OFFICIAL REPORT
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Finance and Public Administration Committee

Tuesday 31 August 2021

Session 6

The Scottish Parliament
Pàrlamaid na h-Alba

Tuesday 31 August 2021

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FINANCE AND PUBLIC ADMINISTRATION COMMITTEE
2nd Meeting 2021, Session 6

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*Daniel Johnson (Edinburgh Southern) (Lab)

COMMITTEE MEMBERS

*Patrick Harvie (Glasgow) (Green)
*Douglas Lumsden (North East Scotland) (Con)
*John Mason (Glasgow Shettleston) (SNP)
*Liz Smith (Mid Scotland and Fife) (Con)
*Michelle Thomson (Falkirk East) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Professor Francis Breedon (Scottish Fiscal Commission)
Kate Forbes (Cabinet Secretary for Finance and the Economy)
John Ireland (Scottish Fiscal Commission)
Douglas McLaren (Scottish Government)
Dame Susan Rice (Scottish Fiscal Commission)
Professor Alasdair Smith (Scottish Fiscal Commission)

CLERK TO THE COMMITTEE

Joanne McNaughton

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Finance and Public Administration Committee

Tuesday 31 August 2021

[The Convener opened the meeting at 09:30]

Decision on Taking Business in Private

The Convener (Kenneth Gibson): Good morning, and welcome to the second meeting in 2021 of the Finance and Public Administration Committee. The first item on our agenda is a decision on taking business in private. Do members agree to take item 4 in private?

Members *indicated agreement.*

The Convener: I inform members that Patrick Harvie has resigned from the committee, no doubt due to his elevation to ministerial office. Although he has been to only two meetings, I thank Patrick for his contributions to date.

Scottish Fiscal Commission (Economic and Fiscal Forecasts)

09:30

The Convener: We will hear from two sets of witnesses today. The first panel is from the Scottish Fiscal Commission, with whom we will discuss a number of recently published reports, including the commission's economic and fiscal forecasts. Members have received copies of those reports, along with a private briefing paper from the financial scrutiny unit and the Scottish Parliament information centre.

I welcome from the Scottish Fiscal Commission Dame Susan Rice DBE, chair; Professor Alasdair Smith, commissioner; and John Ireland, chief executive. We will also be joined remotely by Professor Francis Breedon, who is also an SFC commissioner. If members have any questions for Professor Breedon, or if Dame Susan wishes to bring him in at any point, they should make that clear so that our broadcasting operators can activate Professor Breedon's microphone.

I intend to allow 75 minutes for the session. Before we open up to questions from members, I invite Dame Susan Rice to make a short opening statement.

Dame Susan Rice (Scottish Fiscal Commission): Good morning, and thank you for the invitation to give evidence to the committee. I am joined by Professor Alasdair Smith and by our chief executive, John Ireland. Francis Breedon joins us remotely.

We published our most recent economic and fiscal forecasts last Thursday, following a recommendation made by the previous session's Finance and Constitution Committee. We also published the second part of our forecast evaluation report, covering income tax and non-domestic rates. Along with the report that we published in July, the committee now has the full statutory annual evaluation of all our forecasts. Our third and final publication last week was a fiscal update that looked at the evolving budget position for this and the previous financial year. We hope that the reports will assist Parliament in its pre-budget scrutiny.

We are all struck by the success of the Covid vaccines in weakening the link between case numbers and serious illness, which has led to a clear shift in Government policy since the January forecast. Although case numbers have been climbing steeply this month, hospital admissions and deaths remain low and public health restrictions in Scotland are minimal. We are taking a far more positive outlook for the economy than we did at the start of the year. We now anticipate that gross domestic product will reach its pre-pandemic level by the second quarter of 2022, which is almost two years earlier than we previously forecast. Prospects for a long-term recovery are also good. We have reduced our January estimate of 3 per cent long-term scarring or damage to productive capacity to 2 per cent.

However, there are on-going risks to the recovery. We are all mindful of the current rise in case numbers and the longer-term possibility that vaccines may not be effective against new variants or that the protection that they offer may wane over time. The First Minister is clear that, in the event of significant pressures on the national health service, heightened health restrictions would be considered.

Many of our tax forecasts have also been revised significantly upward since January, which is due both to the improved prospects for the economy and to rising inflation. For example, our income tax forecast for this year has been revised upward by around £900 million. However, that significant increase in expected income tax receipts will not feed into this year's Scottish budget. That element of the budget was fixed earlier in the year, using our January forecast, and the offsetting block grant adjustment was set using the Office for Budget Responsibility's March forecast. The most recent estimate of this year's net income tax position, accounting for our new forecast of Scottish receipts and the same block grant adjustment, is £1.3 billion. That large difference is the result of a significant improvement in the economic outlook between March, when the OBR made its forecast, and now, when we have made ours.

There is no evidence of a significant divergence between Scottish and UK economic performance that would support such a high net funding position. When the updated OBR forecasts are published in October, we expect the net funding position for income tax to be reduced significantly and to return to a level similar to that of previous years.

I turn to social security. We predict that spending on devolved payments will increase from £3.7 billion in 2021-22 to £5.2 billion in 2026-27, as more people receive support each year and payments are uprated by inflation. From next summer, the Scottish Government will gradually replace the UK personal independence payment with the Scottish adult disability payment. That is a major step in the devolution of social security. For the first time, we have estimated the additional spending. Although there are no changes in the overall structure of the payment, there are changes to the processes for application, review and appeals, as well as changes in how the payment is communicated. We expect that, by 2026-27, spending on ADP will reach £3 billion, which is £0.5 billion higher than would have been spent on PIP.

We also expect spending on carers allowance to increase as more people become eligible because of the larger number of adults receiving disability payments. The Scottish Government receives funding from the UK Government based approximately on what would have been spent on PIP in Scotland, so the additional spending on ADP will need to be met by raising taxes or reducing spending elsewhere in Scotland.

The forecast is, by its nature, uncertain. It is always difficult to estimate spending on new social security payments. In this case, we have only limited information to guide our estimates of how the delivery innovations will affect the case load and average payments.

I remind members, too, of other Scottish Government commitments to increasing social security spending, such as doubling the Scottish child payment, which we have yet to include in our forecasts.

The Convener: Thank you. Before I bring in other members, I have some opening questions—that approach will be the norm for future committee meetings.

You talked about taxation, which is of great interest not just to the committee and the Parliament but to the wider public. Can you tell us a wee bit about the impact of fiscal drag inflation on taxation and whether the Fiscal Commission can specifically quantify its impact in comparison to the increased output as a result of the reduction in Covid pressures?

Dame Susan Rice: We can all say something, but Francis Breedon might be best placed to respond to that question.

The Convener: Straight in at the deep end.

Professor Francis Breedon (Scottish Fiscal Commission): Yes, but I will have a go.

The short-term outlook is for significantly higher inflation than anyone was expecting, which will have fiscal consequences. Most of those will come out in the wash in the sense that higher inflation not only increases spending but increases revenue. However, you are correct, convener, that there is also some fiscal drag. In the main, that will be the same for the rest of the UK as it is for Scotland, so the actual net position will not be so large. However, the inflation will generate more real revenues. It will mainly be illusory—or nominal—but there will be a little bit of a real gain if higher inflation occurs over a long period.

The Convener: That will mean that more people become higher-rate taxpayers.

Professor Breedon: Yes, but there is uprating of most of the thresholds, so some of that will be offset.

The Convener: Thank you. SPICe produced an interesting document, which you might have seen mentioned in the press. It says that because of the Scottish Government's tax policy, some £500 million was raised in taxation, but only £148 million benefited the Scottish budget due to block grant adjustments. We have an explanation from SPICe, but will you talk about that a wee bit?

Professor Alasdair Smith (Scottish Fiscal Commission): The SPICe briefing is interesting and is a valuable piece of work, but it addresses a different question from the question that is in our remit. I understand that the briefing looks at what the Scottish income tax position would be if income tax responsibility had not been devolved, versus the current situation, in which a large part of it has been devolved and the Scottish Government sets rates. That is a hypothetical question about how the devolution of income tax has changed the system.

Our job is not to make judgments about the devolved income tax system versus other hypothetical alternatives but to look at how the devolved income tax system is working. We make income tax forecasts and we forecast the effects of Scottish Government policy changes—such as, notably, the introduction of new tax bands two or three years ago. We focus on a slightly different set of issues and we do not get into the business of judging whether it is better for income tax to be devolved and what the effects of that are.

The Convener: I fully appreciate that, but do you produce for the Scottish Government forecasts of what specific tax levels could mean for the block grant adjustment, so that the Scottish Government has a clearer focus on what the result of a tax policy might be?

Professor Smith: Yes. When tax policy is to change—as it has done in a number of years—we forecast the effects, and we have forecasts of the block grant adjustment. When the Scottish Government makes a proposal in a particular year, our forecast of income tax revenue will include the effects of that year's policy change, which is compared with the block grant adjustment to give the net effect on the Scottish Government's budget.

The Convener: That is clear.

Your report says that house price stability will be established in the current financial year and that prices will grow in subsequent years. How did you come to that conclusion? House prices appear to be rising quite significantly.

Dame Susan Rice: House prices have been rising for a while; the average house price is now a little over £200,000, and we expect the figure to rise to an extent.

John Ireland (Scottish Fiscal Commission): The convener is right that, as our graph shows, there has been upward movement in house prices in the past year. As Susan Rice said, we have now breached the level of £200,000 for the average price. We expect the figure to remain reasonably steady over this financial year as a whole, and we are already part of the way through the year. In the subsequent years of our forecast, we expect house prices to continue to rise, because of the growth that we expect in nominal income. There is almost a gentle point of inflection in this financial year. We have seen some data, and we expect prices to remain stable for the rest of the year.

The Convener: I have pages of questions, but I will let other committee members in after my next question, which is on a different topic: international supply pressures. Your forecast says that

> "we assume there are no future waves of rapidly rising ... deaths and hospitalisations"

but that

> "There are ... ongoing international supply pressures which combined with domestic recruitment challenges present risks to our forecasts."

The impacts are from not just Covid but Brexit. How do you quantify the risks from supply pressures? We have heard about significant rises in raw material prices, for example, which could have an impact on the ability to deliver the Scottish Government's capital programme.

Dame Susan Rice: The two pressures certainly exist. I make it clear that the supply pressures are not simply directly in relation to Brexit; they come from countries around the world. We have previously mentioned that China is undertaking a huge building and construction plan, so it is using rather than exporting a lot of its supplies. The supply pressures come from a lot of places. John Ireland might be able to give you the detail of how we quantify the pressures.

09:45

John Ireland: We have thought about the mechanism by which those supply constraints are likely to impact on the Scottish economy. That is taken into account in our forecast in two ways. We have built that into our judgment about output. We have thought about the potential impact that supply constraints might have on production this year. You can see that reflected in the path of output. Although output is rising rapidly this year, it does not bounce back as quickly as it might have done in the absence of supply constraints.

We have also looked at inflation. In common with the Bank of England's latest monetary policy report, we judge that inflation will peak at 4 per cent by the end of this year. We are seeing a price effect, which is also built into our forecast.

Those are the two mechanisms by which we have attempted to quantify those supply constraints.

Dame Susan Rice: The quotation that the convener read out also mentioned a blockage in job recruitment. That is a slightly old situation, which I expect will change in the coming months. There seem to be many jobs, as businesses begin to gear up in hiring, yet there are many stories about companies' inability to hire lorry drivers and therefore to make deliveries. Something funny is happening in that part of the labour market.

The UK-wide furlough scheme is coming to an end at the end of September. There is some speculation that people may have stayed on that scheme. We will see then whether employers are still viable businesses. Workers might decide to, or might have to, look for another job at that point. There is some stasis, which may last until we reach that cliff edge. We do not know, but that is our speculation.

The Convener: There is a significant mismatch in the labour market between skills and geographic location.

Liz Smith (Mid Scotland and Fife) (Con): Notwithstanding the better news that you published last week, when you said that you felt that the scarring to the economy was not as bad as had originally been anticipated, you also said that there are significant risks ahead. You have said that that is partly due to the difficulty in predicting future consumer and business behaviour. All of that is tied to the significant pressures on the budget. Public spending and public sector debt are rising, and tax receipts are likely to fall because some businesses are failing.

It is not your job to hint at Government policy, but can you tell the committee where you see the most significant future risks to the economy?

Dame Susan Rice: All my colleagues can answer on that. When the economic forecast talks about risks, we have dealt only with downside risks; we have not called out any upside risks. The downside risks draw from the economic impact of unknown or possible changes in health policy that would then impact on economic activity.

We have already seen that households that have managed to save money are beginning to spend again. There has also been a lot of home improvement and there are shortages in many of the trades that serve that sector. They have full order books and it is difficult to get work done. That activity will continue.

Professor Smith: A couple of downside risks are worth mentioning. We give significant attention in the report to the future risks of Covid. There might be vaccine escape, for example. Our forecast is based on the assumption that there will not be another period of significant economic restrictions related to Covid, but none of us can discount the risk that that might be too optimistic. We all understand what the implications of that might be.

On the economic side, as Susan said, our outlook is considerably more optimistic than it was in January. That is not just because the situation with the pandemic has eased with the roll-out of the vaccination programme, but because the bounce-back of the economy as restrictions were removed has been faster and healthier than we, and pretty much everyone else, had expected it to be.

If we think about economic scarring, for example, it is possible to contrast our situation now with the situation in the 1980s and 1990s, when economies were responding to the decline of heavy industry, coal mining and so on. Those declines left a lot of scarring in the economy that lasted for a long time. There were people who lost their jobs and never came back into employment. Communities lost economic opportunities, and new economic opportunities did not arrive.

At the moment, our view and the view of many others is that Covid does not look as if it is going to be like that. The bounce-back is going to be reasonably healthy. Young people will have difficult labour market experiences for a year or two, but we can hope that that will not last too long.

With all of these things, we have to be realistic and recognise that we might be making an overly optimistic judgment and that the long-term damage to the economy could be greater than we are forecasting. That is one other significant risk that we need to think about.

Liz Smith: There have been a lot of interesting articles and debates recently about the play between inflation and economic growth, following one of the interesting comments that the governor of the Bank of England made a couple of weeks ago. In your overview of the Scottish economy, are there areas that you think have good potential for relatively quick economic growth? In terms of tax revenue coming in, what areas could be helpful for the Scottish economy and Scottish budget?

Dame Susan Rice: That is a big question. Francis Breedon might have thoughts on that.

Professor Breedon: As you will see in our report, we looked a bit at a structural breakdown. It is clear that one important aspect of the economic effects of this situation is that it has hit certain sectors much harder than others. Many sectors have been unaffected, while others have taken a very significant hit. We are hoping and expecting that those that took a significant hit will be a major part of the bounce-back and that that will be an important part of where the economic growth and tax growth comes from.

Following on from what Alasdair Smith said, one thing that we expect to happen as a result of Covid is that a bunch of structural changes in the economy will be accelerated. For example, although I could be in a room with all of you now, I am not because we can meet through screens. That sort of change will change the structure of the economy and where growth comes from in the future. The slightly more optimistic view that we have of scarring is partly because people generally expect—and the research certainly shows—that some of those structural changes will be beneficial in the longer term.

However, it is fair to say that forecasting structural change, and trying to work out which of our sectors will benefit and which will lose, is actually very difficult, because structural changes are very difficult to predict.

Dame Susan Rice: I will add a closing sentence to Francis's comments: It is not so much sectors as were, but sectors as will be. For example, the agriculture sector, which is a big part of Scottish economic activity, might reinvent itself to some extent in anticipation of changes in eating habits and diet because of net zero sensitivities. Sectors will change according to what is happening in society more widely. It is a little hard to pinpoint which ones will change and change quickly.

Daniel Johnson (Edinburgh Southern) (Lab): Following on from some of the topics that have already been touched on, I have a question that is by and large about some of the short-term elements that we been discussing and some of the longer-term ones that you have just touched on with Liz Smith.

In the shorter term, your forecast has us returning to pre-Covid levels in quarter 2. Given what you have just set out, how safe is that forecast? Furlough is coming to an end and we can see from what has been happening over recent months the phenomenon of unexpected savers who are spending money on things that they would not otherwise have bought. I saw a report yesterday showing that used car prices are up by 15 per cent and you just highlighted spending on home improvements. It strikes me that those spending patterns cannot be sustained into the medium or long term. If that is true, is it safe to straight-line our economic performance from quarter 2 of this year? That is what your forecast appears to do, on the basis of your report. Should we not at least have a sense, if not an expectation, that there is a risk of more of an oscillation in our recovery or that there may be some head winds resulting from some of those effects?

Dame Susan Rice: Absolutely. There will always be head winds, but one of the factors that encouraged us to bring that timeline earlier was the fact that in the second lockdown in January we found that businesses overall and in general had figured out how to operate during a lockdown and the funny times that we have had for close to the past year and a half. They had worked out how to sell online and all of those services had improved. Therefore, we saw the economy coming back up to speed sooner than we had thought previously because the economic activity was stronger. That was one of the factors behind our thinking. I turn to Francis Breedon, who has a lot of thoughts on that.

Professor Breedon: First, Daniel Johnson is right that we highlighted in the report that one of the tricky moments for the economy will be when the furlough scheme ends. However, we are encouraged by the fact that there are significantly fewer people on furlough than there were even a few months ago. That makes us slightly more confident that we can negotiate that particular tricky moment better.

I think it is right that we will have a period in when spending patterns will flip around. It is understandable that people's excess savings are going mainly on durable long-term goods, in the sense that that is a way of investing those savings. However, we are expecting that to be replaced by more standard consumption patterns as the economy recovers, so we will see sectors such as hospitality and recreation stepping up to take over where spending has been dominated by durable consumption at the moment.

Daniel Johnson's question raises a good point about those transitions in consumption and the economy. Each one of them is necessarily uncertain, so there are definite risks as the economy comes back on to an even keel.

Daniel Johnson: To follow up that point, I challenge what was said about businesses having figured out how to operate through Covid. The businesses that I speak to have managed to get through Covid but, although they are trading, their trade is significantly down from where it would have been. For a lot of consumer-facing businesses, 60 to 80 per cent is not unusual and it is not sustainable for them. Furthermore, most of those businesses have got to that point by accumulating significant sums of debt, whether that is through Government schemes, deferred payment of rent to landlords or other arrangements. It has even been reported that small business owners have cashed in their pensions. I am told that a lot. It strikes me that those businesses are operating under a very different set of circumstances from those that existed pre-Covid, and that, too, must imply a degree of fiscal headwind when you start looking at those figures, or certainly the overall economic performance of the country.

10:00

Dame Susan Rice: Your point is absolutely correct. I was not implying that it has been a good road for all businesses.

Daniel Johnson: No.

Dame Susan Rice: It is just that, compared with our earlier expectations, businesses have rallied overall—not every one but on average—and functioned somewhat better. The other factors that we considered earlier this year included schools opening up a little sooner, which meant that there was more economic output relating to that; and the vaccination programme, which had barely started by the time of our January forecast, being rolled out with a speed and success that I am not sure many people anticipated. That added to output on the health side. What helped us change our view on economic activity and the speed of recovery was simply that things happened a little sooner than we expected.

Daniel Johnson: I will ask a final question about the longer-term impact. I accept that it is difficult to predict right now what the long-term structural changes in the economy will be, but I agree that there will be some. Are some of those, even if we are not able to safely predict them, a good bet? It is very likely that there will be structural changes in relation to the consumer-facing economy, especially retail, and I declare an interest as a former retailer. Those patterns of spending have permanently changed—I do not think that anybody in the retail industry thinks otherwise.

To what degree are you starting to consider or identify those changes so that you can embed them in your forecasting as soon as possible and anticipate them? Some of those changes are very likely. Likewise, in relation to changing patterns of work, having a screen and being able to work over Zoom is all well and good if your work involves things for which that is suitable, but if you are a retail worker or a delivery driver, it is somewhat more difficult to do those things by Zoom. Not only sectorally but in terms of types of employment, the recovery might well look very different depending on where you are and what industry you work in. Are you starting to identify that and embed it in your forecasting?

Dame Susan Rice: I will make a quick comment about delivery. We all receive an awful lot of deliveries at home that we did not receive before the pandemic. There will probably be a rethink about how deliveries are done, for example using small hubs where different organisations can have an exchange from large-scale lorry containers to last-mile delivery. There is a lot of work being done on that, but it is still to develop.

Things will change as well. We need to remind ourselves that they will not just go back to the way they were before. Alasdair, do you have any views on that?

Professor Smith: I am afraid not. I do not have any further wisdom to add.

John Ireland: The only thing that I would add is that, as well as looking at the sectoral industry-based factors that Dame Susan Rice has talked about, we prepare our forecast by looking at very high-level output series. To some extent, within that there is a cancellation of the effects that you talked about. The sectors with strong growth will to some extent be mitigated by the sectors with slower growth, so we might see some greater stability at the aggregate level than we would if we look at the detail underneath.

Douglas Lumsden (North East Scotland) (Con): I will follow on from Daniel Johnson's point about the high street and non-domestic rates. From your forecast for 2022-23 to 2026-27, non-domestic rates are due to go up by 17 per cent. How realistic is that considering how much the high street will have changed through the pandemic? Should we also consider how different businesses will pay NDR in future, or is that not part of your forecast?

Professor Breedon: The bounce back in NDR that you mention is really just the end of the relief, so that is somewhat baked in. However, I think that you are right about the longer-term issues with regard to commercial property. We have looked at that very carefully, and we have tried to use contacts with industry and trade bodies to get a feel for whether a change in the use of commercial property will have a big impact on that tax revenue. You are right to highlight potential structural change as an area that we might need to keep an eye on. At the moment, we do not have strong indications of structural change in the use of commercial property but, clearly, we are keeping a close eye on that, because it is a pinchpoint for the structural changes that we anticipate.

Dame Susan Rice: A lot of information about NDR still needs to come out. There were a large number of material change of circumstance appeals, and everything has slowed down in terms of the assessors coming to conclusions. We have to wait to see how the numbers play out, so there are some question marks over that, if not downside risks.

Douglas Lumsden: Income tax revenue is projected to move from just under £12 billion in 2020-21 to £17.3 billion in 2026-27. However, at the same time, the 16 to 64-year-old workforce is set to decrease by, I think, 60,000. I am trying to work out how there could be such a big increase in revenue when the workforce will reduce.

Professor Smith: That is primarily driven by the economic growth in the forecast. As we have already discussed, there is an element of inflation in that and in part it is real growth. Yes, the Scottish workforce is expected to decline in numbers, but the overall Scottish economy is, nevertheless, growing. Income tax grows with a somewhat accelerated effect as the economy grows.

Douglas Lumsden: Also in the report, nominal earnings are due to rise by 2.1 per cent and then 2.5 per cent, which does not match the increase in income tax. I wonder whether I am missing something here. Do you assume that income tax bands are going to change—that people are going to pay more tax per person?

Professor Smith: One factor is that most income tax is paid by a relatively small minority of better-off taxpayers, so there is not a straightforward one-to-one relationship between income and income tax. As I said, as the economy grows, one effect is that people who were not paying income tax are drawn into paying it and people already paying it are drawn into paying it at higher rates, which has an accelerating effect on tax revenues. The relationship between tax revenue and income in our forecast is a perfectly normal relationship that would be expected. We are not doing any fancy magical maths to get these effects.

Douglas Lumsden: Are assumptions made about the tax bands? Do you assume that they will stay as they are or that they will go up in line with inflation?

Dame Susan Rice: I think that embedded in your first question was the question whether we are expecting a change of tax bands or something of that sort. We work with what the policy is today. We do not think, "Ah, the Government may change tax bands," so the answer to that is, no, we are not playing with scenarios of that sort. We work with what we have today.

John Ireland: We make assumptions about the indexation of bands. For example, the UK Government has announced that the personal allowance will be frozen for the next few years and we have built that into the forecast. We use policy announcements in that way.

John Mason (Glasgow Shettleston) (SNP): As inflation has been mentioned a few times already, I do not want to spend a lot of time on it. However, as I understand it, you follow the Bank of England instead of the OBR on this matter, mainly because its forecasts are more recent. If inflation is at 4 per cent just now, how confident are we that it will fall to 2.5 per cent? If pressures such as shortage of labour were to continue in the longer term, would inflation continue to be higher in the longer term, too? Being of a slightly older generation, I remember inflation at 15 per cent, so 4 per cent seems reasonably low to me, but compared with recent years it is relatively high. Do you have any thoughts on that?

Professor Breedon: You are entirely correct that it is a risk. We very much agree with the Bank of England's assessment that, on the current information, it is a short-term issue. However, short-term issues have a habit of becoming long-term ones. Indeed, if, as you have suggested, there are constraints on the labour market, that is where we will start to see longer-term pressures on inflation. Currently, a lot of the issues are to do with the supply chain, and we think that they will wash out over the coming period, but you are right to highlight that as a risk.

The ultimate bulwark against inflation going back to 15 per cent is the Bank of England itself. If it were to begin to perceive that risk of inflation, it would react. It has not reacted to the current temporary increase, but it will react the more it thinks that any increase is longer term.

John Mason: On the wider question of population, our birth rate in recent years has been low. On the whole, immigration has made up for that, but there has been a bit of a reduction in that, too. What are your assumptions on population? How big an impact will the issue have, and should we be worried about it? My simple thinking is that if the population grows, the economy will probably grow, too, but if the population falls, it becomes very difficult to make the economy grow. Moreover, if the population of the rest of the UK grows while ours does not, where do we go?

Dame Susan Rice: It is a very important issue to think about. First, the fertility rate is dropping not just in Scotland but in countries all around the world, so it is a general phenomenon. Nevertheless, our fertility rate has been dropping. On your point about comparisons with the rest of the UK, I note that its population growth is a little bit faster than ours, and we expect that to continue to be the case.

The other factor in Scotland is the growth of its older population, many of whom are no longer working and are therefore no longer active in the labour market. Because fewer children are coming in, we expect fewer people to join the labour market in due course, and there will be more people in that older age group who might not be actively working but who might nevertheless be costing something. We look at both sides. Coming back to ADP, the fact is that more people will start to attract that benefit, and possibly for longer. It is a combination of things that balance each other, and it certainly matters.

John Mason: Presumably, the birth rate will not change very rapidly, but things could change on the immigration side. There is demand from industry for immigration to be allowed for specific sectors, although the UK Government has said that it will not do that. How important would that be? If immigration were suddenly to be allowed, would that make a big difference to the forecasts?

Dame Susan Rice: One can only speculate, but one could say that, if immigration were to be allowed, what would matter most would be that immigrants were people of working age who started to create more activity in the economy.

John Mason: I was interested that page 33 of my copy of your report—I am not sure whether it is the same page 33 for everyone—shows box 3.1, on uncertainty indicators, which I understand are a new measure that you are trying. I was fascinated by that and I wonder whether somebody will explain what that tells us.

10:15

Dame Susan Rice: I am excited by what we have created, which is very good. Such measures are about political uncertainty—the impact of what is being thought about, discussed and debated in public. If that creates greater uncertainty, it might affect the decisions that people make and the behaviours that they show economically.

The Scottish uncertainty index has been created and it can go back any number of years to reflect events in society. We will continue to monitor that; I will not go into the detail of what it picks up.

John Ireland: We have taken methodology that other people, including the Bank of England, are using to look at policy uncertainty in the political sense. The measure is based on online searches of newspaper articles. We select a number of key words and the index picks up how many times those words occur in articles. In a sense, the approach is simple. It takes a bit of time to do but, fortunately, it is all automated, which makes life easier.

If we look at box 3.1, it is fascinating to see that the first independence referendum and the European Union referendum feature in the index, and the impact in Scotland was greater than that in the UK as a whole. We can also see the effect during the Brexit negotiations in 2019 and 2020, when independence came back into the news.

We are interested in this. We need to do a lot more work to calibrate it to what is happening in the economy. It is a good starting point.

John Mason: How objective is the index? We do not all have faith in how newspapers operate.

John Ireland: What matters is not necessarily whether the newspapers' reporting is accurate—it might or might not be accurate; it depends on your faith in newspapers and journalists—but what people are talking about. The index captures the sense of what is in the news. Because other people around the world have taken this approach and the Bank of England has taken it for the UK for some time, we have faith in the methodology.

John Mason: What is the impact on people's behaviour? If there is more uncertainty, do people save more?

Dame Susan Rice: We could speculate almost anything—people could hold back on big spending decisions or they could consider where they live or whether it is time to change jobs and take a risk. There are lots of ways in which uncertainty could impact on decisions, and those decisions will have an economic impact.

John Mason: We will keep an eye on that.

John Ireland: It is important to say that we are developing the index and that we have not taken the next step, which Susan Rice talked about, of looking at the impact on the economy.

John Mason: I will ask about an area that has come up before. Are you getting the data that you need, with the quality that you need, from Scottish sources and the UK HM Revenue and Customs?

Dame Susan Rice: Thank you for asking that question. You have been on the committee for a while and know our journey along that road. The position is much better than ever before. We have developed good relationships with major UK agencies that provide us with data. Sometimes, it takes time for them to change reports; sometimes, time limits make a difference to us. As you know, we make every effort to use publicly available data. Part of our approach to transparency is that we publish the sources of the data and what those data are.

We are in a much better space, but that does not mean that improvements could not be made. Because of a request from another parliamentary committee some years ago, we publish every year a statement of our data needs and we identify what would help us next. The situation has improved.

John Ireland: As Susan Rice says, the position is stable this year. For the past three years, we have produced a statement of data needs, after a recommendation from the Economy, Energy and Fair Work Committee in the previous session of Parliament. This year, we have decided to move that publication to every two years, because we have no pressing data needs at the moment. We have not produced that statement this year, but we will do it next year.

Michelle Thomson (Falkirk East) (SNP): I have been listening to the contributions with great interest. The themes that keep recurring are around uncertainty and complexity. I appreciate the very difficult job that you have to do in reconciling what has actually happened with a forecast of what might happen, and I am interested in exploring that a bit further.

We have touched on some of the rationale that you use for your analysis when questions have been asked. I am interested in understanding the rationale for some of your analysis in your report. For example, we know that climate change will affect us, and net zero targets are being talked about a great deal. How do you reflect such issues in your analysis? Can you see a development of your report in which you reflect more on those issues?

Dame Susan Rice: That is interesting. I am looking at my colleagues. Francis, do you want to come in?

Professor Breedon: Obviously, we want to develop our thinking about those longer-term issues, although climate change is a current risk as well as a longer-term one. There are issues—we have raised them already in this meeting—about long-term population changes. We could usefully look at those issues, but they are not written about very much in the current report, because it has a specific focus on the shorter-term forecast and the budget implications of that. You raise an important question.

John Ireland: The only thing that I would add is what I said to Mr Johnson earlier. A lot of the things around net zero, such as the commitments and changes relating to energy efficiency and the production of energy, are the sort of things that go in the balances and changes underneath. At the top level, we forecast for five years, so you probably do not see an immediate impact, but there is important stuff going on underneath, which we need to keep an eye on. As Francis Breedon said, thinking about 20 years forward is very different from thinking about five years forward.

Michelle Thomson: In that respect, I, too, was excited about box 3.1, which started to get into that sort of thing.

My next question follows on from that and is on the similar theme of GDP per capita. We know that there are endless debates about how effective that is as a measure, although it is internationally understood and you rightly use it. However, what, if any, thinking have you done about measures in addition to GDP per capita, given its known and understood crudity, and particularly as we start to move to the so-called wellbeing economy, which I know is somewhat amorphous at the moment?

Dame Susan Rice: That is a good question. Again, I see Francis Breedon nodding, so I will turn to him.

Professor Breedon: I was nodding in the sense that I agree that that is an important area and that GDP is a somewhat narrow measure. Sadly, from our point of view, because we have a significant focus on the budget and on money, GDP is actually the measure that matters to us for that particular job. It is not really in our world to look at those other measures, but I agree that they are valuable and important, and I would encourage others to think about them. If, like us, you are always looking at monetary and budget implications, GDP is pretty much the best measure for that job.

Michelle Thomson: It is the best worst, as I think people would agree.

Professor Breedon: Yes.

The Convener: We still have time, so I will let colleagues come back in again, but I will ask some more questions first. The first one is a follow-up to John Mason’s question about the uncertainty index. Where does the co-operation agreement between the Greens and the Scottish Government sit on the uncertainty index? Does it make the Scottish Fiscal Commission’s ability to forecast more or less certain?

Dame Susan Rice: We do not forecast political outcomes.

The Convener: No, but the deal contains financial detail and specific components—for example, £500 million for the north-east and Moray and 110,000 more affordable homes by 2032.

John Ireland: In essence, our forecasting of Government expenditure is limited to social security. Some of the content of the agreement between the Greens and the SNP—for example, the doubling of the Scottish child payment—is in that portfolio. The direct impact for us is around the expenditure commitments that are in our remit, such as social security spending.

The other interesting thing about the agreement is how it will change the budget process. We have been used to operating in a world in which the budget process is two bites of the cherry—the initial budget and the negotiations about how to get it through Parliament. Obviously, that will go away and make a difference to how we approach our forecasting and that sequencing.

The Convener: So in that regard, there will be a reduction of uncertainty.

John Ireland: Yes. It will be up-front uncertainty—a one-off, rather than a two-off.

The Convener: This morning, members of the committee received a detailed letter from the Cabinet Secretary for Finance and the Economy. No doubt colleagues will ask questions about that in the second session. She says in that letter:

> "there is logic for publishing the MTFS alongside the Scottish Budget and thereby basing it on the updated SFC and OBR forecasts. Publishing it before the OBR October forecasts would mean having to use OBR forecasts from March, the effect of which would be to give a misleading sense of the fiscal outlook."

Does the commission agree with that statement?

Dame Susan Rice: The OBR forecasts affect the block grant adjustments and therefore affect our budget position. The OBR would be the first to say that the March forecasts are out of date. We expect it to produce an up-to-date set of forecasts on 27 October. The statement that the OBR forecast from March cannot be relied on because the numbers are out of date is legitimate.

John Ireland: It is very difficult, because we have not had sight of that letter from the cabinet secretary.

Dame Susan Rice: Yes.

John Ireland: I presume that the letter talks about this year's medium-term financial strategy. There are timing considerations about when the forecasts are as up-to-date as possible and when they coincide. In all honesty, it would be better to read that letter and write to you to give you a considered reaction and a sense of our views about it, if that is okay.

The Convener: I am sure that the clerks will let you have it. We only received it at 7 am this morning, so I am sorry for throwing that question at you.

Dame Susan Rice: I think that Alasdair Smith wants to add something.

Professor Smith: As John Ireland said, we will not respond to a letter that we have not seen.

Uncertainties arise from the fact that the OBR forecasts are important to the Scottish Government's budget because they affect the block grant adjustments. The current OBR forecasts are somewhat out of date, and we will have more up-to-date forecasts in October.

We have highlighted some areas in our report where that is significant. We clearly indicated that the current forecast of the net position on income tax should be considered with great caution because, although we have as much faith in our income tax forecast as we always do, the income tax BGA is based on an out-of-date forecast, so we should not attach too much weight to the net position.

There are other important elements in the social security budget—the adult disability payment in particular is a big element in it—in which uncertainty about OBR forecasts is not really a factor for postponing serious consideration of the issues.

The Convener: You have talked about social security a couple of times, but no committee member has yet asked about it. Your figures predict a £1.5 billion increase over the next five years in social security spend, of which the adult disability payment will be a major component. Given the fact that that increase has been mentioned a couple of times, is that a cause for concern for the Scottish Fiscal Commission, or do you just want to ensure that we do not omit it in our deliberations?

10:30

Dame Susan Rice: It is not our job to be concerned about policy—I say that somewhat tongue in cheek. We are trying to call out the fact that, because of the Government's policy to make those social security benefits more widely available and easier to access for more people, there will be greater spend there, so there might be a difference between the spend and the funding that is available to the Scottish Government, some of which comes from the Department for Work and Pensions. As you know, the Scottish Government is required to have a balanced budget, which means that, if it spends more in one place, it needs to match that in some way from within Scotland, either by raising taxes in Scotland or by not spending on some other programme in order to fund that programme.

The thing about social security, particularly the ADP, is that it covers a large number and is somewhat open-ended because, once people qualify for it, they do not often come off it, and we do not know for how many years they will receive the benefit. It is not a one-off benefit at a certain point in time, which is easier to predict. Therefore, we raise that issue simply to bring out the possible need for thoughtfulness when looking at the budget overall.

The Convener: The child payment could be £163 million a year. I think that you said in your opening statement and your report that about £0.5

billion extra would have to be found from the resource budget by 2026-27. Is that correct?

Dame Susan Rice: Yes, and there are still a tiny number of social security payments for which we do not yet have a clear policy on the Scottish side, so we have not costed them. Half a billion pounds is a big sum of money, so it has to be thought about and anticipated.

Liz Smith: A not-too-distant date on the horizon is 1 October, which the Government is identifying for publication of the outturn report for the fiscal framework, which will lead on to the revision of the fiscal framework and the agreement. Are there things that you would like to see within the fiscal framework parameters that would make forecasting a bit easier?

Dame Susan Rice: That is a good question. A review of the fiscal forecast has always has been in the plans for this fiscal year, but it is not our job to shape or drive that; it is for the Scottish and UK Governments to do so between them.

Liz Smith: However, are there things that would perhaps reduce uncertainty and help you to plan ahead with regard to forecasting?

Dame Susan Rice: If we are consulted, we will obviously respond, but one thing that we have raised before—I thought of mentioning this a minute ago—is a greater degree of certainty, expectation and planning around the timetabling of the MTFS and the budget and when those activities will happen. We require many weeks to produce our forecasts, so if we knew ahead of time when the MTFS and budget were coming, that would be really useful to us. We have been very open about that.

John Ireland: I think that Liz Smith was asking specifically about the physical outturn report. We have been working with the Government on that for many years and we think that, over the years, the quality of that report, the information in it and the transparency have increased enormously. Without saying that it is absolutely perfect, we are pretty happy about the way that the report has been going and the improvements in it over the years.

Liz Smith: With all the additional forecasting that now goes on and the improvement in the use of the data, do you, as statisticians who predict the future by using that data, think that economic forecasting is getting more accurate? [*Laughter*.]

The Convener: Just look at the most recent block grant adjustment—it was only £34 million.

Dame Susan Rice: It is complicated. Does Alasdair Smith want to say yes or no?

Professor Smith: As Susan Rice said, the availability of data has improved over the lifetime of the Scottish Fiscal Commission. That has somewhat reduced the uncertainties that we face, but forecasting is inherently a business of dealing with uncertainties. We are not looking for magic solutions that will make our job easier. The issue about fiscal uncertainty is not about making our job easier. As John Ireland and Susan Rice said, it is not for us to propose what changes to the fiscal framework should take place, but the central question relating to the fiscal framework is whether the Scottish Government faces uncertainties in the current system that could be different in a different system.

Liz Smith: I will put it in another way. If there have been improvements in the data over time, that implies that your job has become slightly easier—it is not perfect by any means, but it has become slightly easier. What you produce for the Government is therefore more accurate than it used to be, even though there are complexities. Is that fair to say?

Professor Smith: I will be optimistic and say yes—that is fair.

Dame Susan Rice: “Accuracy” is a word that makes me take a deep breath, because forecasts are never really accurate. Since the commission has been in existence, given the better data and more sophistication, we have created and improved our forecast models, so we are now doing a much better job. We have our economy forecasts, which we created ourselves. Initially, we did not use them, but what we are doing now is better. We are using different data sources and we understand the impact of real-time information data compared with that of the data that we used to use from HMRC. All of that has led to improvements. However, the words “more accurate” make me hesitate briefly.

Liz Smith: We will take that as an accurate answer anyway.

Daniel Johnson: I want to return to the block grant, income tax revenues and the SPICe paper that the convener mentioned. I recognise what was said about not wanting to get into the hypotheticals of previous regimes. However, as I understand it, the paper sets out that the current fiscal framework relies on income tax growth, which seems to point to the fundamental issue that income tax receipts per capita in Scotland have grown more slowly than those in the rest of the UK. Is that conclusion supported by the data that you have? If so, what are the reasons behind that?

I ask those questions because we are all mindful that the fiscal framework is being renegotiated. Understanding the fundamentals of how the framework works and what we benefit from—as I understand it, income tax growth is critical in the current regime—is clearly important as the framework is renegotiated. Will you elaborate on the insight that you have on the growth of income tax receipts per capita in Scotland compared with that in the rest of the UK?

Professor Smith: The fundamental point about the devolved income tax system is that Scottish income tax receipts depend on the income that is generated in the Scottish economy. In a non-devolved income tax system, Scottish income tax receipts would depend on Scotland's share of UK income tax receipts. That fundamental feature means that, if the Scottish economy evolves such that the pattern of income is different from that in the rest of the UK, devolved income tax receipts in Scotland will be different from what the receipts would be in a non-devolved system. That is just a statement of the basic facts. It highlights that Scottish income tax receipts—and therefore the Scottish budget—depend on the performance of the Scottish economy and the growth of Scottish productivity, because high productivity basically means that there is a higher proportion of high income tax-paying jobs in the economy.

There is nothing magic about that, but it focuses attention on important questions about the long-term growth of the Scottish economy, the growth of productivity and the demographic changes that Susan Rice talked about—in particular, the ratio of the non-working elderly population to the working population. Those are the issues on which the future of the Scottish economy depends, as is the case for any other economy. Devolution focuses more attention than ever on the Scottish economy specifically.

Daniel Johnson: To take the next step, I absolutely understand those points, but the key conclusion that is drawn in the paper is that growth has been slower in Scotland than in the rest of the UK. Do you share that conclusion? Do you have insight into that?

Professor Smith: As John Ireland or Susan Rice said earlier—I am sorry that I cannot remember who said it—the SPICe report asks a question that is different from the kinds of questions that we ask. We are not going to take a position on whether we would line up with the SPICe report, because that is not our job.

I had better stop there. The SPICe report addresses a series of important questions, but they are different from the questions that we address. I am therefore not going to get into a detailed discussion on how the analysis in the SPICe report is drawn.

Daniel Johnson: The fundamental point is that we want productivity to go up so that people are paid more and they pay more tax. That is the fundamental of what we are discussing, in broad terms.

Professor Smith: I would not disagree with that.

The Convener: Absolutely. Daniel Johnson is just warming up for the cabinet secretary—do not worry.

Daniel Johnson: Exactly so.

The Convener: I have a final question before I call this evidence session to a halt. Regarding the fiscal overview, the Scottish Fiscal Commission notes that the UK Government has not guaranteed any additional funding for Covid-19 for 2021-22 and that there are currently no arrangements for deferred funding. Given the Scottish Government's requirement to maintain a balanced budget,

> "large changes in COVID-19 funding late in the financial year may create difficulties for the Scottish Government's management of its budget."

Can you talk us through one or two of those difficulties?

Dame Susan Rice: Last year, there were several tranches of funding from the UK Government that were spread out and went to the nations, relating to Covid measures. They came at different points in the year. The numbers that are involved in that kind of funding are firmed up only towards the end of the fiscal year, usually in February. That makes it very hard for a Government that has to have a balanced budget and has to make decisions throughout the year on how to spend money wisely.

The Scottish Government spoke to the UK Government, and what came out of that—in early summer last year, I think—was a guarantee that the number that had been put on the table at that point was a minimum, so the amount would not drop below that. There were more tranches after that. One was announced in March with the UK budget, weeks before the end of the fiscal year. It would have been impossible for the Scottish budget to put that into place and for it to be spent. Scotland has a hard stop at the end of March in order to fund councils and confirm income tax bands. It does not have flex in time at that point. The UK Government—the Treasury, specifically—agreed to let that money be carried over to be used this year. That was a helpful form of support to ensure that the money could be used properly and thoughtfully by the Scottish Government—and, I assume, by the other nations.

This year, a little over £4.5 billion of Covid support funding has been put on the table, but there are no guarantees of that sort and there is no promise at this point about a carry-over. That number—which may go up if things get worse, or may stay the same—would possibly go down by the time the February supplemental estimates are agreed relatively late in the financial year. That is why we have pointed that out—there is not quite certainty about the extra funding.

John Ireland: It might help if I say that, last year, there was £1.2 billion-worth of late funding from the UK Government. Only up to £700 million can be used in the reserve. You can see that, even with the greater ability to use the reserve because of the Scotland-specific economic shock, there is that constraint of £700 million.

The Convener: I thank our witnesses very much for their very interesting presentation and for answering our questions.

10:45

Meeting suspended.

11:05

On resuming—

Cabinet Secretary for Finance and the Economy

The Convener: In our second evidence session we will hear from Kate Forbes, the Cabinet Secretary for Finance and the Economy, and Douglas McLaren, deputy director, budget, pay and pensions, in the Scottish Government. I welcome our witnesses to the meeting, not least because the cabinet secretary has come straight from the Local Government, Housing and Planning Committee meeting and has already had an exceptionally busy morning.

Committee members have received a paper providing background information for the evidence session, but before I open the session to questions from members, I invite the cabinet secretary to make a short opening statement.

The Cabinet Secretary for Finance and the Economy (Kate Forbes): Thank you, convener. It is great to be with you this morning. I am sorry that I am not there in person. I had hoped that it might be the first in-person finance committee since the pandemic struck.

I want to continue to build on the open and collaborative approach that we had with your predecessor committee in the previous parliamentary session, and I am grateful for the early engagement that my officials have had with your clerking team.

I will raise a few issues at the outset. I am getting quite a bit of feedback from my microphone; I hope that you can all hear me okay.

First, I know that the committee will want as much early clarity as possible on the process and the timetable for next year's budget. I would like to build on my experience with the past two budgets with regard to contending with the implications of, and uncertainty around, the timing of the United Kingdom Government's net fiscal event and to move to early consideration, with the committee, of those implications. In light of the uncertainty around the UK Government's budget, there are pros and cons to going ahead of, or waiting for, the UK Government's budget. That debate has been informed by the SFC's forecast last Thursday, and the Office for Budget Responsibility has now been requested by the chancellor to produce its forecast at the end of October.

There are several other areas that the committee will need to—[*Inaudible*.]—so I will make only one more point before I hand back to you, convener. Needless to say, we are producing Scotland's first framework for tax for consultation—a new enhanced Scottish approach to taxation. We are setting out our programme of work on tax over this parliamentary session. I look forward to the committee's views on that.

I will stop there and again make the point that I am getting a lot of feedback, so I hope that you can hear me and that I can hear you.

The Convener: Thank you, cabinet secretary. I think that some members are having a wee bit of difficulty in hearing you clearly. Perhaps we can make some technical adjustments. If that is not possible, we will have to soldier on. Please bear with me for a minute.

I have been advised that broadcasting is trying to improve communications but that we should plough on in the meantime. I hope that you will be able to hear me, cabinet secretary. I will try to enunciate and to not sound as west of Scotland as I normally do in asking these questions, you being a poshie and all that. [*Laughter*.] You will probably be able to translate what Daniel Johnson is saying much more clearly than I could.

Daniel Johnson: Undoubtedly.

The Convener: First, has any progress been made on the review of the fiscal framework? There has been real difficulty in getting the UK Government around the table. Of course, we hope to have the review by the end of the year.

Kate Forbes: There has been progress in the sense that we continue to engage on an on-going basis with the UK Government. Obviously the fiscal framework is due for review in 2022, and that will be preceded by an independent report that will be presented to both Governments by the end of this year.

The committee will agree that the framework has been subject to some quite unprecedented stress testing, and we would not have anticipated the pressures that have been put on it when it was originally agreed in 2016. There is some disagreement on this, but my view is that the review should be quite broad in scope and that the report on it should consider not only the operation of the framework but how it can be improved.

The arrangements for the review require joint agreement between the two Governments. We have not been able to achieve that to date, but I will discuss the next steps with the Chief Secretary to the Treasury in the coming weeks. My goal is to get agreement and ensure that we meet the timetable, and I would really welcome the committee's support in continuing to make the case to the UK Government for a broad-ranging review that is in line with the predecessors' report on the fiscal framework. I hope that we can work together to achieve a meaningful review instead of just ticking the review box.

The Convener: Politics moves very fast in Scotland, and we now have the co-operation agreement between the Scottish Government and the Green Party, with ministers, including Patrick Harvie, a former member of this committee, being appointed this afternoon. What work has been done on the implications of that for the public finances? For example, the number of affordable houses to be built to 2032 is to increase from 100,000 to 110,000, although that will happen at a time of labour and skills shortages; £500 million is to be invested in a just transition fund for the north-east and Moray; and there is to be a fair fares review to provide a realistic alternative to car use and increase investment in active travel and public transport. Given the likelihood of the funding for those measures impacting on other Scottish Government policies and programmes, can you take me through the process of how the agreement will work as you take the budget forward?

Kate Forbes: As you can imagine, I have been all over this—for want of a better phrase—to understand the financial implications and consequences. On housing, which you mentioned, we set out the budget for our original target of 100,000 homes in the capital spending review, and as a result of a number of different discussions—and in light of next week's programme for government, which is a really important consideration—we will be considering that capital requirement. As for the core financial implications on the resource and capital sides, they will be settled in the budget-setting process. We have come to an agreement, and our responsibility now is to fund that part of the budget.

Secondly, I point out that it is a multiyear co-operation agreement, which leads us into the resource spending review. That review is where we had intended to cost and plan for multiyear commitments, and the co-operation agreement will now be factored into it. I am sure that you are all sighted on this, but, just to give you a little bit of history, we had hoped to carry out our multiyear spending review last autumn. However, we could not proceed with it, because the UK Government's planned resource spending review did not go ahead last year. We are hoping—certainly the hints have been made and the intentions are there—that the UK Government will do its comprehensive spending review this autumn, and that will allow us to publish our own plans for our intended multiyear spending, which will include the co-operation agreement.

11:15

The Convener: A number of members, myself included, have raised issues with regard to tax and demography. One issue of concern is the need to grow the Scottish economy relative to the UK economy. We have real demographic challenges, and there is also a productivity issue. What steps will be taken on that?

As the Scottish Government recently pointed out, the UK has had the lowest economic growth of any north-west European state over the past 12 years or so since the financial crash, but Scotland does not seem to have done particularly well in comparison, as reflected in the block grant adjustment in some years. What can we do to try to increase productivity so that we can restore and improve the health of, and enhance, the public finances?

Kate Forbes: There is a lot in that question, so I will take each point in turn. The bottom line is that the primary way of increasing public revenue in order to fund our public services is through broadening and increasing the tax base. In order to do that, we need to maximise the number of people in fair, well-paid secure employment. I am sure that the SFC made that point in relation to its updated forecast.

There are primarily two ways of doing that. My primary concern is an economic subsidy over the next 10 years that deals with the structural challenges of productivity and maximising the number of well-paid jobs. In addition, although we are—I hope—heading for significantly lower unemployment than we perhaps feared, a lot of businesses are saying that they are struggling to recruit. Many of them formerly relied on European Union labour. Without the staff, most businesses cannot grow and develop, and individuals are not earning and are therefore not paying income tax.

First, therefore, we need to ensure that our economic strategy for the next 10 years has a laser-like focus on the areas where we want growth and development and economic recovery, and secondly, we need people. First, we need to focus on ensuring that as many people as possible who are already resident in this country have the right skills for those jobs, but we also need to ensure that we have an attractive immigration policy. So many sectors just cannot recruit right now because of their previous reliance on EU labour, which is no longer materialising.

In terms of what I am actually going to do, those are the answers. First, we need a long-term economic strategy that deals with structural issues such as productivity; that is what I intend to do in the economic strategy that is due to be published in the next few months. The second focus is immigration and attracting to this country a workforce that is able to fill roles in order to allow businesses to trade profitably and to enable people to pay income tax.

The Convener: I agree with your comments. However, the UK and Scotland have the same immigration policies. What can Scotland do to improve its position relative to the rest of the United Kingdom? The block grant adjustment and taxation are obviously major issues in future budgetary considerations.

Kate Forbes: I will take a short detour, as you talk about block grant adjustments. One of the areas of the fiscal framework that needs to be reviewed concerns income tax and the associated methodology. The SFC has detailed that in its own reports. We are conscious that the methodologies that apply to income tax for our tax base are probably not as helpful as they could be, in that we have a different tax base from the rest of the UK. For example, we need to maximise the number of people who are paying, and broaden the tax base at the upper end because of the way in which tax is calculated. There is currently a question around the methodologies that are applied to the tax base and the way that the block grant adjustment is calculated. However, I shall leave that to one side.

With regard to what else we could do, it is clear that we are more exposed to the impact of what happens with oil and gas. The committee will have seen that in the forecast that the SFC published last week.

When there is a reduction in demand for oil and gas, that has implications for individuals who are working in that area, and therefore we are more exposed to the income tax implications of that. My view is that we need to diversify, and that is why the point of the economic strategy is to focus on the opportunities that there are with alternative emerging technologies, renewables and the just transition. Different countries around the world are grappling to get the competitive advantage that new and emerging technologies offer. I want to ensure that it goes to Scotland—that the supply chains in Scotland are creating new jobs as a result of pioneering research and development. That is one area where I think that we can have a competitive advantage, if we get it right. None of this happens automatically, without us intentionally trying to ensure that we capture the opportunities here in Scotland.

The Convener: Thank you. I have a final question before we open up to questions from committee members. The Scottish Fiscal Commission noted that the Government has not guaranteed any additional funding for Covid-19 for 2021-22, and that there are currently no arrangements for deferred funding. It has said:

> "Large changes in COVID-19 funding late in the financial year may create difficulties for the Scottish Government's management of its budget."

I asked the SFC about that, but can you also say what kind of difficulties that could create for the Scottish budget?

Kate Forbes: It is one of my greatest headaches, because last year we were deeply concerned that the UK Government could go right up or down with the funding that we receive. Bear in mind that consequentials emerge only from the money that is actually spent, and not the money that is announced.

Last year provides an important comparison. If the UK Government were to announce X hundred million pounds for the Scottish Government to spend on business, we would immediately be under pressure to spend it, but that amount from the UK Government could then be changed, after we had given the money over to business. Therefore, midway through last year, the UK Government implemented the guarantee, which was just to say that the amount would not be revised downwards. Unfortunately, that guarantee has not been extended to this year. That means that money that is announced could actually be clawed back, and, in the past, it has often been clawed back, as late as February or March in the financial year. Because I have to balance my budget to the penny, by February or March I will already have confirmed that, for example, teachers or businesses will get a certain amount of money. I am then left having to repay some of that money to the UK Government late on in the financial year. Clearly, I do not have the capacity in a fixed budget to suddenly create more headroom, once we have already confirmed that that money is being spent.

That happened the year before Covid. In February 2020, we got confirmation that, despite all the money that had been announced for us during the year, the money that we were going to get was less. That meant that I would have to repay some of that money—and that meant that it was capital—very late in the financial year.

I cannot afford to hold money back—businesses need it and public services need it. Our citizens need that money to be spent in the health service and in remobilising the justice system. Equally, in the back of my mind, I have the fear that money that is announced will be revised down, as has already happened in education; I think it was £25 million pounds that had been previously announced that was clawed back in May.

It is easier to handle that if it happens earlier in the financial year, but if it is in February or March, it is almost impossible. We cannot borrow—we cannot suddenly create additional money to pay it back.

The Convener: Thank you. I open up for questions from the committee.

Daniel Johnson: Following on from the convener's remarks at the beginning of the meeting, we can agree that we both have excellent diction and enunciation.

I want to follow up on some points that have already been raised. I am clear that you have read the SPICe report and the Fraser of Allander Institute piece looking at the outturn reports and comparing them with the tax plans. In the 2019-20 budget, the Scottish Government expected its tax plans to raise an additional £500 million, but, based on the outturn, they have raised only £148 million. I understand what you were hinting at with regard to the block grant mechanism. However, it is clear from both of those bodies that what that difference fundamentally tells us is that income tax per capita has not grown as much in Scotland as it has in the rest of the UK.

First, do you agree with that assessment? More importantly, and given what you were just saying about the need to expand the income tax base and to make sure that people are earning more within that, what does that say about the policies that you have been pursuing? What policies will you pursue to ensure that people are earning more so that they pay more tax, which we can all agree would be a good thing?

Kate Forbes: On the first point, about the outturn report, I understand the premise of your question but it is important to reflect that our income tax policies raised £148 million over and above the block grant adjustment. That £148 million would not have been secured for the public purse if it had not been for the change in policy.

I will make two additional points. First, we have been clear that our income tax policy is endeavouring to do two things. We are seeking to achieve two results. The first is security of public revenue. In order to say that the health service will get £X billion over the next year, I need to know that that money is coming in. We need to be sure that we will raise it. However, we are also trying to ensure that the policy is fair. We have been clear that we intentionally made changes to maximise the progressivity of income tax. It is not perfect, but we have powers only over rates and bands, not over the personal allowance, incentives such as gift aid or the interaction with things such as pensions. It needs to be seen in that context.

Having said that, I clearly want to secure the long-term sustainability of our income tax policies. In other words, I want to continue to ensure that we have the money that we need. We are currently undertaking a policy evaluation to better understand the impact of the 2018-19 policy reforms. We hope to publish the findings later this year on the precise impact of those policy changes. I am sure that that will be of interest. Covid excepted, we have continued to see growth in Scottish receipts exceeding that of the rest of the UK. This is the second consecutive year in which we have seen that growth and we want that to continue. We will wait to see what the impact of this Covid year has been.

I have a third point, which is around the risk that all of that creates. If we look at the reconciliations from the past two years, we can see that the existing borrowing and reserve powers in the fiscal framework are not sufficient to deal with the level of volatility in forecast error. I will stop there, but there are three implications of that. One is to ask whether it is important that we have more than one objective for income tax. Secondly, is it important that we continue to raise more than we would have done from the block grant adjustment? Thirdly, what is the best way of managing that level of risk and volatility? My view is that we need a broader review of the fiscal framework to ensure that it can deal with that level of volatility.

Daniel Johnson: I agree that we need to get into the detail of the fiscal framework, but I do not think we have time for that this morning. However, there is clear agreement that we need to increase income tax on a per capita basis. Fundamentally, that would tell us that people in Scotland are earning more money, which is a good thing. Indeed, you summed it up earlier as more people participating in the economy and earning more money, underpinned by productivity.

In relation to some of the things that the convener was raising, my concern is that that sounds a lot like economic growth. I am very clear that economic growth is a good thing, especially when it is underpinned by growth in productivity, because it means that people are better off and are leading better lives. However, certain people who are about to join your Government think that economic growth is a bad thing. What is the Scottish Government's view on economic growth?

11:30

Kate Forbes: I can be very open and honest about my view on economic growth. Obviously, the co-operation agreement, which I am sure you have already read, had some excluded areas, including GDP growth.

My view is that we need fairer and increased prosperity. We cannot have economic growth without looking at fairness, because that would not secure the outcome that you and I are talking about. If we see a ballooning of income for the highest earning, with the tax revenue that comes from that, but we still see huge levels of in-work poverty, that is not a good result. Therefore, economic growth has to be fair and distributed.

In my view, we do that by ensuring that the focus of Government is on supporting businesses, industries and sectors that will bring more people into safe, secure and well-paid employment. We have seen the implications of that during the pandemic, because being in employment is a great blessing but, in and of itself, it is not enough to ensure that people are not in poverty. Employment has to be safe, secure and well paid. There are great opportunities in the Scottish economy when it comes to the just transition, the green economy, new and emerging technologies and alternative forms of energy. We must also ensure that each of our local economies is thriving because, to take a more regional approach, if Edinburgh and Glasgow are doing well, the national picture probably looks quite healthy, but I have a vested interest in making sure that the Highlands, the south of Scotland and the islands are doing well and that areas of deprivation are doing much better. Therefore, we must make sure that economic growth is fair, inclusive and sustained and not just economic growth for the sake of it.

Daniel Johnson: Thank you—I almost completely agree with everything that you have just set out. We need growth because, ultimately, that should lead to greater fairness and prosperity for people. My only concern is that you and I might agree more than you agree with some of your new ministers. However, I will leave that there.

I have a final point. Earlier this morning, we were discussing the Scottish Fiscal Commission's forecast. On one hand, the forecast is very encouraging, because it looks like we will return to pre-Covid levels by quarter 2 of 2022, which is a good deal earlier than we expected. However, our discussion with the commission's representatives raised a number of risks. Indeed, one of the things that they said was that the forecast assumes that the current relative absence of restrictions is maintained. Given the events of recent weeks, we are all concerned about the levels of infections. Understandably, there has been talk of circuit breakers and the possibility, at the very least, of restrictions being reimposed. Within the Scottish Government, what work is being done to look at the impact of those measures and how they would impact on spending in the current year? Can you outline the fiscal consequences of a circuit breaker or any other interventions that might be required if the situation does not improve?

Kate Forbes: Thank you—that is a very good question. The SFC forecasts are cause for optimism. I do not think that we can downplay the difference between the January forecasts' really tough outlook for the Scottish economy—which I had to base my budget on and which reflected the huge impact of the pandemic—and where we are now. They are but forecasts, which are based on various variables that the SFC would have gone into, such as vaccinations and lockdowns.

In terms of the fiscal impact, from a financial perspective, one of the biggest challenges right now is the fact that there has not been much additional consequential funding from the UK Government in the past few months. Right now, we are trying to remobilise the health service, the justice system and a host of different public services, as well as dealing with the on-going Covid impact, from a budget that has not been supplemented by additional consequentials from the UK Government in the way that it was last year.

At the moment, the pressures on the Scottish budget are such that we really need the structural support for businesses to be in place—furlough and self-employment income support. If we were to find ourselves going into another lockdown—at the moment, that is not what we are discussing; we are talking about trying to maximise the impact of the baseline measures—we have no certainty that furlough would be in place or that self-employment income support would be in place. I have no certainty that there would be any additional funding in place and I am not sitting on funds right now that I could deploy to support businesses. We would need additional help from the UK Government.

There is a bit of déjà vu here from last October, when furlough was due to come to an end and we repeatedly asked for it to be extended. It was extended at the last minute, but the Scottish Government's resources are just not sufficient to help businesses to the level at which they need to be supported through furlough and self-employment income support. We would need to ask the UK Government for additional help, because funding would be required on a scale that we cannot provide in light of the need to balance and fix our budget. I cannot borrow for those emergencies that you are talking about.

John Mason: One of the subjects that we talked about quite a lot with the Scottish Fiscal Commission was inflation. The commission now seems to be following the more recent Bank of England projection of 2.5 per cent, falling from the present 4 per cent. The commission seemed reasonably relaxed about inflation, in that, if we had to pay out more, we would get more in by way of tax and so on. Are you relaxed about inflation, and is it a concern for you and for the budgets?

Kate Forbes: Yes—those matters are always a concern, in the sense that they are among the many variables that we are dealing with as we try to manage our budget. I have said already that this year's budget feels extremely challenging, because there is the need to remobilise our services, and there is the need to deal with the on-going Covid implications. There are a number of multiyear pay deals being negotiated, and we are also dealing with what is probably a more challenging outlook of funding from the UK Government, which will, we hope, publish a multiyear comprehensive spending review.

The biggest impact of inflation lies in trying to understand what our costs will be and whether there is sufficient budget to deal with those costs. This is not to sound like a broken record, but I have limited powers to increase capacity when it is needed. For example, if inflation was to rise considerably, meaning that our budget does not go as far as it needs to go, I cannot suddenly increase it. To take our capital budget and the affordable housing programme that Kenny Gibson talked about at the outset, trying to budget for that and trying to understand what the costs will be is where I am most challenged. The UK Government or any Government around the world that is dealing with fluctuating costs of that sort can make the appropriate changes either to borrowing or to other areas, but all that I can do is to cut the cake differently; I cannot increase the size of the cake to deal with increased costs.

When it comes to pay deals, workforces will be looking for adequate recompense for their labours, and there will be inflationary implications. Inflation is a very important reference for pay negotiations. If UK Government pay is flatter, we obviously do not get additional consequentials from that either.

I am sorry that that was a very long and waffly answer, but there are quite a few ways in which inflation has an impact. We are monitoring the matter carefully.

John Mason: I appreciate that. It is an important issue. I lived through a time of higher inflation some years ago, and it concerns me very much.

The SFC was also more positive about the long-term scarring effect of Covid. It had thought that the effect would be greater—it thought that the figure would be about 3 per cent of the economy, but it now says that it will be 2 per cent. Do you recognise and agree with those figures?

Kate Forbes: They are very helpful figures. For the past year, we have been in discussion with the chief economist about the long-term impacts of Covid. Probably as early as last summer, we were very much looking at a K-shaped recovery. In other words—I think that I spoke to the Finance and Constitution Committee about this—some businesses and sectors were doing comparatively well. New businesses were being created. The tech sector, for example, was obviously booming. However, other sectors were really struggling. That could have led to the SFC's figures, which suggest that there will be less long-term scarring. Some sectors will probably be dealing with that scarring for longer than others. Although the national picture might be more optimistic, some sectors of our economy will probably need help for longer and will have longer-term scarring than others. There is a different picture when we break it down sectorally.

John Mason: The SFC also made the point about different sectors recovering in different ways.

The SFC was slightly more negative about non-domestic rates. Its forecasts are lower than they were in January, showing that revenue from non-domestic rates will be £27 million lower this year, and £34 million then £48 million lower going forward. Is that inevitable? Is that just a result of Covid?

Kate Forbes: There has been an impact from Covid. We should also recognise the fact that we have maintained 100 per cent rates relief for a full year. We are tracking the situation. One reason why our guarantee to local government is so important is the fluctuations in non-domestic rates. South of the border, there has been a dip in revenue from non-domestic rates, and local government has been exposed to that, whereas there has been a guarantee that local government in Scotland will receive the income that we have confirmed.

John Mason: Finally, I want to touch on social security spending. The SFC has forecast that the adult disability payment, which is replacing PIP, is likely to cost some £500 million more. It is warning that, if we put more money into social security, it will need to be balanced out somewhere else in the budget? Is the SFC being overly pessimistic? Do you have the figures in your budgets?

Kate Forbes: I will make two points. Whether or not I agree with the SFC, the value of its forecasts is that I have to live with them. I have to live within its forecasts, particularly for revenue but also for spend. That is another area in which there are impacts from higher inflation, which goes back to your earlier question, so we are monitoring that. We will continue to provide the support that we are, quite rightly, obliged to provide for demand-led payments.

11:45

I do not want to sound like a broken record, but it is precisely because of that volatility that we need the requisite tools to manage it. After all, any demand-led payment creates a risk for the Scottish Government in managing it within our fixed and balanced budget. The SFC is right to say that I cannot increase the size of the cake, and if one slice of it is bigger than was originally intended, that increase needs to come from elsewhere in the Scottish Government. That is the level of risk and volatility that I have to manage within a balanced and fixed budget.

John Mason: I am totally in favour of having a more generous social security system than that in the UK, but it will come at a cost. No matter whether we are independent, it will, to some extent, be demand led. Is it right to say, therefore, that it will be something that will always have to be managed?

Kate Forbes: That is right. I agree that it is by nature demand led. We make a big effort to promote uptake, because we believe that it is right for people to get the help that they need, but that clearly impacts on demand and the budget. We will fund that need and demand, because it is important that, as a fair and kind society, we protect the most vulnerable.

Liz Smith: Good morning. Turning our attention back to economic growth, which we—with, perhaps, one political party exception—think is very important, I believe that, in your most recent budget speech and in your answers to some of the questions in the last parliamentary session, you said that business wants certainty and predictability in order to plan ahead and wants to know exactly where it is going. First of all, what plans does the Scottish Government have to work with the UK Government on access to cash and banking services?

Kate Forbes: I will work constructively with the UK Government on every issue of importance to the people of Scotland. On business and other support, the difficulty that we face right now is, to put it bluntly, a complete lack of clarity about what is happening. One example that has a direct impact on local areas is green ports and freeports—and I am saying this just down the road from the Port of Cromarty Firth—and our problem in that respect is not a lack of constructive engagement but the fact that we are just not getting a solution or any resolution. We, like the Welsh and Northern Irish, had been hoping for a resolution of the issue in the March budget, but it did not come. The same applies to the levelling up agenda and any funding that might come through that.

The issue is less to do with constructive engagement and nearly everything to do with a lack of clarity. A newspaper headline last week, I think, suggested that we had rejected millions of pounds, which was news to me. For the most part, there is just a complete lack of clarity or engagement. Indeed, if you have engaged with any local authorities, you will know that they find engaging with the levelling up agenda to be a bit of lottery. They do not know whether they will get money or even what the precise process is. I will engage constructively, but it helps to know precisely what is happening and not to get pulled in at the eleventh hour.

Liz Smith: Some of the schemes such as the levelling up agenda, which you have just mentioned, are extremely important and can be Government led, but many businesses in Scotland, as in the rest of the UK, are facing a cash flow problem. This is not a political question, but what discussions are happening between the two Government on improving access to cash and banking services? After all, that will be absolutely critical to the survival of many businesses in the future.

Kate Forbes: Thank you for clarifying the question. There is quite extensive engagement on the banking issue through, for example, the banking forum where we engage with the banks and the UK Government.

With regard to the nitty-gritty of how it happens, I have had quadrilateral meetings with my counterparts in Wales, Northern Ireland and the UK Government. The agenda in the latter meeting included items on access to loan funding and on what the banks were doing or not that we would like them to do. We have direct engagement with the UK Government on banking through active face-to-face conversation.

With regard to access to cash, we have made the point about extending some of the schemes that we think should be extended.

There is a general commitment to work together on supporting businesses. I think that it was the Scottish Financial Enterprise that said that businesses are facing a wall of liabilities right now, and we discussed that point at length with the Chief Secretary to the Treasury and my counterparts in the other devolved Governments in the last quadrilateral meeting.

Liz Smith: On the infrastructure angle, to which you have previously referred, good quality infrastructure is critical to economic growth and to ensuring that business has some certainty and can plan. First, could you comment on the reports that, because of the new deal between the SNP and the Greens, some of the infrastructure planning to which the SNP was previously committed might be in jeopardy? Secondly, there was a report at the weekend that some money that the Scottish Government had been offered for road improvement infrastructure had not been used. Is that correct?

Kate Forbes: On the capital point, we knowingly published our capital spending review last year before the UK Government published its spending review, which is due in the autumn. It would therefore have been the case anyway that we would have had to look at our capital spending review and our multiyear commitment to infrastructure in light of what the UK Government publishes, and that will still be the case.

Clearly, we have to factor in what capital we receive and what our commitments are, but our commitments still stand. We have not rolled back on our published commitments when it comes to capital investment, but they are subject to what capital is allocated to Scotland as part of the spending review. Do you want to come back on that point?

Liz Smith: Yes—it is interesting that you say that, because it is contrary to some of the reports that we were getting. As Cabinet Secretary for Finance and the Economy, do you feel that there is a strong commitment from the Scottish Government that the announced infrastructure projects will go ahead? Business and industry consider those commitments extremely important, particularly with regard to connectivity and accessibility.

As you know, we have had a huge fuss—nothing to do with the Scottish Government—about ScotRail's commitments to changing services, and people are anxious about the lack of connectivity and increased journey times. The projects to which the SNP had committed were trying to address some of those connectivity issues. Can you give a commitment that those projects will go ahead? They are obviously extremely important to Scotland.

Kate Forbes: They are extremely important and my commitment to them going ahead is subject to a massive issue over which I do not have control. When we published our spending review last autumn, we said that we were publishing ahead of the UK Government's spending review and basing those proposals on the best available evidence that we had at the time.

I really hope that the chancellor publishes his multiyear spending review in autumn—it still has to be multiyear, because we cannot lurch from year to year in our capital plans. What we did last year was in good faith and based on the best available evidence. When the chancellor publishes his capital review, I will look to ensure that what we are given can fund what we have committed to. We will need to ensure that there is money coming in for the amount to go out.

Liz Smith: I understand that, cabinet secretary. I am just interested in whether, if the Greens said that one price of the deal was that one aspect of the infrastructure development might not go ahead, that could jeopardise any of those projects. That would be a big concern to many people, particularly in more rural areas of Scotland.

Kate Forbes: Everything that relates to the Green deal has now been published and we have not sacrificed our commitments. The A9 is still going to be dualled, and the A96 is referred to in the co-operation agreement in terms of the priorities for the next few years. As far as I am concerned, as someone who represents a rural area, there are no consequences for the projects that I, as a local MSP, am fighting for—I usually lobby myself, which does not work very well. I am fighting for investment in local communities, and that will continue to be the case. What I am trying to say, in a roundabout way, is that what makes the biggest impact is not deals but our having the cash—the actual, hard money—to invest.

I will pause there, because I want to talk about the report about our missing out on funding, about which I was quite confused. There is an irony at the heart of a report about the UK Government, in essence, using the United Kingdom Internal Market Act 2020 to try to spend directly in areas of devolved competence, which then says that we are not engaging sufficiently. It seems ironic that, after having joined the Welsh and Northern Irish in saying that the United Kingdom Internal Market Bill was an attack on devolved competence, we are being accused of not engaging sufficiently.

Our big problem with levelling up, the unionisation of spend and so on is that we are usually kept in the dark. Occasionally we are brought into the light to be told what is happening, but that is a rare experience, as far as I am concerned.

It is really difficult to prioritise our spend when another Government is spending in devolved areas. As far as I can see, all local authorities are considering whether to bid for things such as the levelling-up fund, so there is a big question for us. For example, fair distribution is at the heart of the Convention of Scottish Local Authorities' methodology, to ensure that every local authority gets a fair share of the capital that is available, so if some areas are getting substantially more, directly from the UK Government, does that mean that we should compensate the other local authorities and give them capital that would otherwise have been shared fairly across local authorities? Where we are already spending on, for example, the key roles that were mentioned in the news report to which you referred, but some areas are now to get money directly from the UK Government, should we use the funding for other priority projects, which have not yet been funded? It is extremely difficult to determine how to use our limited capital funding as far as we can for hospital projects, roads and schools when the UK Government is making decisions about capital spend that we are not sighted on.

I think that it was David Duguid who made the comment about our missing out on money. I have certainly not rejected any money and I am not aware of ever having rejected any money. Scotland needs as much investment as possible. It seems a bit rich that we are being accused of not engaging by people who are trampling over the normal devolved processes for distributing funding.

Michelle Thomson: Cabinet secretary, your comments lead neatly to a question that I have, which concerns an alarming statement from the Fraser of Allander Institute in its report for the Economic and Social Research Council, "Designing and funding the devolved nations' policy responses to COVID-19", which you will know about. It said:

"The effect is to circumvent not only the Barnett Formula but the devolved governments themselves."

I was interested to hear you talk about the implications of spending coming in from left field. Have you given further detailed consideration to a range of scenarios in which that might have unintended and potentially undesirable consequences for your ability to control and manage your budget and your ability to deliver on your policy imperatives?

Kate Forbes: May I clarify that you are talking specifically about things like replacing EU funding and levelling up?

Michelle Thomson: Yes. I am talking about the new funding streams on levelling up, community renewal, UK shared prosperity and so on.

Kate Forbes: I think that there are three issues in that regard. The first is the lack of clarity, which I mentioned. The lack of clarity on how some schemes are operating or will operate, and on how communities, local government and others will access them, is extremely unhelpful. Even before I get into the territory of saying that the UK Government should not interfere in devolved areas, there is the fact that we are faced with trying to prioritise a lot of infrastructure projects, such as hospitals and roads, which are important to communities, as I have already said.

12:00

The lack of clarity means that some of these communities and local authorities do not know whether they will secure capital funding through these alternative routes. I can think of an example with transport infrastructure in my local authority area: the local authority is considering going after the levelling up funding and it is also lobbying us for funding. What do I do? Do I allocate that funding, not knowing whether it will get funding from an alternative source, but knowing that, if it does get funding from an alternative source, that money could be used for another community? That lack of clarity is making our financial decision-making process extremely convoluted, and it is not giving communities and local government the certainty that they need.

The other element of that lack of clarity is about fairness. Again, when it comes to local government, the point about fairness is right at the heart of the methodology. I cannot announce any schemes or funds without COSLA, telling me, rightly, that the money should be shared equally across local authority areas. If one local authority area is getting substantial additional funding through the levelling up fund, and the others are not, do I use the funding that I have to compensate the others, or do I still share it equally? Will those local authorities that have not secured funding be content with that?

The second issue, which is really important, is that, right now, it will not, in any shape or form, compensate for the loss of EU funding. The assumption that it will is totally flawed. I am speaking to you now from the Highlands—an area that has benefited disproportionately from EU funding because of its rurality, deprivation levels and transport distances. Levelling up funding and shared prosperity funding will not compensate for the loss of that EU funding. The additional complex routes to funding, where it is, in essence, a lottery, will make that even worse.

The third point is that I do not believe that that funding will be additional. In the last budget, the UK chancellor talked at length about the additional capital spend on infrastructure across the UK and, in the same breath, announced a budget for Scotland that saw our capital budget cut by 5 per cent. I posed the question—well, my counterpart in Wales posed the question—to the Chief Secretary to the Treasury, of whether all that capital will be additional or whether we will see a net decrease in our budget as it is redeployed to alternative routes. The silence has been deafening, but what we saw in last year's capital budget was that the increase in UK-wide spend saw a decrease in the Scottish Government's capital budget. That means that that money will be spent on pet projects or whatever the UK Government chooses to prioritise. There is an actual tangible impact on our capital budget, which we spend on schools, hospitals and roads.

Those are my three primary concerns: first, the convoluted process and lack of clarity are undermining the certainty with which we can make plans, leading to increased unfairness across Scotland; secondly, it is no compensation for EU funding; and thirdly, there will be an equal and opposite decrease in the Scottish Government's budget, which goes directly on hospitals, roads and so on.

Michelle Thomson: Thank you for those points. I will move on. I would like more information, which I think will be of general interest to everyone. In your letter to the committee dated 30 August—thank you for that—you mention that you plan to launch Scotland's first framework for tax. It would be helpful if you were to share what additional information you can about that. I am generally interested in the discussion about tax that we had last week.

Kate Forbes: The new framework for tax supplements the Scottish approach to taxation, and forms our framework for how we make tax policy. It invites stakeholder views on how we can better design and deliver tax policy in Scotland. The devolution of income tax and other taxes is still relatively new, and tax stakeholders continue to tell me that engagement around and understanding of devolved taxes still need to be built and developed.

The framework is trying to put more flesh on the bones of our approach to taxation. It builds on what we have said before, but views and comments from stakeholders are also being invited on how we improve the design and delivery of tax. I hope that it might also raise broader awareness of those relatively new devolved and local tax powers.

Michelle Thomson: There might well be a residual benefit in letting the larger public understand the dog's dinner of the current fiscal framework, but that is by the by.

Local government faces very similar challenges with regard to its being confident about when money will appear and so on. On the review of capital accounting, which I believe you requested and which is being led by directors of finance on behalf of local government, are you able to express any view on the extent to which the focus should be on understanding service concession flexibilities to facilitate financial planning, or do you intend to wait for the outcome of the review before local councils can get some more certainty about what flexibilities they have?

Kate Forbes: Thank you for the question, as this is an issue that local government has raised with me quite frequently.

I want to make two points, the first of which is that we are waiting for the outcome of the review to try to provide local government with certainty now. There was a request that we provide additional certainty, and I have confirmed to COSLA that I am content to do so. COSLA had raised with us the English model, in which changes can be proactively and prospectively made to capital accounting, and we are already giving an additional two-year flexibility in that respect. I have also confirmed to COSLA that I am willing to extend that further in the same vein as the English model, in which councils have additional discretion on what is the best model to use.

It is still important that we carry out the review, because there are questions to explore about what the most prudent and sustainable approach might be over the long term and how we ensure that it is consistent not just with other public bodies but with our standards, too.

Michelle Thomson: For my last question, I want to pick up on Liz Smith’s point about the debt burden on small businesses. When you have your conversations with the UK Government, could you impress on it the need to implore banks to have flexibility in certain loan schemes? There are some protections in place, such as no personal guarantees for coronavirus business interruption loan scheme loans up to a certain amount, but the fact remains that, post the 2008 recession, there was some really poor behaviour by banks, with small to medium-sized enterprises forced into very distressed circumstances and made bankrupt or sequestrated. Will you add your voice to ensuring that banks understand their obligations, particularly to the SME community?

Kate Forbes: Absolutely. Those issues have been raised with the UK Government, and I will continue to raise them. I will also raise them directly with the banks. We have a good and constructive relationship with the banks in Scotland, and I think that they have been quite helpful through this crisis. However, the real test comes now, as people face a wall of liabilities. The question is how banks will help businesses through the next few years when repayment of bounce-back loans, CBILS loans and so on will be required, as it is already being required.

Douglas Lumsden: The SFC is predicting a 17 per cent rise in revenue from non-domestic rates between 2022-23 and 2026-27. We have a revaluation next year. Given the changes to the retail and commercial sectors, for example, will that rise be achievable? A lot of businesses will be wondering where that money will come from.

Kate Forbes: I might ask whether Dougie McLaren wants to come in on non-domestic rates. To be clear, that does not indicate that there will be a 17 per cent increase in the tax rate. It refers to, I hope, the strength of the business community in terms of business survival rates and business growth. Right now, Scotland has the lowest poundage rate in the UK, which means that we are delivering a lower tax on more than 95 per cent of properties.

Over the next few years, we must ensure that we continue to provide certainty to businesses and allow them the headroom to recover. That was the reason why, this year, we extended the 100 per cent rates relief. Knowing that they will not be paying non-domestic rates will, I hope, allow businesses to recover and use the funding that they would have otherwise been paying in tax to invest in their businesses or to see them through the rest of the challenges that we face.

I know that there was a lot of discussion about the revaluation. One of my primary reasons for scheduling the revaluation for when we have is to allow the impact of the pandemic to be seen in rental values. I know that the north-east has a particular reason for wanting the revaluation to be earlier rather than later, in the light of the big economic challenges that it faces, but the reason for my decision is to ensure that rental values have filtered down and that the revaluation is fair. Going for a revaluation too soon could have meant that the rental values had not changed. For example, people were waiting until after the pandemic to rewrite their tenancy agreements. My hope is that, after the next revaluation, the rateable values will take into account and reflect the impact of the pandemic, so a fairer amount in taxation will be paid.

I am happy to take any follow-up questions on that. That probably covers it—Dougie McLaren does not need to come in unless he really wants to.

Douglas Lumsden: I have a question about the NDR pool, which now stands at a deficit of £192 million. What impact will that have on businesses as we move forward through the pandemic? I guess that the money will have to be repaid back into the pool.

Kate Forbes: It is good to have a question on the non-domestic rates pool, which probably reflects your wealth of experience as a local councillor. The non-domestic rates pool should not have a direct impact on businesses; it is our way of managing the risks to public finances from non-domestic rates. We have had previous conversations on the matter, so you will know that, in relation to local government spend, we guarantee the amount of revenue from non-domestic rates that local authorities receive. In some years, that means that you and others in the north-east say that that is not fair. In other years, such as those during the pandemic, it means that local authorities can budget with certainty and security.

We manage potential fluctuations in revenue from non-domestic rates from year to year through the pool. It will not have an impact on business, and it does not influence or inform my view on what rate of taxation to implement. My interest is in ensuring that Scotland is as competitive as possible in relation to the poundage. Our non-domestic rates pool is just our means of balancing the account from year to year.

Douglas Lumsden: I imagine that, to balance it and pay off the £192 million deficit, the intake will have to increase.

Kate Forbes: It is a case of reconciling forecasts with outturn. At the beginning of the year, the SFC will forecast what it thinks we will receive in non-domestic rates. We plan what we will spend on public services on the basis of that forecast, but forecasts are just forecasts. The outturn—the amount that we receive in non-domestic rates—could be higher or lower. It is a balancing account, so we need to manage it and ensure that we can meet our commitment to spend £X million on the health service, for example. At the end of the day, it is just a forecast on which we base our budget, not the actual amount of tax take.

12:15

Douglas Lumsden: If the estimate has been wrong for the past three years, how confident are you that it will be right for the next four years?

Kate Forbes: I am fairly confident, in that the SFC is good at its job, but this is clearly a time of huge uncertainty. Earlier, Daniel Johnson asked about whether other issues—such as a further lockdown, for example—need to be factored in. There are a lot of uncertainties right now in relation to the performance of our economy, and that clearly has an impact on tax take. Two years ago, I could not have foreseen that we would be implementing a full year of non-domestic rates relief at 100 per cent. There is quite a lot of volatility right now.

The SFC and others are very good at their jobs, and they produce the best forecasts that they can. I cannot deviate from the SFC's forecast—I must spend within it, whether I think it is right or wrong. However, from year to year, the forecast will be out. No forecast is perfectly and completely aligned with the outturn, so there will be some addition or reduction.

I am happy to bring in Dougie McLaren if he wants to come in, but that probably—I hope—answers your question. The forecast will never be exactly right, but I have confidence that the SFC knows what it is doing.

Douglas McLaren (Scottish Government): I have nothing much to add. If I have understood Mr Lumsden's question correctly, we have a shared understanding of the non-domestic rates pool. The forecast is just that—it will never be exactly right. Given that it is a balancing account from year to year, the end-year pool will be either in deficit or in surplus from year to year, and we try to balance it from year to year.

Douglas Lumsden: The SNP-Green deal was mentioned earlier. Cabinet secretary, do you see any consequences for the oil and gas industry as a result of the proposed deal? I know that a lot of people in the north-east in particular are very nervous about it, especially when we hear a future member of the Government saying that, if you work in oil and gas, you should be looking for a new job. That does not inspire confidence going forward. What is your view on whether people's jobs in the oil and gas industry are safe? It is still a big piece of the Scottish economy.

Kate Forbes: Workers in the oil and gas industry have some of the most critical skills that our economy needs over the coming years. My commitment is to ensure that they have access to skilled work that reflects their talents and capabilities.

Around the world, every society and every Government is grappling with what a just transition looks like. In my view, a just transition means a fair transition in which we do not leave people behind. Right now, there are huge opportunities on the horizon as part of that just transition, including in renewables.

The oil and gas industry is already grappling with the issue. Irrespective of what I say or my Government says, we have seen 18 months of a global reduction in demand, which has led to a lot of people—including those in the wider supply chain, in which Douglas Lumsden will be more well versed than I am—being concerned about their jobs and what their future holds.

The Government's job is to try to provide certainty by looking at how we diversify the economy, which has been impacted by issues that are outside our control. Nobody could have foreseen Covid or, perhaps, the renewed and intense focus on the climate emergency. Our job is to ensure that every individual who is working in oil and gas right now, with some of the most important skills internationally, continues to be able to use those skills in a meaningful and secure job. In so doing, we will ensure that the north-east continues to be a vitally important contributor to the national Scottish economy.

Douglas Lumsden: It was mentioned earlier that the social security bill was going to rise from £3.7 billion to £5.2 billion, and that is without adding in some of the SNP manifesto pledges. Does that rate of increase in a relatively short space of time concern you?

Kate Forbes: Trying to ensure that we have sufficient budget for commitments is clearly an issue that dominates my attention. Social security is no different. We must try to ensure that we are cutting the cake of funding in a way that is fair.

I do not think that anybody could disagree that, as we emerge from the pandemic, some individuals and sections of society have been more exposed to its impact than others. Inequalities have been exacerbated.

Just as my job is to try to help businesses through this tumultuous time and give them the support that they need, in the same spirit, helping families through is one of the reasons why we wanted to help local government to freeze council tax and ensure that there was more money in people's pockets. Clearly, the social security system must help people who need help, when they need it, with a view to helping them to get back on their feet or at least to tackling child poverty.

It is not a concern, in that it is important to do, but we ultimately need to ensure that the funding is in place. When it comes to the budget—I am sure that I will be in front of the committee again in the not-too-distant future to talk about it—we have choices about what to prioritise. We cannot create new money, so what do we prioritise within the budget that we have?

The Convener: I thank members of the committee.

I have a couple of questions to wind up with. One relates to capital budget. Raw material prices are growing by between 5 and 15 per cent a year. You said that the agreement with the Greens would not threaten the delivery of Scotland's capital projects that are already committed to but, clearly, if there is significant pressure on the capital budget because of inflation, that may make it more difficult to deliver some of those projects. What discussions have you had with the UK Government regarding an uplift to the Scottish Government's capital programme budget?

Kate Forbes: I regularly engage with the UK Government, and I firmly believe that one of the most powerful levers that we have when it comes to economic recovery is capital investment in infrastructure. It creates jobs, it supports businesses and it is good for our local communities. It is a triple win as far as I am concerned.

Our primary source of funding is the UK Government. That is the primary means by which I am trying to secure additional capital, and capital is now one of the areas of greatest risk when we look at the future, because of the unionisation of spend under the United Kingdom Internal Market Act 2020. It is an area on which I continue to press for additional security and certainty, with a plea that we invest in infrastructure over the coming years as a way of recovering well and recovering better.

The Convener: I asked a question about the possibility of deferred funding, and members asked about the impacts on a number of areas of the Scottish budget. You talked about how difficult it was, as did members, with additional funding coming in at a time when local authorities were agreeing their own budgets and the council tax settlement was being agreed. Should we get into that situation—I hope that we do not, because I hope that the UK Government will do as it has done previously and agree a carry-over if necessary—do you have any shovel-ready projects available that would allow you to provide additional support to businesses or other areas of the economy, so that that money is used effectively?

Kate Forbes: The short answer is yes, but the way we budget involves trying to get a sense for the full year. What we do not want for the budget is to spend and then have to save, save, save and get more money at the last minute because money is suddenly getting cut. That is an ineffective way of budgeting, so my team and I manage the year's budget by trying to get a sense from every portfolio of what they want to achieve. Most of these projects are not just for one year; they are multiyear projects. Building a new hospital is multiyear. You cannot just turn on the tap for two months and hope that that delivers a project. We try to manage that demand over a longer period, because very few projects can be delivered with, for example, just a month's extra funding in one year.

The key is being able to carry forward and being able to manage our money over several years. Having that arbitrary break at the end of the financial year and not being allowed to carry capital forward leads to very ineffective budgeting, because it causes you to spend an amount in one month that should be spent over several months in the next financial year.

The Convener: That allows me to neatly segue to your letter to the committee of 8 July, in which you indicated that the Scottish Government had started work

"to support a potential multi-year Resource Spending Review concluding in the autumn."

Where are we with that now? Is it on schedule, and will it be informed by the fiscal framework?

Kate Forbes: Yes and no, but the most important ingredient is the UK Government's spending review. Last year, as I said, we proceeded with a capital spending review even though we did not have a capital spending review from the UK Government. There is a lot of inherent risk in that, because the UK Government is our primary source of funding.

When it comes to our own resource spending review, we are undertaking internal work right now to develop a sustainable, multiyear financial plan. I know that it is of great importance to local government as well as other bodies, including the NHS, to be able to plan on a multiyear basis, instead of lurching from year to year. For example, third sector organisations often want multiyear commitments from local authorities and cannot get them.

That internal work is on-going. We have not taken a final view on a publication timeline, because so much depends on whether the UK Government publishes its own comprehensive spending review in the autumn. Once we have more clarity on that, I will fulfil our commitment to set out a framework in advance of a spending review and to engage with the committee, as well as stakeholders more widely, to inform that final document.

The Convener: The committee received a letter from you earlier this morning regarding a number of matters. The letter's heading is "Process and timetable around Scottish Budget 2022-23". In it, you touch on the delayed medium-term financial strategy and say:

> "There is logic for publishing the MTFS alongside the Scottish Budget and thereby basing it on the updated SFC and OBR forecasts. Publishing it before the OBR October forecasts would mean having to use OBR forecasts from March, the effect of which would be to give a misleading sense of the fiscal outlook."

When I raised the matter with Scottish Fiscal Commission representatives, they agreed with that.

Where are we in terms of the MTFS? Are we going to see it alongside the budget? Can you give us any further thoughts on the timing of the budget, given all the stramash that you outlined in your letter regarding the difficulty of not having confirmed timings for UK fiscal events?

Kate Forbes: I will start with the MTFS and then move on to the wider subject of the timetable. The original intention would have been to publish in May, but that was not possible, due to the election. I am interested in the committee's view on that. There is on-going uncertainty because of the UK Government's plan for a spending review. That spending review would be very helpful to inform our medium-term financial strategy. If we have it, we will be forecasting not on the basis of the best available evidence but on the latest data from the UK Government.

I think that there are no perfect timing options, given that the MTFS could not be published in May. It does not make sense to publish it in advance of the OBR forecasts. If OBR forecasts are published on 26 October or we have the promised UK spending review, it would be quite misleading to rely on OBR forecasts from the previous March. There continues to be a lot of movement in our economic and fiscal outlook, so block grant adjustments that were based on March forecasts would significantly overstate our budget.

12:30

That is the territory that I am in just now. I am happy to take the committee's view on how we can spread out scrutiny of the budget, the MTFS and the resource spending review in a way that allows you to give the budget the appropriate attention that it needs, and I would be open to your views on how I can best work with the committee on that. I would intend, certainly for the 2022 MTFS, to revert back to its previous publication timetable in May, in line with the written agreement.

I hope that I have given you enough information without concluding a position right now, and you can perhaps take a view on that.

On the budget timetable, we have obviously had two years of significantly delayed budgets. There is no perfect time. If the UK Government publishes its budget first, we have the best available evidence that we need but, if there are any delays to the UK Government's budget, we are left in a position of choosing whether to take inadequate and inaccurate information and base a budget on that in order to give security and certainty to businesses and local government, or to wait, increasing the delay of giving that certainty to local government but having the best available evidence. I would very much like to revert this year to what we did formerly, which would be to consider a budget in late autumn.

The Convener: You mention in your letter that

> "the Chancellor has publicly asked the Office for Budget Responsibility to produce forecasts on 27 October".

Does that mean that you believe there is likely to be a budget in mid-November or soon after?

Kate Forbes: That would be my hope, but we really need the UK Government and the chancellor to confirm that. Until he confirms that, I am working off hints, suggestions and indications, rather than anything more concrete.

The Convener: We will certainly deliberate on that in our next private session, which is about to start in a few minutes, when we consider our work programme.

I thank both our guests today, particularly the cabinet secretary for answering so many questions in such depth, particularly after a session at the Local Government, Housing and Planning Committee. I realise that it has been a very heavy morning for you, so I hope you will have a wee break now before the rest of the day's proceedings.

12:33

Meeting continued in private until 12:47.

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