



OFFICIAL REPORT
AITHISG OIFIGEIL

DRAFT

Finance and Public Administration Committee

Tuesday 19 September 2023

Session 6



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Tuesday 19 September 2023

CONTENTS

| | |
|--|---------------|
| SUSTAINABILITY OF SCOTLAND'S FINANCES | Col. 1 |
|--|---------------|

FINANCE AND PUBLIC ADMINISTRATION COMMITTEE
23rd Meeting 2023, Session 6

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*Michael Marra (North East Scotland) (Lab)

COMMITTEE MEMBERS

- *Ross Greer (West Scotland) (Green)
- *Jamie Halcro Johnston (Highlands and Islands) (Con)
- *John Mason (Glasgow Shettleston) (SNP)
- *Liz Smith (Mid Scotland and Fife) (Con)
- *Michelle Thomson (Falkirk East) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

- Professor David Bell (University of Stirling)
- Ruth Boyle (Poverty Alliance)
- Stuart Hay (Living Streets Scotland)
- Professor David Heald (University of Glasgow)
- Michael Kellet (Public Health Scotland)
- Alastair Sim (Universities Scotland)
- João Sousa (Fraser of Allander Institute)
- Adam Stachura (Age Scotland)
- Dr Judith Turbyne (Children In Scotland)
- Philip Whyte (Institute for Public Policy Research Scotland)

CLERK TO THE COMMITTEE

Joanne McNaughton

LOCATION

The Robert Burns Room (CR5)

Scottish Parliament

Finance and Public Administration Committee

Tuesday 19 September 2023

[The Convener opened the meeting at 09:30]

Sustainability of Scotland's Finances

The Convener (Kenneth Gibson): Good morning, and welcome to the 23rd meeting in 2023 of the Finance and Public Administration Committee. We have one public item on the agenda, which is to take evidence on the sustainability of Scotland's finances from two panels of witnesses as part of our pre-budget scrutiny this year. I welcome the first panel: João Sousa, deputy director of the Fraser of Allander Institute; Professor David Heald, emeritus professor and honorary senior research fellow at the University of Glasgow's Adam Smith business school; and Professor David Bell, professor of economics at the University of Stirling.

I intend to allow up to 75 minutes for the session. If you want to be brought into the discussion to respond to a question that has been directed to a specific witness, please indicate to the clerks and I can bring you in.

We have the witnesses' excellent submissions, so we will go straight to questions. João Sousa, in your submission, you say:

"The Medium-Term Financial Strategy ... highlighted a large funding gap, of £1 billion in 2024-25 and close to £2 billion by 2027-28. The 2024-25 and future budgets will need to include realistic assumptions on spending commitments given the available level of funding and be clear about prioritisation decisions, as well as realistic policy on tax."

What do you consider to be "realistic assumptions"?

João Sousa (Fraser of Allander Institute): I was highlighting that, given the constraints of the fiscal framework that the Scottish Government must operate under, it cannot have a gap in funding as large as is currently planned. There will have to be discussions and decisions made about whether there will be increases in tax, reductions in spending or prioritisation across different programmes. Clearly, it will be possible to raise revenues, should the Scottish Government wish to do so, but there are limitations to how much revenue can be raised. For example, there was a proposal to raise income tax by introducing a new band between the higher rate and the additional

rate, or top rate, with a 2p rise, but we highlight that that would only go a limited way towards filling the gap that is currently forecast.

It is worth saying that the gap that was projected in the medium-term financial strategy is likely to be lower now, because the income tax reconciliation has come in lower than the Scottish Fiscal Commission had anticipated at that time. In addition, as a result of the fiscal framework review, the Scottish Government has more borrowing powers for day-to-day spending than it did before.

There was some talk about filling some of the gap with things such as wealth taxes, but we highlight that introducing new taxes is challenging not only given the devolution framework but because the process of introducing a new tax is quite long. Time is required to be spent on designing the tax, consulting on its implementation and preparing the implementation and collection mechanisms. It is unlikely that a new tax would help the Scottish Government's financial position in 2024-25, because it is highly unlikely that all that would be able to be done by the time the new financial year rolls around.

The Convener: That is very helpful. You have touched on wealth taxes, which I wanted to ask about next. We will be taking evidence in a round-table meeting straight after this session, and we will be speaking to the witnesses about that issue, because a number of them have suggested that, over a relatively short time, wealth taxes could raise quite substantial sums of money, if not in the current financial year then in financial year 2025-26. What is your view on that?

João Sousa: If a wealth tax was to be created, there would need to be careful consideration of what to levy it on, how to institute the collection mechanism and what kind of assessment there would be. Would the tax be assessed like property taxes are at the moment, or would it be self-assessed? All that would take a long time to implement. When you think about how long it takes HM Revenue and Customs or Revenue Scotland to introduce a new tax and get all the collection mechanisms in place, you see that it is quite hard.

You might remember that, when the United Kingdom Government tried to implement the health and social care levy, it had to implement it as a national insurance levy first. The levy was never put in place, but, at the time, it was to be collected through national insurance because it took such a long time to get the health and social care levy in the system. If Revenue Scotland were to implement such a tax, there would be a question about whether it would have the budget for it to be implemented. It is unlikely that substantial amounts of revenue could be raised

immediately, because it would take a long time for the administrative processes to be put in place.

The Convener: Professor Heald, you said that you

“do not accept that the Scottish Government has prioritised economic growth or has demonstrated a strategic approach to tax.”

Given your expertise in the area, what do you think the Government should or could do differently?

Professor David Heald (University of Glasgow): While I was waiting to come into the room, I was given a copy of a diagram that—

The Convener: Thrusting economists.

Professor Heald: —I had prepared. For a very long time—since the 1970s—I have been an advocate for devolved taxes. However, the UK tax system is a total mess, and the Scottish Parliament has made the tax system in Scotland worse.

We are in a nonsensical position. We have a big peak at the higher-rate threshold, because the higher-rate threshold in Scotland is different from that in the rest of the UK. The national insurance threshold operates at the UK level, not the Scottish level, so people in Scotland pay the higher rate of national insurance, whereas England has gone to the 2 per cent rate. We are also in the strange position whereby an emergency measure that Alistair Darling introduced—he started the withdrawal of personal allowances at the threshold of £100,000—remains in place and produces another peak. We have two peaks in the marginal rate threshold—one relates to national insurance and the other relates to the withdrawal of personal allowance. That is complicated.

The diagram that I mentioned makes the point about income tax being separate taxation. In the 1980s, there was a major issue about whether people who were married would be taxed separately or independently. We are in a position whereby the tax system operates on individuals but the benefits system operates on households. We are in a strange position in which a household with one income could very quickly hit the threshold at which child benefit is withdrawn, whereas a household with two incomes could have a much larger combined income but might not hit it.

The Convener: That is the UK scenario whereby someone on £51,000 a year loses child benefit, but two people who earn £49,000 a year continue to get it.

Professor Heald: They do not completely lose child benefit. There is a phased withdrawal. They hit the phased withdrawal period.

The Convener: Yes—they start to lose it at £50,000.

Professor Heald: That is why we get the peak, because, eventually, all the child benefit and all the personal allowance is lost. That is not strategic. The Scottish Parliament is constrained by what the UK Government does, but we have not been agile in trying to make the system work.

A very important technical point is that, when it comes to incentives, it is the marginal rates that matter. We will get into a position whereby national health service consultants and senior scientists will start negotiating with their employers for net pay, in the same way as footballers and football managers already do. We have to be very careful. A rule of thumb that I noticed some time ago is that about 5 per cent of income tax payers in Scotland—I should say that instead of “Scottish income tax payers”, because the money does not all go to the Scottish Government—contribute 40 per cent of income tax revenues. That is the figure in HMRC’s published data. We have to be very careful about how we treat that group, because, if we teach public sector professionals about tax avoidance, we will have a serious problem.

The Convener: The reason why I am labouring the point a wee bit—that said, I have asked only two or three questions so far, but the answers have been excellent and very interesting, and they lead to many other questions—is that there is so much pressure on the Scottish Government to increase taxation. Later, we will speak to the Poverty Alliance, which is a coalition of many organisations, all of which have talked about increasing benefits, introducing wealth taxes and putting up the higher and upper rates of tax. What would the impact of that be on behavioural change and on economic growth?

Professor Heald: I will try to unpack your question. At the time of the Smith commission, there was broad cross-party consensus on devolving some social security benefits. We are now in a position whereby the Scottish Fiscal Commission thinks that, by 2027-28, Scottish social security benefits will cost £1.4 billion more than the Scottish Government gets in positive block grant adjustments. The problem is that that means that the Scottish Government, which has a largely fixed budget, has to divert money from core public services such as health, education and local government—local government clearly faces a very serious crisis—to pay for what the Northern Irish call “super-parity spending”. I really worry about that. The people whom others are trying to help through progressive taxation policies are the very people who depend on public services more.

People on lower incomes have fewer options to use private sector services if public services are not working. That is a very serious issue.

There is also an important technical point. In England, social security spend is annually managed expenditure. It is recognised that you cannot necessarily predict that very well, so, once the benefit level is set and agreed, the Treasury covers any overspend. In Scotland, because of the way that the system works, it becomes part of the Scottish budget, as part of the departmental expenditure limit. That makes the Scottish budget much more difficult to manage.

The issue for the UK is that the current position is not fiscally sustainable. We cannot afford the present package of public services from the present package of taxes, so something has to give. Scotland has the same problem, because it is locked into UK policies, which affect what comes down the Barnett pipeline. We know that there is a problem, because there are big demographic drivers behind the Office for Budget Responsibility forecasts and the Scottish Fiscal Commission forecasts, but there is paralysis. One can either try to do something now or wait for the cliff edge, at which point there will be complete panic.

On your point about economic growth, I do not regard industrial subsidies as necessarily the way to improve economic growth. The Scottish Government has to make public services and infrastructure work better. One issue that commonly comes up in evidence is the lack of multiyear budgeting. To some extent, that is outside the Scottish Government's control, but it is a very serious problem.

09:45

Furthermore, whenever the UK has a problem with its public finances, it cuts capital spending, and, because there is separate control of capital DEL and resource DEL, that problem is passed on to the Scottish Government. That is one of the reasons why the UK is bad at delivering infrastructure. If we want successful private sector delivery of capital investment in infrastructure, private firms need to have a reasonably steady flow of work. When there are erratic jumps and then collapses in capital expenditure, capacity is lost.

There is another problem in that local government and health services in the public sector are also affected, because clients lose the capacity to be intelligent with capital expenditure. Without enumerating the various disasters that Scotland—

The Convener: I was going to ask you about capital expenditure. I do not like to interrupt you in

free flow, but I also asked about behavioural change. For example, what would the impact on people be if the Scottish Government decided that, because, politically, it would be very difficult to cut spending or whatever, it would have to hit the 1 or 2 per cent of the highest taxpayers? You talked about people who are just over the threshold of the higher marginal rate. What impact would it have on them?

Professor Heald: It is difficult to know what the behavioural effects would be. I point you to the Scottish Fiscal Commission, which reckons that, for 2023-24—the first year of the changes—decreasing the top-rate threshold to £125,000 would gain £33 million if there was static costing, which means that nobody behaves any differently. If there was behavioural costing, the gain would be £8 million. If the top rate went to 47 per cent, the figure would be £32 million with static costing and £3 million with behavioural costing—90 per cent of the revenue would be lost.

I have read the evidence that has been submitted to the committee, and I do not think that there are any easy sources for higher tax. If you want to bring in more income tax, you have to hit the basic rate. There is not much more scope. We will find out in due course whether the Scottish Fiscal Commission is being too pessimistic, but that, of course, is what determines what is available to be spent, because of the way in which the fiscal framework works.

The Convener: Professor Bell, you have been very patient, and I know that João Sousa wants to come back in. I also want to be able to give my colleagues an opportunity to ask questions. However, I am a bit miffed that I have asked only three or four of the 25 questions that I had written down to ask.

In your submission, Professor Bell, you mention the following:

“the outlook remains difficult, with funding for day-to-day non-benefit spending set to be almost 2% lower in 2027-28 than in 2022-23. This is despite forecasts for a significant increase in net revenues from Scotland's devolved income tax revenues over the next few years: if this did not materialise, the reduction could be closer to 5% over the same period.”

Will you talk about that? We have already talked about tax, but how do you feel the Scottish Government could adjust its taxation policies to be more “strategic”, as Professor Heald put it?

Professor David Bell (University of Stirling): That presents the strategic approach. This question that occurred to me was: overall, do you really want to tax work? If one of your top strategies is to get to net zero, for example, why are you not taxing carbon? That is a general point that one might make if one were thinking about taking a strategic approach to taxation.

We are where we are; as the other witnesses have said, the UK system is a mess, and Scotland has added to it. It seems to me that there is further potential to confuse things. The introduction of a wealth tax, for example, would take a lot of time and probably require co-operation with the UK Government, given that a large part of people's wealth holdings will be financial assets, and where those are held will presumably matter, as far as the way in which they are going to be taxed is concerned.

The Convener: Will that be impacted by the United Kingdom Internal Market Act 2020?

Professor Bell: It might be, and it is an interesting possibility. However, I think that there would also be informational requirements on HMRC to be put in place. That might require the UK Government to go along with it, so I imagine that it would create a difficulty.

When we were talking about the length of time that it would take to implement a wealth tax, what crossed my mind was that it took us about six years to implement social security in Scotland. The social security measures that we have introduced are very complex, and a wealth tax is not a simple tax. In most countries, there is a lot of avoidance. The only place where it seems to work is Switzerland, but, in other places, it is largely regarded as not being a very significant potential source of revenue.

Coming back to economic growth, I think that you have to bear in mind that if Scotland does end up with higher tax rates than other parts of the UK, that will be seized upon by those other parts of the UK whenever potential inward investment opportunities arise in an attempt to ensure that they do not come to Scotland but go instead to their regions, wherever they happen to be. Whether such taxes are significant and would ultimately deter people once they are here is another matter, but the impression that is given, not just the tax rates themselves, matters quite a lot, too.

The Convener: Yes, because of the message that is being sent.

In your submission, you have said:

"tax increases are likely to be unpopular and possibly counter productive and ... funding reductions to other spending priorities are likely to be valued more by the electorate than the gains resulting from the introduction of the new policy—this is so-called 'loss aversion'".

I find that quite interesting. I have talked about that a number of times in committee with regard to council tax reform: the people who gain will just shrug their shoulders, but the people who lose will be less than chuffed. In fact, the consultation on council tax closes tomorrow, and no one has contacted me to say, "This is great", but I have

had plenty of people tell me that they are not too chuffed about it. Perhaps you can say something about that, Professor Bell, and then I will let João Sousa in.

Professor Bell: That is the danger of entering into commitments that have medium or long-term implications and then feeling that it is not possible to stop them, because of the danger of the associated bad publicity that comes once something stops being funded.

We have drifted into a position where what has happened in some key parts of our public sector systems, such as local government, has not been significantly noticed by those who set the budget. Local government is pretty much in severe difficulty, and other programmes have started and continued to grow. As I point out in my paper, health is an area in which spending has been growing consistently over the piece, but you end up in a situation in which there are constant additional demands for cash and a requirement to continue the programmes that have already started. There needs to be a clear strategy and an understanding that funding that starts does not always continue forever. Unless you have that kind of understanding, you end up with loss aversion—that is, with people deeply unhappy about the fact that their particular spending programme has been stopped when everyone thinks that such programmes are the most important things since sliced bread.

The Convener: That loss aversion makes Governments nervous about making radical change.

João Sousa: Coming back to what Professor Heald was saying about behavioural change, I think that the Scottish Government has to take into account the fact that Scottish income tax is not the same thing as income tax in Scotland. Because it is on only non-saving, non-dividend income, you will find that, at higher income levels, you are more likely to get people who can change the way that they get paid.

The graph that we were talking about takes only labour income into account. If you can pay yourself in dividends, say, the calculation between the marginal rate that you pay at different levels of income could be very different. You could end up in a position where, if you hike the rate a lot for people who can shift the way that they get paid, more income will go to the UK Government, not to the Scottish Government.

The Convener: I have a few other things that I would like to ask about, but I want to let colleagues in, so I am just going to ask one more question, which is on an issue that we have not touched on yet: transparency.

João, I will stick with you. You said in your response that

“A more forthcoming approach from the Scottish Government to the publication of financial memoranda for the Committee’s scrutiny”

would be an improvement. I wonder whether you can talk about that, as that clearly has a direct impact on the committee’s work.

João Sousa: It is really important for those documents to be presented in good time. I know that the committee has had some back and forth with ministers about being able to access them. It is important for everyone to know the consequences of legislation when it comes out—and, indeed, when it is announced, too. One thing that generally works well is to present costings when you announce something instead of waiting until the legislation is being passed. It is not necessarily the same thing.

The Convener: Thanks.

Professor Heald, you have said:

“budget documentation should set out clearly the additional cost of ‘above-parity’ expenditure and the reduced costs from ‘below-parity’ expenditure.”

Would you like to touch on that?

Professor Heald: It comes back to my earlier point that, given the very constrained total budget, if Scotland has services or things that it provides that are not provided in England, there are no Barnett consequentials to fund them. That means that, as I pointed out with regard to social security spend, the problem is that that reduces the amount of funding available for core public services. People think that the Scottish public are getting benefits from the Scottish Government that the English public do not get, and that is true, but those extra benefits, whether they be social security benefits or free university tuition, are being funded out of money that might otherwise have been used for local government, health and education. That is what seriously worries me.

A technical point about the social security spend is that it is very difficult politically for Scotland to be less generous than the English. Every time that Scotland has the power over social security, there will be pressure for Scotland to show how much more generous it is. However, that further erodes the funding available for core public services.

Coming back to the convener’s point about the council tax consultation, I point out that that consultation is looking to raise another £176 million before any compensation for low-income households in highly rated properties or for councils that do not get any more money. It is ludicrous, given the fact that the issue is fully devolved, that we are still using 1991 house prices as the basis for council tax. I am strongly in favour

of a residential property tax, but one discredits the principle that it is a useful mechanism for funding local government by using 1991 values. It just brings the system into total disrepute. If I lived in Ardrossan, I would be somewhat upset that house prices in Ardrossan, and the west of Scotland generally, have gone down relative to those in the east of Scotland.

10:00

From a study that it has done in England, the Institute for Fiscal Studies reckons that 50 per cent of English properties are in the wrong council tax band. It cannot do the same work for Scotland, because of data availability problems. It would be very beneficial if the committee could look into why it is not possible to replicate that work for Scotland.

If people are in the wrong band—some will be in too high a band and some will be in too low a band, compared with current values—it discredits the system, so my personal view is that I am in favour of a revaluation. I would be in favour of thinking about what the multiplier should be between band D and the higher band, but you cannot sensibly do that on the basis of antique valuations.

The Convener: Yes, I do think that this goes back to loss aversion, to be perfectly honest. Whatever the Scottish Government would do on that would be attacked from all sides. Indeed, our predecessors—and the Government south of the border—have not exactly run to change it.

Professor Heald: But it is worrying.

The Convener: Of course it is. I think that we have already said that.

Professor Heald: It is worrying that we wanted a Scottish Parliament and this to be a core part of devolved functions, because if we cannot properly manage and run our own local tax system, which has long been run in Scotland—it was run by the Scottish Office before devolution—it does not give any great credibility to Scotland when it asks for more tax powers.

The Convener: I think that the issue is the Government’s survivability if it were to implement this across the board, given the ferocious onslaught that would come from all sides. That is just the political reality. In my view, the economic reality is different from the political reality. I think that we would all agree with the economic reality.

David, my last question is on transparency with regard to mitigations. The Scottish Government mitigates a lot of UK taxes; in fact, some of the witnesses who will follow this session are suggesting yet more areas where the UK Government has reduced expenditure or where

more expenditure should be given. What do you think that we should do to make the mitigations more transparent?

Professor Heald: By “mitigations”, do you mean—

The Convener: I am sorry—I was asking that question to Professor Bell.

Professor Bell: Can I ask the same question?

The Convener: I am sorry—I said “David”, and you are both called David. I forgot—apologies. There is a plethora of Davids in the economics world.

Professor Bell: I want to ask the same question that David Heald was going to ask. What exactly do you mean by “mitigations”?

The Convener: The obvious one is the additional room supplement or bedroom tax. The Scottish Government has been mitigating that for years, but I do not see much transparency in that respect. That is just one thing that it is mitigating. What should it do to try to make that sort of thing more transparent in the budget?

Professor Bell: David Heald is absolutely right. A strong case can be made that the changes in support for people on lower incomes are justified, but there is necessarily a cost, and that cost should be made clear in the budget documents and, indeed, all Government communications.

It seems to me that we need to understand broadly the share of spending that is going to key areas such as health, education, social security as well as the share that is going to capital spending. That kind of message and the trajectories that those shares have taken, and will take in the future, are not clear to Parliament and to Scottish society more generally. It came as quite a shock to me to note that, on current trends, health will be accounting for more than half the budget in a relatively short period of time. Even if people are not into the weeds of public spending, those generalities with regard to the movements of our main spending areas are the sort of thing that needs to be put across very transparently.

John Mason (Glasgow Shettleston) (SNP): We have not really mentioned the fiscal framework, and the fact that it was agreed very rapidly, which was somewhat to the committee’s surprise because we expected a long, drawn-out battle. Was it agreed too hastily, Professor Bell?

Professor Bell: I have to say that it came as a surprise to me that we were told that the framework had been agreed on the day on which our report was published. We expected much longer discussion. Clearly, discussion had gone on in the background. Our report was held back for five months after it had been completed, and then,

all of a sudden, all the announcements came out together. It is an incredibly complex area; as you know, if you are not called David, you cannot understand it.

The mechanism that was selected for setting the BGAs is probably as good an outcome as Scotland could have hoped for. There have been some increases in borrowing powers, but not massively so. I suspect that that was the trade-off that was being argued about, in the background, between the Scottish Government on the one hand and the Treasury on the other. We are where we are. As I point out in my paper, we could be considerably worse off.

John Mason: I note that your paper states that the index per capita method is better than the comparable model, but are we not still left competing with England—specifically, with London and the south-east of England, which dominates the English economy—and, therefore, are we not permanently at a disadvantage?

Professor Bell: As far as the report was concerned, the rules of engagement were that we took the current broad structure as given, then we argued between the comparable method and the index per capita method. We did not look at the option of going down the Welsh route, for example. It is true that, for most of the BGAs, it is either tax revenues or social security spending in England as a whole that will matter.

One can go into very finely-grained detail about what risks are appropriate to run. There is no manual that says, “Well, this is how it should be”. What you are saying is correct. The way in which the framework has been reformulated does not significantly change anything. That broad framework, in which the comparator is England, will continue.

João Sousa: The fact is that the block adjustments are linked to England, including London. The weight that London has on the economy is significant, but it is difficult to think about what could very easily be done otherwise without changing the whole framework significantly.

Professor Heald: My personal view was that keeping the per capita index method was crucial, so that is a success. I would like to have seen more borrowing powers, both for capital and for resource, but I can see that there was a trade-off. When the fiscal framework was originally introduced, the Treasury refused to accept the fact that the fallback method was the index method. It is a positive gain that that is now the established method.

John Mason: We have heard from various places that we need a better public understanding of how budgets work. We have discussed

whether, in the longer term, we should have more taxes and more spend or fewer taxes and less spend. We get the impression that in other countries—correct me if I am wrong, but I am thinking about the Nordic countries—there is a public debate on that and public agreement that they want higher taxes and better public services. Do you think that it is possible to have that debate in Scotland or the UK, Professor Bell?

Professor Bell: You will recall that we had a citizens assembly way back in pre-Covid times. I remember that David Phillips and I spoke at that. That mechanism seemed to lead to a better understanding of the way in which the finances work, at least among the members of that assembly. As I and the other members of this panel have implied, it is incredibly complex, but some general principles can be got across. One to one with citizens, it is possible to convey the key messages but, when they are filtered through the media, the kind of discussion that we are currently having will not generally make the headlines, will not sell more papers and will not get more views.

John Mason: Okay. That is very pessimistic.

João Sousa: I would like to be a bit more optimistic. When the general public is polled on whether they want more or less tax, they say that they want less tax. When they are asked whether they want more or less spending, they say that they want more spending. There is the possibility of having a conversation, but this relates back to the medium and longer-term budgeting that we are advocating for. If you have a coherent strategy, not everything that is in a budget has to be popular individually for it to be understood by the public. Therefore, having a coherent strategy and a direction of travel that can be explained and that can be put into plans that then allow public services to deliver and plan ahead will go some way towards addressing possible concerns about being able to have that conversation.

John Mason: Is the idea of longer-term and multiyear budgeting possible under the present fiscal framework when we do not know what we are going to get year by year?

João Sousa: It is necessary to have some sort of medium-term plan, even if that funding is not completely set in stone, because there has to be a baseline against which you compare what you eventually want your policies to be. Therefore, it is really important to have some holding assumptions, even if they are not the final ones, because that gives you a direction of travel that then allows you to make a decision on whether things should go towards more spending, less spending, more tax, less tax and so on.

John Mason: Professor Heald, do you want to comment on that? Furthermore, does the Scottish

Government have too many priorities? That has been suggested to us.

Professor Heald: Most Governments have too many priorities because nobody likes saying that something is not a priority. One of the fundamental problems is that the basic way in which the UK spending review developed after 1998 was that a Government would get elected and would set a four-year or five-year spending review, covering three, four or five years. Various events such as Brexit, Covid, the cost of living crisis and political instability at Westminster have destroyed that system.

10:15

It has become a one-year budgeting system, even if we call it a spending review. We have a problem at the UK level, which then transmits down to Scottish Government level, which then transmits down to local government, which then transmits down to voluntary organisations, some of which are giving evidence to the committee, with one-year funding. If you want to improve efficiency in the way in which public spending works, going back to a multiyear system would make a vast improvement. The trouble is that political instability makes it difficult to see how to get that back at the UK level in the present climate. Without some stability at the UK level, it will not be possible to have stability for the Scottish Government, local authorities and charities. The efficiency of revenue spending can be improved through medium-term planning. You will also not make such a mess of capital projects, because, as I said earlier, it is about not just the provision of services but the fact that public sector clients must have project management capacity, and private firms have to know that there is a steady flow of work. Not having that is one reason why the UK is so bad at infrastructure spend.

John Mason: Okay. Thank you. I assume that we are not getting 34 minutes each, so I shall finish there.

The Convener: You can have that when you are the convener.

Liz Smith (Mid Scotland and Fife) (Con): I want to ask about UK tax and global tax debates. In the first instance, there is a huge issue about the UK tax structure being far too complex, having far too many loopholes and not delivering the revenue that it should. People are avoiding tax too much, and there is a big debate about inheritance tax. On the global scene, there are lots of debates about whether we should move towards environmental taxation to stop some of the big multinationals depositing their money in safe havens. Those are all academic debates that take up lots of column space in *The Economist*,

Financial Times, The Spectator, New Statesman and so on. To what extent does a Government in Scotland have to try to second-guess what will happen with those debates, because, technically, they could mean important changes in the future?

Professor Heald: My advice to the committee and the Government is to manage what we have better. That is the first point. The other thing that the devolved Administrations can do is represent such arguments to the UK Government. Clearly, the UK is a minor player, and Scotland is not even a player, when it comes to Organization for Economic Co-operation and Development initiatives on corporate taxation. One has to be careful. There has been a serious loss of trust in politics and democracy. It is important that the tax system is seen to apply to everybody. It is not just about revenue losses or the fact that some taxes are seen as, essentially, voluntary for people with certain income and wealth; it damages the tax compliance of other people in the economy. The Scottish Government and Parliament should concentrate on managing the taxes that we have better. As I said at the beginning of my evidence, we do not have a strategic approach to tax. Marginal rates matter for incentives. Average rates matter for progressivity. You do not make the system more progressive if you just put up marginal rates at the high end and do not think about the longer-term consequences. In fact, the Scottish Fiscal Commission thinks that those consequences come very quickly.

Liz Smith: What do you think the strategic tax objectives should be if we are to create more economic growth?

Professor Heald: We should get away from the idea that there are easy places to get more tax revenue. We could have a much more sensible income tax structure. We should think seriously about the problem of the income tax schedule. Some people might think that earning £44,000 a year makes people rich. I do not think that. For a country that is worried about its demographic profile, the child benefit withdrawal policy, which is a UK policy, seems to be totally counterproductive. Economic growth is a question of public services and infrastructure working well and of having an economy that makes the people whom we have educated at great expense want to stay in Scotland. We want to be a high-wage economy, because that has benefits in the form of the private consumption of the individuals and of the tax revenues that they pay into the Scottish budget.

Liz Smith: Professor Bell, do you have any thoughts on the global and UK tax structures that would have an impact on what we do in Scotland?

Professor Bell: I echo what David Heald has just said about the long-term future of the Scottish economy. It is essential that we retain as many

skilled, well-educated workers in Scotland as possible. People are most mobile in their early 20s. At that point, they make decisions that will affect them for their lifetime, so having opportunities for such young people seems to me to be an essential part of enhancing the growth of the economy. It probably also means making things such as start-ups much easier and supporting them. That is where the public sector could play a role in de-risking, to some extent. We will not become silicon valley, but there are areas that Scotland can help to develop.

There is also the question of the relationship with the private sector and of ensuring that there is confidence in that sector to invest and grow its own operations in Scotland. Political instability, manifested in the sense of not really being sure what will happen next year with tax rates or whatever support people might get, does not help with that.

I mentioned that, globally, there are arguments that, if you take a very strategic approach, you should think about taxing carbon rather than people's work. That is really tough to do, because it has big distributional consequences. It is much less progressive than income tax. If you start taxing road use, rural communities will be hit hard. I make the point in my paper that fuel duties will fall over the next few years. That will create a huge hole in the UK Government's budget. How will that be filled? We need some strategic thinking on that front.

I am happy to discuss carbon taxation further, but I would add to what David Heald said one thing that further throws into confusion the taxation of individual work. That is the national insurance system, as it further complicates the marginal rates that individuals face and over which there is no control in Scotland.

Liz Smith: I am interested in this because, although I hear what you say about the fact that we should do a lot better with what we already have, I feel that, in the context of our being part of the UK and of the global community, we have to be careful that our strategic objectives are in line with what is coming down the line on UK and global taxation. If we go off at a tangent and suddenly find that something slightly conflicts with that, we will have a problem. I know that it is a very complex area, but it is about trying to get a grip on that.

Professor Bell: Yes, but it is true that, where you have differential tax rates between jurisdictions, you will set up incentives that will cause either capital or labour to move. That move might not be instantaneous, but if two distinct tax systems sit close by each other, incentives are created over time.

Liz Smith: Mr Sousa, do you have any views on how we have a strategic objective that will allow us to create more economic growth, not necessarily related to tax? What do we have to do to get more economic growth?

João Sousa: What both Davids have said about infrastructure is important. In my response, I talked about the cumulative effect of infrastructure spending and investment in the capital stock. That is really important. Every year in which there is less investment and less capital stock is built, that compounds over time. Scotland has lower overall investment than the UK as a whole, and it is significantly lower—by about a quarter—than that of the OECD. That means that productivity, which is heavily linked to the level of capital per worker, will grow more slowly. That is really important, and it is one of the places in which the public sector can make a difference in inducing growth.

I echo the point about tax. It is important to think about how the tax system in Scotland compares with the UK system in terms of the tax rates on non-savings, non-dividend income and on savings income. It is really important to avoid kinks in the schedule, and that has to be considered when deciding on things such as thresholds and rates. Small divergences will probably not make a huge difference, but the effects can be non-linear. If you increase income tax on a particular band by 1p, that is fine; if you increase it by 2p, you are changing the incentives a bit. If you increase that by 5p, that is a big difference. That also needs to be considered.

Liz Smith: Thank you.

Ross Greer (West Scotland) (Green): I want to pick up on what Mr Sousa said about public opinion and challenge the idea that there is wide public opposition to increasing tax. I am looking at two polls from roughly this time last year. The Scottish poll is from last December, and it showed that a majority of people—by a margin of more than two to one—are supportive of rather than opposed to the Scottish Government's increase in the higher rate of income tax. There was a UK-wide poll just before the Liz Truss mini-budget that showed that a majority of people are in favour of increasing taxes to increase spending on, among other things, social security, which is interesting, given the attempts to demonise that. The most recent British election study shows that the vast majority of the UK electorate have left-of-centre economic values, even if they would not use a label like that, including a majority of Conservative voters.

I recognise that there is a difference between public opinion and the actual effect of public policy changes. If every general practitioner in the country was in the minority of people opposed to tax rises and half of them moved to Australia as a

result of tax rises, that would clearly have an impact. Is there an issue that, when we are talking about the public discussion of taxation, as John Mason touched on, the public discourse as defined by politicians and experts is quite far removed from the majority of public opinion on core economic values?

João Sousa: There are two things to say. You are talking about that specific policy, and I am perfectly happy to concede that I was not aware of those numbers. As with all policies and policy intentions, support tends to be higher when they are less specific and tends to fall when specifics are introduced. That is something to take into account, especially when looking at future tax policies. I will not necessarily comment on whether I think that the public are on a particular part of the political spectrum. However, it is important to try to gauge those views more systematically and have that conversation about tax.

10:30

It is also important—I come back to what I was talking about—to have a long-term view of where we want to end up, because we have had multiple groups about tax. In the medium-term financial strategy, there was mention of a national conversation about tax, which is one of a number of conversations that have been put forward on this over time. It is important to think about the levers and have a plan that gets discussed, rather than just wanting to do more or less. We need to have a plan for tax and think about how it fits with the overall aims of what it is spent on. In a system such as the one that the Scottish Government operates under, which requires a roughly balanced budget, there is a direct link between tax and expenditure that is less true at a UK level, where an overall change in fiscal stance could be taken that is not available to the Scottish Government.

Ross Greer: Professor Bell, do you have any thoughts on that? If I remember correctly, the citizens assembly that you mentioned came up with a pretty long list of potential new tax and revenue-raising powers. In that assembly, which was supposed to be broadly representative, there was a pretty broad consensus on the need not just to raise additional revenue but to broaden the sources of it. I am interested in your thoughts on where public opinion sits on these questions.

Professor Bell: I suspect that public opinion is broadly in favour of increasing taxation. As we have heard, in general terms, that is not a difficult proposition to agree with. What is more difficult is when people are confronted by the effects on them of the changes that might occur. I am not an expert on public opinion at all, but we know that economic realities sometimes bite, and none more so than with Brexit. Public opinion was obviously

in favour of Brexit, and I am afraid that chickens are coming home to roost now.

Professor Heald: The numbers that Ross Greer referred to have changed with time. If you go back to 1979, there have been shifts between when people wanted less tax and less spend or more tax and more spend.

Another point is that people tend to have the view that the best taxes are taxes that other people are thought to pay. That is the problem. I have already made the point that 5 per cent of Scottish taxpayers pay roughly 40 per cent of total revenues from income tax in Scotland. It is the behavioural response of a relatively small group of high-earning taxpayers that is relevant to the Scottish Fiscal Commission's numbers. Whether the Scottish Fiscal Commission is right to be so pessimistic about the effects of, for example, dropping the threshold and putting up the top rate, I do not know—we will find out in due course. The movement of a relatively small number of taxpayers would have a significant effect on Scottish tax revenues. At the top end, if people who are paying very large amounts of tax relocate to England, Switzerland or wherever you like, that can have a significant effect. One should be cautious about assumptions.

We also have to think about the question of the tax package that people face. Paul Johnson of the Institute for Fiscal Studies regularly denounces stamp duty land tax in England—and, by implication, land and buildings transaction tax in Scotland—because it impedes mobility. It impedes labour market mobility and people downsizing. When one is trying to get more money out of high-income groups, you have to think about the various ways in which they are taxed. As David Bell has said, one has to be careful about the overall picture where people make migration and labour supply decisions.

Ross Greer: Sticking with you first, Professor Heald—although I am interested in others' views—it is easy for us to get stuck in a chorus of despair about this. We all acknowledge that we face the greatest financial challenge so far in devolution's short history but, at the same time, as you have all mentioned, particularly Professor Bell, we have really ambitious targets for hitting net zero, lifting children out of poverty and so on. Inevitably, substantial increases in spending will be required if we are to stand any chance of hitting those targets, whether for net zero or child poverty. Even if we were very committed to a laissez-faire free-market economic model, we do not have enough time left, on net zero in particular, to find out whether that would work, because we have such a limited period.

You have all identified serious challenges to raising additional revenue through taxation, and

the opportunities for us to cut spending elsewhere are extremely limited in the context of the Scottish budget. It is therefore hard not to feel as though you are edging us towards acknowledging that the targets and objectives that the Government has set are not realistic with the financial resources available to us. Is that fair?

Professor Heald: Obviously, it depends what the UK Government does, because the Scottish system functions relative to it. I go back to the point that the marginal rate of tax matters for incentives and the average rate matters for progressivity. I am therefore in favour of a more progressive tax system, if you get it right. The 1991 values for council tax bring the system into total disrepute. The peaks that I talked about in the marginal rate threshold are ridiculous but, in the longer term, they have potentially serious consequences.

We need a debate, and, as the convener implied, nothing will happen without a degree of cross-party consensus on what to do. Given proportional representation, parliamentary majorities in the Scottish Parliament will always be tight, and nobody will have a massive Blair-type majority here. Consequently, you need consensus among the parties to try to settle the problem. We have had 25 years, and that has not happened.

Ross Greer: Can I jump in? Would the aligned and progressive tax model that you talk about be possible purely with currently devolved levers if the UK Government were not to work in lockstep, for example, on the child benefit policy that you identified? Is it possible for us to do that just with what is currently available under the devolution settlement?

Professor Heald: If we managed our local government taxation and our income tax properly, we would have more standing, in conjunction with the Welsh Government and the Northern Ireland Executive, when it exists. The UK is essentially paralysed. We have had five chancellors in about as many years, so the UK has its own problems. The devolved Administrations can give some leadership. The UK is a strange animal, because most federations have at least a reasonable number of jurisdictions within them and no one jurisdiction dominates. I think that in Canada, Ontario is the biggest jurisdiction, at about 35 per cent, whereas England is 84 or 85 per cent of the UK, which totally imbalances the system.

I commend the work that the Northern Ireland Fiscal Council has done in producing a very good guide to Northern Ireland public finances. To an extent, it did that because the collapse of Stormont in Northern Ireland meant that there was no Executive in place to do it. One thing that the committee could do is to press for the Scottish Government or somebody to produce an

authoritative guide to the way that this very complex system works.

Ross Greer: Does anybody else want to come in on that?

Professor Bell: I will go back to the net zero strategic objective. As I said, you can do that in two ways. One is to tax carbon, and the other is to provide incentives for reducing carbon usage. Essentially, that will not happen without a huge amount of investment. Government spending is required in order to de-risk investment by the private sector in areas that will reduce our carbon usage. As I have already said, taxing carbon is problematic distributionally. Also, providing incentives for the private sector, which is the only sector with a significant amount of money to invest at the moment, is problematic, because the public sector needs to put in some money to take a bit of the risk out of investment in that area.

You have to be up front about the challenges that are being faced. I am not saying that it is impossible, but it seems to me that all the discussion has suggested that there are too many demands on the public purse at the moment for them all to be simultaneously satisfied. In a sense, there has to be prioritisation.

Professor Heald: I will pick up on something that David Bell said. Some carbon taxation will be regressive, but alcohol taxation and tobacco taxation are regressive, and I support those. What matters is what the system as a whole is like—one has to look at the whole system. There may be very good public policy reasons for tobacco and alcohol taxation. We know that those are distributionally regressive, but you have to think about how the system works as a whole. It is obviously partly a problem of having the UK Government taxing, the Scottish Government taxing and local authorities taxing. That makes a degree of fiscal co-ordination much more important. We have not had fiscal co-ordination even within Scotland. One of the reasons that local authorities are short of money is that we had a nine-year council tax freeze.

Ross Greer: Thank you.

Michael Marra (North East Scotland) (Lab): The tax working group that the Government has put in place is looking at the increase in the higher rate, which has already been discussed. According to the SFC's modelling, that will raise £128 million, if we look at the static costings, and, if we take account of behavioural effects, that goes down to £92 million. On the change in the top rate from 46p to 47p, Professor Heald mentioned that the static costing was £32 million and that, after behavioural effects, it was £3 million. Could you say a little about what you think the reason for that is? One of those measures loses 90 per cent of its

value, while the other loses a smaller percentage. Could you explain that?

Professor Heald: I am not a fiscal modeller. You will have to put that question to the Scottish Fiscal Commission.

Michael Marra: Would anybody else like to respond?

João Sousa: I am happy to talk about that. The way that the Scottish Fiscal Commission models this is that there are different taxable income elasticities. The level of response, whether by reducing work hours or changing the patterns of payments that people use to get income, is much greater the higher your income is. I think that the Scottish Fiscal Commission assumes that the effect of that is quite low with salaries of up to £150,000, higher with salaries of up to £300,000, and much higher with salaries above £500,000. That is why you get such a loss in the static costing from that.

Michael Marra: Do you have confidence in those numbers?

10:45

João Sousa: All these costings are very uncertain. That is the nature of it, because they usually apply to relatively low numbers of taxpayers. It is very hard to do good studies on that. HMRC is doing an assessment of the effect of changing rates in Scotland on movement within the UK and on changes in taxable income. We will get some more evidence in due course, but it is very hard to be extremely precise. If the OBR were to do this kind of assessment, it would probably rank it as a very highly uncertain costing. However, it is pretty well established that the higher your income, the more likely you are to respond to tax changes.

Michael Marra: As a panel, you have illustrated some risks that you think are coming. Professor Heald mentioned that, if we teach higher-earning public sector workers to avoid tax, in essence, the more people will have to be involved in where our income might come from. There are real risks in the longer term.

Overall, that £92 million is going into a black hole of nearly £2 billion, which is the figure that we are looking at by 2027-28. Given the risks that you have illustrated, do you think that it is worth it?

Professor Heald: If I had been advising the finance secretary, I would not have suggested putting up the higher rate and the additional rate; I would have tried to redo the rates structure in order to get rid of the sudden peaks. The real problem, of course, is the question of the alignment of the national insurance threshold with the tax system for the rest of the UK. Teaching

people who would not normally go in for tax avoidance how to do tax avoidance is not a very sensible policy.

I would try to clean up the schedule. It goes back to what Ross Greer was saying: if there is a change of public mood, one has to make an argument for people that the system should become more progressive. It may have to become more progressive if things such as carbon taxes are regressive, in order to offset that effect.

Professor Bell: The different bodies are measuring income tax elasticities to the best of their ability, but there is still quite a large margin for error. I agree with David Heald that the rather strange structure illustrated in the diagram for our marginal rates makes no sense at all. I am not convinced that, even if we get all of that right, it will change the revenues in such a way that it will have a significant impact on what the forthcoming deficit looks like. Economic growth, however we define it—whether as sustainable or as associated with wellbeing or whatever—will drive revenue and the income side of Scotland’s balance sheet more positively.

Professor Heald: We are still suffering from the global financial crisis. Until 2008, the economy was doing reasonably well. Since then, the UK economy and the Scottish economy have performed badly. It is a question of getting over that shock. Then, of course, we had the Covid shock and the cost of living crisis.

Michael Marra: None of this accounts for behavioural effects that are external. That is the kind of messaging that you are concerned about when it comes to attracting breast cancer oncologists to NHS Tayside, in a very competitive international situation in which candidates could have multiple job offers.

Professor Heald: Yes.

Professor Bell: Absolutely—

Professor Heald: You get stuff in the sports pages about footballers and managers who come to the UK from abroad wanting to bargain for their net pay rather than their gross pay. I imagine that that will be the kind of argument that public sector bodies in Scotland are going to have as they attempt to hire consultants or top scientists.

Professor Bell: I agree with David Heald on that front. It is also important to ensure that everyone in the tax system feels that they are making a contribution. The fact that 40 per cent of income tax revenue is generated by a relatively small number of people is, in itself, a big risk. There is a case, therefore, for increasing the number of people with jobs that pay less well than that, if we can. That might be how you define sustainable growth; it might be about trying to

switch the balance by giving a larger number of people—it would have to be quite a large number—jobs the salaries for which mean that they come below the top rates of tax. As David said, we have struggled to do that since the financial crisis.

Michael Marra: What about the gearing and the relationship between the UK and Scotland? The performance of the Scottish system will always be looked at relative to the performance of the UK system, whatever the constitutional settlement is. How exposed are we? We have talked about the different measures of our demographic trends in the SFC projections, which are a key factor in that. Within those assumptions, are we more exposed than other parts of the UK?

Professor Bell: I would not say that we are necessarily more exposed than all other parts of the UK; we are probably more exposed than the south-east. Even the demographics are quite difficult to interpret. First, we have just had a census, so, in due course, we will get another set of population projections that will replace the ones that the SFC has been using. As I show, population projections tend to vary quite a bit. That will have an influence.

There is also the effect of changing demographic structure and how that affects spending. That is also a contested area, as I allude to in my paper. The assumption or theory that spending, particularly health spending, necessarily increases with age is not fully accepted across the board. It seems to me that the Health, Social Care and Sport Committee and the Finance and Public Administration Committee will have to keep a very close watch on how public health spending is growing.

Michael Marra: Mr Sousa, you said in your submission:

“if one assumes that the UK Government will take action to avoid the public finances continuing on an unsustainable path, the Scottish Government’s funding gap looks very different.”

There is a gearing issue here, is there not?

João Sousa: There is a real issue, in that, as I mentioned in my submission, the projections that the SFC has made have been made on the basis of what is, essentially, an unsustainable path for the UK Government. That is why the gap looks as though it is under 2 per cent: the block grant grows by a lot because UK spending grows by a lot. The relationship is such that the two are intrinsically linked. Under the current constitutional and fiscal framework, if the UK Government cuts back on that spending or does not increase it quite as fast, all other things being equal, the funding position for the Scottish Government looks worse. That has to be managed in that context.

Michael Marra: My final question might be more of an observation. On multiyear budgets, you mentioned political instability and the difficulty in 2016. I recall calls for multiyear budgets going back as far as 2010. Looking back, we thought that we had political stability, and the Scottish Government was not delivering multiyear budgets at that point. Is that something that is intrinsic to the political performance of the Scottish Parliament, our institutions and the relationship with local government? I recognise that instability is now the key driving factor, but there is a longer-term problem.

Professor Heald: There were reasonable-length spending reviews until 2015. Since 2015, there has been a series of very short-term reviews, whatever they were called.

We need more stability at UK level that gets transferred to the Scottish Government, which can then transfer it to local authorities. There is pressure for multiyear budgeting from other people who have given evidence to the committee. I totally understand that, but—of course—if the Scottish Government itself does not have the required stability, it is difficult for it to give genuine stability promises to those further down the system.

Michael Marra: Even under the relatively stable longer-term budgets, the Scottish Government still did not deliver multiyear funding settlements to Scottish public services prior to 2015. It did not do that. It says in the papers that people called for it in 2013. I am challenging this, because I worry that, although political instability in the UK is the key issue right now, if we cannot deliver multiyear funding it is a big problem. Let us hope that we can do so. Is there something about the way in which this place performs that means that people are more reactive, in setting one-year budgets? I am wondering whether we will not find multiyear funding to be the solution.

João Sousa: My view and that of the Fraser of Allander Institute is that it is possible, even under the current arrangements and with the instability that there has been in the past few years, to take a multiyear approach so that there is more risk management. We could look at things such as the baseline level that we could expect if nothing were to change, and as there is more defined funding closer to the time, we could revise that. That would be informative for the public debate, because people could see where things were going over time. It is natural for Parliament, as it builds its processes, to start with the immediate pressures. It is in the Scottish Parliament's gift to try to impose that structure. That could be looked at by MSPs as a whole.

Professor Heald: May I come back to your earlier point about demography? It is important to

look at demography not just at the Scottish level. Having a smaller population might make one think that it would be possible to save money because there are fewer people for whom to provide services. You might find, however, that you have redundant facilities in the parts of Scotland from which people are moving and that you need new facilities in the parts of Scotland to which they are going. There is a spatial dimension to the demographic problem. It is not only about the total Scottish population; it is also about where people live and work. I made the point that there has been a long-term decline in prosperity in the west of Scotland and increasing prosperity in the east of Scotland. Aberdeenshire, for example, has required a lot more schools, whereas there might be spare capacity in places in the west.

Michael Marra: Scotland's more dispersed population is one of founding principles of the Barnett formula, from which we benefit as well, of course. Thank you.

Michelle Thomson (Falkirk East) (SNP): Good morning. I would love to be able to lead us on to a topic that cheers us all up a bit, but I am not convinced that I will manage that.

All of you have given a compelling sense of the macro environment in the UK—chronic underinvestment in capital expenditure, high debt relative to GDP, demographic challenges, Brexit, short-termism and, of course, the slowest recovery of all large advanced economies after the crash of 2008. The list goes on. You have also given us a compelling insight into the limitations of Scotland's being part of that wider economy.

My first question—I have two—is this: do you think that the challenges are really understood? They are understood by economists, and they are understood, mostly, by the Government. I am aware that, following this session, we will hear from a number of bodies that will, inevitably, be looking for more money, with very good reason, which is that people are really struggling. To what extent is that realistic? To what extent is the real nub of the issue that short-term political expediency is set against long-term structural and strategic planning? That has been an issue in the UK and in Scotland over a long period. David Bell, do you want to go first?

11:00

Professor Bell: Thank you. We are coming to a period in which the challenges are such that new initiatives will have to be examined with a much closer lens than has been the case in the past. You should, possibly, be thinking, "One out, one in", and asking what policy would be cut in order for a new policy to come in. As has been alluded to, we are in a period of huge political instability,

which has not helped. In relation to the longer term, a little bit of stability that we previously had was that structural funds ran for a seven-year period, but they have pretty much disappeared and been replaced by annual budgets for everything.

We could certainly improve the way that the tax system works, but trying to increase the productivity of workers in Scotland is a greater and more important problem. That interacts with all the other things that we have been talking about—demography and so on. It is very difficult to say no, but very serious trade-offs would have to be made, unless revenues improved and there was a tax system that generated at least as much as we are currently getting. The key way in which Parliament can, perhaps, help is in making sure that there is transparency and in not letting things drift into a very difficult situation. If I was to pick two examples, they would be capital spend and local government.

Michelle Thomson: I will bring in Professor Heald in a moment. Professor Bell made a comment about productivity. Surely there is a link between that and the limitations in capital borrowing powers, which are a critical way for the Scottish Government to improve productivity. Is there not a direct link between that pretty significant limitation and productivity?

Professor Bell: It seems to me that public sector capital spend can improve infrastructure, which, in itself, can have a beneficial effect on productivity. If capital is used wisely, it can also de-risk private sector investments and be a catalyst for the private sector to invest. We have to be able to do that in a way that generates the productivity enhancements that we are talking about. We want to avoid, at all costs, infrastructure investment that does not lead to improved economic performance in one way or another.

Michelle Thomson: Professor Heald, what do you think?

Professor Heald: I concur with most of that. Very clearly, given that we have not recovered from the 2008 hit, we are dependent on the economy doing better. Regardless of whether we talk in terms of improved productivity or economic growth, what happens on that front is crucial to the fiscal prospects of the Scottish Government. Some of the issues that you refer to stem from the current constitutional arrangement, but an independent Scotland would be very much affected by what was happening in its much bigger neighbour, and the tax questions that we have been talking about would very much apply. If Scotland was an independent country, it would still have the question of the relationship of its tax system relative to the tax system of the UK.

Professor Bell: That is very true of Ireland: Ireland managed to get a very low corporation tax rate, but its income tax structure is not much different.

Michelle Thomson: Professor Heald, you used the term “coherent strategy”. I am long enough in the tooth on this committee not to ask, “What would you do if you were the Scottish Government?”, so perhaps we could phrase it as, “What would you do if you were in charge of an economy of roughly 5.4 million people, located next to a large neighbour?” What would be the key elements of that coherent strategy?

Professor Heald: I have already answered that in relation to the current constitutional context. In the independence context to which you are leading me, one of the temptations would be for the small country to have lower taxes than its big neighbour. Some people on the political left think that independence would be a socialist paradise, but one point that I always make is that the actual temptation would be for Scotland to try to have lower taxes than England, whereas we are now in a position in which Scotland has marginally higher taxes than the rest of the UK. In an independence situation, one would probably find that the small country that is next to a very big neighbour would be tempted to have lower taxes. Canada is, obviously, an exception to that: Canada is very small relative to the US and actually has higher taxes. That can only be done if there is political consensus for higher taxes. People keep talking about Scandinavia, but the point is that a political consensus built up in most of the Scandinavian countries that is different from when the UK had a political consensus, and from the present moment when it does not have consensus.

Michelle Thomson: Mr Sousa, do you have a final comment about my original question on short-term political expediency versus long-term strategy?

João Sousa: On the budget limitations that the Scottish Government faces, again I come back to the point about not thinking that resource is the main thing. There are different measurement systems for resource and capital spending, but there is always a temptation to exchange some capital to pay for reserve pressures today. However, as I outlined before, Scotland already has relatively low capital spending, and that accumulates over time. It is important to keep in mind that cuts to capital today can have a significant impact on growth and productivity in the long term.

Michelle Thomson: Okay. Thank you.

The Convener: Thank you very much. That concludes questions from committee members.

I am going to ask one more question. Given the talk about increasing taxes, I think that the Government is going to play it safe and impose fiscal drag on us all, as both the Scottish and UK Governments did last year. Professor Heald has said that income tax rises are always popular among those who will not have to pay them, but when the SNP brought in the “Penny for Scotland” campaign, which added 1 per cent to the basic rate, our opinion poll rating went down from 48 per cent to an eventual 27 per cent. I was standing in the constituency with the highest unemployment in Scotland, and people who did not have a job denounced us for that, believe it or not, even although one would have thought that they would have benefited.

My question is on an issue that we have not touched on. Yesterday, it was announced that some pension funds, such as the Strathclyde Pension Fund, are so awash with money that they are going to reduce local government contributions by about two thirds over the next couple of years, which will be a wee boon to local authorities. Is there a possibility that the Scottish Government could tap into pension funds to fund some of its capital projects? João, do you want to have a go at that one?

João Sousa: Bringing in that kind of thing through direct taxation can have risks. The main duty of the people who look after those funds is to ensure their solvency. It is important not to interfere too directly in a way that makes liability problematic. I would caution against looking at such funds immediately as a pot of money to go after directly. I remember, from my experience in Portugal, pension funds being directed to buy government bonds when rates were high because that would help to bring rates down, and it turned out to be a disaster. In general, such funds are quite separate, and one should not necessarily just go after them immediately.

The Convener: I was thinking about such funding being used for housing, for example, for which there would be a return to a pension fund in the long term. I appreciate that although funds are there specifically to maximise income for their members, some pension funds, over recent years, have looked at whether investments are ethical—in tobacco or carbon-intensive industries, for example.

João Sousa: That could be done by making investments such as you suggest more attractive, rather than necessarily directing funds to do that. That is my view.

The Convener: Okay.

Professor Heald: I am instinctively nervous about directed pension fund investment. The Scottish Government—devolved Administrations

generally—ought to be arguing to the UK Government that it not cut capital departmental expenditure limits.

If I was running the system, the UK would not cut back capital in response to present fiscal problems. It would probably expand capital for the growth reasons that we have talked about. In terms of the mechanics of the Scottish Parliament, that could be done through its having enhanced capital borrowing powers—which is unlikely, given the fact that that is not significant in the new fiscal framework. You could have more capital borrowing or higher capital, but with DEL coming through Barnett.

The Convener: There is a cut of about 10 per cent for the coming financial year.

Professor Bell: I find that to be an interesting idea, but I would be wary of taking it too far, because pension funds’ responsibilities mean that they have to be seen to be contributors to the pensions. However, quite a few overseas pension funds invest in aspects of the Scottish economy and the UK economy more generally. It would be good to understand what motivated their investment in bits of infrastructure in the UK and what kind of incentive could be put in place to, perhaps, leverage some of that money to replace, in effect, at least some of the capital DEL that is being lost.

Professor Heald: I do not know the mechanics, but part of private finance 2, which the Treasury announced in 2018, was going to be that there would be more pension fund investment in public sector capital projects, but that quietly died.

The Convener: I am going to conclude by allowing witnesses to make one final comment on any issue that they feel we have not touched on but should have, or on something else that they want to reinforce with regard to what has been said.

Professor Bell: One point that I have alluded to is that there should be understanding of the causes of health spending increases. It is important to get a handle on that, given that the projections suggest that more than 50 per cent of the budget will be going that way in about five years. It is a very contested area. The question is whether health spending on a person increases as they get older or increases with their proximity to death.

The Convener: That was a nice cheery comment. *[Laughter.]*

11:15

Professor Heald: If something like 50 per cent of the Scottish budget goes on health, that will have devastating consequences for the rest of the

budget, given the likely total spend. It is also very important that we recognise that health is not affected only by health spending. The quality of the environment that people live in, the quality of the housing that they live in and whether they have rewarding jobs—both financially and in terms of satisfaction—are also very important.

One of the worries about the problems on the local government side is that some of the backlash from the cuts in local government spend is reverberating in the health service. It is very important to see the connections between the different kinds of spend.

The Convener: I think that some of the witnesses in the next panel will touch on that.

João—we started with you and we will finish with you.

João Sousa: I will bring in something a little different that we have not talked about, but which I put in my submission. As part of the process of multiyear budgeting, it will be important to look at what the Government compares its spending plans with. We have reinforced that we think that it will be important to have more information about in-year execution and about comparing plans with actual outturns, because we might be missing some important information on, say, how much of the allocation of capital is being spent in-year. It might be that the 10 per cent cut in the in-year allocation is a different percentage in actual execution. The Scottish Government could prioritise different capital projects to ensure maximum utilisation of allocations, rather than focusing just on the overall plans.

The Convener: It is important that we do not compare apples with oranges. That was an important point.

I thank our witnesses very much. You have given us lots of food for thought for the second panel and beyond. We will have a break now.

11:17

Meeting suspended.

11:24

On resuming—

The Convener: Folks, we continue our evidence taking on the sustainability of Scotland's finances with a round-table discussion. I welcome to the meeting Adam Stachura, head of policy and communications at Age Scotland; Dr Judith Turbyne, chief executive of Children in Scotland; Philip Whyte, director of the Institute for Public Policy Research Scotland; Stuart Hay, director of Living Streets Scotland; Ruth Boyle, policy and campaigns manager at the Poverty Alliance;

Michael Kellet, director of strategy, governance and performance at Public Health Scotland; and Alastair Sim, director of Universities Scotland. I thank everyone for their written submissions.

Rather than my asking a whole load of different questions, I will ask only one, which will be to Ruth Boyle, to kick us off. Anyone who wants to comment on what Ruth has said, please let me know. We will buzz around the table so that everyone gets the maximum opportunity to speak. I will come in only as and when, which will not be very often. That will satisfy John Mason, because he is always moaning about how much I speak at these events.

Ruth, your very detailed and excellent submission is called "The case for fair tax reform in Scotland". You will have heard some of what the economists said earlier in the meeting. In your submission, you say that it is important that

"critical national priorities cannot be sacrificed due to a lack of funds".

You talk about

"new and improved forms of local taxation that target under-taxed wealth, as well as business and polluters."

You call for

"a fundamental rethink, from scratch, of how the Income Tax system can be best designed".

You call for a

"cross-party process to replace the current Council Tax".

You call for "a local inheritance tax" and a "local payroll tax".

The economists said that we have a small, finite group of people who pay a very high proportion of tax in Scotland, and they have real concerns about behavioural impact, for example, if we were to decide to go down the road of increasing taxes significantly. How can we deliver what the Poverty Alliance wants to deliver on its social policy? How can we fund those objectives, given the constraints that the economists presented to us, not only the fiscal gap that the Scottish Government has now but the impact on higher taxpayers should some of these policies be implemented? Higher taxpayers might leave Scotland, they might decide to work less or they might engage in more avoidance.

Ruth Boyle (Poverty Alliance): Thank you very much for inviting the Poverty Alliance to give evidence today. I am really pleased to be here. We are here because we think that it is totally unjust that people are experiencing poverty in a wealthy country such as Scotland. Yet, right now, we see that a quarter of a million of our children are living in and having their life chances restricted by the injustice of preventable poverty. You are right that we think that key national priorities

cannot be sacrificed due to a lack of resources. We see in the latest scrutiny report from the Poverty and Inequality Commission that the investment in the actions in “Best Start, Bright Futures: tackling child poverty delivery plan 2022-2026” has not matched the ambition of those policies.

Philip Whyte and I are here today to represent more than 50 organisations that endorsed a briefing on using our tax powers progressively, and those 50 organisations have come together with a very simple message: to see the transformational change that we know is needed in order to meet our national priorities on poverty and the climate, we need to see transformational investment. In the current economic and fiscal environment, we think that that necessitates a progressive use of Scotland’s taxation powers. We know that Scotland has taken a more progressive approach to tax than the rest of the UK so far but, in our briefing, we are calling for the Scottish Government to go further and faster. We heard stark modelling earlier today about that £1.9 billion shortfall by 2027-28, and that will put pressure on existing spending, never mind the additional resource that we know is necessary to meet those national priorities.

If we do not take progressive action on tax, that will mean further cuts. In the papers for the committee today, we see that local authorities are saying that all the easy cuts have been made, and we see from the people and the community organisations that we work with day to day that that is absolutely the case. People are still dealing with the impact of over a decade of austerity, and we know that any further cuts will have a tangible impact on their lives, particularly because, in some cases, that will mean cuts to statutory services. We have outlined a range of options in the paper that, I am sure, Philip Whyte and I will be able to talk through in the course of the session. In the short term, we are outlining options for using our income tax powers more progressively.

11:30

The Convener: However, what the economists have said is that, if you implement some of these policies, you will not get any more money, because people will simply avoid it, work less hard or leave Scotland. For example, they said that, when the top rate went up by 1p in the pound last year, 90 per cent of that revenue was lost through behavioural change. Someone who works five days a week might say, “Do you know what? I am just going to work four days a week because I am not going to lose all that money to tax. Why should I work for that?” It is one thing to say that, if we do X, we will raise an extra £500 million or whatever in tax, but if we lose 90 per cent of that or possibly

end up losing £600 million in tax because we have implemented that change, it does not deliver the changes that you and, I am sure, everybody really want to see. Everybody wants to tackle poverty, create better-paid jobs and have more money for the health service, but how do we realistically fund that when the impact of behavioural change is so fundamental to doing that? You can raise tax as much as you like, but if the money goes elsewhere, how do you deliver?

Ruth Boyle: In the papers for today’s committee meeting, we see that the Scottish Fiscal Commission has said that that behavioural change is challenging to quantify. When we put forward progressive policy change, we often see a slight backlash about unintended consequences. We have seen that from policy changes on the national minimum wage, for example. When there were changes to non-dom status in 2017, there was a lot of concern that that would lead to a mass exodus. When you look at analysis from the University of Warwick, you will see that that did not play out in what happened. We need to be clear that there is a range of reasons that people choose to build their life in Scotland, and that would move beyond simple tax powers. We also need to ensure that, if we are going to increase tax, people feel the benefit of that taxation in their local public services and the opportunities that they have.

From looking at polling, we would absolutely disagree that tax is unpopular. Polling from IIPR Scotland shows that 60 per cent of people support tax increases, even if it means that their tax will go up, if the money is to be invested in our social safety net. Similarly, in the Scottish social attitudes survey, we see an increasing majority who support the redistribution of wealth from those who are better off to the least well-off. We are talking about people working less. One of the fundamental issues with our tax system is that it is overly reliant on income tax. We rely on income tax to do much of the heavy lifting. One of the key points that we put forward in our briefing is that we need to shift the dial towards taxing wealth. There is untapped potential there for how we could raise revenue. That is why we have put forward other proposals around replacing council tax with a property value tax or a local inheritance tax. We should not focus solely on income tax but instead look at that package of reform.

The Convener: Philip Whyte is the only other witness who has indicated to come in. If anyone else wants to come in, do not be shy. Put your hand up.

Philip, you were nodding a lot at what Ruth Boyle was saying. One thing that the economists said was that wealth taxes are complex and can take several years to implement. We are looking at

the budget for 2024-25. Even assuming that we thought that wealth taxes were appropriate and could be implemented, what kind of time are we talking about and what can be done for the forthcoming tax year, which is the one that is staring us in the face now?

Philip Whyte (Institute for Public Policy Research Scotland): There are a couple of things to say. We acknowledge the pressures on income tax—the figures are in our submission. You have 1 per cent of taxpayers paying the top rate and only 5 per cent paying the higher rate. It is a small group, and that is well recognised. There is an argument here about needing to grow the tax base as much as anything, and that is well recognised.

On behavioural effects, the joy of having been at the Health, Social Care and Sport Committee earlier this morning at its pre-budget scrutiny meeting is that I can now repeat here lots of what I said there. As Ruth Boyle has mentioned, the evidence on behavioural impacts right now with the devolution of the Scottish rate of income tax is incredibly limited, so we still do not quite know what is going on. Two factors are particularly pertinent. One is that there is a very high proportion of public sector workers sitting in the higher and top-rate brackets, and that is because of the high proportion of public sector workers in general in Scotland. The other is that, since the devolution of income tax to Scotland, the simplest way to avoid it has been to shift your income into dividends, given that only non-savings, non-dividend income was devolved, so there is also a question about how that can be addressed through the devolution settlement. Overall, the answers to the questions about behaviour changes are still not quite known yet.

To go on to your more substantive point, if you look at this year, you will see that there is a question about the sustainability of public finances, so we absolutely have to look at the long term. In the short term, the First Minister has spoken about his attraction to introducing a new rate and band between the current higher and top rates. We have set out some options for what you could do there. Ruth Boyle alluded to the other thing that you can do. Timescales probably do not allow you to do it for April, but you need to go as far as you possibly can. We recognise that income is potentially limited, given the size of the taxpayer base in Scotland. We also know that wealth is a hugely untapped resource in Scotland. The richest households have 217 times the wealth of the least wealthy households. That is a huge disparity, and, when you look at where that wealth is held, you will see that it is in property, which is the single largest asset that people have wealth in. That is why we have kicked it into the long grass for years. I have lost count of the number of commissions, manifesto commitments, reviews

and everything else that we have had on council tax. We know that council tax is outdated and regressive and that it is not playing its full role in revenue raising in Scotland. We absolutely need to replace council tax.

There is a question about revaluation taking a long time. Could you do it by April? Potentially not but, at the very least, it is about starting to go further. The Scottish Government's options include playing around with the multipliers by increasing them for the higher bands. We have approached that as, basically, a necessary evil, and we have cautiously welcomed it, knowing that it still has some regressive elements, albeit that council tax reduction smooths out quite a significant chunk of that. There is more detail in the paper, but that is your most immediate option. We can go further on income tax right now and we can do more with council tax, but to just keep tinkering around the edges of both those things will leave a lot of revenue untapped and ensure that we continue to have a relatively small base of taxpayers.

The Convener: I am tempted to come back in, but I will call John Mason, to be followed by Michael Marra.

John Mason: We have concentrated on how we can raise more tax for existing expenditure, and I am sympathetic to that but, to be a little bit of a devil's advocate, are there areas of expenditure where we could make cuts? For example, compared to the UK, is the Scottish social security system too generous? The previous panel told us that making up the difference is having an effect on other services. Linked to that, has the Scottish Government got too many priorities? Should we be trying to simplify things and just have fewer of them? What about the idea that we are being too generous in, say, giving the bus pass to everyone? Should we means-test and target some of that expenditure?

The Convener: John Mason is not asking a question to anyone specifically—is that right, John? You are just looking for people to respond.

John Mason: Yes.

Dr Judith Turbyne (Children In Scotland): I will start with a general comment. First, this is a chance for us to look at the long term. I know that we have to look at next year, but when you are in a crisis like this, you need to think about what you are doing in the long term. Getting a political consensus on using taxes differently is the work that we should be doing now. I absolutely agree about the priorities. There is a lot of work going on, and there are some really hefty projects. The prioritisation exercise is very difficult, but we should have the conversation about what will help us fulfil the work. How are we going to not let child poverty, over all else, slip any further? How are we

going to do that, and what could we not do at the moment?

There are a lot of really good policies. The national care service is a good policy, but do we have the capacity to implement it in the way that we are implementing at the moment? There is a discussion to be had about expanding it, and there are other things that we should concentrate on to make sure that we invest in the preventative stuff that, in the long term, saves us having to invest more money. That is where the prioritisation exercise has to sit. We have to be brave about that, because the discussion has to be had.

The Convener: Ruth Boyle, John Mason is saying that we should cut back on some areas of expenditure. What areas would you suggest?

Ruth Boyle: The first point that I will come back on is the idea of the social security system being too generous. We would push back on that. The approach that the Scottish Government has taken to social security has been extremely welcome. We all rely on the social security safety net, but we know that it is a vital lifeline for people who live on low incomes. When we look at the child poverty targets right now, as I said, we see that we are not on track to meet them, but we know that the action that has been taken through the social security system, particularly the Scottish child payment, has basically done all the heavy lifting in helping us to get closer to those targets. The Scottish child payment is expected to lift 90,000 children out of poverty, and our members do not think that we have reached the end point of what we can do through the social security system to address poverty.

You made a point about universalism versus targeting. I will not sit here today and say that that is a simple debate, because it is absolutely not, but when we look at the pros and cons of universalism versus a targeted approach, we know that universal services are important in overcoming the impact of poverty-related stigma. We know that stigma functions as a barrier to uptake, and I am sure that Adam Stachura will be able to talk about that in the context of pension credit. We also see it functioning as a barrier in the context of free school meals. Targeting was a theme that emerged from the First Minister's anti-poverty summit, but we would be concerned about whether we have sufficient data, particularly intersectional data, to target resources and policies effectively. We know that there are tools in the budgetary process—human rights budgeting and gender budget analysis—that help us make sure that the budget is meeting the needs of those who need it most, but we are not routinely using those tools.

The priority family approach is important in the context of child poverty. Ninety per cent of children

who experience poverty fall into at least one of those groups, but we do not have sufficient data on the experiences of poverty for those family groups and we do not have sufficient data on how policies are meeting their needs. If we are to go down a targeting approach, we need to make sure that that is being accompanied by the gathering and usage of robust equalities data to make sure that we are meeting the needs of the people whom we say we are intending to help.

The Convener: I think that it will be a theme that everyone will talk about areas that we could spend more money in but no one will say that we should spend less on other areas.

Michael Marra: I will take one step back to the questions that the convener was pushing on. Your response on tax rates was that, essentially, you believe that the jobs involved are sticky. There are two other issues in that. I was speaking to doctors yesterday at general practitioner surgeries in Dundee, and they were telling me that they do not have a head count problem but that nobody works five days, so they have a massive capacity problem and cannot deliver. That is a trend in the workforce anyway. Will the changes in the differential tax rate that you propose not impact on that?

The other thing that I have problems with in Dundee is attracting breast cancer oncologists. You will know that breast cancer rates for the poorest women are much, much worse than those for richer women, so this is actually about poor people. That is an internationally competitive sector, and we are finding it difficult to bring people to Scotland to do that. What modelling have you done or what consideration have you given to whether it is more likely that I will get breast cancer oncologists in Dundee to help those women if we increase those tax rates?

The Convener: Who do you want to answer that?

Michael Marra: Any colleague, but I think—

Philip Whyte: I want to say something in response to John Mason's question, so I will take each of them in turn. I will not sit here today and say—albeit that I probably could—“These are areas where you could save.” Equally, that debate about means testing and universalism rages on—I say that it rages on, but I do not think that we have ever really had a grown-up debate about it; it normally gets shouted down on either side.

Let us take the example of childcare. It took years and really significant investment to get universal childcare for three and four-year-olds. A commitment was made at the start of this session of Parliament to extend that to one and two-year-olds, starting with the lowest-income households, by the end of this session of Parliament. That is

five years to extend that to one and two-year-olds. If you want to talk about getting women back into the workplace, which is a huge problem, that is the group where a significant and generously funded offer, particularly to help the lowest-income households get back into work and to tackle poverty, would have been hugely beneficial. We started with a universal offer at the upper age group and then decided to extend that to, at least to start with, a means-tested offer for younger ages, whereas, in the ideal world, you would probably have said, "You know what? It is a difficult choice, but we are going to do a means-tested offer for one to four-year-olds right now, and then we will look to expand that to universal as resources, time and capacity allow."

However, we did not do that. It is one of those examples of where it does not have to be an either/or. It is about how you phase, target and ensure that you are using resources in the best possible way but, again, we almost did it back to front and upside down.

11:45

There is a separate point about where you put your money—for this answer, you could literally go and get a transcript of my comments at the Health, Social Care and Sport Committee this morning. We had a huge discussion about scrutiny and preventative spend, and that is one issue that, more than a decade on from the Christie commission, is still an ambition rather than a reality. Public Health Scotland has said lots about this. Look at those health projections, for example. Over the next 20 years, we know that Scotland's population will decline but, equally, the annual disease burden will increase. That is happening for two main reasons. In particular, we have an ageing population, so we know that costs will increase, but we are also getting sicker as a nation and, as a result, we are also getting poorer.

A large proportion of that is avoidable disease and avoidable mortality. Had we started to shift our resources much earlier, we could have prevented that. We did some analysis earlier this year on the economic and social harms of poverty. A couple of the highlight findings from our analysis are that at least £2.3 billion of health board funding is being directed towards responding to the costs of poverty. Over and above that, we are losing at least £1.6 billion in economic contributions as a result of lower employment and lower output. You can see the huge drag that poverty has on the economy, but because we have not shifted our resources at any point to prevention, we are still often dealing with the consequences. Whether that is in health, social security or in any other public service, we are dealing with the consequences rather than tackling the root causes.

The Convener: Phil, can you answer Michael Marra's specific question? He was concerned about how an increase in taxes was going to enable us to—

Philip Whyte: I am sorry. I knew that there were three points that I had to come back on. I agree that there are lots of quirks in the tax system that make suboptimal. For example, it has been raised previously that, as a result of the quirk of devolution—I am going to call it "quirk" because it is one, and I do not think that there are ways that you can fix it—suddenly, we have an income tax system that is no longer aligned to a reserved national insurance system. There is an instance where, when people hit the higher rate of tax in Scotland but have not yet hit the higher rate at the UK level, their national insurance contributions are still at the higher rate, whereas, obviously, they drop 2 per cent when they hit the higher UK rate. Those people, earning between about £44,000 and £50,000, have much higher marginal tax rate than those who then hit £50,000, triggering the UK drop in the national insurance rate, when their marginal tax rate comes down.

You have quirks such as that, which is why we recommended that there should be a fundamental review. We quite often just tweak. We will either freeze rates, which brings people in by fiscal drag. I have already said that we will introduce new rates and bands, but there comes a point where you are just adding more clunky bits into a system without recognising and responding to the quirks that exist in the devolution settlement and elsewhere, and to what they mean for someone's marginal tax rate.

We suggest that we need to go right back to scratch. We recognise that we want to have a progressive system, but I do not think you do that in the long term by just adding in more rates and bands. We must start to rethink what the tax system that we need looks like and, more importantly, where those quirks and interactions come through with the reserved system.

The Convener: Does that answer your question, Michael?

Michael Marra: No. Sorry.

Philip Whyte: That is all right.

Michael Marra: The two examples I used—Philip, sorry, I recognise that we are jumping about a little bit—were about people reducing their hours in the first instance. Some GPs are not working full time and are therefore contributing to massive capacity issues in GP surgeries. That has been a general trend. In the proposals that you have put in place, have you thought about whether increasing those taxes would result in people reducing their hours in key core services essential to help poor people in Scotland?

The other question was about attracting international talent, such as breast cancer surgeons in Tayside, who—

The Convener: To stop them moving elsewhere?

Michael Marra: I want to get away from the stickiness side of it, although I think that that is right. However, in this scenario, we are trying to recruit somebody internationally. Are we going to prevent the NHS from being able to do that? Again, it is a key service for the poorest people in Scotland. Have you done any work on how your proposals might have an impact on those two issues?

Philip Whyte: We have not specifically, but there is lots of economic analysis around how rational people are, whether they are rational actors and what they respond to. If we are talking about recruiting and attracting talent, I highly doubt that someone sitting in country A, B or C is looking at the tax system. They are looking at the salary on offer. Liz, you may disagree. When we are attracting international talent, people are looking at the starting salary and the compensation package before they may get to comparing a starting salary in the UK or Scottish tax system with a starting salary in a French or Australian tax system. That is the attracting of talent.

The retaining of talent and the potential to reduce hours is all part of the behavioural responses. Again, people can be irrational in how they respond to those changes. It is as much about pay, rewards, compensation and burn-out, particularly in the health service. There is probably as much risk of someone reducing their hours in the health service as a result of burn-out and demand as there is of it being a result of the tax system. I am probably not answering your question in the way that you want, because I am not convinced that there is a satisfactory black or white answer.

Michael Marra: There definitely is not. In our previous evidence session, Professor David Heald talked about people negotiating their net pay position. In essence, he was agreeing with you that, internationally, people will look at that. Whether there is less pay because of tax or a lower basic wage is probably immaterial to somebody making that move internationally. Does that not result in the national health service having to pay substantially more to make up for the cuts and it becoming a vicious cycle where, on your logic, the public sector has to pay into the system rather than gain from it?

Philip Whyte: That is a separate discussion about pay; indeed, lots of projections that show increasing health spend are driven primarily by increasing pay awards. One way or the other, pay

will go up in the health service. There is a question about the extent to which it goes up to compensate for those effects as opposed to general awards that would just be expected, but we definitely know that pay pressures are increasing in the health service.

The Convener: Stuart, you have been very patient.

Stuart Hay (Living Streets Scotland): I will try to answer a question about areas where we could, perhaps, not spend some money. One such area is our transport priorities, including some of the road building schemes. The £3 billion for the A9 is a lot of money that could do a lot of good elsewhere. That is not to say that you should not spend some money there, but, if you want to get road safety benefits, you can get them for a lot less. We need to look at those types of projects.

Transport can start to fund itself if we are a bit smarter about it. I will give one example. When you put in any bit of transport infrastructure, the land value uplifts. That is straight profit to whomever is building on that land. We do not capture that well through the planning system. We could do that fairly quickly. There have been attempts to do it, but we need to have a national system for it.

The other area is parking. We give away parking for free in a lot of towns. Councils say that they are skint, but they still give away parking for free. They need to think what they could do with that money for that community rather than subsidising parking.

The Convener: There was a bit of a backlash in my area when it was suggested that parking be priced, and the council changed its policy on it.

One of the things that came out of the previous session was road pricing. How do you do that without impacting adversely on rural communities? Would you have road pricing only in urban areas or on motorways, for example? How would you get round that? Many rural communities in Scotland are fragile, and people in them do not really have any alternative to cars. You can talk about public transport all you like, but it will not make much odds to some people whether you increase the bus service from twice to three or four times a day. The car will remain essential for a number of people in our communities.

Stuart Hay: We need to look at urban and rural areas separately. As our economist said, we need to look at the whole system and at what people pay overall. A compensation mechanism is needed in road pricing to make sure that rural communities are not penalised. The technology and systems are available to do that.

We have a target to reduce traffic in Scotland but, at the moment, we are not doing anything in a

fiscal sense to achieve that. We will not achieve it, and that will have all sorts of negative consequences that will impact on the NHS. It will cost money in road deaths, road casualties and the consequences of air pollution.

Probably the biggest consequence in relation to the NHS, which we do not talk about, is the cost of inactivity, where people do not get out and about because there is too much traffic in their communities and they do not feel safe. That impacts on our old people especially. If they are not walking, they are not getting the strength to balance, and they are more likely to pick up a long-term condition that will cost the NHS a lot of money.

The Convener: I will bring Adam Stachura.

Adam Stachura (Age Scotland): Thank you, convener. To your despair, I will not be giving you a list of things to cut just now, although I wish that I could.

In response to John Mason's question, the situation is quite complex. The budget process is not that transparent. We are looking at budget lines of billions of pounds, where the decimal points—the rounding error element—represent vast amounts of money that, in themselves, can pay for massive projects such as the national concessionary travel card.

It is about universality. For 20-plus years, Scotland has gone down the path of making things free for as many people as possible, which has been hugely popular with the public. On the face of it, you are looking at the bus pass, for instance, costing maybe £250 million or more than that, now that younger people—rightly—have access to it. However, you have to think about the other benefits and the long-term benefits.

I remember that, probably a couple of years ago, convener, you tried to skewer me, in a sense, to suggest that the 60-year-olds' free bus pass should become a 65-year-olds' bus pass. At 59, our former chief executive was delighted that that did not succeed on the ground.

The point is that we are looking to the future with these things. A quarter of people between 55 and state pension age are living in poverty in Scotland. They are most likely to be women and carers. Just because you have a bus pass—I am using the bus pass as one example—does not mean that you can use it. The convener's point about rural Scotland will speak to lots of older people who would love to use that entitlement but cannot. The connectedness that they will have as a result of access to some kind of transport means that their lives are better, the public health challenges are less severe and they can take part in social fabric activities such as volunteering, childcare and lots of different things.

The point that I want to come to is that your job is unenviable. Every year, you have the same challenge, which is that there are a huge amount of priorities for the country that are getting more severe, and the wriggle room for funding those things will be really tough.

The universality point is important. Ruth Boyle alluded to the fact that there are many people who do not claim, even though they have a very low income and are eligible. Pension credit law is not within this Parliament or the Scottish Government's remit just now, but one third to 40 per cent of those who are entitled to pension credit do not claim it. That could be because of stigma, inaccessibility, digital exclusion or them not knowing that it existed in the first place. The system fights against them. As soon as you create a system whereby there is a line, it is very inaccessible. There has never been discussion about what that line is; about what the line for a deserving person is.

I have been to many cost of living events for MSPs and MPs over the past 18 months, and, more often than not, older people come up to me and say, "My income is £10,000 a year. What is there for me?", and the answer is nothing. They are just over the pension credit level, and that is that. The line is somewhere, and it is absolutely devastating. When 42 per cent of pensioners in Scotland do not even have enough income to pay income tax—receiving under £12,500 a year—that demonstrates that, across our society, a huge number of people are struggling.

That is a challenge for the future. I am not the bearer of good news who is telling you all the things that you can cut, but I am thinking about all those pots of money being very much interlinked. The real challenge is how that money is spent and spent well, and there needs to be transparency over future spends for the committee and the Parliament. That multiyear question that we have had before is important. We do not want to be in a position—although perhaps this is necessary because of the politics—of having political giveaways, for election purposes or otherwise, or commitments to some things that are not realised.

It is a challenging position, and it is challenging to find easy fixes. Council tax is a good example that is in the news at the moment. Increasing the amount paid by those in the highest tax bands can be seen as regressive because of how those people are identified in the first place.

This is not just about wealth. I do not disagree with IPPR or the Poverty Alliance on this, but what we do not measure is somebody's ability to pay—their liquidity. If we look at just wealth—capital in a house, for instance—we see that someone might have to sell their home to pay a tax, but they would not have anywhere else to go.

That is not to forget the social care system. Most people who interact with the social care system, particularly residential care homes, have to use their own home to pay for social care. If that is gone, their ability to pay for social care is depleted. We now have the social care contract, which is nowhere near enough to meet need, when someone has run out of money.

All those challenges are interlinked. I do not think that there is an easy solution of saying, “Stop this. Do that”. Part of the solution is about transparency around how money is spent, whether it will be spent well in the future and how we can prove that preventative spending will help those with the lowest incomes. That is because our population is ageing—of course it is. Even if we have more younger people, we will have more and more older people.

Whether you agree with it or not, David Bell’s point was about the fact that getting closer to death will cost more. Everyone’s life is a little bit different, depending on where you are. In your constituency, convener, there are low incomes and health challenges too.

12:00

I have gone on a bit of a rant there, I know, but the point is that we do not have a simple switch on/switch off option, and, in fact, the knock-on impact of switching off might be that you spend more money later on. For instance, £140 million a year is spent on late discharge, but the cost of meeting someone’s care and health needs as a result of their being in hospital for a week or two weeks is much more than that £260 a day in hospital. You are asking very complicated questions.

The Convener: There are a couple of points there. First, the suggestion not to lower the bus pass age from 65 to 60 came not from me but from Callum Chomczuk, who was then at Age Scotland, during the 2011 to 2016 parliamentary session. He said that the money saved should be spent on adaptations for older people. I thought that what Age Scotland had to say at that time was very brave. So many people come here—I am not mentioning any names or looking at anyone specifically—and say that we should spend more money on this, but they do not say how we can save money on that. We as a committee and the Scottish Government have to look at that. John Swinney then said that he was not going to reduce the bus pass age from 65 to 60 but would increase the disabled adaptations budget by 25 per cent. So, there was a big win there for Age Scotland.

You touched on people having to sell their homes, not just because of the wealth tax but to go into a residential care home. That affected my

mother and many other people. I was speaking to a leading economist, who has a good relationship with this committee, and he said that two of his aunties said, “You know what? Rather than go into a care home and see the house getting sold, we will just go on a world cruise for the next couple of years and spend the money that way.” That was not a flippant remark; that is what they did. There are some people who, of course, are not able to save up and buy a house, and they do not have an asset to sell. People who feel that they have an asset that they might want to pass on, at least in part, to their children are unable to do so. There is a real issue about the fairness of that.

One of the things that people talk about is fairness. I do not know whether anyone wants to define it for me. Fairness for one person is, perhaps, fairness for another. Anyway, I am starting to wander off as well. The next person to comment will be Judith Turbyne, to be followed by Michael Kellet.

Dr Turbyne: I made my submission quite some time ago, but, I want to reflect on the incentives that make people want to work somewhere. That is quite important, because I work in a sector where people are not incentivised by money. We are trying to get to a state where we are paying people fairly—the question of what is fair is a good one—which is when people are paid appropriately.

In my sector, we will never be in it for the big bucks, and I see that in lots of different realms of life. Some people make decisions that are based on salary, and salary is important. However, if we create a society where people come to the sector for other reasons, you might not immediately attract the best cancer specialist, but they will be coming for not just the package that they are getting from the hospital but the package that they get when their child goes to school or the package that they get because they will be looked after when they are old, and all those different things.

That is very simplistic, and I know that that is not what you are saying, but money is not the only driver of the decisions that people make and what they do. In fact, very often, in my experience, it is the secondary or tertiary driver.

The Convener: It is a chicken-and-egg situation, is it not? If the economy does not grow and we are not able to attract inward investment because people feel that they will be taxed disproportionately highly, we will not have the money to provide those services. Scotland could become more of a backwater, with more young people leaving and the population stagnating and declining. We had the lowest population growth in the entire world in the 20th century. For example, two million people emigrated in the half century after world war one.

There are real issues to address in the whole package. It is about trying to get the optimum right, not the maximum or the minimum, so that we can achieve what most of us want to achieve.

Michael Kellet (Public Health Scotland): I welcome the opportunity to be here today. I am not a tax expert at all, so I will not attempt to answer the committee's very sensible questions. I agree with Adam Stachura: this is a really difficult challenge.

The one thing that I wanted to make clear—it might surprise the committee—is that I am not here today to make the case for a bigger slice of the pie for the NHS and the health and social care budget. The pressures on the NHS are very real. Mr Marra talked about some of those, but there are many right across the country. One of the things that Public Health Scotland is prioritising is working with our patient-facing boards to deal with those pressures. The reason that I am not making a case for a bigger slice of the pie is because, as Professor Heald said, we recognise that investment in health services does not equate to improvements in health.

I am sure that the committee will have heard this before, but, based on the estimates of the King's Fund, only about 20 per cent of health services' contribution to the nation's health is caused by that investment. Fifty per cent is about the building blocks of health: the social and economic factors and the physical environment in which people live. That is why Public Health Scotland wants to make the case today for preventative investment and particularly primary preventative investment.

In answer to some of the questions that we heard—I think that this is one of the statistics from research that Philip Whyte's organisation published earlier this year—the failure demand from poverty alone is estimated to cause £2.3 billion of NHS spending out of the £19 billion total spend on health and social care services. I think that that will be an underestimation of the total failure demand of the impact of not investing preventatively.

Another point that we have perhaps not covered concerns sustained collaboration across public services and the third and private sectors on meeting shared goals, with improved health and wellbeing at its heart. That is why, in this context, we in Public Health Scotland welcome the review of the national performance framework, which is really important. We welcomed the Verity house agreement and that parity between the national Government and local government in recognition of the need to work very closely together. We heard about the challenges related to local government funding and about the fact that local government controls so many of the social and

economic building blocks that I have just talked about.

We also welcome the thinking around the Wellbeing of Future Generations bill, learning from the experience of the Future Generations Commissioner for Wales. For me, that is about systematising a long-term and preventative approach to how we think about public spending in Scotland. Our submission to you is that the committee should pay attention to that when scrutinising the budget this year and in future years.

The Convener: Alastair, in your submission, you talk about how research and development in Scotland is still punching well above its weight, at 13.25 per cent of UK research and innovation funding, compared with 8.2 per cent of the population, but that funding is down from around 15.4 per cent just a few years ago. Will you talk about how important that is and how important the university sector is to Scotland's economic growth, wealth and prosperity?

Alastair Sim (Universities Scotland): I welcome the opportunity to do that. I will declare an interest. As well as being director of Universities Scotland, I am a board member of the Scottish Council for Development and Industry. Some of my perspectives also reflect that role.

From a university perspective, we believe that we are drivers of inclusive growth and productivity, which are absolutely key to the sustainability of Scotland's finances and, indeed, to creating the prosperity that lets us invest in making sure that we are looking after the most vulnerable in society.

What we are doing in investing in a high-skills economy is incredibly important. A couple of weeks ago, I spoke to colleagues in the Republic of Ireland, who were saying that their much faster bounceback from the 2008 financial crash was largely based on their very high skills availability, the very high number of graduates in the population and the ability to attract foreign direct investment on that basis. They have bounced back a lot faster than we have, with that being one of their advantages.

Graduates create growth, bring skills to the economy and create tax growth by generating a virtuous cycle of high skills and more productive employment. They are also motors of social inclusion. As universities and colleges draw more and more people in from the most disadvantaged backgrounds, they create opportunity, and we therefore get more people into positions in which they are using all their talents and contributing effectively to tax revenue.

There are many economic studies on research and innovation and we reckon that there is about an 8:1 economic multiplier from investment in

research and innovation. Such investment draws in competitively won resources from the UK, international sources and business and creates talent attraction. Our research and innovation projects are drawing people in to Scotland from across the world, to create clusters of innovation and economic growth.

Looking at Michael Marra, I think of Dundee and the contribution that life sciences based at the university there have made to generating a huge cluster of businesses around it. That has been absolutely fundamental in revitalising Dundee. We do a huge amount to support businesses, including consultancy for small and medium-sized enterprises, providing continuing professional development and working with tens of thousands of businesses a year.

You talked in the first session about the importance of capital expenditure. There is an artificiality for us, in that research and innovation is classified as capital, so we need that capital DEL to keep coming. At the more concrete end, we are trying to maintain an ageing—largely 1960s and 1970s—estate. There are huge opportunities for creating that pipeline of confidence in capital investment that the economists are talking about by having projects that renew the estate and make it greener and more effective. Last time, we got a one-off in-year investment of £40 million from the Scottish Government. We tracked where that was spent and found that 90 per cent of it was spent on Scottish businesses that came in and did the work.

There are also huge opportunities in lifelong learning and in what we can do and what should be invested to help people upskill and reskill throughout their lives so that they are continually able to refine what they bring, for their own satisfaction and for their work.

Looking at this through the lens of the sustainability of Scotland's finances, my plea is this: invest where you know that you will get a return on the investment through the creation of sustainable, green, inclusive economic growth that gives you the resources to address the many challenges that face society.

The Convener: No one else has indicated that they want to come in, so I will make a couple of comments.

What has been done in Dundee with life sciences and gaming is phenomenal. Scotland really is on the global map when it comes to its universities and knowledge economy, which is important. However, have you tried to get a roofer, a plumber or an electrician these days? There is a real issue with the balance between people going to university and those not going to university. For example, we talk about building houses and the importance of affordable housing, but there is a

chronic shortage across the construction industry. Sadly, some teachers in schools—I certainly found this in my area—say to children, “You will be a bit of a failure if you do not go to university,” so the people who would go into apprenticeships and probably go on to have really good and highly skilled careers are not doing so. We have chronic skills shortages in engineering and construction, for example. Where do we strike the balance?

What we need and want in Scotland is for our universities to remain cutting-edge, but what about the rest of the economy? What about the situation with apprentices perhaps not being valued as much and, therefore, not enough people doing apprenticeships? Of course, without those basic skills to support the universities and other sectors of the economy, we cannot grow as well as we could.

Alastair Sim: I believe strongly—this is shared across my membership—that there is no wrong path. There should genuinely be parity of esteem between the various pathways that people can choose. There need to be pathways that are just as valuable for those for whom university may not be the right answer when they leave school. It may be the right answer for them later in their careers, but it is not the right answer for everybody when they leave school. We need to have a high-quality offering across the range of people's talents and aspirations. That comes out very strongly in the Withers review.

Coming back to the capital point, if we keep a sustained pipeline of capital investment in infrastructure, as well as contributing to total factor productivity, it will create confidence that those industries will invest in the throughput of talent in apprenticeships and build confidence among people that there are sustainable careers in construction and engineering that will not be boom and bust because there is a sustained pipeline of capital projects to employ them.

The Convener: Parity of esteem is really important and I certainly endorse your comments on that. When you gave evidence two years ago, John Mason pointed out that Glasgow University had cash assets of, I think, £770 million. Of course, you pointed out that not all universities were as well off as Glasgow was at that time. I do not know whether it is still as well off—John Mason has probably got a better grip on those accounts than I have. Surely, the university sector, at least in Glasgow, has plenty of money to invest, without seeking additional resources from a public sector, which, as we have heard, is already constrained.

12:15

Alastair Sim: It is an incredibly varied picture across the sector, and one where some of the high levels of what appeared to be assets were actually reflecting high levels of borrowing that were then being invested in things such as the transformation of Glasgow's west end. That will bring huge economic benefit to Glasgow. It will be transformational for the west end and for the university's impact, so it is a good investment to make; it will have a broader economic return.

I talk to my members a lot. Generally, universities are feeling the strain of doing research and of teaching Scotland-domiciled students at a level that is far below the actual economic costs of what they are doing. Since 2014-15, we have seen erosions of about a third, in real terms, in teaching and research funding. The pips are starting to squeak across the sector. Everyone does what they can to provide the best-quality experience to students, but they are coming forward with greatly increased needs post pandemic. We saw those increased needs during the pandemic. From talking to my members, I know that the situation is different in different places, but trying to meet students' increased welfare and learning needs, particularly post pandemic, is a real stretch for them on a diminishing teaching resource.

The Convener: I was talking to an economics professor about the number of people who are economically inactive. That includes students, who are not unemployed, despite what the *Daily Mail* said on its front page a week or so ago. He suggested that Scotland could do as well with a three-year degree what we do with a four-year degree, given that there are three-year degrees south of the border. I thought that that was an interesting suggestion to at least look at. How do you feel about that? What would the impact of that be on the cost base of the university and so on? Would it free up resources? It would certainly mean that people would leave university a year earlier and contribute to the workforce a year earlier.

Alastair Sim: Obviously, there are degrees of different length, but, increasingly, we like to look at four-year degrees as a flexible spine with different entry and exit points. The problem, in some sense, with trying to standardise that to a three-year degree is that it would require the fundamental re-engineering of what you do at school. Essentially, we have a four-year degree because we have highers as the general entry qualification. Most schools cannot offer a wide range of advanced highers, and many learners need the time over the course of a senior phase to develop their full talents and their portfolio of highers. Therefore, for as long as highers are the normal entry requirement for university, you will need to start a

year lower than those who have done A levels in England, because you basically have a year's less content. If you are going to be serious about looking at shortening university degrees, you would have to make parallel investment in schools to make sure that people were routinely able to get up to what is currently advanced higher level. There are lots of other considerations, not least workforce considerations, but a lot of our degrees are accredited by professional regulatory bodies, so you need to do the full course to make sure that you are qualified to enter professions, and that is not something that they can unilaterally abbreviate.

The Convener: I am not sure that it is on the immediate horizon, but it is something that I wanted to throw into the mix. Stuart Hay wants to come in, but Michael Marra wants to make a comment on universities first.

Michael Marra: Alastair, you know that I am a big supporter of the universities in Dundee, and we have had conversations regularly, but you will also be aware that we have industrial action this week at various institutions across the country. Unite and the University and College Union are out, looking for pay that is commensurate with something approaching the cost of living, frankly. How can we make sure that our universities are delivering the pay deals that we require, given that we are sitting here talking about budgets?

Alastair Sim: To be candid, we all recognise that there are difficulties in industrial relations in universities. My point of view is that those are symptomatic of a system that is under stress. Whether it is collective UK-level negotiations through the Universities and Colleges Employers Association or individual institutional negotiations, they are all taking place against a background of severe financial stress in the institution, with the constant real-terms diminution of core funding, and also with an increasing feeling of risk that the one-way bet that we have, essentially, been led towards of relying on international students to try to cover the losses that are being sustained elsewhere is starting to look a lot more vulnerable than it did. Although markets such as Pakistan and Nigeria were expanding, the change in rules about whether students can bring dependents with them is reducing those markets. When I speak to my members, just walking the beat, people are worried that some of the international students who accepted offers will not turn up because they have chosen instead to take up an offer at a different university in a different system.

We all want industrial harmony, but the background to some of the current difficulties is genuine stress in the system, including the worry that we have a one-way bet on international students who, although great for our educational

and cultural diversity, should not be the pillar on which the sustainability of our system is resting.

Stuart Hay: This is a follow-up on the point about having pipelines of capital projects, which is really important. Also, across the public and third sectors, having annualised budgets is becoming more and more difficult. We are learning later and later when we will have money to deliver projects, and that has massive implications for the staff, who have to gear up and gear down. That costs a lot of money. If you do that every year, as opposed to every three years, there will be three times the cost for all the scrutiny that goes into that. We are planning the schools programme for next year. The schools have been back for only six weeks and we are already starting to work on reporting what we have done and what we will do next year. We need to start doing things in the long term so that we get some data coming through that will allow us to do some evaluation. The way that we are budgeting is really painful right across the public sector.

The Convener: Okay. There is no comment on that.

Adam Stachura, I will ask you a question and put the same question to the IPPR and the Poverty Alliance. Age Scotland's submission talks about

"fair and multi-year funding for third sector organisations",

and says that

"comprehensive investment in the support provided by these organisations is needed."

The submission goes on to say that

"The continued delivery of significant funding programmes and activities which connect people, such as older people's groups, is crucial"

and that

"We would like to see appropriate resourcing to address and reduce excessive waits for healthcare".

How much are we talking about? It is one thing to say "appropriate resourcing," or that we need to spend more, or that we need to make a significant investment, but the committee is taking evidence on the 2024-25 budget to make an impact on the Scottish Government's decision-making processes. What additional resources are we talking about? How, specifically, will that be funded?

Adam Stachura: To continue my theme of being unhelpful with precision, convener, it is a bit elastic. My point, and leading from Stuart's point about multiyear funding or timescales, is that you can get much more return on investment made with three-year funding. If a charity is organising a programme with one-year funding, time is taken out of delivery to account for and evaluate what

has been done, and we go through a lot of scrutiny, sometimes for modest amounts of money. We have found, particularly with the response to the Covid-19 pandemic, that community organisations and charities can do a lot with not very much in the grand scheme of things. One great example is from the work of community groups, and I am grateful to the Scottish Government for the £200,000 it gave us at the beginning of the year to distribute to older people's groups across the country to help keep their doors open, because 200,000 older people across Scotland rely on local groups to keep them connected, fed and warm. Some groups told us that £500 would keep them operating for the rest of the year. Without that funding, those folks would have to stay in their homes, probably with a higher burden of health challenges, and they cannot afford their energy bills, so there are a lot of knock-on impacts.

I know that it is not particularly helpful, but some of this is about how long you get to go and deliver a project and about getting guarantees, so that you can use your staff time—when you have it—effectively to deliver things for people. Part of it is about the significant scrutiny that the charity sector, for instance, has of its public funding. The evaluation processes are good but time-consuming. To what degree is the scrutiny of big public sector projects commensurate?

Not very much goes a long way. We have looked at loneliness and isolation funding. At the beginning of this parliamentary session, that was initially suggested to be £10 million. In reality, more like £5 million has gone into it, and that has been cut away in different spending reviews. You are looking at big projects that cost billions of pounds. This is millions or hundreds of thousands of pounds, but the knock-on impact and bang for the buck is significant.

I know that that is not particularly helpful, but the idea of multiyear funding—

The Convener: It is helpful to an extent, because it helps us to focus. A number of people, including the economists who were here before, have talked about three-year or five-year funding. The Scottish Government is not funded beyond year to year, but there is still the question whether we should plan. I was on the Social Justice Committee during the 1999 to 2003 parliamentary session. We produced a detailed report on why we should do exactly what you have suggested and, 20-odd years later, we are still taking about it. It is a fundamental point, although you have not put pounds, shillings and pence on it.

Ruth, you have some statistical analysis in your report and you have produced some wonderful graphs. Talk us through, in a few short minutes, exactly what additional resources we should

provide, Given all the caveats about wealth tax—that it cannot be implemented for the next financial year and so on, according to the economists—what can we do in the next year in order to deliver the agenda that you, the IPPR and others would like?

Ruth Boyle: No problem. Philip is the maths man, so I will let him speak to some of those tables.

We recognise that the things that we would call for in order to end poverty are costly. Ahead of challenge poverty week—it takes place from 2 to 8 October and is, I am sure, in the diaries of everybody around the table—we have called for a series of policy changes on the minimum income guarantee, housing and transport. We recognise that those are costly.

Picking up on Adam's points, fair funding for the third sector is another of our key calls this year. As you say, convener, a long-standing call of the Scottish Government is to recognise the value of the third sector with multiyear funding awards that are fair and sustainable. We echo the Scottish Council for Voluntary Organisations' call for fair funding. That is important, particularly because, during the cost of living crisis, some of our community-based membership have been at the front line of efforts to tackle poverty. They should be recognised with fair funding, but current trackers from the SCVO show that around two thirds of the third sector face financial challenges.

We have looked at the modelling of what we could raise with the tax changes that we propose. Of course, they are just options, but setting a higher rate of income tax—a new tax band—could raise between £110 million and £260 million, depending on where you set it. In the longer term, around £300 million could be raised from setting an inheritance tax at the local level.

The Convener: That first figure is assuming no behavioural impact, is it?

Ruth Boyle: Yes. I presume that, in the modelling, we have not accounted for behavioural impact, but I am sure that Philip will be able to come back on that.

There could also be £350 million from changes to council tax. For us, it is not solely about new money but about thinking about the way in which we approach the budget process. I have already highlighted things such as human rights budgeting and a gender budget analysis. When we are in economic crisis and budgets are tight, it is even more important that we undertake those analyses to make sure that we make the most of the resources that we have.

I really liked the turn of phrase that the Health and Social Care Alliance Scotland used in its

contribution, about human rights being the “golden thread” that runs through everything that the Parliament does. It is important that, when committees are undertaking their budget scrutiny, we do not think that equality budget analysis or human rights budget analysis should take place only in the Equalities, Human Rights and Civil Justice Committee; it should be a priority for all committees. That is one of the key ways in which we can make sure that we maximise our resources when we are in a tight fiscal environment.

The Convener: Is there anything that you want to add, Philip?

12:30

Philip Whyte: I am not sure that I will be much more helpful, but your starting point for 2024-25, which is where your primary interest is, is -£1 billion. That is the central estimate of resource spending requirements to commitments. If you start with -£1 billion, your next step is to ask, “With the money that we have, are we meeting the big commitments that we have set?”, so you go to the resource spending review and the programme for government and look at the three big ones.

On NHS recovery, we know that targets in the NHS recovery plan to get elective backlogs under control are not being met yet across in-patients and out-patients. You then look at child poverty. Current projections say that the interim child poverty target for next year will not be met. You look at climate change. Again, climate change targets are not being met. So, with regard to where your money is going, if you start with -£1 billion, even on the current spending commitments, it is not meeting those three really big commitments that the Scottish Government has set itself. That clearly says that you need to look again at your spending to ensure that you are diverting all resources to being able to meet those, if you think that those are the three big ones. I could give some specifics right now to say where to put it, but, at a conceptual level, those seem to be the three big areas and, with -£1 billion, some difficult decisions will need to be taken to start to see money being put towards those.

That leads on to the two other things. The first is that we are still not very good at outcomes-based budgeting. Quite often, our position is still, “This is how much money we have, so we will put it into this,” rather than, “How much money will this require to tackle it?” We quite often talk about the NPF being our north star. I always torture the metaphor and say, “If I get lost, I can follow the north star, but I still might fall off the edge of a cliff because although I am following it, I do not know where I am going.” We are still not very good at determining what things we are changing in

pursuit of those large-scale national outcomes. We are not there yet.

Finally, on multiyear spends, we did not get a spending review for a decade and then the one that we got last year gave us only level 2 figures. There is something in that for me. At level 2, you either know what your level 3 assumptions are, so you know roughly what the assumptions behind the level 2 figures are, or you have arrived at a level 2 figure with not much idea of what that means for individual spend at the programme level beneath it. We clearly need more detail if we are going to do a spending review with the purpose of aiding long-term understanding of where we are putting our money and what that means for long-term outcomes.

The Convener: Before I let Ruth Boyle in, Jamie Halcro Johnston and Ross Greer are keen to come in.

Jamie Halcro Johnston (Highlands and Islands) (Con): I will come in on the points that were made. The Government is very good at saying, “This is how much we spent”, rather than, “This is the outcome of what we have spent.” We have been talking about multiyear funding. One of the issues is not just about how many years something will take, even when we have seen projects that have had extended deadlines; it is about the criteria not being set up in the right way. For example, on the rural and islands housing funds, the process was meant to take a year, and that was extended, but the money still has not been utilised.

How important is it for the Government to get the criteria right in the first instance? If we have a limited budget, we have to make sure that the money is being used, and too much of it at the moment seems to be underutilised.

The Convener: I echo that on that specific area, because I have raised that point myself.

Ross Greer: I want to follow up on the point that Ruth Boyle just made—this is probably another question for Philip Whyte, and is on a point of clarification. I am broadly sympathetic to the tax proposals that you have laid out. However, on the question of local inheritance tax, my understanding of the current settlement is that we are allowed to create new local taxes but not if they replicate an existing national tax. Something like local inheritance tax or local capital gains tax would be outwith the current devolution settlement—the UK Government would not allow that because it replicates something that already operates UK wide. Obviously, that is in your proposals. Do you have a different understanding of what is currently within scope?

Philip Whyte: We have not gone into it in that level of detail. The Scotland Act 1998 refers to

new local taxes for the purposes of funding local revenue. The proposals in our paper were not meant to be intended as a job done. There has been lots of discussion on wealth taxes at a Scottish Government level and beyond, without any substantive detail of what that could start to look like. As much as anything, it was meant to be a helpful contribution to starting a conversation about the local tax powers—they are probably the most substantial, given that national tax powers are restricted to income tax—and what you could do with them if you wanted to start using them. Our paper was not meant to be definitive; it was very much about giving initial suggestions.

The Convener: The last person to comment will be Adam Stachura. Each of our guests will then have one minute to wind up and to mention anything that has not been covered so far.

Adam Stachura: Thanks, convener. In response to—

The Convener: You will get your minute after this, by the way.

Adam Stachura: Thanks. I will try to keep it to a minute or so.

On Jamie Halcro Johnston’s point about Government programmes, hundreds of millions of pounds are spent on energy efficiency programmes in Scotland, but the mechanism for spending that and giving it out to households has been closed between spring and autumn this year, because the contract for delivering it was changed. The best time to fix your roof is when the rain is not pouring, so this is the moment. That goes back to the point about how we spend the money—it is not just about headline figures. There could be savings in that regard from what is not spent.

I go back to one of the points about industry and Alastair Sim’s point about investing in things that return money. We have energy efficiency and net zero, and we have an industry in making our homes low carbon. We have spoken in the past about interlinked fire and smoke alarms. Fundamentally, we could not deliver that structurally to the right number of homes for such a low amount of money in a good amount of time. It is about thinking ahead. Hundreds of millions of pounds of investment is not going to the right place at the right time—where the low-hanging fruit is—to get more homes out of fuel poverty. It is about the smart use of data as part of our systems to go first to the people who are on the lowest incomes and make their homes warmer and more secure, which will result in economic benefit in multiple ways.

That was a smart point about how the programmes are set up. It is not just about the high-level money; it is about how you spend it, or

not. What happens to that money afterwards is a black hole.

The Convener: Judith, you have a minute or so to wind up.

Dr Turbyne: Thanks. That was a very interesting discussion, and it has been a delight to be here—I have learned a lot. For me, the key points are around prioritisation and prioritising prevention. It is not about using the crisis to take money away from that and just running along with other things. It is very tempting in a crisis to do that. We are not good enough at outcomes budgeting. We tend to fund activity that can be measured, rather than think about the long-term outcomes that we are looking for. That is easy to talk about, but more difficult to implement. We need to seriously start putting some effort and energy into that.

We need to invest in the long term. I was going to come in a wee bit earlier on multiyear funding. The unintended consequence of short-term funding is that it is immeasurably inefficient for the civil servants who manage the funds and for whoever is receiving money, whether it is the third sector or not. It leads to an industry of creating grant proposals and getting money but not actually doing the work. Getting rid of that inefficiency will free up a lot of time, and we can all do that. Although multiyear funding can sometimes mean less money, you know that you have it for a long time, and it will do much more good than a chunk of money that you have a year to spend. Sometimes, you cannot spend it because you run out of time. Getting rid of that inefficiency would be great.

Stuart Hay: The active travel spend, which is approaching 10 per cent of the transport budget, has been hugely positive. The good thing about that was that it was a longer-term commitment over the course of a session of Parliament. That is the way to go, because it provides time to gear up. Even that has proved to be quite challenging.

Another area where spending will get a lot of value is buses. We have a native bus industry and manufacturing industry in this country. We are good at that, and we have a good bus sector, so we need to keep that going in our transport spend. You might get more money from buses versus rail.

Michael Kellet: I will be very quick. I should have said earlier that the committee knows that Scotland's health is poor. We have low and falling life expectancy and widening health inequalities. For women, there is a 10-year gap between life expectancy in the most prosperous areas and that in the poorest areas. For men, the gap is 14 years. There is a risk that that situation will get worse. Our modelling shows that, if we do nothing, the forecast burden of disease will increase by 21 per

cent by 2043. Hopefully, however, that is not inevitable. Change is possible, as I have said, by prioritising investment in primary prevention. It is also about thinking about how we support public spending to be most effective. We have heard about outcome budgeting, and a multiyear approach is a key part of that.

One thing that we have not talked about that might be helpful is about thinking through the lens of place when we think about how public money is spent. For me, that is about where power resides. Could we take an asset-based approach? Could we trust communities and the third sector over the longer term exactly in the way that Adam Stachura described, as happened in practice during Covid? Thinking through that lens of place when thinking about budgeting might be another helpful addition for the committee.

Ruth Boyle: First, we reiterate the comments that are made every time that we discuss budget scrutiny: the importance of transparency; the importance of changes to allow us to look at how spending is changing over years; and the importance of doing year-on-year comparisons. All of that is really important, but I urge the committee, as you take forward your pre-budget scrutiny, to think about ensuring that you can continue to place an emphasis on poverty. We know that 21 per cent of our population live in poverty, and that rises to 24 per cent for children.

It is easy to become numb to those statistics, but we know that poverty has far-reaching negative consequences for people's lives. During the cost of living crisis, we have heard from women who are going without food in order to feed their children. We have seen the impact of poverty in the recent statistics on suicide deaths, alcohol-related deaths and child homelessness. We know that people in Scotland believe in justice and compassion, and we really want to see those shared values being turned into concrete action to tackle poverty. We have cross-party support for the child poverty targets, and it is vital that we meet them and that they are not sacrificed.

In the longer term, tackling poverty and inequality is good for economic growth. It is not just organisations in the anti-poverty or equality sectors that say that; it is also coming from institutions such as the International Monetary Fund. In this climate, the spending that we have all called for today necessitates our looking at our tax system and at how Scotland can use its powers progressively. Our paper sets out a range of options, and what we really want to come from its publication is a serious conversation about how we might take forward some of the options.

Alastair Sim: If we are to address the medium-term and long-term sustainability of Scotland's finances, we need to invest resources where they

will drive inclusive and green economic growth, improve the productivity of the Scottish economy and drive demographic growth, which was one of the challenges that came out of the first session really strongly. We do not need to accept economic and demographic constraints as a given. We can grow the economy and grow productivity, and we can attract talent and investment to Scotland. I see universities as a crucial part of that, but it is wider than that, so please let us focus on investment where we can get that broad return on it to create a more prosperous and inclusive society.

Philip Whyte: As I said, if your starting point is £1 billion and your end point is -£1.9 billion, that is what we need to start centring all the thinking around. As is stated in our written submission, we absolutely cannot get away from the fact that tax will need to play a big part in that. That means looking again at the whole income tax system and at local and wealth taxes, albeit again recognising that there are absolutely legitimate concerns over unintended consequences and diminishing returns. Those concerns are very real.

If you accept that tax has to do some of the heavy lifting but cannot do it all, as other colleagues said and I reiterate, that requires prioritisation and places a responsibility on this committee and, more importantly, all the subject committees to genuinely interrogate whether all the things in the budget will shift the curve on those big priorities and whether we have the evidence to prove it.

Similar to the point that Michael Kellet made, I say that it requires prevention. We cannot continue to discuss the Christie report as though it is some kind of long-term ambition. The long-term ambition was set more than a decade ago, and we need to start doing something about it and to start to shift fundamentally our spending. We are spending billions of pounds every year and losing from the economy billions of pounds every year through responding to the consequences of not having addressed prevention before now. We really need to start shifting the balance of our spend.

The Convener: I agree, but no one tells us what we should be disinvesting from—that is the problem.

12:45

Adam Stachura: Part of this is that we have demographic changes for which we need investment. It goes back to Alastair Sim's point about investing in things that will generate income and about looking at fair work and how we support an ageing population to work more, if people can. They could perhaps be supported to work a little

bit longer in order to bring more people who are no longer in the workforce back into it and create an age-inclusive workforce across Scotland, thus protecting the public sector and those who are contracted by the public sector.

We might find that more people are generating income for the country financially, but also setting themselves up better for the future, so they might not require as much health or social security spend in future. It is about drawing down money by helping more people back into work in the medium and long term. The ageism in our society makes that awfully hard to do. We can start by using the levers of government—a phrase that I have used before is “low-hanging fruit”—and seeing what the public sector can do to ensure that older workers are supported throughout their lives and have opportunities to get back into work when they can, particularly if they find themselves no longer, or not as much, in a caring role.

We have folks who contribute so much to the country but not financially, with £30-odd billion-worth of care delivered in the unpaid sector. Imagine what would happen if they were not doing that any more. We have a really fine balance there. Supporting an ageing population to be able to contribute more financially for longer in life is really important.

The Convener: If we had more time, I would talk to you about the taxation of occupational pensions.

Philip Whyte: Convener, can I add one point?

The Convener: Very quickly.

Philip Whyte: We come here and demand money so, absolutely fairly, you expect us to say where money can be saved as well. I will make a bit of a plea—not to anyone in this room, necessarily—that the opposite should apply on the political side. We talk about prevention. I think that Michael Kellet mentioned this, although I do not want to put words in his mouth. In health, for example, secondary care continues to dominate the system, attention and funding, but you get some of the greatest returns in primary care. You could start shifting your spend from secondary care into primary care for some really big outcomes, but I can imagine the political bun fight that would arise as a result.

I suppose that, as much as there is a plea to our side to be realistic, equally, there is a bit of a plea to the political side to get to the position where we can have a grown-up debate about where our money is best spent and what return it delivers.

The Convener: I thank all our guests. I will allow them to leave and we will then have a short five-minute private session. We will put most of our private work programme to one side and

discuss two issues very quickly, seeing as time is
marching on.

12:47

Meeting continued in private until 12:54.

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