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Finance and Constitution Committee

Wednesday 10 February 2021

Session 5

The Scottish Parliament
Pàrlamaid na h-Alba

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FINANCE AND CONSTITUTION COMMITTEE
5th Meeting 2021, Session 5

CONVENER

*Bruce Crawford (Stirling) (SNP)

DEPUTY CONVENER

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

COMMITTEE MEMBERS

*Dr Alasdair Allan (Na h-Eileanan an Iar) (SNP)
*Tom Arthur (Renfrewshire South) (SNP)
Jackie Baillie (Dumbarton) (Lab)
*Alexander Burnett (Aberdeenshire West) (Con)
*Patrick Harvie (Glasgow) (Green)
*Dean Lockhart (Mid Scotland and Fife) (Con)
*Fulton MacGregor (Coatbridge and Chryston) (SNP)
*John Mason (Glasgow Shettleston) (SNP)
Anas Sarwar (Glasgow) (Lab)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Professor Francis Breedon (Scottish Fiscal Commission)
Kate Forbes (Cabinet Secretary for Finance)
John Ireland (Scottish Fiscal Commission)
James Kelly (Glasgow) (Lab) (Committee Substitute)
Dougie McLaren (Scottish Government)
Lucy O'Carroll (Scottish Government)
Dame Susan Rice (Scottish Fiscal Commission)
Professor Alasdair Smith (Scottish Fiscal Commission)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

Virtual Meeting

Scottish Parliament

Finance and Constitution Committee

Wednesday 10 February 2021

[The Convener opened the meeting at 08:55]

Budget Scrutiny 2021-22

The Convener (Bruce Crawford): Good morning and welcome to the fifth meeting in 2021 of the Finance and Constitution Committee. We have started a wee bit later this morning because of some technical gremlins, so we apologise to those who tried to watch the meeting earlier.

We have apologies from Anas Sarwar and Jackie Baillie. James Kelly will be Jackie Baillie's substitute.

The only item on our agenda this morning is to take evidence from the Scottish Fiscal Commission and then from Kate Forbes, the Cabinet Secretary for Finance, as part of our budget scrutiny.

I welcome our first panel of witnesses, who are from the Scottish Fiscal Commission, to the meeting: Dame Susan Rice, chair; Professor Alasdair Smith, commissioner; Professor Francis Breedon, commissioner; and John Ireland, chief executive. I invite Dame Susan Rice to make some brief opening remarks.

Dame Susan Rice (Scottish Fiscal Commission): Good morning. Thank you for asking us to give evidence. I will take a few minutes to share some headlines from our report. Covid obviously made the past year really tough for everybody. Both the Scottish and the United Kingdom economies were significantly affected, contracting by 11 per cent in 2020. We expect that the current lockdown will reduce economic activity by a further 5 per cent this quarter. However, our forecast for 2021 as a whole is for growth of about 2 per cent, rising to 7 per cent next year.

We expect Covid to affect the economy for a long time. We think that it will not be until 2024 that gross domestic product returns to the level that it was at before the pandemic, and we expect unemployment to remain elevated over the forecast. There is an important consequence of our forecast this year. For the first time, our forecasts—along with those of the Office for Budget Responsibility—have triggered a Scotland-specific economic shock. That means that the Scottish Government will get additional borrowing powers for the next three years to manage forecast errors. The shock arose because the OBR's November 2020 forecasts were made before the current lockdown was even announced, so it took a more optimistic view of the UK economy for the beginning of 2021 than we have done now for Scotland.

At this stage, we do not see any stark difference in how the pandemic has affected the Scottish and UK economies. As in previous years, income tax revenues contribute more than the reduction in the budget from the block grant adjustment. That position of income tax in the 2021-22 budget is now forecast to be £475 million, an increase from £155 million in our pre-pandemic forecast. That is because we are now forecasting that, between this year and the next, Scottish income revenue will grow 3.5 per cent compared with the 1 per cent growth in the BGA based on the OBR's income tax forecast. We believe that that difference largely arises from uncertainty around Covid and its effects on the data and judgments used by both organisations.

Covid is an exceptional event; we do not expect a divergence unrelated to economic factors or policy to happen in other years. If the net position of income tax in the budget proves to be too large, there will be a negative reconciliation in the order of £300 million in 2024-25.

In our previous forecasts, we have said that the devolution of taxes and social security introduces additional risk into managing the Scottish budget. We are clear that in 2021 and next year, the budget management challenge is different from what it was previously and it is much more risky. Any variation in the budget due to tax revenues and social security payments has been far surpassed by the scale of the pandemic-related funding from the UK Government.

Over the course of this year, Covid funding increased successively from £3.5 billion in April to the latest estimate of £8.6 billion. Overall, resource funding has increased by 21 per cent since the budget was introduced a year ago. Next year's resource budget has been set at £1.8 billion of Covid funding but, given the uncertain nature of the pandemic and the tightening of restrictions across the UK since November, there might be further changes in funding in next month's UK budget and later in the year as well, so it is likely that the Scottish Government will continue to have to hit a moving target when managing its finances.

09:00

Overall, our view is that the Scottish Government's plans to use the reserve and resource borrowing to manage the budget are reasonable during an exceptional year, but we recognise that the on-going uncertainty means that those plans might change significantly.

That is my high-level overview. We will all divvy up the questions that you have and we are happy to take them now.

The Convener: Thank you, Dame Susan. Your overview and opening remarks were very helpful.

Obviously, the committee acknowledges the difficulty that the SFC has faced in producing forecasts in these highly challenging and volatile circumstances, and we are also aware of the complexities of the fiscal framework. However, we are struggling to understand why your income tax forecast is so much higher than the OBR forecast, when the opposite is the case for your GDP growth forecast. It would be interesting to understand the key differences between the judgments that you and the OBR have made in underpinning your respective forecasts and why that apparent contradiction is part of the forecast.

Dame Susan Rice: Thank you for that question; it is genuinely pertinent. I hope that it does not sound flippant to say that a lot of the difference is about timing but it is rather more complicated than that. To begin, I will ask Alasdair Smith to respond to the question, because he is very articulate on that subject.

Professor Alasdair Smith (Scottish Fiscal Commission): I will do my best. The convener asked a very important question about our forecast. As Susan Rice said in her opening remarks, there is a timing difference between our forecasts, which were done in January, and the OBR forecasts, which underlie the BGA and were done in November. That has resulted in our forecast for the overall economy being more pessimistic than the OBR forecast. As the convener pointed out, that does not really explain the difference between the income tax forecasts, in which we are more optimistic than the forecast from the OBR.

It is perhaps worth starting off where we were last year in our forecasts for this year. The combination of our forecast and the OBR forecast estimated that the Scottish budget would get a net addition of about £150 million from income tax. Since then, the pandemic has come along, the OBR has adjusted its forecasts, as have we, and both of us are now making income tax forecasts that are substantially reduced. However, the OBR's forecasts have gone down by more than ours; the OBR reduced its income tax BGA by £950 million, while our forecast for income tax revenue has gone down by much less, with the result that we now have a net difference of £475 million between the two forecasts, which is £320 million more than our previous forecast. Frankly, that is out of line with past data on income tax outturns; for example, in the last outturn year of 2018-19, the net outturn for the Scottish budget was £120 million, so our earlier forecast of last year was more or less in line with that.

It is hard to explain why that number should now have been boosted by almost £500 million. There is no obvious reason why our forecast of the income tax reduction should be much less than the OBR's forecast since, broadly speaking, we do not see evidence that the economic effects of the Covid pandemic have been very different in Scotland from those in the rest of the UK.

I apologise for that long introduction in trying to answer your question, but it is important to set the framework. We all know from past discussions that relatively modest differences between our forecasts and the OBR's forecasts can generate quite large reconciliations. We are both trying to estimate a number that is of the order of £12 billion, so relatively small differences and divergences can lead to significant gaps.

I turn to the effects of the pandemic on our forecasts. It is important to appreciate the uncertainties with which tax forecasters in the SFC and the OBR have had to grapple in the current circumstances. The pandemic has broken the normal connections between gross domestic product on the one hand and employment and earnings on the other. Therefore, as is shown by the summary that the committee has, our forecast for this year indicates that we think that Scottish GDP fell by more than 10 per cent in 2020 compared with 2019, but employment fell by only 2.5 per cent and earnings actually seem to have risen by 2.5 per cent.

In an ordinary recession, a fall in GDP of 10 per cent would have been accompanied by similar falls in earnings and employment, but that did not happen in 2020, because both Governments made deliberate policy interventions to safeguard employment. Specifically, the furlough scheme kept workers in employment and earning wages, even if they were not actually working.

The pandemic has also had effects on income distribution. The incomes of the well-off have been largely unaffected by the enforced downturn in economic activity, while the incomes of many low-paid workers and families have suffered. Since a high proportion of income tax revenue comes from the higher paid, that will have an effect on tax revenue. The pandemic has also affected the reliability of data, because the statistical agencies have been collecting economic data in much more difficult circumstances than in a normal year.

In this highly uncertain environment, the OBR and the Fiscal Commission seem to have made different judgments about how to interpret and use the data. We have made a lot of use of the RTI—real-time information—data from Her Majesty's Revenue and Customs on employment, earnings and tax receipts to try to track what really happened in those difficult circumstances and what is likely to happen in 2021, whereas the OBR has given more weight to labour force survey data. The OBR data also includes information from self-assessment, which is not included in the RTI tax receipts data, although it is a relatively small fraction of tax revenue.

We think that those different judgments about data are probably the biggest source of the forecasting difference that has led to the addition of £475 million to the Scottish budget compared with last year's forecast.

Obviously, there is anxiety about whether that £475 million is a real increase to the budget that the Government can safely spend, or whether, as Susan Rice suggested in her opening remarks, it is an artefact of the difference between the two forecasts and when the outturn for tax in 2021-22 comes along in 2023, we will find that that £475 million was not really there and the Government budget will face a reconciliation.

That is the issue that we face, and I hope that I have explained why we think that that is largely the product of two organisations making forecasts at different times and facing unprecedented difficulties in forecasting income tax revenue at this time.

I apologise for the length of my answer, but I know that you are concerned about that important issue.

The Convener: It was important for you to give us a detailed and lengthy answer.

I have a follow-up question. In terms of the normal models that you quite rightly described—[*Inaudible*.]—the difference between GDP and income tax growth, I guess that the real challenge for you in making forecasts is that you are looking into a crystal ball that is incredibly misty—it is smoky—and you can hardly see what is going on with the real-terms future. That brings huge risks—you have talked about the relative difference in the forecasts producing significant gaps. I am concerned about the level of risk that will inevitably arise from the different judgments and the impact of reconciliation of forecasts on the outturn in 2024-25. That might seem to be a bit further down the road but, because of the system that we work with, we have to look that far ahead.

What are the risks for 2024-25? How large are they? Do we have enough flexibility in the fiscal framework to deal with the potential significant level of risk?

Professor Smith: If the £475 million in the Scottish Government budget remains in the budget during the year and is spent, but it then turns out in 2023 that the outturn was way out of line with that amount, there will have to be, as you have indicated, a reconciliation in the 2024-25 budget. If that reconciliation is about £400 million or £500 million, that would be larger than the Government's current borrowing powers. Therefore, on the face of it, there is an issue.

However, I would not focus too much on the question of what will happen in 2025. We will have a review of the fiscal framework before then, and everything that has happened this year will have provided interesting material for whomever is reviewing the fiscal framework to think about, and they can consider that question.

The more important issue is to think about what the Scottish Government should do this year, given that it has got that addition to its budget for 2021-22. Our best guess is that that is a slightly artificial increase as a result of the forecasting difference. It might be, for example, that the OBR, when it produces a new set of forecasts at the end of March to go alongside the UK Government budget, revises its view of income tax forecast, and the BGA might get revised at that point.

If the BGA came down by a few hundred million pounds in March, under the arrangements that are agreed for this year when the two budgets are out of line with the usual practice, the Scottish Government could choose to go with the existing BGA and leave the £475 million in the budget, or it could—if, hypothetically, there is a lower BGA—revise the budget to use the amount of the excess in the budget. However, it is important to emphasise that, because of Covid expenditure, there is a huge amount of budget uncertainty this year. The Scottish Government got £8.5 billion of additional expenditure, in steps, during the 2020-21 financial year; some of it came in quite late in the year.

09:15

The budget that is before the committee has £1.8 billion of additional funding for Covid, £1.3 billion of which comes from United Kingdom funding decisions at the time of the UK spending review in November. The Scottish Government estimates that it will get another £0.5 billion of Covid funding during the year.

We think that, given all the uncertainties about how Covid is going to develop over the year, the Government's assumption in its budget of an additional £500 million is pretty modest and cautious. Against the scale of the likely pressures and changes in the budget during the coming year that will be associated with the evolution of the pandemic, the income tax issue is not a huge issue, relative to the scale of all the other uncertainties.

I am not trying to talk it away; it is a real issue. What I am saying is that, although we cannot ignore it—it is a significant issue—we can be relatively relaxed about it, for the moment. Perhaps later in the year, when we have seen how 2021 has evolved, will be a better time for us to judge whether it is a little quirk of the fiscal framework, whereby two forecasts made at different times have given the Scottish Government a modest, but welcome, relaxation in its borrowing power. After all, that is what a reconciliation is. An addition to the budget followed by a reconciliation is effectively an interest-free loan to the Scottish Government for a couple of years, which then has to be repaid in 2025. In the current circumstances, an additional loan of £0.5 billion might be regarded as welcome. Later in the year, when we review the numbers, we might think, “There is an issue here which needs to be tackled,” but that is probably a better time to tackle it.

Murdo Fraser (Mid Scotland and Fife) (Con): Good morning, Dame Susan, and thank you for your responses to the convener. I want to follow up on a couple of points around forecasting. To put that in context, I accept everything that has just been said about the unprecedented nature of the times that we are in and the difficulty in forecasting, so my questions are not intended as a criticism.

I want to ask about your forecast for economic growth next year. You are forecasting it at 1.8 per cent in 2021, followed by a big rise to 7.5 per cent in 2022. That is quite far out from the Office for Budget Responsibility’s forecast, albeit that that forecast was produced back in November.

I note that the Treasury publishes a summary of economic forecasts every month. Its most recent forecast, which was published in January, projected UK growth in 2021 at 4.5 per cent, which is quite a lot higher than what you are forecasting for Scotland. Is there any particular reason for taking such a pessimistic view in comparison with the surveys that the Treasury is highlighting?

Dame Susan Rice: Again, that is a good question, which might be in the minds of a lot of people. In a moment, I will turn to another of my colleagues, Francis Breedon, who can give you a detailed answer. First, I point out that these forecasts are all quite time dependent, as we can see if we look quarter by quarter at the OBR forecast, and at the Treasury forecasts; the Bank of England recently came out with a forecast as well. If the growth begins in the second quarter of this year, it makes a difference overall—quite a lot of difference, in fact—if it is shown to start a little bit sooner or later.

The forecasts are made at different points in time. The differences do not reflect pessimism on our part; it is simply that we used the data and the information that we had at the point when our economic forecast closed, which was a couple of weeks ago in January. Francis Breedon might want to give more detail about some of those differences.

Professor Francis Breedon (Scottish Fiscal Commission): As Susan Rice said, it is all in the timing. As the committee heard, many forecasts that were made last year, including the Office for Budget Responsibility’s forecast, did not expect the second lockdown. Indeed, looking at the Treasury survey, we can see that quite a few of those forecasts were made in that period. A reason why we were pessimistic, relative to the survey, is that our forecast included the second lockdown—not every forecast in the survey had that. As Susan pointed out, since we made our forecast, things have somewhat improved on the Covid front because the vaccine roll-out has been quicker than we expected; the Bank of England forecast has a relatively quick return to normalcy compared with what we had, because it expects the vaccine roll-out to help to speed things up.

I think that you can judge from my answer that it is not just about the timing of when the forecast was made; the variation by a few weeks or a couple of months in the lifting of Covid restrictions makes a huge difference to growth in 2021. However, as the question implied, it comes out in the wash, because growth gets pushed, and we have forecast a very strong 2022 as a result. What we are really talking about is a couple of months’ difference in how the restrictions play out, and because the restrictions have such a powerful impact on gross domestic product when they are in place, those small differences in assumption can make big differences—not to the long-run forecast but to the path of recovery.

Murdo Fraser: That is helpful. On the slightly tangential issue of the Scottish Fiscal Commission’s forecast of employment, unemployment and earnings growth, compared with the OBR’s estimates for the UK, you project slower employment growth—again, that could be down to the timing—and higher unemployment in Scotland, but you predict substantially higher earnings growth. What is the explanation for how those figures reconcile with each other?

Dame Susan Rice: Francis Breedon, do you want to pick that up, or shall I kick off?

Professor Breedon: I will start, but there is not a very helpful answer to that, in the sense that, as we have been saying, the relationship between all those numbers is broken. Normally, if we know one of the numbers, we can predict roughly what the other ones will do, but that is not the case now. Clearly, factors such as the timing of restrictions being lifted is a key part of that story. Unless John

Ireland wants to add more detail, I am not sure whether there is a helpful answer to that question.

Dame Susan Rice: One factor that Alasdair Smith mentioned—Francis Breedon might have mentioned it, too—is that we used the RTI data, which we have talked to the Finance and Constitution Committee about in previous evidence sessions. We used that data, which gives us real-time information about employment and earnings for Scotland, in January. We felt that that was a better snapshot of what was happening here than the labour force survey, because the survey relates to one point in time and refers back to a pre-Covid base. Therefore, in part, the use of different information led us to our forecast. We think that it was absolutely right to use the RTI data in this instance, as it brought us closer to what was really happening on the ground recently—just in the past few weeks. John Ireland might want to give a more nuanced reply to that.

John Ireland (Scottish Fiscal Commission): There is a range of alternative sources of earnings data. There are also alternative sources of data on employment and unemployment. It is probable that the OBR relied on those alternative sources, including, but not uniquely, the labour force survey, whereas we have relied more on real-time information. That information gives us data on earnings, employment and tax receipts.

The Office for National Statistics, which provides the LFS, has put out a couple of warnings against using its data about changes in and levels of employment. Those warnings were issued after the OBR forecast was published.

The HMRC RTI data shows a fall in employment in 2020, although that is not evident in the LFS data. The question is how to weigh up those two sources of labour market information. We have gone for the RTI data in making our forecast, in part because of those warnings from the ONS.

Patrick Harvie (Glasgow) (Green): Can we move on to look at the longer-term picture? When we look beyond the coming financial year, we see differences between the forecast from the Scottish Fiscal Commission and the one from the OBR. Can you comment on those differences? Also, what does the picture for the years to come tell us about the way in which the fiscal framework operates? There are unresolved questions. Perhaps the framework was not designed to be resilient against serious bumps in the road of the sort that we have encountered.

Dame Susan Rice: Those are two questions that need two separate answers. The second one is about the nature and efficacy of the fiscal framework; the first is about what we see when we look further ahead. I will say something about the first question and ask my colleagues to give you some of the detail about what we see in the future.

As you all know, the fiscal framework is due for review later this year: that was always in the plan. I find it interesting that the framework, as first created, anticipated that there might be a situation in which there was a Scotland-specific economic shock. That has come into play for this round of forecasting. The framework anticipated a range of activities that could happen.

However, it is not the role of the Fiscal Commission to comment on the efficacy of the fiscal framework. That is an agreement between the two Governments and is to be reviewed by them. If, as part of that review, we were approached and asked technical questions, or were asked for clarification of how things worked in practice, we would engage as fully as we were required to. We are unable to comment on whether the framework has served its purpose or would serve future purposes. We work with what we have. We have become more able to work with what the framework offers. All of us, including the committee, have gained an understanding of what is there.

That is the general answer to that part of your question, Mr Harvie. On the question of what we see in the future for the economy, I will ask Francis Breedon or John Ireland to come in.

09:30

Professor Breedon: The long term is a really important issue and one that we will have to keep monitoring. We know that education, training and health are all important long-term determinants of economic growth, which will buy us good outcomes. Obviously, we have had a difficult time with all those things and, as a result, we and pretty much all other forecasters are expecting permanent impacts on the economy due to the pandemic. We have a nasty temporary spike, but we also have a permanent one that will cause scarring effects for those growth determinants.

If we compare our forecasts with those of the OBR, it is a little bit difficult to unravel—[*Inaudible*.]—and the timing is important, but our assessment of the scarring effects is similar to that of the OBR. We have discussed some of the effects, but there are others, such as population and unemployment effects. The OBR included some of those in its previous forecasts, so it does not look as if it has changed its forecasts as much as we have. However, if you unravel that, you will find that we and the OBR have taken relatively similar views on the long-term effects. They are—sadly—difficult issues, which we are going to have to manage once the crisis has passed, and they will have fiscal implications.

Patrick Harvie: If, in the years ahead, the situation develops roughly in line with the projections that you have given, what are the implications for the Scottish Government's ability to use its borrowing powers to deal with the negative reconciliations that might emerge over the next few years, or as far ahead as we can reasonably see?

Professor Breedon: As we said, we have done some analysis that shows that the reconciliations that we expect could be larger than the borrowing powers that are currently in the system. That is a current budget issue and one that will continue in the future. As Alasdair Smith said, there is potentially a reconciliation on the horizon that is larger than the borrowing powers. That is implied by both forecasts.

Patrick Harvie: I would like to clarify something that has come from our adviser. You have forecast that there could be positive reconciliations in 2022-23 and 2023-24. Would that prevent the Scottish Government from using borrowing to deal with negative reconciliations that also occur? Would they offset each other, or are positive reconciliations disregarded in respect of the borrowing power?

Professor Breedon: I will pass that question to one of my colleagues.

Dame Susan Rice: John Ireland might be able to give some clarity on that.

John Ireland: They do not cancel each other out. If we have a negative reconciliation, say in land and buildings transaction tax, that will allow us to borrow against it regardless of the fact that we have an income tax reconciliation that is positive.

Patrick Harvie: There is no constraint due to the overall net effect.

John Ireland: That is my understanding. We can borrow against the negative reconciliations, which are not cancelled out by the positive ones.

Patrick Harvie: Thank you.

The Convener: I apologise to John Mason. I should have brought him in first.

John Mason (Glasgow Shettleston) (SNP): That is all right, convener. Do not worry. Thankfully, Patrick Harvie did not ask the questions that I am about to ask.

The witnesses said that, so far, Covid has affected the UK and Scotland in broadly similar ways. Is that still the case? Are we pretty sure that Scotland and the UK will be affected similarly this year and in the coming two or three years? Is there any reason to think that they will be affected differently?

Dame Susan Rice: That is a pretty big question. If we consider the past year, the hit to GDP is roughly similar in Scotland and the UK. We always see differences when we go down to the detail, but we have seen similar issues overall through both lenses, and we do not have reason now to envisage a huge divergence in the impacts of Covid. I do not know whether Francis Breedon or Alasdair Smith have a view on that point.

Professor Smith: I agree with everything that Susan Rice said, of course, and I am happy to come in with an additional observation. Covid affects different sectors of the economy in different ways. There are small differences when we compare the structure of the Scottish economy with that of the rest of the UK. The public sector, which is well—although not completely—protected against Covid effects, is a bit larger in Scotland, but so is the hospitality and tourism sector, which is badly affected by Covid, so that pulls in the other direction.

Differences between the Scottish economy and that of the rest of the UK do not seem to justify any reason to suppose that the effects of the pandemic will be fundamentally different. That idea underpins our view of not just what happened this past year but what is likely to happen in the future.

John Mason: Murdo Fraser mentioned unemployment. What is your thinking on the end of the furlough scheme? There are suggestions that, because of the scheme, many businesses did not go bust this past year that would otherwise have done so. Do we face a real cliff edge of a huge number of redundancies when the scheme ends?

Dame Susan Rice: That question is probably debated all the time and is really hard to pin down. A bit of logic says that people have received an income through the furlough scheme and that if the business has not survived or cannot survive when the scheme ends, that income will cease. As we know, the furlough scheme has been extended during the year, in part as the repercussions of Covid have stretched out, so to some extent they have operated in parallel.

We keep talking about timing. Part of the question is whether the economy is able and ready to pick up and whether some of those businesses will be able to build when the furlough scheme ends. I know—as we all do—small, individual businesses that have put huge amounts of effort into building the business through their principals or a small number of staff, who might not be on furlough but work around flexible furlough, so that the business is ready to run as soon as the economy and the world open up a bit. Others clearly cannot make a go of it. It is hard to say with certainty what will happen, and some of the issue is around timing. That is my surmise, but

I turn to colleagues again if they have a different view to share.

Professor Breedon: I do not have a different view, but let me make a point in response to Mr Mason's question about whether this is a cliff edge. You are right—we expect a big increase in unemployment when the furlough ends. We assume that 7 per cent of those on furlough in Q2 will move into unemployment, so unemployment will rise to 7.6 per cent in the future. There is an impact. As Susan Rice said, the aim of the furlough scheme was to try to ensure that the employment hit was not as big as it could have been. However, a hit is still coming.

John Mason: I was going to ask about the £500 million assumption, but I noted the comment about it being modest and cautious. I take that on board.

On the underspends for the current year, I think that £161 million is the figure that has been used. Are we expecting greater underspends this year because so much has closed down?

Dame Susan Rice: I will say a little about underspends before I turn to one of my colleagues—probably Francis Breedon. In any year, there can be underspends, because the Scottish Government has to balance its budget, as you know, and it needs to ensure that it has a little excess towards the end of the year, rather than overspending. This year, of course, with all the Covid pandemic-related funding—the £8.6 billion, some of which came earlier in the year and some of which came quite late, towards November and December—it has been very hard for the Government to develop and implement policies and begin to spend money close to the end of the financial year. This year, in particular, it certainly makes sense that there are underspends and that that money will have to be banked and—hopefully—used in the following year. Francis might offer a little more substance on that.

Professor Breedon: As members know, the Scotland reserve is the key tool for managing underspends across years, and in normal years there is a draw-down limit on the reserve, which could become an issue if an underspend is large. Because of the Scotland-specific shock this year, that draw-down limit is removed and transferring money between years through that mechanism is therefore much easier than it has been in other years. That is a welcome result of the Scotland-specific shock, given the current uncertainty about spending.

John Mason: Thank you.

James Kelly (Glasgow) (Lab): Over recent years, forecasting has been a challenge for the commission—and for the committee, as members have tried to get their heads around the issue—and it has become more difficult because of the pandemic. The use of data is key to forecasting. Professor Smith, you talked about the different data sources that the commission and the OBR use: you said that your preference is to use the HMRC data, whereas the OBR uses the labour survey data. When restrictions lift or the furlough scheme ends, there could be a significant impact. How quickly are you able to collect data from your data sources, so that you can start to measure the effects of such changes?

Professor Smith: On the point about reacting to new data sources, I agree with you that the economic situation could change rapidly in 2021—indeed, we all hope that it will change rapidly during the year, as the pandemic subsides. A reason why we have made much more use of the real-time information data this year is in the name—it is information that comes in, in real time, about cash flows into HMRC. The big advantage of RTI data is precisely that it gives us a quick fix on what is happening in the economy, whereas other forms of data might be a little slower.

I emphasise that deciding what is the best data source to use is a matter of forecasting judgment. We try to explain why we have given particular emphasis to the RTI data in the current circumstances—why that seemed to us to be the best judgment—but it is perfectly proper for other forecasters to make slightly different judgments and come to slightly different conclusions. That gives rise to issues when our forecasts differ, but we expect to continue to use RTI data during the year, because it gives us a quick picture on a situation that might change quickly.

09:45

Dame Susan Rice: The other side of the data picture is the outturn data that we use. Depending on what tax or benefit the data is about, it comes in different ways. As the committee knows, income tax data is about the outturn data. Data on what actually happened in a particular year comes about 16 months later, so there is a real delay with that. That will not change, but we have some in-year data on devolved taxes and the data collection for those has become quite smooth, whether it is from Revenue Scotland or, more recently, from Social Security Scotland. There will not be much change from the past in the timing of those sets of data.

James Kelly: You pull in all that data and run it through your models, which updates the results that you have. The situation is likely to change at a fast pace. If your models start to produce results that are materially different from what you forecast previously, will you speed up the timetable for publishing that data?

Dame Susan Rice: [*Inaudible.*]

The Convener: You are still muted, Susan.

Dame Susan Rice: Thank you. There is a tenner on the table—it happens to us all.

We began a programme of issuing what we call fiscal updates, which are short reports on what has happened in fiscal terms over the past year. We have already signalled that we will continue to do that this year. It is important to do that so that we, the committee and anyone else who is interested can see what is playing out.

The data that we use is pretty much universally publicly available data. We pull the data in from different sources when it becomes available. We are very transparent through our website and so forth about what data we have used. It is not in any sense a matter of us creating data that we would keep private. The data is out there and publicly available and it is a matter of how we pull it in, when we pull it in and how we use it.

Our fiscal updates are not full forecasts, which is what the Finance and Constitution Committee usually asks us to prepare. In the updates, we will comment on what is happening mid-year—that is really the point of your question—so that people are up to date with any changes in what is happening. We will do our best in that space.

James Kelly: Thank you. We would welcome that. Up-to-date information is obviously crucial in this situation.

Dean Lockhart (Mid Scotland and Fife) (Con): I return to the discussion on average earnings growth. The point has been well made that the traditional relationship between GDP and tax revenues has broken down because of the exceptional measures that have been taken by Government. I want to focus on the relationship between unemployment and wage growth.

The SFC is forecasting strong earnings growth in 2021 and 2022 notwithstanding a significant predicted increase in unemployment at that time. I ask our witnesses to explain the factors that underpinned that wage growth forecast for a period during which unemployment is also forecast to rise quite significantly.

Dame Susan Rice: I might turn to Francis Breedon or John Ireland to give the detail, but I remind the committee of Alasdair Smith's earlier point that lower-income earners form the part of the population that has been most affected by contraction or restrictions around jobs. Those who earn at moderate or higher levels have not seen such contraction, so it has not been evenly reflected in earnings overall. Perhaps Francis or John will want to add clarification on that.

Professor Breedon: I will add a general point, and then perhaps John Ireland could say something more specific.

The situation is so unusual in many ways, but one of the ways in which it will be so in future is that, although we will have a lot of unemployment, we will also have a lot of mismatches across sectors and skills. Therefore we will see some sectors being hit hard and struggling while others will struggle to find people who are qualified for what they are doing. Again, the normal relationship whereby unemployment puts downward pressure on wages will probably not be as strong, because there will be a long period in which we will be trying to match people's skills with jobs. That is one of the reasons for another normal relationship—that between unemployment and earnings—not being as strong as we might expect in this type of recovery.

John Ireland: The only point that I would add to what Francis Breedon and Susan Rice have said is to remind the committee that the 2019 outturn data for earnings growth was about 4.2 per cent. Our forecasts for 2021 and subsequent years are 2.6 per cent, 2.4 per cent, 2.7 per cent and 3 per cent. It is true that earnings growth is relatively strong in our forecast, but it is also lower than it was in 2019.

Dean Lockhart: It sounds as though there will be even greater disparity of earnings among different sectors in that case. Perhaps that issue is for the committee to consider on another day rather than in this discussion, but that was a very interesting response.

My other question relates to the forecast for productivity, which is predicted to be relatively flat over the next couple of years and then show quite an uptick in 2025, when it will increase by 1.6 per cent. I would like to hear our witnesses explain the factors behind that sudden increase in productivity come 2025. Is there a particular reason for it? Are there underlying factors such that you see productivity increasing by that stage?

Dame Susan Rice: I do not think that we have a crystal ball that tells us that something special will be happening at that point in time. That is among the outer years of our forecast, by which point we think that the economy in Scotland will have returned to pre-Covid levels, there will have been catch-up and, we hope, no more pandemics, and things will be motoring, as it were. Perhaps Francis Breedon will want to add to that.

Professor Breedon: I add a small point, which carries on from my previous one. As I said earlier, we will have a period in which we will have idle resources—for example, where people will have the wrong training for the sectors that they are in or whatever. However, those extra resources will be there and we anticipate that, eventually, they will begin to be used. Therefore one of the factors behind that recovery in productivity is that, eventually, the economy will start to sort itself out and unused resources will begin to be applied in different areas or areas that have been weak will being to grow again.

Dean Lockhart: I have a final follow-up question. How sensitive are tax revenues to productivity growth? We have spoken about how an increase in earnings will be one of the drivers of Government income tax revenues. How big a part does productivity play as a driver of the Government's income tax revenue?

Dame Susan Rice: I turn to John Ireland to give a sensible response.

John Ireland: Productivity is important, because productivity growth is, in a sense, what drives earnings growth over the long run. If productivity grows, earnings grow and therefore tax receipts grow—there is a clear causal chain. We publish information on that sensitivity, not in our main report but in some additional supplementary tables. We can certainly provide the reference for that, but I do not have the figures to hand at the moment.

Dean Lockhart: That is helpful—thank you.

Dr Alasdair Allan (Na h-Eileanan an Iar) (SNP): I want to ask about the scale of the changes that are likely to apply to the funding that is available to Scotland in 2021-22 compared with the year before it. I think that I understand the reasons for that but, if I am reading it right, the total figure, inclusive of Covid spending, is 9.3 per cent lower. Am I reading that right? How does Scotland prepare for budget and fiscal change on that scale?

Dame Susan Rice: For clarification, are you referring to a reduction in Covid pandemic-related funding?

Dr Allan: My understanding is that non-Covid funding will go up but that Covid-related funding will go down on such an enormous scale that it would have an impact on how any country could possibly prepare.

Dame Susan Rice: The quick response is that the Covid funding has been used for special programmes and purposes to see us through the past year of extraordinary volatility and difficulty in running a normal economy, and it is anticipated that such funding will be needed for some of this year. As the economy returns to more normal operation, the Covid funding will become less necessary.

I think that I saw Alasdair nodding when the question was asked, so he might want to say something. Sorry—I should say that I mean Alasdair Smith, as there are two Alasdairs in the meeting.

Dr Allan: Alasdair eile.

Professor Smith: Yes, that is a good description, Alasdair.

To follow up on what Susan Rice said, Mr Allan—let me call him that—is right that the overall funding envelope for the Scottish Government for the next fiscal year is less than that for this year. However, the non-core funding in the budget has actually increased. As Susan Rice said, the difference is that, by the end of 2020-21, the Scottish Government will have had over £8 billion of additional funding related to Covid whereas, in the coming year's budget, that is estimated at £1.8 billion.

That is where the reduction in the overall funding envelope comes from. I do not want to use the word "budget", because we are not comparing like with like; we are comparing the total funding that was available to the Scottish Government by the end of one fiscal year with the money that has been put into its budget at the beginning of the next fiscal year, so that is not a like-for-like comparison.

The way that I would prefer to answer Mr Allan's question is by saying that, if it turns out that we have much less than £8.6 billion of additional Covid funding in the budget next year, that is not so much a funding challenge for the Government to have to deal with as it is a reflection of a reduction in the Covid challenge that the Government will have had to deal with. We ought to hope that, at the end of the year, next year's budget will end up not having £8.6 billion of additional Covid funding in it and that the actual amount of Covid funding will be close to—perhaps modestly more than—the £1.8 billion in the current Scottish budget for the upcoming year. If that £1.8 billion does not rise substantially, it is because of good news, and there will be less adjustment for the Government to cope with in the coming year.

10:00

Dr Allan: Related to that point, we all hope for better news this year, and some of the assumptions that both Governments are making seem to be predicated on an increase in net tax revenues. Is that fair to say, or is it unfair to say that? Are the assumptions that are being made realistic?

Professor Smith: Given how the fiscal system works, if the changes in revenue that the Governments anticipate more or less match each other, the net effect on the Scottish budget is small. There has been a significant reduction in income tax revenue in the past year, with significant changes in other devolved tax revenues such as land and buildings transaction tax and landfill tax. There have been some increases in the cost of social security benefits. Each of those is matched by effects in the wider UK economy, where income tax revenue, stamp duty revenue and landfill tax revenue have fallen, so the effect on the budget is less.

We expect income tax revenue to rise in Scotland next year, and we expect it to rise in the UK at the same time. The effect on the Scottish budget will be of the net take from Scottish income tax revenue relative to the UK, and that is different. Growth in revenues reflects an expectation that the economy both in the rest of the UK and in Scotland will recover, and that is good news. Of course, tax revenues will recover alongside that.

What if it turned out that the optimism was not justified? Let us hope that this is not the case, but if, for instance, there was another wave of pandemic and the tax revenue forecasts turned out to be too optimistic, that would probably be the case both in Scotland and in the rest of the UK.

Alexander Burnett (Aberdeenshire West) (Con): I draw members' attention to my entry in the register of members' interests in relation to the construction business.

I have questions on the LBTT figures. The help to buy (Scotland) scheme is being axed; there is a reduction in the first home fund; the LBTT threshold holiday is being removed, which, incidentally, produced higher revenues; and there is a near £300 million reduction in affordable homes provision. All of that would imply lower volumes and higher prices, early signs of which we are already starting to see. That is the opposite of your LBTT conclusions. Could you explain some of the thoughts behind those?

On a more minor point alongside that, your reduction in the prediction of Scottish landfill tax levels would also be counterintuitive, given that the construction sector is the largest contributor to landfill tax. The two things seem counterintuitive. Again, could you explain some of the thinking behind that?

Dame Susan Rice: I will make a general comment. Either John Ireland—who I think has a lot of detail to hand on this—or Francis Breedon might then wish to add something.

It is interesting that you mentioned LBTT; in England, the stamp duty relaxation was worth quite a lot of cash to the buyer. In Scotland, a different accommodation was made, which was to the level that LBTT kicks in; if we were to put a cash sum on it, that was lower.

The reductions in activity in housing transactions were very similar; we could not say that one of those approaches had an impact that was significantly different from that of the other approach. That is just an interesting observation.

In the latter half of last year, the number of housing transactions grew quite significantly. They seemed to have gone very quiet in the early days of lockdown but, when it was possible, people were getting out and perhaps thinking, "We need to do something now; let's move." A lot of behaviour around those things is not simply about how much is put on the table. That is just a general comment on one of the areas that you mentioned. John Ireland or Francis Breedon may want to come in more specifically on landfill tax or LBTT.

Professor Breedon: I will make a general comment on LBTT in relation to what Susan Rice was saying. We are expecting one of the forestalling effects to be that people change the timing of their transactions according to the timing of tax changes, and the UK comparison shows that. However, we do not think that the tax situation has had an enormous impact on the housing market overall; the housing market has done relatively well but, as far as we can judge, that has not been directly the responsibility of tax changes but, instead, a feature of the situation.

Alexander Burnett: Thank you.

The Convener: I thank the panel members for their helpful and detailed evidence this morning and I hope that they enjoy the rest of their day. I do not envy them their job as forecasters in the current volatile and challenging environment.

10:07

Meeting suspended.

10:12

On resuming—

The Convener: I welcome the second panel of witnesses to our meeting. We will need to conclude this piece of business by midday at the latest, because there is business in the chamber at 12.30.

I welcome Kate Forbes, Cabinet Secretary for Finance; Dougie McLaren, the Scottish Government's deputy director of public spending; Lucy O'Carroll, director of tax; and Graham Owenson, who is head of local government finance.

Having said hello to the panel, I invite the cabinet secretary to make some opening remarks if she wishes to do so.

The Cabinet Secretary for Finance (Kate Forbes): Thank you, convener. I will make some brief remarks.

I am grateful to the committee for its pre-budget report, for the discussions that we have had and for the flexibility regarding the process and the timetabling for this year's budget. I have also been speaking to party spokespersons separately in my endeavour to be as open as possible about the fast-moving situation and the evolving funding position.

I think that we would all agree that the country needs a budget to be passed that deals with the pandemic response and recovery, ensuring continuity of support across the financial years. Accordingly, I am receptive to the committee's and the Parliament's responses.

I listened briefly to the SFC witnesses earlier, and that evidence session demonstrated just how complex it is to set the budget in advance of the UK Government, with late consequentials this year, an uncertain economic outlook and the difficulties of managing forecasts at different points in time.

As regards the funding position, the budget that I announced on 28 January allocates everything that is available, but I expect that position to change, potentially significantly, in the coming weeks, due to the uncertainty of the final budget position for this year and because of the demand-led nature of some schemes, particularly the business support schemes. To that end, I am mindful that we need to ensure that the end of this financial year is not a cliff edge for businesses and public bodies alike. Managing funding across the financial years is hugely important.

I want to update the committee on business support for the current financial year. Last week, I announced that I would be doubling the local government discretionary fund, which provides business support entirely at the discretion of local authorities. In the light of the fact that we are still in some form of national lockdown, I confirm today that I will instead quadruple the fund, from the original £30 million to £120 million.

10:15

The position for next year is, of course, contingent on the UK budget on 3 March, and on any late 2020-21 changes to either funding or flexibility. As the committee will know, the UK supplementary estimates have still not been confirmed for this year's budget.

In the absence of a clear and timely settlement, I have endeavoured to make the budget process more meaningful by prudently assuming £500 million of consequentials from the UK Government's Covid reserve to add to our initial allocation of £1.3 billion from the UK spending review. I reiterate that the Covid funding is non-recurring, so we need to target it accordingly as we seek to maximise its impact.

That is all that I have to say in my opening remarks; I hope that they are helpful in reflecting the various moving parts of the whole budget process. I will keep the committee updated on any further developments, and I will be back in front of you in the not-too-distant future anyway.

The Convener: Thank you, cabinet secretary. Your announcement on the discretionary funding is good news, and it gives me the chance to thank our colleagues in local government for the remarkable way in which they have dealt with all the additional funding that has been provided for business support across the country, and for the job that they have done.

As you noted in the pre-budget report, the Chancellor of the Exchequer announced in the UK spending review that he is considering business rates relief, but that he will do so in the light of the evolving situation. Since then, there has been some indication from the UK Government that further support will be announced in the chancellor's budget in March. I saw a report that said that the chancellor had said to councils south of the border that they should not issue any business rates bills.

Has the Treasury provided you with any further information yet on the level of business rates relief that the chancellor may or may not announce in his budget?

Kate Forbes: The direct answer is that we have not yet had any indication of that from the Treasury. As you can imagine, our respective officials are in touch regularly, and interest is being shown in what we have committed to for 2021-22, but we have not had anything on the UK Government plans. I have pressed my officials to use any means possible to try to get intelligence on that so that we can plan accordingly.

In my view, March is too late for something so fundamental to be announced, because businesses are making decisions right now. That is why I wanted to maximise any resources that I had in order to avoid a cliff edge on 31 March. Our approach has been to extend the current relief for at least another three months. I will keep in close contact with the Treasury on that. Our position remains that I want to extend relief for the full year, but because we have to balance our budget and I have to use the resources that are available to me, I can afford to extend it only by three months at this point in time.

The Convener: If the chancellor provides business rates relief at 100 per cent for the whole financial year 2021-22, that will—if I am right—potentially free up an estimated £185 million in your budget. Can you indicate what your priorities are likely to be in allocating that funding? That is if it becomes available, of course—I realise that there is still a question in that regard. Would you lodge amendments to the budget bill or use in-year budget revisions?

Kate Forbes: My initial instinct would be to use that money to do even more for businesses in the early months of the year, in order to help them to emerge from closure or restrictions. I have been working with sectoral organisations and business bodies to prepare some contingency options, which we could deploy quickly in the coming weeks, certainly in advance of the year end, to provide that further funding.

Ultimately, I think that that money should be used for business support. We have currently chosen to support businesses through non-domestic rates relief, because that was the number 1 ask from businesses. However, I know that there are other asks from them, and my intention would be to use the money for other economic priorities to support businesses.

The Convener: I have one final question. The Scottish Government's "Equality and Fairer Scotland Budget Statement 2021-22" recognises that

"The effects of COVID-19 layer on top of existing structural imbalances and are predicted to be particularly severe for people on low incomes."

Can you set out how the budget for 2021-22 addresses that disproportionate impact in ways that are different to the last, pre-Covid budget?

Kate Forbes: There are three different elements, two of which build on our approach in previous years—the first is pay and the second is tax.

Last week, we set out a progressive pay policy for Scotland, which maintains a distinctive approach that is focused on reducing inequalities by ensuring that the lowest paid get the most significant uplift of 3 per cent.

Tax will continue to be more progressive in terms of supporting the lowest earners.

On top of that, in this budget in particular, you see a strong emphasis on reducing inequalities, such as the £68 million Scottish child payment. We are also building substantially on last year's Covid funding to support communities through local government with free school meals, support for the third sector and ensuring that local authorities have the funding that they need—whether to reduce council tax or for other welfare support—to continue to provide support to families that have been hit disproportionately hard this year. Another example is the council tax freeze. We know that council tax is not the most flexible of instruments, so we have chosen to freeze it to support households that are struggling.

That is just a quick overview of the way in which we have used multiple levers to try to support those who have been hardest hit, and meet the objective of tackling inequalities, which is one of the three priorities for this budget.

Murdo Fraser: Thank you, and good morning, cabinet secretary.

I have some questions on the local government settlement, but before I come to them, I will ask a follow-up to the convener's first question on the overall size of the budget. We are looking to the UK budget at the beginning of March to see whether there will be additional resource after that; however, what account have you taken of in-year underspends for the current financial year when allocating them as part of the draft budget that you have presented?

Kate Forbes: That is a good question for two major reasons. The first is the demand-led nature of the schemes that we are operating, which I mentioned in my opening remarks. Take business support, for example. The strategic framework business fund is demand led, so the nature of the lockdown in March will determine how much we are spending. I am mindful of the fast-moving situation, which could deliver some underspends, but we will ensure that the funding is all recycled into business support. It is not leaving business support schemes, but it might slip into next year. This year, managing the funding position over both years is an important element compared with previous years, but I monitor the position closely. We will ensure that no money is lost, but it might slip into next year.

The other element is the late supplementary estimate, which has not yet been confirmed. I hope that it will be confirmed in the coming weeks—the sooner the better, in my view, as it will finalise the allocations for this year. I cannot necessarily predict what it will be. In previous years, we could have seen a reduction in the supplementary estimate—for example, last year, we saw a reduction in capital. However, this year, we have the guarantee.

That is a long-winded answer to tell you that there are two substantial contributions to the funding position, neither of which I have full control over, but both of which I monitor closely. The key will be to not lose the funding, but ensure that it is recycled in the early part of next year. I hope that that answers your question.

Murdo Fraser: That is helpful—we will see how that develops in the coming weeks.

I really want to ask about the local government settlement. Last week, the committee took evidence from Councillor Gail Macgregor of the Convention of Scottish Local Authorities, who I am sure you know well. According to the Scottish

Parliament information centre, the Scottish Government's overall resource budget will increase from this year to next year by 11.2 per cent, and yet the core funding in your settlement for local government will increase by just 0.9 per cent.

It looks as if you are short changing local government, which has borne the brunt of many of the responsibilities in relation to Covid—not least rolling out business support. According to Councillor Macgregor, even just meeting the Scottish Government's pay policy for local government employees will cost £205 million, which is double the cash uplift that you have provided.

Is the local government settlement fair? As you are giving councils a relatively low uplift in comparison with the uplift in your budget, how do you expect them to meet their on-going costs and commitments?

Kate Forbes: The local government settlement is fair. Through the finance settlement, the total funding package to local government will be £11.6 billion.

The settlement takes a layered approach that involves three funding sources. The first provides a cash increase of £335.6 million—equivalent to 3.1 per cent—in local government's day-to-day spending for local revenue services. Over and above that, the settlement has two other elements.

The second element is the non-recurring Covid funding. Local government has—rightly—been clear about the impact of Covid and the pressures that it has put on the funding position. An additional £259 million has been provided to deal with Covid pressures.

The third element deals with one of the major pressures, which is from lost income. Local government receives money from the Scottish Government and it generates income from fees, charges and other sources. Councils have lost much of that income in the past year, which is why I announced a further increase of £110 million on the initial estimated £90 million to compensate councils for lost income from sales, fees and charges. That brings the total to £200 million this year.

Overall, the funding settlement deals with Covid pressures. The core settlement will increase—we and COSLA have accepted that. On top of that, there is compensation for lost income.

Pay is a matter for local government. We have no role in the pay negotiations with trade unions; local authorities are involved in those. I have regular meetings with COSLA and with trade unions. The only pay element that I will mention is that the settlement contains an additional amount for social care, which is being transferred to local authorities from the health portfolio to support the implementation of the real living wage.

Murdo Fraser: I appreciate all that you say, but a lot of the additional Covid moneys that are going to local government will just put councils back in the position that they would otherwise have been in. Their point, which I am sure that they have made to you, is that the cost pressures continue to go up—not least from the pay settlement.

Local authorities estimate that the revenue shortfall from what they need is £362 million for the coming year. If additional funds become available to you from the UK Treasury or other means, will more money for local government be a priority?

Kate Forbes: I make a distinction between Covid pressures and non-Covid pressures. Pay needs to be met from non-Covid funding, because it is a recurring item. Across the budget, 3 March will be a key date in determining what further funding will be available. As we saw last year, the budget was within a matter of days somewhat redundant because of decisions that the UK Government took to provide us with additional funding, which was distributed to bodies including local government over the year. In relation to the coming year's budget, I certainly do not think that there will be no further funding over the next year. There will be further funding.

Local government is on the front line in terms of distributing grants and welfare support, so it is a priority because of that. In relation to cross-party discussions, which I have had with some parties already, I am happy to look at how we can provide additional funding if local government is a priority.

10:30

Murdo Fraser: My final question is on the issue around council tax. You have provided an additional £90 million to councils if they agree to freeze council tax for the coming year, which is equivalent to a 3 per cent rise in council tax. COSLA has asked whether that money will be baselined for future years. What is your answer?

Kate Forbes: It is difficult for me to set next year's budget in advance of setting this year's. We will take council tax into account next year, understanding the points that have been raised by COSLA this year. I am not in a position to determine what the envelope is for next year's budget, as I hope the committee will understand.

Murdo Fraser: Thank you.

The Convener: Thank you, Fulton—I am sorry; thank you, Murdo. I would not have thought that I would mix up Fulton MacGregor and Murdo Fraser at any stage in my life, but there you go.

Fulton MacGregor: Perhaps it is the Fraser and the Fulton—the Fs.

Good morning, cabinet secretary. I will follow on from Murdo Fraser's line of questioning. You have already gone over some of the main headline figures—the £335 million, the £250 million one-off payment and the £90 million for council tax. Will you expand a bit on how those figures link to the some of the priority areas for local government in terms of recovering from the pandemic? Everyone—people from all political parties and you—will be aware that the Government will put forward something and COSLA and the local authorities will look to get a bit more. Can you say anything at this stage about the areas where there might be some discussion in terms of recovery from the pandemic?

Kate Forbes: One of the main reasons why the £259 million of non-recurring Covid-19 consequentials was de-ring fenced was because councils need the flexibility to address the Covid-19 pressures in their particular areas. That is important because each will face different challenges. If we consider the lost income scheme, each local authority has a different dependency on lost income. Some of them operate arm's-length external organisations but not all do. It is important to have a pot of cash—the £259 million—that is free and flexible for local authorities to use as they wish.

Alongside that, as part of the core settlement, there is additional funding for existing commitments. For example, the settlement will include an additional £59 million of revenue to meet our joint commitment on the expansion of funded early learning and childcare. That is a priority right across the Parliament chamber and local government. The settlement also includes £11.3 million in additional discretionary housing support, additional support for inter-island ferries, some capital for flood prevention and so on. Those are all priorities that have been identified by both COSLA and politicians from across the chamber. They are fully funded, and over and above that there is a pot of cash that local authorities can use as they determine their needs.

Fulton MacGregor: Thanks for that. [*Interruption*.] I apologise—you might hear my kids in the background. The joys of the current situation!

I will ask you a question that I put to the panel last week. How has council funding changed over the past year? You have talked about the costs that they will have incurred and the loss of income, but in some respects, some services will have done less. Has any consideration been given to that and has it helped to develop the priorities?

On that line of questioning, I have been quite impressed with the amount of money that the Scottish Government has given to community groups during the pandemic period. Is that factored into the budget? A lot of it was announced by Aileen Campbell. I did a bit of volunteering for one of the community groups in my constituency, and I was struck by how much work it was doing. They were seeing thousands and thousands of vulnerable people every week, and that is only one community group. I was struck by the fact that they were, in effect, taking pressure off the council, and the council recognised that. I know that that is a bit of a muddled question, but has all that been taken into account? Are there further commitments to be made to these community groups?

Kate Forbes: You have touched on an important point of principle. I have said that there will be no cliff edge on 31 March for business support or support for the third sector, but I say that while knowing full well that only £1.3 billion of Covid consequentials have been confirmed by the UK Government. Incidentally, the continuation of funding to volunteers that you talked about was the first decision that we made on Covid consequentials last March. That figure of £1.3 billion might change on 3 March, so for us to be able to continue that is somewhat contingent on what the UK Government does on that day. We have said that, in principle, we want to continue with that support, but a lot of that will depend on what money is forthcoming.

It is highly likely that more money will be forthcoming on 3 March; that is why we have already made that prudent assumption of an additional £500 million. However, our priority will be to ensure that there is no cliff edge for support for volunteers, the third sector and business, because we are still in the throes of a pandemic. I hope that that answers the second part of your question.

On the first part of your question, funding for local government has changed quite substantially in the past year. Additional funding has been given to directly compensate for lost income, some additional funding has been completely free and flexible for local government to use, and there has also been additional funding to help local government to manage business support grants, for example. In the coming year, we will continue to look at all those different pressures, and we might well need to revisit some of those funding pots, but I think the settlement as it stands just now, the increase in day-to-day spending as part of the settlement, the Covid consequentials themselves and funding for lost income will set local government up for the coming year and allow councils to go ahead and set their own budgets in light of the figures that we have confirmed.

Fulton MacGregor: I know that the cabinet secretary likes to hear good news stories from around the country so I want to put on the record the fact that the North Lanarkshire Council business team has been absolutely superb in supporting local businesses and getting the grants out to people in my constituency.

My final question is a wee bit different but I will try and relate it back to local authorities so that I can stay on the convener's good side. It is about local businesses that are part of the local infrastructure, which of course links to the council and income for the council and suchlike. I have asked you about three areas before, night clubs, soft play areas and taxi drivers, all of which we spoke about last week, and I really appreciate the funding that has been given to them. I know that you have answered the question in the chamber, cabinet secretary, but I wanted to give you the opportunity to put on the record again whether there will be further consideration for that type of business? It might not be specifically just for those three particular businesses but the type of business that might need to stay closed a wee bit longer, or will continue to be affected, such as taxi drivers having to wait until hospitality returned to some sort of normality? Is that factored into the budget?

Kate Forbes: The principle in that regard is similar to the principle that came up in the previous question. The approach of the Government is that there will be no cliff edge on 31 March for the strategic framework business fund and other on-going supports. We are making that commitment in the hope and on the assumption that the UK Government will continue its own business support schemes, which will generate consequential funding that we can use to pay out through our strategic framework fund.

As Fulton MacGregor will know, night clubs and the soft play sector were given grants of up to £50,000 in October, having been closed since March. Since November, such businesses have been eligible for four-weekly recurring payments from the strategic framework fund. Last month, they will also have received a top-up payment of up to £9,000. Although there are no plans right now to augment the substantial funding to night clubs and soft play businesses, businesses may need to stay closed for longer, so we will keep all our business funding under review as the pandemic evolves.

We talked about taxi drivers, too. The £57 million fund for taxi and private hire drivers went live in mid-January with grants of £1,500 and, by the beginning of this month, the fund had paid out almost £5 million. We are engaging with the Scottish Taxi Federation to explore the case of taxi operators who are dealing with fixed costs. Members will be interested to know that statistics published today show that businesses have received £276 million through the strategic framework business fund, as well as money from top-ups and the taxi driver fund.

I will keep the evolving needs of businesses under review in order to prioritise and maximise the impact of our limited resources. Business support, in particular, shows one of the challenges that we face with the budget, which is the cliff edge on 31 March. The Scottish Government's position is to extend support across the strategic framework business fund and to the third sector and local government, but we are doing so in the hope that the UK Government will provide clarity on 3 March about our funding position.

The Convener: Cabinet secretary, since the start of the meeting, I have noticed that the sun has been streaming in on you in the Highlands. Is it causing a problem?

Kate Forbes: I will just close the window.

The Convener: I will let you do that before we go to Patrick Harvie.

Kate Forbes: Thank you. That is kind of you.

The Convener: No worries. It is sunny here, too, but with eight inches of snow.

Patrick Harvie: I would like to first ask a question about the medium-term financial strategy, then perhaps pull back and ask one or two specifics on this year's budget.

How do you respond to the suggestion that the MTFS has a useful role in providing a bit of a look ahead but that it is not strategic? It does not set out the general approach that the Scottish Government intends to take on, for example, the future use of tax policy, which is particularly important at a time when the whole of the UK is increasingly aware that recovery from the pandemic will have to involve some pretty deep and searching questions about the role of taxation and, potentially, significant change to our forms of taxation. Should the MTFS develop into more of a strategy that sets out the Scottish Government's general direction of travel on issues such as tax, spend, borrowing and the potential for fiscal consolidation to result in further austerity measures?

Kate Forbes: The MTFS sets out the context for budget decisions, and actual decisions on tax and spend are reserved to the budget or a spending review. There are legitimate questions about how we do multiyear spending and on setting out our approach to multiyear tax and spending plans.

We have challenges now on two fronts. We are still awaiting a spending review from the UK

Government; there were plans to do it last November but, due to the pandemic, it has been delayed. We went ahead with our own spending review of capital, which is the capital spending review that was published last week, but there is also a need for a revenue spending review that takes a multiyear view of our tax and spend position.

10:45

The MTFS brings together the risks to our funding and spending outlooks. It will set out how we seek to manage those and the tools available to us. However, given what we all know—namely that UK budget decisions are a key determinant of the Scottish Government's funding position—the scope for setting out future spending plans is very limited. That might change once the UK Government sets out its spending review, because, in that sense, we would have a multiyear outlook on our budget position. It is very difficult to set out tax and spend over a five-year period when (a) much of our budget is dependent on what the UK Government does, and (b) it has not even done a spending review yet.

I am always interested in recommendations and suggestions on how we could make the MTFS more useful and helpful and on how we could bring greater clarity and transparency to our tax and spend decisions. However, given how critical the UK Government's decisions are, it is very difficult to do that without a UK Government spending review at the very least.

Patrick Harvie: Yes, I appreciate the difficulty of the lack of a UK spending review, and I am not suggesting that the medium-term financial strategy should set out year-by-year propositions for the specific use of specific taxes. However, given that the cabinet secretary describes it as an "outlook", calling it a "strategy" might be mislabelling it. Surely a strategy would set out, not specific year-by-year tax propositions for future years, but a general approach to the role of taxation, the potential changes to the role of taxation that are under consideration and how the Scottish Government intends to strike the balance between protecting public services, protecting household incomes and avoiding austerity measures.

Kate Forbes: To that end, expected tax revenues in Scotland are built into our central funding scenario. This year, I was keen that the MTFS set out the risks over the next five years and how we will deal with them. In that sense, it was strategic in setting out what some of those challenges will be. On the spending side, for example, we are on track to increase spending on the health service, and the MTFS sets out the impact of that on other areas, the spending for which must be found from an ever-decreasing share of the overall budget. It also sets out issues around population, demographics, pressure on various services and how we will deal with those. The MTFS goes into detail on the case for further borrowing, further use of the reserve and tax powers as a strategy for how we deal with those risks. If there are suggestions or recommendations on how we can provide more detail, I am happy to consider those. However, we tried quite hard this year to set out the risks over the next five years and how we will contend with those through tax, borrowing and the use of reserves.

Patrick Harvie: I will pull back from the issue of the MTFS and turn to look at specific measures that are proposed for the coming financial year. Murdo Fraser asked you about the council tax freeze that you have proposed to COSLA. You placed that in the context of a general intention to support household budgets, to reduce poverty and inequality and to target help where it is most needed. What other policy options were considered alongside a council tax freeze? For example, you could consider a child payment uplift, expanding eligibility for free public transport as we emerge from the pandemic, free school meals or anything more than half measures on rent controls. There are a number of ways in which you could benefit household budgets that would direct support to those most in need. What policy options did you consider alongside the council tax freeze, and what level of assessment led you to conclude that freezing council tax, which saves the most money for people in big houses, is the most effective way of targeting support for household budgets at those who need that help the most?

Kate Forbes: I would disagree with the premise of the question: it does not need to be one or the other. On the council tax freeze, when it comes to building the budget, we are considering a whole host of different policies, as you can imagine, to ensure that we are using our funding as effectively as possible.

We are all on record—or almost all of us are on record—as highlighting the ways in which council tax is not as progressive as it could be. A council tax freeze is therefore quite a blunt way of protecting households. It is difficult to deliver a more nuanced approach, although increasing the council tax reduction, as we did at the beginning of last year, is one way of doing that.

I do not think that it is a matter of doing either one thing or the other. The measure sits alongside a substantial increase in the Scottish child payment. The £68 million is in the budget, and there is a total investment of almost £3.6 billion for social security. In 2019-20, the progress report on tackling child poverty suggested that we were spending around £2 billion targeted at low-income households. I would expect the amount to be similar for this year, too.

We will consider other policy areas. In this budget, we have explicitly and intentionally prioritised tackling inequality, which has grown through the pandemic. I am always open to other suggestions on how we do that faster, better and more effectively, but I do not think that the solution needs to be one or the other—a council tax freeze or tackling inequality.

Patrick Harvie: It sounds as though you are recognising that the council tax freeze does nothing for the people and households who are most in need—they save the least from it. There is room for movement on other aspects.

My final question relates to commitments that were given at First Minister's question time on a number of occasions over the past year. The First Minister said that a green recovery from Covid requires a step change in investment in such areas as energy efficiency and fuel poverty. There does not seem to have been one. When and why was the decision taken not to follow through on the First Minister's words on that?

Kate Forbes: Respectfully, I would disagree with that. Looking at our current budget, we see the delivery of a number of commitments that were made, particularly around infrastructure. I firmly believe that investing in infrastructure will be a key part of our recovery. We face choices about whether to invest in low-carbon infrastructure or carbon-intensive infrastructure. The capital spending review includes the £2 billion low-carbon fund, to be spent over the next five years, central to which is an investment of around £1.6 billion for heat and energy efficiency in our homes and buildings. We are trying, therefore, to meet our climate change targets as well as revitalising our economy.

There are other elements in the budget that try to shift behaviour while transitioning to a low-carbon economy. Those include investment in active travel and a five-year commitment of more than £500 million that allows us to invest in large-scale active travel programmes—and that does not even include what we are doing on employability through our employability and reskilling initiatives; we also have a green workforce academy. We are not just investing for the sake of economic recovery; we are investing with a view to economic recovery and transitioning to a low-carbon economy at the same time.

None of that is perfect. Some things will take time, particularly as we emerge from the pandemic. It is important to choose the right time to make investments. That is the case with supporting buses, for example. Public transport has required a huge amount of funding over the past year to help operators just to survive. There will come a point when we can then start to move that funding into more efficient public transport, too.

Patrick Harvie: I could probably pick up on quite a lot there, but I suspect that the convener would like to move on to questions from other members.

The Convener: You are right, Patrick—thank you very much. I call Alasdair Allan.

Dr Allan: I have a couple of brief questions, cabinet secretary. This year, you have had to deal with additional spending, a lot of which has been demand led. It has therefore not been easy to predict, and you have set out some of your plans and coping mechanisms in that regard. Have you factored in any contingency in the event that, from month to month, demand is not as high as was forecast?

Kate Forbes: Yes—we have to do that. Without repeating myself, I go back to my point about managing the cliff edge from a business perspective. Businesses are not interested in what my pressures are coming up to year end; they just want to know that they can access the same funding in April as they can access in March. However, the fact that there is a major cut-off point on 31 March makes it very difficult for me to provide assurance on funding in April.

In this budget, therefore, I have assumed £500 million pounds of additional funding for next year. I think that more funding will be forthcoming, but it is very important, in this year of all years, that we have flexibility around the year end. The SFC made it clear that the economic shock has enabled us to have slightly more powers with regard to the transition from one year to the next. However, I am managing the position right up to the wire this year, and any funds that were allocated but not spent—in health or in business support, for example—will still need to be spent next year.

I invite the committee to consider carefully how we manage the year-end cut-off, in the knowledge that there might still be rate consequentials and that, although there might be a reduction in demand, demand will continue into April and I will need to manage that.

Dr Allan: You mentioned that you have to manage that business support, much of which is demand led. If it is possible to predict the volatility within business support, which areas present the most challenges in terms of volatility and managing the flexibility that you mentioned, such as it exists?

Kate Forbes: I will take two examples: business and health. On business support, we are still in a national lockdown of sorts, which will probably continue for a while yet. In March, therefore, it is likely that demand for the strategic framework business fund will still be high, but it is also likely that some businesses will struggle to resume trading in April, so the business fund will therefore need to continue to pay out in April. Any reductions in certain funds now could therefore be recycled in the strategic framework business fund, but from April. It is not that the need will have reduced—it will just have moved to a later point.

The same applies to employability. We had originally assumed that, with the end of furlough last autumn, our employability and skills programmes would see a huge uptick. However, they did not, because furlough has now been extended to the end of April, and it is therefore likely that we will see an increase in unemployment from the end of April.

As a result, those schemes, which had funding allocated to them this year, will need to have funding allocated next year. Managing support across the year end is so important. It is not that the need has gone away—it is just that when that funding has to be drawn down, it will be in the next financial year. The Government was able to draw down from our reserve a grand total of only £250 million. That has changed slightly due to the economic shock, but there is still a need to manage that funding over two years.

It is the same with the health service. If we think about the need to continue to fund test and protect vaccination programmes, it is clear that we cannot front load everything into March. There will still be a need in April, but I have a very hard finish on 31 March because I am unable to be as flexible as I would like in moving funding between the years. The funding need is still there, but where it falls is outwith my control. Nonetheless, I still need to ensure that there is funding in place, whether it is for this year or next year.

11:00

James Kelly: Housing is obviously an important part of the budget when it comes to addressing the housing shortage and supporting the construction sector. It was therefore a surprise to see that the more homes budget has been reduced by £268 million. Given the backdrop to housing and the importance of those issues, why was the housing budget penalised?

Kate Forbes: The simple answer is that, in the spending review last November, the biggest cut was to capital, and the biggest proportion of that cut was to financial transactions, the bulk of which would normally support affordable home ownership and investment in charitable bonds. That area has therefore taken the biggest cut as we move into next year's budget. I cannot predict whether the UK Government will change its approach on 3 March and restore the capital and FTs that have been cut. Our cut to FTs, which has had a knock-on impact on housing commitments, is largely a result of the UK Government's decisions around reducing its housing commitments in all parts of the UK.

The capital reduction reflects the levelling of expenditure over the next five years. We know that we have led the way in the delivery of affordable housing across the UK, with almost 97,000 affordable homes delivered since 2007. The need to continue to support the affordable housing supply programme is more important than ever before, and we have therefore used our financial transactions and capital, as far as we could, to bolster that programme over the next five-year period. My position is that, if there is a restoration of FTs or capital in the UK Government's budget, we can revisit the approach that we have taken in our current budget.

James Kelly: [*Inaudible*.]

The Convener: You are still on mute, James. Broadcasting will get to you. Try again now.

James Kelly: Thank you, convener—apologies for that.

Cabinet secretary, we are talking about the Scottish Government budget, and it is for the Scottish Government to make decisions on budget allocations for housing.

I highlight one specific consequence of those decisions. Homes for Scotland has drawn attention to the reduction in the first home fund, which is crucial in helping first-time buyers into the housing market and supporting them to purchase new or second-hand homes. The fund also takes pressure off other areas of the housing market, such as the private rented sector and the social housing sector. Homes for Scotland has expressed the legitimate concern that the budget has been reduced to £60 million—a reduction of 70 per cent—which will constrain opportunities for first-time buyers, compared with previous years.

Kate Forbes: On the first point, I agree that it is the Scottish Government's job to prioritise, but there has been a 67 per cent cut in the total Scottish Government financial transactions budget. That is not a small cut—it is huge, in the overall context. That budget helps to fund our affordable housing programme. Where limited FTs are available, we have deployed them first to our priorities and, within the available budget, we have protected support for the small and medium-sized enterprise house-building sector through retaining the help to buy smaller developer scheme, with a budget of £14 million. We will also reopen the first home fund—which you just highlighted—with a budget of £60 million, and the open market shared equity scheme will continue with a budget of £44 million, while a further £10 million will finance applications to the main help-to-buy scheme that have already been approved.

We have tried to stretch the smaller pool of funding that we have available as far as possible, to get the benefit of every last penny by prioritising the schemes that help the most. It is important that a broad package of support is available for affordable housing, because different parts of the country, different house builders and people with different individual and family circumstances will make use of different schemes. All those schemes are part of the broad range of support that is available. I would like to go further, and if there is a restoration of the financial transactions budget, I will consider that.

Dean Lockhart: Following up on the budget for affordable housing, you said that the £270 million cut to that, which is under the more homes item in table 5.05 of the budget document, was made because of a reduction in financial transactions funding. However, annex G of the budget document shows that FT funding available to the Scottish Government is declining by only £100 million, which is significantly less than the £270 million reduction in the affordable housing budget. Why is there such a large cut in the affordable housing budget, given that FT money is going down by a much lower amount?

Kate Forbes: It needs to be looked at in the broader context of the reduction to capital of 5 per cent, as well as the reduction to FTs. On the overall need for capital, you have regularly asked me questions about the Scottish National Investment Bank. We have protected the FT money going to the SNIB and we have also tried to protect the affordable housing programme as far as we can. We can either salami-slice the smaller pool of FTs and achieve less overall or prioritise the two main beneficiaries of FTs—the SNIB and the affordable housing programme—which is the approach that we have taken. The 67 per cent cut in FTs has an impact and a bearing on what we can do, but so does the reduction to capital.

One of my officials might want to come in to complement what I have just said on affordable homes. The figures are quite clear. Last November, there was a 5 per cent cut in capital, the bulk of which was FTs. FTs are required for the affordable housing supply programme and the SNIB and we have pushed the value of every last penny as far as we can to ensure that both the bank and the programme can play a key role in economic recovery.

Dougie McLaren (Scottish Government): Mr Lockhart said that annex G in the budget document shows a cut in FTs of around £100 million, but that is actually from 2019-20. The table in annex G is based on 2019-20 with reference to the national infrastructure mission. The profile was a bit different then, compared with 2020-21. There was a much greater cut between 2020-21 and 2021-22, as the cabinet secretary said.

Dean Lockhart: The cabinet secretary mentioned the Scottish National Investment Bank and I will take up that discussion. Last year the bank was allocated £240 million and for the upcoming year it has been allocated £205 million. That is a total of £450 million. We know that one of the missions of the bank is to increase the availability of housing options as part of a place-based approach. As I understand it, the bank has announced investments of only £10 million to date, leaving £440 million of the bank's budget available for the remainder of this financial year and next year. Will you consider using some of the bank's budget to make up for the cuts to the affordable housing budget, given that that is part of the bank's mission statement?

Kate Forbes: If that is Dean Lockhart's request, I am quite surprised. Every other time that I have been before the committee, he has asked me about ensuring that there is adequate support for the Scottish National Investment Bank. There are choices to be made, but the SNIB will play a critical role when it comes to economic recovery, and affordable housing is part of its remit. That is a timely reminder of the point that I just made, which is that there is a broad package of support when it comes to affordable housing, to ensure affordable housing supplies.

The Scottish National Investment Bank will play a role in other deals as part of its three core missions. I am therefore quite surprised if Dean Lockhart is suggesting that we gut the SNIB to provide support for affordable housing. Of course, I would rather not be in the position of robbing Peter to pay Paul. I would rather that the 5 per cent cut to our budget—not as a result of what we have decided but as a result of what the UK Government has decided—be restored. I hope that the UK Government will restore that cut on 3 March.

Dean Lockhart: As I understand it, the total revenue budget available to the Scottish Government has increased by something like 11 per cent.

The reason why I am focused on the budget of the Scottish National Investment Bank is that £240 million was allocated to the bank for the current financial year, which ends in six weeks' time. The bank was set up only eight weeks ago and, to date, it has announced only one investment of £10 million, leaving a balance of £230 million for the bank for the current financial year. That is a lot of money to spend in six weeks. What is going on with the budget for the Scottish National Investment Bank? How will that money be spent? Will all £230 million be spent in the remainder of this financial year, which ends in six weeks' time?

Kate Forbes: You will be most relieved to know that that is not how we budget; we do not provide or allocate funding and then wait until the last possible moment to use it. Particularly during the pandemic, we have made sure that we use every penny at our disposal to respond to Covid. You will recall that I have come to previous committee meetings and done budget revisions to revise the allocation. For example, FTs have been used to provide support, in loan form, to businesses and other things. We have not let FTs sit there unused; we have ensured throughout this year that every penny goes towards responding to the pandemic, which includes FTs.

Dean Lockhart: To clarify, are you confirming that there is significant excess budget available at the Scottish National Investment Bank that has not been used?

Kate Forbes: No—I am confirming the opposite of that.

Dean Lockhart: To clarify, the budget for the bank this year was £240 million. There are only six weeks left of this financial year for that budget to be spent. Do you know roughly how much the bank has invested in this current financial year?

Kate Forbes: The bank has been operational only since November 2020. It is therefore fairly recent, but it is already getting into the business of doing deals. My point is that it is not as though we have abandoned the budget that was agreed last March; we have used that budget. We have used funding right across all the different lines to respond to Covid and we have used FTs to respond to a number of different priority areas, largely through loans. It is not that we leave FTs untouched; we do not leave anything untouched. We constantly ensure that we are getting the best value from the money that we have.

Next year's budget allocates £200 million of fresh capital for investment next year. The outturn statement will be in a couple of months' time. Towards then, I assume that there will be clarity on what the bank has actually used—largely as a result of changing priorities over the course of this year because of the pandemic—versus what we budgeted would be used.

Dean Lockhart: I would be grateful if you would write to the committee to confirm how much of that £240 million budget the bank has invested. That would be very useful.

The Convener: Thanks, Dean. I think that the cabinet secretary has heard that request.

11:15

John Mason: Dean Lockhart seemed a bit confused about the financial transactions funding, so I wonder whether we can pin down the numbers. The figures that I saw were that, for 2021, there was £606 million in transactions funding, which is falling to £208 million, or something like two thirds. Are those roughly the correct figures?

Kate Forbes: That is right. I mentioned a 67 per cent reduction.

John Mason: The Scottish Fiscal Commission has suggested that in 2025 or so, after the pandemic, the economy will still be some 3 per cent less well off than it would have been if we had not had the pandemic. How will we tackle that in the longer term?

Kate Forbes: I said in the budget statement that, if this budget had any overarching priority, it was economic recovery and job creation. Based on the figures that John Mason has just quoted, investment in new jobs and protecting jobs is essential to our future prosperity. There is more than £1 billion in the budget to drive forward that national ambition for jobs and equip our workforce with the future skills that they need. As part of that, the budget tries to ensure that nobody is left behind. For example, there is the £125 million investment that is targeted at employment support, including the national transition training fund to help people to reskill and upskill, and the young persons guarantee, to ensure that everybody under the age of 24 has an apprenticeship, a job or an education opportunity. There is also £230 million for Skills Development Scotland, which is a small increase.

If our economy is going to transition to a green recovery—this relates to a question that Patrick Harvie asked earlier—we need to ensure that there is the pipeline of skills required. There is an opportunity here both to provide reskilling and upskilling opportunities and to ensure that we have the right kind of skills in the pipeline. The green jobs workforce academy is there to help people to retrain to secure work in the low-carbon economy.

There are a lot of reskilling, upskilling and employability programmes in place. The reason why there are so many is that we recognise that people will be at different stages and have different skill sets. That sits alongside the substantial capital investment over the next five years to inject confidence in the economy, as well as to ensure that we are doing things on the margins, for example the productivity clubs in conjunction with the Scottish Council for Development and Industry.

John Mason: We also spoke to the SFC about the Scotland-specific economic shock, which is allowing us a bit more flexibility and means that we can borrow in the short term. We discussed the fact that, by about 2024-25, we might have to have reconciliations to get back from that. The SFC seemed quite relaxed about that—it seemed to feel that we should not worry too much about 2024-25. Is that also the cabinet secretary's feeling? What are her thoughts on that?

Kate Forbes: Whoever is the finance secretary in 2024-25 will need to contend with that. What all that illustrates is the risks—this was also brought out in the SFC's evidence—of basing a Scottish budget on the interaction of two sets of forecasts that are made by different forecasters at different points in time. The current circumstances exacerbate that uncertainty. Although these are very technical conversations, they have real-life impacts. We have just talked about the affordable housing supply programme and the Scottish National Investment Bank, and we could talk about the health service and other things. All those programmes, initiatives and services rely on real money, and that real money is determined by two sets of forecasts. We have based our budget on the best information that we have available today.

I cannot second-guess the scale of any future reconciliation, as the net position will become clear only once outturn data is available in the summer of 2023. One point that is helpful from the UK Government is that we will have the choice to use provisional or UK budget BGAs. We will take that decision after the UK budget when the position is clear, as we did this past year, although adopting updated BGAs might not necessarily reduce the risk of reconciliations. The economic shock has triggered additional flexibilities.

All those points illustrate that we need adequate and sufficient flexibilities in order to manage those risks, which are not necessarily of our own making. I dare say that those risks are not necessarily of the UK Government's making either, but our request and our plea to the UK Government is to work with us in managing those risks—not for my benefit or that of the Government or to make Parliament's life easier but because they have real-life consequences for our public services.

John Mason: The cabinet secretary mentioned risks a lot in that reply. My final question is about the £500 million that we are assuming is coming from Westminster as part of the Covid funding. Can the cabinet secretary give us a bit of her thinking about that £500 million—why that figure? Could it have been more or less? Have we any indication from Westminster on what is happening?

Kate Forbes: Because that £500 million is, in essence, unconfirmed funding, I had to take a prudent decision about the value. That figure is a prudent assessment of the likely additional funding that we expect to receive and is based on the £21 billion that the UK Government has set aside but not allocated.

It is interesting to reflect on some of the Opposition's complaints about the contingency funding that I have set aside to manage all demand-led schemes up until the end of March, and the constant criticism that we should allocate and spend every penny immediately. It would perhaps be better to take up that point with the UK Government which, interestingly enough, has taken a similar approach in setting aside £21 billion that it has not yet allocated; I assume that that is because it will allocate it in its own budget.

That £500 million is a prudent assessment of what we would likely receive. The UK Government might not follow through with the allocation of the £21 billion that it has set aside and, if that is the case, I will have to reassess the overall funding position. However, I remain committed to prioritising Covid funding on the basis of the allocations that I have presented in the budget. I cannot wait for the UK Government to make announcements. I have to provide an assurance right now to local government, the health service and taxpayers, which is why we have chosen to go ahead of the UK Government, although that means that there are far higher levels of risk in our budget assumptions.

Alexander Burnett: In an earlier answer to John Mason, you touched on productivity. We all recognise that productivity is a key part of the economy and we have talked here many times previously about how it is not performing as we would hope. Our committee adviser says that

"We've been hoping for productivity growth to return for 15 years but it hasn't."

What are you doing differently in this year's budget to address that trend?

Kate Forbes: That is a good question. With the understanding that you have listened to the SFC—these are hugely uncertain times and the economy will look different, because of both intentional decisions that we make and changed behaviour as a result of the pandemic—I say that, although there are probably two key drivers, the key driver for productivity in this budget is better tech and digitalisation across the board. That point was a major reason for commissioning the Mark Logan report on the creation of a digital ecosystem. Many businesses have had to move to digitising their work, both internally and externally, in their engagement with customers and consumers. That process of doing things better and smarter is a key driver for productivity.

An example of that is the digital development grant. For the past few years, the grant has sat at about £1 million to £2 million. It has had a decent take-up but not the huge take-up that I would like to have seen, with employers using the funding to digitise their operations. Yet, in the course of about three hours, we saw £10 million being applied for. Therefore, there has been a substantial transition.

To answer your question, the budget builds on the recommendations from Mark Logan and on our approach to providing businesses with the tools that they need to digitise and make better use of tech. Tech was already forecast to be the second-fastest growing sector in Scotland over the next five years, so it is about accelerating that approach when it comes to productivity.

The second element is population and ensuring that our workforce has the right skills. As we come out of the pandemic, if we get our employability approach right, and if get the reskilling and upskilling approach right and tailor it to the jobs that are available and will be available over the next five to 10 years, we could see a marked shift in productivity in Scotland.

Alexander Burnett: Thank you. I have no more questions.

Tom Arthur: I just have one question, which is on the theme of wellbeing budgeting and a wellbeing economy. Over the past 12 months, we have all had cause to reflect on the meaning of wellbeing and to ask what really matters both in life and in public policy. Alongside that, we have seen many of the shibboleths of conventional economic funding, particularly around borrowing and the sustainability of public debt, being questioned. We have the opportunity to be informed by the experience of the past 12 months, in terms of both the changed economic landscape and the collective experience of living through the pandemic, and to refresh how we think about the purpose behind budgeting and public policy more widely.

Given that the Scottish Government has been pursuing wellbeing budgeting for some time now, particularly through the national performance framework, how will the experience of the changed economic landscape and the collective societal experience of the past year inform decisions that are taken on budgeting and priorities not only for this budget but in the longer term?

Kate Forbes: Tom Arthur's question is important. We often used the terms "wellbeing economy" and "wellbeing outcomes", and it is important to pin down and define what they mean.

If committee members have not seen it, I strongly recommend that they look at the report that was published by the Scottish Government just before Christmas, on the impact of Covid-19 on national performance framework national outcomes, and how it has informed spending plans and other Scottish Government decisions. Monitoring and being accountable for whether we are delivering on our national outcomes is important.

I do not think that any of us across party lines would disagree on the national outcomes in the national performance framework, and aligning those outcomes with the choices on spend is important. The budget and the medium-term financial strategy both focus resource on delivering on our approach to the programme for government, which was based on the national performance framework. The delivery of the approach in the budget is directly informed by the analysis and evidence from the December report. I boiled down the three priorities of the budget to, quite simply, economic recovery, tackling inequalities and the on-going health response, to ensure that every penny we spend contributes to those outcomes.

There are many things that a Government can do, and we have many priorities. I am sure that there are priorities across the parliamentary chamber, which will emerge in cross-party discussions. We have choices to make and, with limited pools of funding—because we need to deliver a balanced budget and there are huge needs due to the pandemic—we have to make choices. The choice that we have made is to align the budget with the national performance framework, which contains the most tangible outcomes and descriptor of a wellbeing budget.

Tom Arthur: Thank you, cabinet secretary. I have no further questions.

The Convener: I have one final question, which is a technical one for the purposes of the record. We were discussing with the SFC the issue of borrowing for forecast error on income tax. You might need to write to me about the specifics, or maybe one of your officials can deal with the question if it is too technical.

Does borrowing for forecast error on income tax mean borrowing against the net income tax position once outturn figures have been published? Is that the situation?

Kate Forbes: I am happy to bring in an official on the question of what our borrowing limits are. Perhaps Lucy O'Carroll could come in on that point.

Lucy O'Carroll (Scottish Government): Yes, I am happy to do so.

The Scottish Government and the Treasury have agreed that we can unlock resource borrowing powers for forecast error based on any negative differences between forecast and outturn budget positions. We can borrow for the total negative effect of forecast errors, subject to the overall limits. Forecast errors that result in increased funding for the Scottish Government budget do not reduce the Government's ability to borrow. Resource borrowing can be drawn down at any point in the financial year, and we can change our plans at any point and draw down more or less than planned, subject to the overall limits and the existence of reductions in funding caused by forecast error. Borrowing is based on the overall negative effects, not the net impact, and there is no netting off of positive errors.

The Convener: That is helpful. Thank you, Lucy.

I thank the cabinet secretary for her helpful responses to our questions this morning. We expect to publish our report on the budget later this month. We have no further items on our agenda, so I wish everyone a good day.

Meeting closed at 11:31.

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