected from economic shocks that are felt across the UK?

Mairi Spowage: The provision for extra borrowing if there is a Scotland-specific economic shock is fairly clear. If the conditions are met, the extra borrowing provision will be made available. The question that I have about the Scotland-specific economic shock provision is how much extra borrowing will be made available. In theory, it will double the borrowing that is available for forecast error, but the provision has not been enacted yet, and exactly how much will be made available is unclear to me.

The second part of your question was about whether there is a differential impact on tax revenue. I guess that the point of the devolution of income tax is for the Scottish Government and the Scottish Parliament to be able to set different tax rates, so they may raise more tax or less tax, and to bear the risk of the fact that the tax base may perform differently in Scotland.

The fiscal framework protects the Scottish budget from population effects, so it looks at tax revenues per head, but if there is a poorer performance of the Scottish tax base compared with that of the rest of the UK, that will impact on the Scottish budget. That is deliberate. It is designed in, and it is part of the point of devolution.

If there is a poorer performance in relation to Scottish tax revenues per head, that will impact negatively on the Scottish budget. On what could be done about that, I suppose that the Scottish Government could ask the Treasury for additional flexibilities, given the unprecedented nature of the crisis. However, the fiscal framework was designed for the risks to be borne by the Scottish budget, so they will be.

Angela Constance: Thank you for that. I think that it is clear to most people that the Covid-19 pandemic will indeed have an impact on tax revenues, which, as you say, come into play in relation to the fiscal framework. It appears to me that there is no cast-iron guarantee that Scotland will be protected against a much broader UK-wide or, indeed, global pandemic.

Mairi Spowage: It is correct to say that, if there is an asymmetric shock in tax revenues in Scotland, the Scottish budget will be negatively impacted. However, we do not know whether there will be such a shock. If the impact on tax revenues is not as bad in Scotland, the Scottish budget will be better off. It will depend on the impact that we see in Scotland.

Our analysis suggests that, given the sectoral make-up of the Scottish economy and the way that the guidance has been interpreted here, it is more likely that there will be a more severe shock in Scotland than in the rest of the UK, but much of that will depend on the route out of the crisis and what happens over the next six to 12 months. There is the immediate impact and then there will be the long-term impacts on the Scottish and UK economies.

Jackie Baillie: I want to focus on the immediate impact on the budget. We know that revenue from income tax is likely to fall, but we will not need to account for that until 2023-24. Immediate reconciliations will happen in the current financial year—for example, for land and buildings transaction tax and social security—and my understanding is that the block grant adjustment, which we overestimated in the budget by £231 million, will also need to be reconciled this year. Do you have a best estimate of the variation? If not, when will that become clear?

Mairi Spowage: That is a really good question. The statistics do not yet show what the impact on LBTT might be. If there is a big impact on LBTT, there might be an immediate cash management issue until the reconciliation comes through from the block grant adjustment. If there is a similar fall in stamp duty land tax in England, there will also be a block grant adjustment. It really depends on whether, over the year, there is a differential impact on Scottish LBTT revenues as opposed to stamp duty. We do not know that yet. It might be affected by how quickly the housing market and related activity gets up and running in different parts of the UK. Obviously, if transactions are resumed in England but not in Scotland, there will be a difference in revenue.

There is also the question of the extent to which purchases or exchanges have just been delayed and how many will be subdued or suppressed for some time to come, given the uncertainty and the fact that many people have lost their jobs or their income has been cut, and therefore whether the housing market is more depressed in general. We do not yet know whether that will be more severe in Scotland than in the rest of the UK.

There is potentially a big issue in relation to social security. As I said earlier, many payments are linked to whether someone is a UC claimant or is claiming particular parts of it. We have seen the number of applicants for UC absolutely skyrocket in both the UK and Scotland. Anyone looking at the forecast for what was going to be spent on various benefits this year will say that such payments will definitely increase.

I understand that the Scottish child payment has been delayed because of the practical concerns about introducing it this year, so that expenditure will not be happening. It remains to be seen whether that is enough to offset the payments for other social security benefits that are likely to increase—for example, we have seen the introduction of more money for carers. It is likely that more money will have to be found for such payments over the year.

Jackie Baillie: I want to follow up on what you have just said. As I understand it—you alluded to this earlier—we have an estimated £100 million in the Scotland reserve and a balance of £93 million of borrowing left for this financial year. That adds up to £193 million, which does not give us a lot of headroom. That feels incredibly tight to me. If the cost is greater than that, what options are currently open to the Scottish Government? Is that likely to have an impact on the provision of public services?

Mairi Spowage: The options are open. The Treasury may make more borrowing available, depending on the flexibility that it is prepared to grant in order to deal with these unprecedented times. Additional borrowing may be made available because Scotland’s specific economic shock can be demonstrated.

Moving past borrowing, there may be options to look at other spending that was planned for this year, which is either difficult to proceed with because of the current situation or is a lower priority. Spending might be stopped on other things in order to free up funds to cover costs, or money may be diverted from other things because it is impossible for them to proceed—the Scottish child payment might be an example of that. The option is to have increased flexibility in borrowing, either through the current provision or through new negotiated provision, or to divert money from other things that cannot happen because of the situation or that have been deprioritised.

I do not imagine that the UK Government will be spending money in quite the way that it imagined at the time of the budget. A lot of money will be diverted to certain things in order to support economic recovery.

11:00

Jackie Baillie: If that is the case, even just diverting the money that the UK Government intends to spend at the UK level might have consequences for the Scottish budget. If the UK Government does not provide additional borrowing, we will have to look at delaying projects and changing our budget around.

Mairi Spowage: Yes—absolutely. If there are UK policy announcements that change the plans for infrastructure investment or other things that were announced in the UK budget, that will have implications for Scotland. Exactly when that might become clear is difficult for anybody to predict right now, as it depends on when the next UK budget is and what announcements will be in it.

Murdo Fraser (Mid Scotland and Fife) (Con): Good morning. I go back to the questions that the convener and Angela Constance posed on the fiscal framework and the impact of an economic downturn on tax revenues. The fiscal framework protects the Scottish budget in the current year from any downturn in tax revenues, and there would be a subsequent impact only if there were a differential impact between Scotland and the UK as a whole.

You said earlier in response to Angela Constance, I think, that, because of the make-up of the Scottish economy, the impact on Scotland might be greater. For example, tourism is a more important part of the economy here, as are oil and gas. However, the paper that the Scottish Fiscal Commission has given to us makes the point that the public sector in Scotland is larger than that in the rest of the UK and that that could have a balancing impact. Are you taking a more pessimistic view than the Scottish Fiscal Commission is on the matter?

Mairi Spowage: That is a good question. It is true that the public sector is larger in Scotland and therefore it can have a stabilising impact on the economy.

On the way that the economy is measured, it is more likely that the negatives that I mentioned will offset any increases in the public sector. There is also the potential for issues around, for example, the expansion of the public sector and public sector pay, which might be more constrained in future years than it has been in the past couple of years, depending on how public finances come out of this situation.

On balance overall, in looking at the affected sectors, our view would still be that Scotland is at risk of experiencing a more severe impact than the UK as a whole. For example, Scotland has a strong financial services sector, but it is more a part of the larger UK economy than it is a part of the Scottish economy. All the evidence is that the professional, financial and business services sectors seem to be doing all right just now. A lot of their staff are able to work from home and the businesses are able to continue operating. There is still an impact on them from the wider economic shock, but they are less impacted than public-facing, hospitality-driven sectors. Therefore, on balance, I would go down on the side that Scotland will be more severely impacted than the UK as a whole.

Murdo Fraser: Thank you very much—that is very helpful. Witnesses from the Scottish Fiscal Commission will speak to the committee after you, so I will them ask that question.

I would like to ask a follow-up question. We touched on this issue earlier. We are now seeing the economic lockdown in Scotland extending longer than in England. You have already said that there are important sectors of the Scottish economy in which people are able to work from home, such as financial services. How significant do you think the impact will be on the Scottish economy relative to that of the rest of the UK and therefore on tax revenues if the lockdown here continues for a much longer period than in England?

Mairi Spowage: It is really tough to quantify that right now, given that we are in the middle of the first week of the restrictions being eased in England. There are a lot of practical considerations that make it difficult to know how much activity will return in particular sectors. For example, if people do not have childcare and kids are not back at school, how many people will be able to go to work? If people are not able to use a car or to walk or cycle to work, and they cannot use public transport because they are worried or because there is not the capacity, how can they get to work? How can they be safe at work? How are the social distancing guidelines being implemented in a practical sense? It will take a wee while to understand exactly what the restrictions being eased in England means and how much economic activity is returning, in order to understand what the difference might be between here and there.

I am not really answering Murdo Fraser's question, because I do not think that I can. We will have to wait and see what the easing of restrictions actually means in a practical sense and how much output is able to return in the economy in England.

Tom Arthur (Renfrewshire South) (SNP): Good morning, Mairi. I want to pick up on the question of the economic impact of the lockdown. We have been discussing "the lockdown", but I am curious to know whether any modelling or work has been done to understand what the consequences would be of a second lockdown—that is, if we had a period during which the economy started to open up again but then very suddenly had to close down. Are any particular sectors of the economy particularly vulnerable should that set of circumstances—a second lockdown—prevail?

Mairi Spowage: Gosh! It is difficult to quantify what the impact of that might be in relation to the view of the year ahead. Looking at things such as public attitude data, we have the direct measures, whereby certain businesses are not able to operate right now because they are told that they have to be shut, but we also have the wider policy measures that say to people, "Stay at home to save lives" and, "Don't go out unless it's essential."

Obviously, we can open businesses again. For example, we may be able to open restaurants, pubs and theatres later in the year—or maybe not until next year. However, the question is whether people would want to attend those places and spend money. A lot of the data shows that people will be very wary of going to restaurants, pubs, theatres and large gatherings for quite a long time to come. Therefore, I imagine that those discretionary, social spending sectors would be most vulnerable.

It is about whether people, even if they are told that they are allowed to, will want to travel within the UK—never mind abroad—and whether they will want to eat out and support the creative sectors, which are particularly vulnerable. It seems that those sectors might be quite depressed for some time to come. That goes hand in hand with the fact that, if people lose some of their discretionary income, those are the things that they tend to cut out, or cut down on, first. The hospitality and tourism sectors will therefore be particularly vulnerable to a second shutdown, if they are able to get up and running at all this year.

We have been speaking to lots of people across the country and to lots of different tourism-facing businesses. They are describing that—in essence—they have had a winter, they will have another one over the summer and they will then be into the next winter. The worry is how many of those businesses can survive until next spring, when things might pick up again. Those sectors are particularly vulnerable to either continued or second lockdown measures.

Tom Arthur: I share that concern, particularly as I have been in contact with a lot of businesses in the hospitality and entertainment sectors, which have described this as potentially an extinction-level event for their businesses. A lot of capacity and talent might be irrevocably lost if there is a prolonged period of lockdown or, indeed, a second lockdown.

The First Minister and others have spoken about the move towards a "new normal". There is clearly a question mark over how long that "new normal" will last, uncertainty over whether we will be able to develop a vaccine and a longer-term uncertainty about what the public attitudes towards living with Covid-19 will be.

Ms Spowage mentioned that the fiscal framework is already under strain, with all that uncertainty, and that there will be much to discuss in the forthcoming review. She also suggested, in her earlier response to the convener, that we cannot fully update the fiscal framework until we have a sense of what the "new normal" will be, as we come out of the crisis.

Given that we do not know when that will be, what do we do in between? Will the fiscal framework need to be updated more regularly? Will it need far greater flexibility until we have a sense of that "new normal" and of when we can expect a prolonged period of stability and predictability?

Mairi Spowage: There is a case for greater flexibility in these unprecedented times. I have already said that it has become clear that the fiscal framework does not have sufficient flexibilities in normal times, given the level of risk that the Scottish budget bears.

There is potentially a case for the introduction of more flexibility over this crisis period in order to get us through it—until, as you say, we know what the "new normal" is and how volatile tax receipts might be over the next few years. I agree that this is a time for the two Governments to try to come to an agreement about the additional flexibilities that might need to be introduced in order to get us through this strange time.

Tom Arthur: My final question concerns something that we have not mentioned so far, but that we inevitably must: Brexit. The UK Government has committed to the transition period ending at the end of this year. It is fair to say that the best estimates are that it will be able to achieve only a bare bones deal, and some estimates suggest that such a deal could knock between 4 and 8 per cent off GDP.

What is your view on the potential impact of a hard Brexit at the end of the year? How could it impact recovery? If any sectors in Scotland are at particular risk because of the current pandemic, could a hard Brexit amplify the stress that is being put on them?

Mairi Spowage: The modelling of the impacts of different forms of Brexit was done using a baseline of what "normality" was at the time—compared to our being in the European Union and trading as we had done for the past however many years. We are currently in the transition period, but we still have the same flexibility and access to the EU right now as we would have had as a member.

The current crisis means that nothing is operating normally. A lot of businesses whose main export markets are in the EU are shut down and are not exporting right now. How that situation might evolve over the year and what impact it will have in the case of a hard Brexit at the end of the year is difficult to say, with regard to the relative scale of the shock.

Nobody would think that sleepwalking into a bare bones trade deal as we come out of the transition period is a great idea, given what is going on in the current crisis. The transition period is likely to be extended—one would think—although we are not hearing those noises from the UK Government at the moment. Adding trade frictions at a time when businesses will be trying to get back up and running and to re-establish their export markets would not be a good thing to do, economically.

11:15

Alexander Burnett (Aberdeenshire West) (Con): The Fraser of Allander institute has continued to produce a number of excellent reports during the current period, and I have a couple of questions about that. First, how easy is it to get good data, particularly at a sectoral level, given that so many people are furloughed? Secondly, is it possible to show which sectors restarting and recovering first would have the most positive impact on the economy?

Mairi Spowage: We touched on that in the article that we wrote about what the impact might be. One issue with Scottish economic statistics—I have talked to a number of members about this a number of times—is that a lot of the data that is collected is at the Great Britain level, so, in order to capture the Scottish activity, we have to make assumptions. We do not always get a good proxy for the way that activity is changing in the very short term in Scotland, which can make the process challenging. Having said that, a number of sectors of the economy are covered very well, particularly where there are small businesses that are wholly Scottish—those are captured properly in the data that is used to estimate the impact.

However, some sectors of the economy are captured more by proxy measures. For example, there has been an issue with measurement of construction in the past. My concern about that sector is that, given that staff have been furloughed instead of having lost their jobs, we might not be picking up all the changes that are happening in construction in Scotland as opposed to changes at the UK level. Therefore, some of the initial estimates of the impact of the crisis might be underestimates or might be revised in the future. It could take a few years for us to understand exactly what the impact has been on the Scottish economy.

To be fair, that is not solely a Scottish issue. The Office for National Statistics has written an article about the challenges of the proxy measurements that are used in the very short term to capture changes in the economy—that is an issue at the UK level, too. In a crisis situation such as the one that we are in now, in which people are furloughed and so are attached to their employer but are not producing any output, it is really challenging to measure things in the short term to understand how the situation is changing. That is challenging, particularly in a crisis situation in which things are very uncertain.

You asked about understanding which sectors might have the biggest impact during the recovery. That is a great question, but it is really difficult to know the answer. Because people in so many parts of the economy have been furloughed, just unwinding some of that will immediately mean that there is more activity, which will have a large impact. Obviously, it would be good to get some of the most productive sectors, such as those with high wages, up and running in order to get more money flowing through the economy. Sectors such as construction are important in that regard.

It is not just about individual sectors; it is about how sectors are linked to others. For example, the construction sector has high multipliers because the sector purchases things from manufacturers and so on. It has a ripple effect throughout the economy, which means that more and more businesses will be able to up their production and output to support the economy.

I guess the answer is that it is sectors that are high productivity, that have high wages and that have many supply chain links. However, we cannot lose sight of the sectors that have important regional impacts. For example, in some parts of Scotland, hospitality and tourism businesses are a significant part of the economy and support a significant number of jobs. If those sectors continue to be furloughed, mothballed and suppressed, that might have a significant impact on particular areas of Scotland. We cannot lose sight of the potential regional impacts of focusing too much on particular sectors in the economy rather than on the impact on individual communities.

Patrick Harvie (Glasgow) (Green): Some of the questions that I am going to raise lead on quite well from the areas that you started to touch on with a few other members, with regard to the issues of recovery. Sometimes, there seems to be a bit of an assumption that recovery just means that we lift the restrictions and stuff will start to take off again. The Office for Budget Responsibility's projection, which initially showed that the reduction in GDP could be as much as 35 per cent, suggests an extraordinarily optimistic view of an immediate bounce back after the restrictions are lifted.

How do you gauge the state of the debate on whether Governments around the world, including the UK Government, will need to come forward with a whole new package of stimulus measures, which again will fundamentally change the nature of the debate in Scotland about the financial impact on how we fund public services and so on? How do you gauge the political debate in the UK about whether that is likely to happen? If it does happen, how much discretion will Scotland have with regard to how we deploy those resources? For example, you just talked about trying to prioritise areas with high wages. However, many people would say that it is the sectors with low wages that will need the most help, as those people will be in the most need.

Mairi Spowage: In terms of supporting people through the crisis, I absolutely agree that the sectors in which people have low wages will need the most help. My point is that, if we are looking at matters from an economic point of view and in terms of overall growth, we could prioritise opening up the sectors with high multipliers. However, in any economic crisis, it is always the people in areas with lower wages and lower productivity who suffer the most. A number of our articles have focused on the people in particular sectors who are being affected, such as people who are on lower wages and people in sectors that are dominated by women and young people. It is those people who will suffer the most through the crisis.

The UK measures to lift lockdown ask people, for instance, to use the car, to walk or to cycle, or to come back to work if they can, but what about lone parents and people who do not have a car? Again, it is poorer people and women who will be impacted the most. Therefore, we need to seek to protect those people as we consider the economic recovery that we want to have.

I go back to what you said initially. To defend the OBR and the Bank of England a little bit, they are setting out a scenario but they are not saying that it will happen. If there is to be a shutdown for three months and then a bounce back, they are saying what the impact over the year will be. I agree that it is inevitable that people will say that that is what the OBR thinks will happen, whereas I do not think that anybody thinks that that will happen now. There will be long-term impacts on the economy; we will not bounce back. The social distancing measures that we need to have in place for goodness knows how long will act as a significant depression on the economy. Lots of people have lost their jobs and are now on universal credit, and lots of people have had a significant cut in their income. Therefore, there will be a wider impact on our economy that persists throughout the next couple of years at least.

With regard to the whole new package of stimulus measures and the political debate in the UK, one of the interesting things that has come out of the situation, in terms of wider public attitudes, has been the intervention in the private sector, which is fairly unprecedented. That might mean that there is more appetite in future crises for Government intervention in the economy. It might mean that, coming out of the crisis, certain things that were considered to be unthinkable prior to it, such as state ownership, may be more likely, particularly on the transport side.

From the poverty point of view, people are now saying that the amount of income that is given through universal credit, for example, is ridiculously low and they are asking how people could possibly live on that. A lot of people are already expected to live on that level of income, and that was seen as being all right before the crisis.

Those are some of the interesting things that have come out of this. Whether they will persist into the political debate about the "new normal" depends on your world view. We spoke to different people and, quite often, their ideas are driven by what they want to happen rather than what might actually happen. However, those have been interesting features of the debate, which may persist into the new package of stimulus measures.

The chancellor has already indicated that he is prepared to look at the current situation, whereby the employed pay the most tax and the self-employed do not pay so much tax, as part of looking at the overall tax system in the UK. That is a minor example of how things may change.

I think that there will have to be a whole new package of stimulus measures from the UK Government. How much flexibility that will give Scotland is an interesting question. It depends on the areas in which the UK Government introduces stimulus measures. For example, there have been calls for job guarantee schemes in order to support economic recovery. Again, that would be quite a significant intervention in the economy, although it is not unprecedented. There was something similar after the financial crisis. Whether such a measure will be in the area of devolved policy and will give flexibility to the Scottish Government or whether it will be a UK measure is a grey area in the space of employability policy, social security and so on. It depends on the areas in which the UK Government chooses to set out its stimulus plans.

Patrick Harvie: I certainly agree with your point about how more and more people are being exposed to just how inadequate the economic circumstances are for people with precarious incomes or who are dependent on the social security system. It is much more immediately obvious to a lot of people how broken the old normal was.

That opens up the question of what kind of economy we want in the future, rather than just going back to business as usual. For me, there are two further questions in that. If we are looking at a substantially smaller economy—potentially for a long time if the post-Covid economy is two thirds the size of the pre-Covid economy—do we have the ability to ensure that that smaller economy, even it grows at some point in the future, is enough to meet people's basic needs?

Secondly, what opportunities are created by the fact that pretty much all private sector business is now dependent on state intervention and support? What are the opportunities for deliberately and assertively restructuring the economy around things that Government already says that it wants to achieve? That could include levelling up, as the UK Government would see it, and the climate emergency—most Governments have said that they prioritise that but have taken slow, incremental action rather than emergency action on it.

Given that intervention is now the fundamental mode of economic activity, what are the opportunities for deliberate restructuring around the challenges of the future, as opposed to just rebooting something that was not working to achieve those objectives?

Mairi Spowage: There is an opportunity in this situation to do something radical if that is what the

Government wishes to do, given that significant parts of the economy are mothballed and people are working in new and different ways that they never imagined they would be able to do. For example, lots of employees who were told for many years that they were not able to work from home have suddenly been able to do it, and that could permanently change our economy and how we work. How we work will wind back a bit, but what has happened will certainly change things quite a lot.

The economy will not be one third smaller, because the current situation will not persist. As soon as a lot of businesses open up, the economy will start to grow again. The new level of economic output is unknown at the moment, but it is likely to be lower than the pre-Covid level for some time to come.

11:30

As I said, there are opportunities to do things differently. We will change the way that we work. We have made significant interventions in the economy because we had to, and now there are interesting discussions to be had—on the levels of state intervention and changing the way that we live—about what we can do to deal with the climate emergency.

There will obviously be a focus on economic stimulus and recovery and on ensuring that livelihoods are restored. The challenge for Governments is to take that action in a way that meets their wider objectives—whether that is, in Scotland, on being more inclusive or, in the UK, on levelling up. It will be challenging to do that without going back to the way that things were, but there is an opportunity to do radical things. It is an opportunity for the UK and Scottish Governments to look at how they spend money and whether they could spend it in a different way in order to achieve some of their aims, which we have discussed in previous evidence sessions.

The Convener: Thank you. Finally, we have a question from John Mason. John, thank you for holding on for so long.

John Mason (Glasgow Shettleston) (SNP): That is all right, convener—there is no rush.

We have concentrated a lot on the Scottish budget and how there could be differential impacts or an asymmetric shock, but I presume that, at the UK level, there is also the question of the extra borrowing that has been taking place. Some estimates say that the UK has taken on £300 billion, although that number could vary from £200 billion to £500 billion, which is vague .

Is there any indication of what the UK Government is going to do about that debt? It would cost £30 billion a year just to service it. If the UK Government were to raise taxes, I presume that we would need to raise taxes to match that. If it cut expenditure, which would—[*Temporary loss of sound.*]—Government, what would the impact be? I presume that it would be serious. Although we face Scottish-specific risks, are we also facing risks that might come from the UK Government?

The Convener: Mairi, did you hear all that?

Mairi Spowage: Yes, I think so.

The borrowing at the UK level, which is driven by things such as the job retention scheme, is huge—far more than was borrowed at the time of the financial crisis, which led to the decade of austerity that we have emerged from. The Government is borrowing eye-watering sums of money to get through this crisis.

In the past day or so, we saw the leaked Treasury document, which had policy measures in it that the Government might consider. In general, coming out of this crisis, Governments around the world will accept that a high level of indebtedness will be a reality for a long time to come. It is likely that they will issue more government bonds to support the extra borrowing.

Borrowing is still cheap, although that might not persist for ever. The key thing for the UK Government is whether the markets think that it is credible. The Government needs to stabilise its debt level, so that it does not shoot off on to an unsustainable path, because, if markets lose faith in the UK Government, borrowing will become more expensive.

A higher level of indebtedness will therefore be accepted, but when it comes to reducing spending to more normal levels, the leaked document proposes things such as ending the triple lock on pensions and freezing public sector pay—although those are not policy at the moment. A lot also seems to be focused on potential tax rises—perhaps for income tax.

Exactly what the UK Government will do to get the finances under control and pay back the borrowing is not yet clear, but a number of policy announcements in that leaked document suggest the way that it might go.

John Mason: Thank you very much. Jackie Baillie talked about the big risk that we face in Scotland. I suppose that, in a sense, it is a double risk: the risk of Scotland being hit worse than the UK, but also, as you have just said, a risk if the UK Government raises taxes or cuts expenditure. That concerns me a lot.

Presumably—and this is my final point—if the UK Government takes on more borrowing just to service the debt, there is a cost to that, even if it does not try to repay it.

Mairi Spowage: Yes, absolutely; there is a cost to that.

If the impact on Scotland is not as bad as on the rest of the UK, the Scottish budget will be better off. However, increases in the Scottish budget in recent years have been driven largely by Barnett consequentials, due to UK Government spending increases. If there is more restraint on UK spending, and at the same time there is a larger impact on Scottish tax revenues than at the UK level, there is a potential double whammy on the Scottish budget in the likely outlook for our growth and spending power.

The Convener: I have a final question, which seeks some perspective. I have seen numbers that provide a comparison between the amount of money that has, understandably and quite rightly, been borrowed just now, and the amount of money that was borrowed post 2008 to support the banking industry.

I do not know how accurate they are, but some of the numbers that I have seen in the media suggest that the Government in effect borrowed £800 billion to support the banking industry, and that the borrowing to support us through the current huge challenge stands at £300 billion or thereabouts. I know that the numbers are big estimates, but how does the amount of money that the UK Government is borrowing compare with what happened post 2008?

Mairi Spowage: It is important not to mix up the flexibilities that might be offered to institutions such as the Bank of England and through loan guarantees, with how much the Government is actually spending on things such as the job retention scheme and other day-to-day spending to shore up the economy and get us through the crisis.

If the cost is around £350 billion, that is already more than double the 2009 deficit, although for a shorter period of time. A lot depends on how long the situation persists. How large the figure gets will depend on the number of employers who choose to continue to furlough their employees and in what form—some employers may start to bring people back part-time and thus draw on the scheme less. There are a lot of other schemes, but the job retention scheme is the most significant one in terms of on-going costs; it is fantastically expensive.

Borrowing is way higher than what happened in the wake of the financial crisis, albeit for a shorter period of time, and, as you have said, for perfectly legitimate reasons. It puts into context how big the crisis is, and the amounts of money that we are talking about.

There are other schemes for guaranteeing loans, such as the coronavirus business interruption loan scheme and the bounce back loan scheme. How much money those will ultimately cost the Government depends on how many people default and leave the Government to cover the money. We will not know how much that will end up costing the taxpayer until we get to the other side of the crisis and see how many of those businesses persist and can pay the money back.

The Convener: Thank you—that puts things in perspective.

Thank you very much for the evidence that you have given today, Mairi. Not only was it interesting, but it was very helpful to us and has begun to throw some light on the significant challenges that we will face in both the UK and Scotland. We are very grateful to you.

I suspend the meeting for around five minutes, to allow time for the next witness to connect.

11:40

Meeting suspended.

11:50

On resuming—

The Convener: We now move on to take evidence from our second panel of witnesses, who are from the Scottish Fiscal Commission.

We are joined by John Ireland, who is the chief executive of the Scottish Fiscal Commission, and Claire Murdoch, who is the head of social security and public funding. I warmly welcome you both to our meeting, and I invite John to make some opening remarks—if he wishes to.

John Ireland (Scottish Fiscal Commission): Thank you, convener, and thank you to the committee for its invitation to give evidence.

The Convener: Can we unmute John, please?

John Ireland: I think that my microphone is unmuted.

The Convener: Give us a couple of seconds, John. We are not quite there yet. [*Interruption*.]

Am I the only one who cannot hear John?

Members *indicated agreement.*

The Convener: For some reason—based on what I can see on my screen—everyone else can hear John, but I cannot. Can you please proceed, John, and we will try to sort out my problem as we go? As deputy convener, Murdo Fraser might need to take over if I continue to be unable to hear.

John Ireland: I will start again.

Thank you for the invitation to give evidence to the committee. As the convener said, I am joined by my colleague Claire Murdoch, who is also on the commission staff.

Three weeks ago, the commissioners published a fiscal update on the Scottish budget position. That update covered the changes in the Scottish budget in three stages. The first stage it covered was the budget deal agreed between the Scottish Government and the Green Party, which amended the budget bill. The second stage that it covered was the UK budget on 11 March. The final—and most significant—stage was the change in Scottish Government and UK Government expenditure commitments that were associated with the Covid-19 response.

At the time when we published our report, Covid spending commitments had increased the Scottish budget by £3.5 billion—of course, there have been subsequent announcements. The report also included the commissioners' early thoughts on the possible effects of the Covid pandemic on the economy and the Scottish budget.

We are happy to answer any questions that you have on the report.

The Convener: I am back in action. I am not sure what happened, but I can hear you now, John, and I managed to hear most of that statement.

You will probably have listened to some of the previous evidence session, in which we discussed economic shock. Given that the fiscal framework is designed to protect Scotland from a UK-wide economic shock, what does the Fiscal Commission think are the main risks to the Scottish budget in the short and medium term, and what should be the priorities of the Scottish Government, the Scottish Parliament and this committee in addressing those risks?

John Ireland: As the committee discussed in the session with Mairi Spowage, the fiscal framework is designed to protect Scotland in the event of a UK-wide shock, in terms of the impact of a UK-wide shock being the same across Scotland and the UK.

If there is a differential impact between Scotland and the UK, the Scottish budget is exposed to risk. That is clearly a risk both in the short term of this financial year and in future financial years. In accounting terms, the nature of that risk comes from the potential effects on tax revenue from income tax and the other devolved taxes, and there will be effects on the expenditure side, too. On the expenditure side, there is another dimension, which is around the needs of the Scottish budget. Expenditure in Scotland might need to be higher because the crisis affects Scotland more.

Those are the accounting risks, and we can talk a bit more about the specific risks in terms of tax revenue and social security expenditure. Perhaps it is worth saying again, as everyone has said this morning, that the budget is protected from any changes in income tax revenue this year, because the money from income tax revenue from the UK Government is locked in, and we will not face a reconciliation on income tax until 2023-24. There is a degree of protection in that important element of the budget's take on income tax.

The budget is more exposed on the devolved taxes, and LBTT is the one at the front of our minds. The risk is that Scottish revenues are less than UK revenues, so there will be a differential hit on the Scottish budget from there. Underpinning all of this is the sense of an economic shock that is differential in its impacts, with Scotland faring worse. The committee talked earlier this morning about the additional borrowing that that might release, but a differential economic output shock will affect tax revenue as well, and that is a particular concern.

Those are the key risks that the Scottish budget faces. How they will be distributed over time falls from the fiscal framework. The fact that income tax revenue is now locked into the Scottish budget for this financial year is an important protection, but as we go into the next financial year, that protection will obviously not be in place.

The Convener: I want to look at one sector in particular. Tourism was mentioned during our earlier discussion with Mairi Spowage of the Fraser of Allander institute. It struck me that we all understand that the footprint of tourism and the business directly related to tourism is probably larger pro rata in Scotland than it is in the rest of the UK. Therefore, we would expect there to be a larger problem for Scotland when there is a downturn in the hospitality and tourism sector.

Then I thought, "What about the huge economic drivers in the tourism sector in the rest of the UK, such as Gatwick and Heathrow?" Are they part of the discussion about the pro rata impact on the tourism sector when Scotland and the rest of the UK are compared?

John Ireland: That reflects a long-standing problem with looking at the tourism sector. Tourism is often not an explicit sector in how the national accounts are put together; it is just a degree of categories of expenditure.

Over the years—particularly in Scotland, where Scottish Enterprise and the Scottish Government are interested in following what happens with tourism—a sort of proxy has been assembled for measuring how tourism is doing as an industry. However, in formal statistical terms, it is not measured as an industry, which makes those issues harder to address.

Thinking about the economic consequences on tourism at a higher level, the important thing is that a lot of international tourism comes through the major hub airports in the rest of the UK. Scottish tourism will be highly dependent on how they perform—that is very clear. Even though the airports in Edinburgh and Glasgow are important airports and important drivers of economic growth, the big hub airports elsewhere in the UK are the real key for tourism.

12:00

Donald Cameron: I have a specific question and two more general questions. The specific question, which I also posed to Mairi Spowage of the Fraser of Allander institute, is about the "Scotland-specific economic shock" that you mention in paragraph 2.15 of your report. That is defined as

"GDP growth in Scotland on a rolling four quarter basis being both below 1 per cent and one percentage point less than GDP growth in the UK."

You say that that is a possibility. How likely might a "Scotland-specific shock" be? The Fraser of Allander institute suggested that such a shock might be more likely than it had first thought.

John Ireland: I would agree with what the Fraser of Allander said. When the fiscal framework was developed and that Scotland-specific shock provision was put in place, most people thought that it would be reasonably likely to occur. As Mairi Spowage said, in a situation in which GDP in the UK is falling dramatically in one quarter, and is also falling dramatically in Scotland, it is much more likely that the Scottish GDP fall will be greater as a mere matter of chance. In a statistical sense, I would agree with what the Fraser of Allander said: there is more likelihood of a Scottish-specific shock.

There is something else to bear in mind. You had a conversation earlier about the reliability of economic statistics. There is greater uncertainty about the statistics that will be used to measure that test. The test is also defined in terms of forecasting. One reason why the Scottish Fiscal Commission forecasts GDP growth is to feed into that test. Forecasting the difference between GDP growth in the UK and GDP growth in Scotland is approximately twice as uncertain as forecasting only one GDP number. In a statistical sense, there is an increased probability that you will get an outcome where the forecast is more pessimistic in Scotland than it is in the UK.

Donald Cameron: When do you think that you might be able to make meaningful forecasts? You say throughout your report that you lack certainty and that everything is very unpredictable. That is entirely acceptable. When do you think the picture will be clearer? When do you think that you might make a meaningful forecast, particularly of revenue and of fully devolved taxes such LBBT?

John Ireland: It is worth considering what has already happened with forecasting. At the moment, reputable forecasters at UK level and in Scotland have acted by building scenarios. There was some reference to a scenario that the OBR produced. The national institutes for the UK and the Bank of England have also produced scenarios.

Those are no more than scenarios. They are saying, "It is possible that GDP will fall by about 25 to 30 per cent in a quarter. What are the implications of that?" How will we come out of that? It is possible that that will be a V shape, or a tick shape; it is possible that it will be a U shape or a W shape. A lot of people have been thinking about those possibilities and building scenarios or thought experiments.

The commission's job is very different. Our job is to provide numbers that go into the Scottish budget. They are single estimates. We cannot produce a range of numbers for GDP growth and cannot go into a test of a Scotland-specific shock. We have to produce single-point estimates. That is much harder, and in order to do it we need more data—as any forecaster would. We need to understand a little more about how the pandemic is running and about how restrictions are being lifted in the UK, in Scotland and internationally. We need a sense of how economic activity has been affected.

The UK and Scottish Governments are doing useful work to improve data, but we will not have Scottish GDP data for quarter 1 until mid-June and we will not have Scottish GDP data for quarter 2 until September. There are lags in the data.

With the exception of income tax for Scotland, the fiscal data is pretty quick. We receive data on devolved taxes within about a month, and Social Security Scotland provides data on social security expenditure reasonably quickly. The fiscal data will be in place earlier, and we will then be able to make judgements on that basis. Although there is some useful interim data, the economic data will take longer.

To answer your question, a conversation needs to be had between the Finance and Constitution Committee and the commissioners about when you might expect forecasts from the Scottish Fiscal Commission. Committee members will remember that the convener wrote to our chair when the Scottish Government's medium-term financial strategy was postponed to say that it did not expect forecasts to be produced currently. We are continuing to talk to the committee clerk and the Scottish Government about when we will produce our next forecast.

Donald Cameron: Thank you very much—that was very helpful.

My final question concerns reconciliations. Even before the Covid-19 crisis, we were all aware that the Scottish budget faced severe reconciliations on income tax for this and the next few years. While it is all very well to say that the effects of Covid-19 on income tax may not be felt until 2023-24, do you accept that the Scottish Government will still face reconciliations anyway?

John Ireland: Yes. In our last forecast publication, the Scottish Fiscal Commission estimated that the size of the income tax reconciliation in next year's budget would be in the region of £550 million. We will not know the outcome of that data until much later this year, but there will be a fairly substantive income tax reconciliation and other reconciliations will hit the Scottish budget more quickly. The management of reconciliations is still an issue.

I will hand over to my colleague Claire Murdoch to add to that.

Claire Murdoch (Scottish Fiscal Commission): In our reports, we were already starting to highlight how important reconciliations are for the on-going monitoring of the budget and that they will play an increasingly important role, particularly with social security spending being devolved from April 2020. We have already been thinking about the issue, but you are right that reconciliations will be taking place against the backdrop of Covid-19.

The normal uncertainties about the Scottish budget will be a natural part of the fiscal framework and Covid-19 will create additional uncertainties for the budget, such as what it will mean for tax revenues in Scotland and the rest of the UK, as well as the huge change in public spending in both places.

The Convener: I will move to Jackie Baillie, to be followed by Murdo Fraser. Angela Constance has had to leave to join the Equalities and Human Rights Committee meeting.

Jackie Baillie: John Ireland mentioned the medium-term financial strategy. I completely understand why that has been put off this year because of the level of uncertainty, but when the Scottish Fiscal Commission estimated the position last year, it identified something like a £1 billion black hole in tax revenues. I am inviting you to speculate on whether you think that that number will go up, go down or stay the same.

John Ireland: At the moment, our February forecasts contain the best information on that. Unfortunately, I do not have that publication in front of me but, from memory, I think that there was no significant change in the reconciliations that we were forecasting. The outturn data for income tax is a key piece of information; Her Majesty's Revenue and Customs would normally publish that over the summer, but I understand that it will publish it later this year. Once we have that data, we will understand the full extent of the reconciliations that the budget will face next year from income tax.

Jackie Baillie: If, as everyone expects, income tax revenue falls and it falls further in Scotland than in the rest of the UK, we would expect the prospects for our medium-term financial strategy to be a bit bleaker than they are now.

John Ireland: Yes. I am sorry, but I was probably talking about a slightly different issue, which is the reconciliation from previous income tax receipts that we face in the next financial year. Of course, you are right to say that, if there is a differential impact on the income tax forecast for next year, that will also have an effect on the Scottish budget.

Jackie Baillie: That is a frightening thought. Let me deal with the here and now and the immediate impact on the budget that members have started to explore with you. Towards the end of May, we will get data about what has happened to land and buildings transaction tax during lockdown. Some of the effects are behavioural. Do you expect the housing market to be depressed or do you think that it will pick up? I am conscious that there is a potential reconciliation in autumn and that we need to arrive at conclusions about what we need to do for the budget in year.

John Ireland: There is a very mechanistic answer to part of that question. The data that will be published in May for April transactions and the data for May transactions, which will be published in June, will inevitably be very low, because it is almost impossible to make transactions in these markets currently. In that sense, the housing market will be depressed. When the housing market is released so that people can transact again and people feel confident in making transactions, the figures will go up. In a very mechanistic sense, we can expect to see that U shape in the graph of such receipts.

What is a really difficult call is how and when the housing market in Scotland will respond and how and when the comparable market in England will respond. Everyone will have seen the measures announced by the UK Government the day before yesterday, which are intended to stimulate the housing market in England, but we do not know whether they will have much effect or what that effect will be. We also do not know when the Scottish market will be released. It is an almost imponderable question, and I cannot say much more than the very simple mechanistic answer that I gave at the beginning.

Jackie Baillie: Perhaps my final question will be easier to answer, given that social security is much easier to forecast, because there will be real-time numbers on the increase in the number of people in receipt of benefits. When do you expect to receive that data? Your colleague said that that data comes through quite quickly. When will you have an assessment of the likely impact on the budget?

John Ireland: I will pass that question over to Claire Murdoch, who is responsible for social security forecasting.

Claire Murdoch: We forecast two categories of social security benefits. One category is the benefits that have block grant adjustments. Those are the largest benefits and they continue to be administered by the Department for Work and Pensions on behalf of the Scottish Government. Those benefits account for the bulk of the £3.5 billion of social security spending in Scotland. The data that we get from the DWP takes a little bit longer to come through than the data that we get from Social Security Scotland. Those benefits are largely related to disability, ill health and caring and we do not expect Covid to have as significant an effect on spending on those benefits. The UK Government has already introduced some changes, in particular to the personal independence payment application and assessment process, which will affect spending. However, overall, those changes will be less significant than the huge shift that we have seen in universal credit claims.

The other category of benefits in Scotland is those that are administered by Social Security Scotland. The majority of those benefits are linked to entitlement to UK benefits and are means-tested benefits. When we see universal credit claims go up in the UK as a whole, we expect that to lead to an increase in the claims that are made for the Scottish benefits, such as the best start grant, best start foods or the funeral support payment.

It is still quite early for us to see anything in the data. The chief executive of Social Security Scotland appeared before the Social Security Committee a few weeks ago and he said that, at that point in time, the agency had not seen an increase in claims for those benefits. However, that was a very early point in the lockdown, and people first have to apply to the DWP for universal credit and that claim has to go through the process and be successful before they can apply to Social Security Scotland, so there will be a bit of a lead time. We hope that, over the summer, we will start to see more of those universal credit claims translating into Social Security Scotland claims and we will start to see that in the data so that we can produce more accurate forecasts of social security spending in Scotland.

12:15

Murdo Fraser: I will ask John Ireland a similar question to the one that I put to Mairi Spowage earlier. The fiscal framework protects the Scottish budget against falls in income tax receipts provided that the impact is in line with what is happening across the UK as a whole, but there is a potential negative impact if there is a differential, with a higher fall in Scottish income tax receipts.

We had a discussion earlier about the components of the Scottish economy, and Mairi Spowage's view was that the fact that tourism and oil and gas are more important in Scotland could mean that there will be a much larger negative impact on Scottish income tax compared with the rest of the UK. I note that you accept that point in your paper, but you also mention that the public sector is larger in Scotland, which might have a balancing impact. Will you expand on that and tell us what you think the likely prospects are for income tax revenues in Scotland compared with the rest of the UK?

John Ireland: A starting point is that what really matters here is how the income distribution of the people who pay tax is affected by Covid and whether that will be different between the UK and Scotland. In thinking about the sectors, we need to think about exactly where the people who are employed in those sectors fit in that income distribution. That is one set of issues.

The other really important issue is the oil and gas sector. The industry is predicting quite significant job losses, and we know that those jobs are typically quite highly paid, so the income tax revenue from them will be quite large. The fact that the oil and gas sector is much more important in Scotland is a real issue here.

It is true that the public sector is larger in Scotland than it is in the rest of the UK. The reason why we think that that will have a dampening effect on any fall in income tax revenues in Scotland is that those public sector jobs have typically continued and redundancy, at least in the short run, is much less likely than it is in the private sector.

The public sector is certainly a dampener, although not in the sense that it is going to grow more quickly to compensate for falls elsewhere. I guess that it would lead us to be a little more optimistic, although not in the sense that we expect the public sector to grow to offset losses elsewhere.

Murdo Fraser: That is helpful. My second question, which is in the same territory, is about the impact on income tax revenues of different approaches to relaxing the lockdown restrictions. This week, with England taking a more active approach to relaxing the restrictions, we have seen more people getting back to work, whereas in Scotland we are seeing more restrictions. What impact is that likely to have on income tax receipts in Scotland relative to the rest of the UK?

John Ireland: That is a hard one to call. You are right—at the moment, we are seeing the UK Government taking a different approach from the Scottish Government in relation to the lockdown. Mairi Spowage said that she is picking up some evidence that the existing lockdown was imposed in different ways. It is very early days and we do not know how successful the UK Government is going to be in continuing the lockdown and keeping the reproduction factor beneath the comfortable level of 1. We do not know what course the UK Government is going to take, so it is a very hard one to call.

We are at a relatively early point in the financial year and there is an awful lot of potential for releasing the degree of lockdown and, unfortunately, potential for pushing down again, so I think that it is too early to call it in those terms. However, we must be alive to the fact that there are policy differences between Scotland and the rest of the UK, including as we start to formulate our forecasts later in the year.

Tom Arthur: Good morning, Mr Ireland. My first question is a quick one. What impact, if any, is the pandemic having on the operations of the SFC from the point of view of remote working and the timely production of data from other sources? Is it having any impact on your ability to do your work, or is the impact minimal?

John Ireland: There has been a transition—all the commission’s staff are now working at home and our office is closed. That explains my lack of tie. We have made the transition to working at home relatively smoothly. We have produced two publications, albeit small ones, since lockdown. That has gone well, although it has been slightly harder work. We have managed to use the technology well and have managed to keep in touch with our commissioners; in fact, we are probably having more interaction with our commissioners than we would do normally. From the point of view of how we work together, the process is working well. We have also been very fortunate in that no one at the commission has suffered any illness. In that respect, things are going well.

New data sources are starting to arrive—for example, new data from the Scottish Government and the ONS is helping us to look at things—and we are starting to pick up on some of the uncertainties of that data. The ONS has made it very clear that some of the data that it is producing is potentially less reliable. In addition, we are starting to see some delays in data coming through—I mentioned earlier that we think that the income tax outturn data will be published slightly later than we had anticipated.

On the whole, things are going well.

Tom Arthur: That is very good to hear.

I apologise if you made reference to this earlier and I missed it but, given the turbulence of the times that we live in and the unprecedented nature of the economic crisis that we face, on top of the public health crisis, what impact will that have on forecast error, if any?

John Ireland: We would be very fortunate if it had no impact on forecast error. This is not a scientific assessment, because we simply do not know, but I talked at some length about how long it would take us to be in a position to start to make the sort of forecasts that we need to make. Implicit in that is the fact that we expect our forecast errors to be larger. We also know that some of the data is probably less reliable and will have bigger back revisions. Again, that will impact on forecast error.

Economists spend a lot of time worrying about building models, which are all based on past data. When the world suddenly changes, the relationships that underlie those models change. Earlier, there was an exchange between Mairi Spowage and Patrick Harvie about how the Scottish and UK economies might change in nature a great deal as a result of the crisis. That would result in fundamental changes in relationships, which would make forecasting harder.

The quick and obvious answer is that we anticipate that forecast error will go up, although I could not tell you by how much.

Tom Arthur: As has been discussed previously, a key concern is that, in some areas, the forecast error will be beyond the capacity of the fiscal framework, as it stands, to absorb.

My final question is one that I put to Mairi Spowage from the Fraser of Allander institute. How will the SFC re-evaluate the risk of the negative impact of a hard Brexit at the end of the year in the midst of the global pandemic and the global recession that we face?

John Ireland: As we have discussed at previous committee meetings, in the past, we have based our Brexit forecasts on our assumption that there is likely to be a managed exit. Therefore, we have never forecast the consequences of a harder, disorderly exit. We could talk a great deal about how a hard exit in December would interact with the issues that the economy will face with regard to continuing social distancing and disrupted supply chains. However, that would be speculation; we have not done that work. We have not yet looked at whether a hard Brexit in December is likely. Although we have done a lot of preparation for forecasting a hard Brexit, we have not thought about that since the start of the pandemic. We stand ready to do that but, although there would be some interaction, it is too early to speculate on how those two events would interact.

Tom Arthur: Thank you.

Patrick Harvie: Murdo Fraser made the point that the UK Government is being more enthusiastic at an earlier point in encouraging people back to work, which might have an additional economic benefit there, and that the same benefit would be delayed in Scotland. In his response, John Ireland was cautious in saying that it is too soon to know the consequence of that. If the UK Government is more successful earlier in encouraging people back to work, that will have some economic benefit. However if, because of that return to work, more people squeeze on to tubes and buses and get infected and the infection spreads in a more aggressive way, that will have an economic downside. Was John Ireland being cautious because we do not know the direct economic effects of a return to work or the economic consequences of a change in the infection pattern?

John Ireland: We also do not know what the change in the infection pattern would be. In a lot of the scenarios that have been discussed, the shape of Covid's economic impact has been thought about as a V, a U or a tick. We all agree how steeply we went into this, but how quickly can we come out of it? A small number of people have also looked at W-type recessions—in other words, a release followed by a second wave.

About three weeks ago, the Scottish Government published its "State of the Economy" report, which, at the end, includes interesting simulations that look at those impacts. People in the Scottish Government are thinking about how the economy would react in the event of a second wave or a mini second wave, with regard to having to clamp down again if it looked as if the infection rate was going up. Patrick Harvie is right—I am cautious, because, at this stage of the pandemic, we have no sense of how we will come out of it in terms of infection, let alone in terms of policy and the impact on the economy.

12:30

Patrick Harvie: Thank you. We are anticipating an in-year budget revision to be announced soon. Given the circumstances, that might be the biggest in-year budget revision ever seen. We will debate that in the next month or two, in the lead-up to the summer recess. Given that it is probably too early to expect the Fiscal Commission to produce forecasts for the longer term by that point, what is the commission's role in advising Parliament and Government about the options for that in-year budget revision? How much information do you already have, or do you need, about the existing spending impacts, for example on the capital side, where the capital programme might have to be reprofiled simply because work that was in the pipeline cannot now proceed on the planned timescale?

John Ireland: I will answer that briefly; I may then pass over to my colleague Claire Murdoch, who looks after public spending at the commission and will be able to give a more detailed answer.

The commissioners can report on and help out with anything that affects the resources that are available to the Government. The fiscal update that we published three weeks ago was very much designed to do that. It set out the changes that have happened since the Scottish budget was introduced to Parliament as well as the consequences of the budget deal, the UK budget and the Covid-19 commitments that the UK Government has made. With an awful lot of help from the Scottish Government and a little bit of help from the Treasury, we identified the additional £3.5 billion-worth of consequentials that were in the pipeline until about April, when we published. Our role at the moment has been to produce that fiscal update. We hope that it has helped the committee and other people understand the current position for the Scottish Government and the Scottish budget.

If the committee wants us to do other forms of analysis and thinking on the issue, we are happy to consider that but, in a sense, it is for you to ask and for us to have a think about it. At the moment, we are trying to fulfil our role through the fiscal updates.

Alexander Burnett: I note my registered interest relating to construction.

My question expands on Tom Arthur's question about data. Pre coronavirus, I raised with the commission the issue of the poor quality of data in the construction sector, which constitutes such a large part of the economy. Given the impact of the sector on LBTT and landfill tax, what steps have you taken to gather data on the sector and improve the quality of that data? I note from a letter from Revenue Scotland that it has just made some telephone calls to landfill tax payers. Is that the extent of the information gathering on that tax? What challenges did you face in gathering the data?

John Ireland: We do not collect raw data in the way in which the Scottish Government and Revenue Scotland collect data—our interest is very much as data users. However, we are concerned about the quality of data. After the big revisions that were made to GDP a while back, which led to a significant forecast error, we spent a lot of time thinking about the construction data that the Scottish Government publishes and talking to its statisticians. We understand that it has made improvements to that data collection through the way that it uses a combination of UK and Scottish data to produce the construction output series. As Mairi Spowage said, there is still quite a heavy reliance on UK construction indicators early on in that process, so there are still a number of issues with the early construction data, although we understand that the Scottish Government is working on that.

In relation to Revenue Scotland, again we are data users. We spend time talking to its statisticians and understanding the quality of the data, but we do not have hands-on involvement in collecting data.

John Mason: My questions will be similar to those that I asked earlier. We are concentrating on the Scottish budget and the possible asymmetric impact on the Scottish economy of the current situation, but how does that relate to what the UK is doing? We have seen figures showing that there might be £300 billion of extra spending. The Fraser of Allander institute thinks that that will all just come from borrowing and that the UK Government will not try to recover it very quickly. However, how does what the UK Government is doing impact on the Fiscal Commission and your forecasts?

John Ireland: We take UK fiscal policy as given. Obviously, it has an effect on Scottish budgets and how much money is available for the Scottish Government to spend. We have a direct interest in it through the economy, which then feeds into our tax forecasts. In terms of the impact of those decisions on us, we very much take UK fiscal policy as given; it is an outside factor in our forecasts. We understand that those decisions are crucial for the Scottish budget as a whole, and therefore we keep an eye on what is going on there.

John Mason: I also wonder whether the UK budget might end up being late this year. If it is, and if there are big changes either on the tax-raising side or through cuts in expenditure, would there be a big impact on our budget and your forecasts?

John Ireland: Yes, I think so. After last year, our preference would very much be that the UK budget occurred before the Scottish budget. I know from discussions with our colleagues in the Scottish Government that they have a similar preference, and I am sure that the committee has, too. It is likely that there will be significant changes in the UK budget next year, and those changes will impact on the Scottish budget and our forecasts, so it would be very helpful if the UK budget came first.

I do not know when the UK budget will be. We all speculate about politics, but I have no sense of when it will be. I probably have even less information than other people.

At the Fiscal Commission, we are talking to both the clerk to your committee and the Scottish Government to ensure that we can prepare and be as flexible in our response as we were last year.

John Mason: Finally, although we can be relaxed about the income tax reconciliations because they will not occur until 2023-24—we talked about that earlier—I assume that there could be an effect on the block grant before that because of UK action, and that that could happen as of April 2021.

John Ireland: The only part of the Scottish budget that is locked down this financial year is the part that relates to income tax. You might have other in-year reconciliations around social security spending and devolved taxes—that is more of a risk this year. As you go into the next financial year, everything can move around in line with the OBR forecast and our forecasts.

The Convener: I thank John Ireland and Claire Murdoch for their helpful evidence. I do not envy the Scottish Fiscal Commission's role in trying to carry out forecasting in the current turbulent environment. I also thank members of the committee as well as the team behind the scenes who have helped to support this virtual meeting.

Meeting closed at 12:38.

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