OFFICIAL REPORT
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Finance and Public Administration Committee

Tuesday 10 September 2024

Session 6

The Scottish Parliament
Pàrlamaid na h-Alba

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FINANCE AND PUBLIC ADMINISTRATION COMMITTEE
25th Meeting 2024, 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) (Ind)
*Liz Smith (Mid Scotland and Fife) (Con)
*Michelle Thomson (Falkirk East) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Professor David Bell (Royal Society of Edinburgh)
Professor David Heald (University of Glasgow)
David Lonsdale (Scottish Retail Consortium)
David Lott (Universities Scotland)
Vikki Manson (Federation of Small Businesses)
Richard Robinson (Audit Scotland)

CLERK TO THE COMMITTEE

Joanne McNaughton

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Finance and Public Administration Committee

Tuesday 10 September 2024

[The Convener opened the meeting at 09:04]

Pre-budget Scrutiny 2025-26

The Convener (Kenneth Gibson): Good morning, and welcome to the 25th meeting in 2024 of the Finance and Public Administration Committee. First, I congratulate committee members Liz Smith, Michelle Thomson and Michael Marra on winning the political hero, the back bencher of the year and, jointly, the business of politics awards at last week's *Holyrood* political awards 2024. However, I am of course disappointed that colleagues did not refuse the awards in solidarity with the convener, who, through some oversight, was not nominated.

We have one public item on our agenda, which is to take evidence from two panels of witnesses on managing Scotland's public finances, a strategic approach, as part of this year's pre-budget scrutiny.

For the first panel, I welcome Richard Robinson, senior manager for performance audit and best value at Audit Scotland; Professor David Bell, fellow of the Royal Society of Edinburgh; and Professor David Heald, emeritus professor and honorary senior research fellow at the University of Glasgow's Adam Smith business school.

As we have your submissions, we will move straight to questions. I will allow about 90 minutes for this session. If you wish to be brought in at any time, please indicate to the clerks and I can then bring you in. Without further ado, we will start at the very beginning, as Julie Andrews once sang.

Mr Robinson, we set out 11 questions on the Scottish Government's priorities, and we got some very detailed and excellent answers. I thank you all for your submissions. In the second paragraph of Audit Scotland's answer to the first question, you say:

> "activities to eradicate child poverty will rely upon social security payments, education spending, well paid work in a flourishing economy, and many other factors. For the priorities to be meaningfully felt and understood in the annual budget, a clear articulation of how services and spending will work together will be required."

Is that happening?

Richard Robinson (Audit Scotland): There were some positive developments during the emergency budget review last year, and we refer in our submission to the mandate letters that set those out. In our submission, we say that it would be useful to see that type of thing replicated for budgets. As we know, spending takes place in different departments of the Scottish Government, whether that be health, the economy, education or skills.

The Convener: I am sorry to interrupt but, for the record, would you like to explain what a mandate letter is?

Richard Robinson: A mandate letter was set out during the emergency budget statement last year. It allowed each Scottish Government spending area to state how its spending would match against the Government's priorities. That is important because it allows people across Government to understand how different things are working together. From the recommendations that were set out, whether on child poverty, the economy or the climate emergency, it is clear that the same principles will apply because of their cross-Government nature. Understanding the different changes in spending across different portfolios will be quite important.

The second thing that we say is that the priorities will not be achieved overnight; they will require a shared endeavour over a number of years. As well as highlighting the importance of clarity on which areas of spending will work together to deliver the priorities, we say that it is important to be clear about how the sustained effort will develop over the medium-term plans.

The final point that we raise is about the opportunities with the national performance framework, which is undergoing a refresh. There are opportunities over the medium term to say how the shared endeavours that are set out in the medium-term plans, or multiyear spending—if that starts next year—match with the improvement in outcomes, as we can see in the national performance framework.

The Convener: Professor Bell, is the pace of progress adequate, given the situation that we are in at the moment, or could the Government do more to accelerate work on delivering its priorities?

Professor David Bell (Royal Society of Edinburgh): I do not think that the priorities, in their generality, are particularly new, and progress thus far has not been all that quick. In a way, it perhaps speaks to what Richard Robinson said about focusing on delivering outcomes, some of which are pretty difficult. Child poverty is a long-term issue that cannot be easily addressed overnight. With a multiyear focus on delivery and a clear way of measuring, and making sure that there is, delivery, progress could be somewhat quicker than it has been.

The Convener: One of the interesting things that you said in your submission was:

> "One high-level observation we would make on this consultation exercise is that in many cases it asks the wrong questions."

You go on to talk about that in some detail, but can you explain why you believe that it asked the wrong questions, and what questions should have been asked?

Professor Bell: The fundamental issue is that achieving the goals that the Scottish Government has set out will involve thinking in detail about the kinds of behaviour and innovation that are required to deliver on those promises. The path that we need to travel is not as clear as it needs to be to all the potential actors who have a stake in the delivery of the objectives. Therefore, having a clearer focus on the overall objectives is one way of thinking more clearly about where we are and where we are trying to get to.

The Convener: Professor Heald, taxation is one area in which you have great expertise, and you spent a great deal of time on it in your submission. Correct me if I am wrong, but, when I read your submission, a great feeling of frustration came across. You basically said that the United Kingdom tax system is a complete mess and that the Scottish Government has not really done anything to ameliorate that. How should the Scottish Government make progress on addressing that issue?

Professor David Heald (University of Glasgow): I will start by saying that I have been a strong advocate of devolved taxes for about 50 years. I do not think that this Parliament has done at all well in the exercise of devolved taxation. The difficulty is that there are three taxes that really matter in terms of money: Scottish income tax, council tax and business rates. I know very little about business rates, but I know a lot about council tax and Scottish income tax.

On council tax, it is ludicrous that we are still using 1991 house values. Everybody knows that, but no political party dares to move on that. I strongly make the point that, unless the Parliament can find some way to build cross-party consent for reforming council tax, the system will become more and more irrational, inequitable and inefficient. I fully understand that reform is incredibly difficult politically, but it reflects badly on the Parliament that that has not happened.

On Scottish income tax, we have ludicrous marginal rates that are connected to the different higher-rate thresholds, and there has been the withdrawal of the personal allowance on income of between roughly £100,000 and £125,000. Therefore, you end up with marginal rates of 50 per cent for middle earners and almost 70 per cent for high earners. The position is even more complicated with regard to the repayment of student loans and the withdrawal of child benefit for higher earners.

The Parliament has not thought about how we live with the UK tax system and try to persuade UK Governments to improve the UK tax system and not make things worse.

One of the crucial points is that there should be a revaluation of council tax, because, in essence, people are paying the wrong council tax. An important issue that the Parliament will have to think about is whether revaluation is intended to generate more income or make the system more equitable and efficient. Politically, it will be more difficult for there to be a revaluation if the story gets around that there will be very big tax increases for everybody. There must be a clear lead from the Parliament and the Government on the context for revaluation.

09:15

Another point about Scottish income tax is that the Parliament is in a very weak position relative to the UK Government, because the UK Government can change anything at any time. The Parliament can set Scottish income tax only before the beginning of the tax year. It is important that the Parliament thinks clearly about what it wants the Scottish tax system to look like in 10 years' time. It will take a long time to improve the system, and quite a lot will depend on what the UK Government does in the meantime.

The Convener: The issue that you have touched on is politics. The Scottish Government is in a minority situation and we are 18 months before an election, so one would think that the Opposition parties are very unlikely to get on board with whatever the Scottish Government says. Given its huge majority, could the UK Government perhaps not take the lead on an issue such as council tax reform?

Professor Heald: I hope that the UK Government will do something, because English local government is in total chaos at the moment. Many councils cannot even do their accounts remotely on time. One would hope that the UK Government would provide a lead, but the new Government has tied its hands in relation to national insurance, VAT and income tax. One thing that worries me about that context is that the UK Government might well use highly inefficient taxes to plug budget gaps, rather than using the broad-based taxes. My view is that broad-based taxes are fairer and cause less inefficiency to the functioning of the market economy.

The Convener: We are going to see a lot more fiscal drag.

Professor Heald: Yes. Fiscal drag is the main policy that the previous UK Government established, and it looks as though it might well be continued by the new Government.

The Convener: Professor Bell, would you like to comment? According to its submission, the RSE would like the Government to look at "all tax options".

Professor Bell: Sure. There have been a variety of reviews of the UK tax system, the most notable being the Mirrlees review, which was carried out by the Institute for Fiscal Studies. It echoes what David Heald has just said, particularly in relation to taxes such as council tax. I completely agree with his sentiments on the current nature of council tax, its current inefficiency and its current inequity.

As far as taxes overall are concerned, historically speaking, our tax burden is at an extremely high level. Strangely, however, when it comes to direct taxes, average earners' tax rates are, historically, low. It is through other taxes that money is being generated for the UK system, as well as through a much greater contribution from very high earners. The top 1 per cent of earners contribute 30 per cent of income tax revenues.

Other European countries that have much higher rates of taxation take the approach of taxing middle-income earners more highly than we currently do. In a sense, fiscal drag, which has just been mentioned, is taking us back to the situation that we were in a few years ago, before personal allowances were raised quite rapidly by the Conservative Government. Now, we are reverting to that position and people are being dragged into higher tax bands by stealth.

In addition, on the situation with regard to marginal rates, in particular for those who earn between £100,000 and £120,000, it seems to me that there is a very clear case for going to the UK Government and saying, "How can we fix this?", because it might cause key people to be less willing to supply their labour.

The Convener: If the UK Government is not of a mind to do that—I do not see any evidence that it is, at this point—what can the Scottish Government do with its budget to make things more rational?

Professor Bell: There is always an answer. At the different bands, a set of tax adjustments can be made to offset the sudden jumps that are occurring, but it seems difficult for the Scottish Government to do that unilaterally—although I guess that it could. The way ahead is to think about the whole system. The UK Government should probably lead on that.

We have not mentioned stamp duty, which is a crazy tax. The UK Government could take the lead in seeking an alternative revenue-generating system that would obviate the need for that tax.

The Convener: Richard Robinson, you said in your written submission that

"any tax strategy to consider the overall costs and benefits"

should

"be clear about how these align with its tax framework."

Should the Scottish Government therefore publish information about the behavioural impacts that are anticipated from its decisions?

Richard Robinson: Yes. I will probably take a step back and say that, as we said earlier in the submission, the path to a sustainable budget will rely on a mixture of spending, growth in the economy and tax policy. Part of it is about being clear about the degree to which, over the short and medium term, the Scottish Government expects tax to bridge what we know is a fiscal gap in the finances. As has already been said, fiscal drag has played a big part in that, with the additional banding in Scotland.

One thing that is currently under consideration by the Scottish Government, and on which work is being done by His Majesty's Revenue and Customs, is the extent to which the divergence in Scotland is leading to behavioural change. That is slightly different from points on things such as equity and fairness. It is about the extent to which people will change their tax behaviour—leave Scotland, not come to Scotland or choose to pay themselves in dividends—as a result. The more information on that, the better, because it would help the Scottish Government to understand the extent to which tax policy can be used as a lever.

From the analysis that the Scottish Fiscal Commission produced on last year's budget, we saw that there was behavioural change in terms of the effect of tax policy, with the majority of the medium-term picture being raised through the fiscal drag. It is important to understand the extent to which tax divergence—further change away from the UK position—can lead to additional sums for the Scottish budget, because the rest will have to be managed through growth in the economy or understanding and prioritising spending.

Clarity is needed on the role of each of the three levers over time. That will be important.

The Convener: In relation to the question that we asked about capital expenditure, one issue that you talked about in detail was transparency. You said:

"the Scottish Government should understand what effect its prioritisation of its capital projects will have on achieving its ambitions of growing the economy, improving public service and tackling climate change."

However, you added:

"The Scottish Government should be transparent about these decisions, how and why they have been made and the impact they will have on public services."

Richard Robinson: That is right. Last year or earlier this year, colleagues of mine did a report on infrastructure investment, and we understand that there are developments in the prioritisation of the infrastructure investment plan, which we would encourage.

This is just a case of understanding the reality of the capital budget. The Scottish Government has already said that it cannot afford to proceed with all the capital projects that it would like, which means that the prioritisation of what it can spend will be incredibly important.

The first question was about priorities and clarity with regard to how different elements of spending work towards those priorities. We would expect to see clarity—whether in relation to the priorities that are set out in this paper or other priorities—in that we should be told, "These are the areas that we have prioritised because we expect them to make the biggest difference towards tackling child poverty, delivering excellent services, tackling climate change and so on."

The Convener: Do you have concerns that the capital pipeline programme, which we were supposed to receive early this year, has been repeatedly delayed and will not now appear until after the budget?

Richard Robinson: We are auditors, so we are interested in supporting scrutiny. Therefore, the question is: what are the things that would best allow parliamentarians to scrutinise the budget? Those will include capital information and information about the medium-term financial strategy and the medium-term financial picture, as well as the tax strategy that is expected alongside the budget. The issue is the extent to which parliamentarians can see how that prioritisation has been achieved when they are scrutinising the budget and the difference that it will make in the medium term.

The Convener: Professor Bell, in your submission, you said that

"carefully planned public sector investments will be crucial to help to achieve the increase in productivity growth that is critical for the future of our economy and the public finances."

Of course, there is great concern about productivity at the moment. In what areas do you believe that capital should be invested in order to boost productivity at this time?

Professor Bell: The UK does not have a great record on public sector capital spend, and it has an even worse record on private sector capital spend. Where public sector investment can catalyse the private sector to invest more would seem to be an important area to think about. Given the overall Scottish Government priorities, that might include work around housing, and it would include measures that might help the renewables sector—areas that clearly align with the Scottish Government's overall priorities and where public sector spending can help. It is a relatively small proportion of potential total investment, but where the public sector can leverage in more private sector investment, that would surely be one way of thinking about the best way to use our public sector investment.

The Convener: Professor Heald, you have also expressed great concern about productivity. Where should the Government take forward its capital expenditure, given that you have been very critical of the reduction of capital expenditure in recent years, as allocated by the UK Government?

Professor Heald: I am not in a position to know a great deal about the position on capital spending across the sectors that the Scottish Government is responsible for. The point that I would make is that the standard reflex of the UK Government, which has a knock-on effect on the Scottish Government, is to cut capital when fiscal times get hard.

Alistair Darling, who, in my view, was an excellent Chancellor of the Exchequer, reacted to the global financial crisis by cutting capital. Since then, UK performance on public sector capital has been very poor. It has been low in terms of totals but also poor in terms of execution, so there is a double problem. It is not just how much you spend but whether and how effectively things are brought in to time and to budget.

Crucially, it is a question about the quantity and quality of public sector capital spending and about the degradation of public sector facility assets. It is not just a question of new facilities. You have only to go around Scotland and England to see that the physical state of the infrastructure is deteriorating.

It is a maintenance problem—if you do not look after your assets, they will deteriorate faster than they would if you looked after them well. Therefore, there is a double issue. When Governments come under fiscal pressure, the temptation is to protect existing services and jobs and to cut back on capital. Given the starting position—the degradation of the capital stock and the lack of recent investment—it is important that we do not go through the same cycle again.

09:30

Professor Bell: To add to what David Heald has said, there has been a lot of discussion recently about why it costs so much more to put public infrastructure in place in the UK than it does in other parts of Europe, where protections of labour are much more extensive than they are here. That seems to me to be an issue that is worthy of serious research.

The Convener: I remember visiting the Faroe Islands and being astonished at the low cost of building tunnels that were 10 or 20km long. At one time, we were talking about building a tunnel under the Forth bridge, which was costed at some ridiculous figure of about £2 billion. Years later, the Faroe Islands can build huge infrastructure projects for a fraction of that price. That is a very important point.

I have one final question to ask before I open up the session to colleagues. It is about tackling the climate emergency, which is one of the Government's four priorities. Earlier this year, I and other colleagues attended a presentation by the Scottish Fiscal Commission in which it said that the cost to the public and private sectors in Scotland—obviously, this is not an exact science, given that we are talking about the period to 2045—would be a combined £185 billion. While much of that would have to be paid by the public sector, whether devolved or UK, a lot would have to come from the private sector. Per capita, that is a lot of money—it comes to about £35,000 each. Those figures were broken down by sector.

One point that the SFC emphasised was the fact that the longer we delay taking action on the issue, the more expensive it will be to mitigate it. Do you think that, in its budget, the Scottish Government should do more to focus on tackling the climate emergency and to make it clear how it is doing that in the various portfolios?

Professor Bell, you are looking skyward, so I will ask you first.

Professor Bell: I guess that moving quickly on the issue makes some sense, but we do not want to move wrongly. There are significant requirements for change. So far, we have successfully made big changes in relation to electricity generation, but there are other sectors in which it is trickier to make changes that will help to move us towards net zero—agriculture is perhaps an example. It seems to me that one must be very careful not to take the wrong path. We also need to take the actors with us in order to have some kind of consensus around the way forward and an understanding of the extent to which change will be in the general public interest. That is not an easy task. It takes considerable organisational and managerial effort for that to happen.

At the moment, my view is that we should certainly try to get there, but that we should not do so by taking a number of wrong turnings. We should do so in a way that takes the relevant actors along with us.

The Convener: What would a wrong turn be, for example?

Professor Bell: Schemes that are not fully thought through. The electric vehicle revolution has stalled slightly, because people are not sure whether they are going to be able to recharge their vehicles.

The Convener: They are worried about being able to get from A to B.

Professor Bell: Yes—people have range anxiety. I am fairly confident that the technology for that will come, probably in the medium term, but we do not want to lose public confidence by going off in the wrong direction. There is a great danger in so doing.

Professor Heald: Could I come in on that point?

The Convener: Of course.

Professor Heald: When Gordon Brown set up the spending review system in 1998, the idea of having multiyear planning for public spending—preferably multiyear spending for the whole of the UK Parliament and the whole session of the Scottish Parliament—was important. Since the global financial crisis, spending reviews have come along rather erratically for short periods of time. We cannot plan capital expenditure year to year; capital planning for public resources must be done substantially ahead of time. We also need to ensure that the private sector has the capacity to bid for contracts and execute them. Ensuring that we protect and plan capital spend on a reasonably long-term timescale is crucially important.

One of the reasons why there is overspend on capital projects is that we get a splurge of investment. The private sector construction industry builds itself up in order to do that, the supply of funds then stops and capacity is eroded. At some point there is a crisis, so we start again.

It is important that we go back to multiyear planning in both the UK and Scotland. One of the standard responses from people who respond to consultations is that they ask for multiyear funding. The problem is that the Scottish Government cannot give multiyear funding guarantees to local government or the third sector if it does not have a reasonable degree of certainty about what is coming from the UK Government.

The Convener: I hope that that will change in the not-too-distant future.

Richard Robinson: One of the points that we raise is about the Scottish Government's contribution to things that go wider than its own contribution. EVs are a good example of that, in that there will be private investment and UK Government investment in addition to Scottish Government investment that will contribute to the progress or stability that is required in order to make the change. It will be important for the Scottish Government to be clear in its budget what contribution it can make, or how best it can maximise the impact of its financial contribution to EVs. That might change over time, but how the Scottish Government co-operates with the private sector and the UK Government will be important.

There is a wider point that comes back to there being a tendency to protect resource over capital. The SFC has set out the financial impact of the climate challenges in the long term, and has done the same on the huge impact that changes in health and an ageing population will have. That emphasises that preventative measures—the stitch in time that saves nine—will have to be budgeted for in the medium term to help with mitigation.

It can be difficult to get the bandwidth in the budget for longer-term spending measures or preventative measures, because although some of them might have immediate benefits, we cannot necessarily quantify the difference or short-term returns of others. We think that it is particularly important that the strategies in the Scottish Government that support the budget are clear about the areas for which a longer-term return is expected, whether that is the climate or healthcare. The spending that is related to those things needs to be clearly set out so that it can be monitored closely.

Professor Bell: We were talking about preventative spend probably before the Christie commission and, certainly, since it. In my opinion, we have not made a huge amount of progress on it. I was at the Health and Social Care Committee last week and a witness argued that there should be a separate budget for preventative spend that is ring fenced for the kinds of purposes that Richard Robinson has described.

I agree that it is very difficult to monitor the effects of preventative spending because the positives come quite a long way down the line, and other things might happen in between times. Therefore, trying to figure out the real effect of preventative spend is difficult, but that does not mean that you should not try to do it.

The Convener: I think that, in the 2011 to 2016 session of Parliament, there was a £500 million three-year ring-fenced budget. The difficulty—John Mason has asked questions about this many times; he is quite messianic about it—was in trying to get organisations to disinvest in existing programmes. Even though there was that £500 million on top, people said, "That's great. Thanks very much," but there was still real resistance to disinvesting. It is very difficult.

Richard Robinson made an important point about co-operation. The SFC has emphasised that, on an issue such as peatland restoration, for example, although most peatlands are in Scotland, the UK cannot achieve its climate targets without peatland restoration, so co-operation is important.

I will open up the session to colleagues.

Liz Smith (Mid Scotland and Fife) (Con): I will pursue issues about tax. I thank the witnesses for their responses to the convener, in which they have set out clearly and forcefully some of the problems and difficulties of the UK tax system and the Scottish tax system. From the available data, how easy is it to work out the efficiency of the revenue take in terms of behavioural change? Can we interpret what the behavioural changes are with the current tax system that we have?

Professor Bell: That is a very difficult question.

Liz Smith: I know. It is an important one, though.

Professor Bell: It is very important.

Behavioural change might take various forms. The system might make people work less, it might make them seek to avoid tax more and, under present tax rules, it might encourage them to switch from income tax to capital gains tax. One form that is focused on a lot is that people might be less willing to come to Scotland and some people might be more willing to leave Scotland. Another one, which must worry economic development agencies, is that Scotland might acquire a negative reputation as being a high-tax area, which could cause problems.

The way of trying to measure those behavioural effects will never be complete. As Richard Robinson mentioned, HMRC chooses a bunch of people south and north of the border who have roughly equivalent incomes to see how the Scots ones change their behaviour after a change in the marginal tax rates. That study has demonstrated an effect, but it is only one of the effects; there are also effects on firms and migration effects, which are extremely difficult.

To go back to what I said earlier, I note that there is a key issue around high earners. How they react to higher marginal rates may not be linear, in that there might be a tipping point at which large numbers of people move. I know of people who have moved—it is not the case that no one has moved.

The issue requires a lot of work. Part of the difficulty is that the aggregate tax figures become available so far in arrears. It happens way after the end of the tax year, because self-employed people need to have time to submit their returns. There is additional work to do, but the Scottish Fiscal Commission seems to have engaged closely with that work and I hope that it will come up with more detailed answers to your question in the not-too-distant future.

09:45

Liz Smith: We discussed this last week, too. Part of the issue is economic inactivity and the reasons behind that. Some of those reasons, including mental health issues, are justified post-Covid, but quite a large amount of inactivity is among people who could be at work but who, for one reason or another, have chosen not to work. We have heard of various places, Dundee being one, where they are quite keen to get people back into the labour market, for obvious reasons. Are we doing enough to promote policies that will do that and do we have enough information to show what is working?

Professor Bell: That issue is probably not connected to marginal tax rates in Scotland, because a lot of younger people who seem to be economically active would not be at those higher rates when they enter the labour market.

I recently did some work with David Blanchflower about mental health problems among younger people, which increased very markedly post-pandemic, although they were becoming problematic before the pandemic. The UK seems to be in a worse position than other advanced countries. It seems to me that people's wellbeing has a hugely important overall effect on growth in the economy. I did not have time to research it, but I saw a story in *The Times* today that said that a large proportion of the people who are economically inactive are recent graduates.

Liz Smith: Do we know why the UK's record on that is not as good as that of other countries? Do we have evidence of the reason for that?

Professor Bell: I guess that some of it comes from the institutional framework that exists to try to help people into work. It was some time ago, but I remember when youth unemployment was a problem in the UK and I was working on comparisons with Germany. I recall one of our German colleagues arguing that in Germany, where the apprenticeship system is far better developed than the one in the UK, helping people through the transition from education into work was seen as a societal responsibility. We just do not have that culture. It is not something that can quickly be put in place, but if we start realising that we must do better, that could make a difference.

Professor Heald: Can I intervene and go back to your original question? What matters in relation to the budget is what the Scottish Fiscal Commission thinks about behavioural effects. On the question of the increase in the top rate, the Fiscal Commission thinks that 85 per cent of the revenue disappears. In the context of the advanced rate, it thinks that 50 per cent of the revenue disappears. There will be arguments for many years about whether those numbers are correct, but given how budget scoring works, the position in practice for the Parliament and the Government is that those are the numbers that count.

Liz Smith: That is a fair point.

I have one final question. You gave an interesting analysis of the problems within tax structures. To what extent are the UK and Scottish Governments—particularly the UK one—giving enough credence to debates about global taxation, particularly in areas such as environmental policy and tax avoidance? Do we have to be more cognisant of what is happening in such areas?

Professor Heald: We now live in a world economy that is much more mobile; it is very mobile at corporate level. The Organisation for Economic Co-operation and Development has done a great deal of work on rationalising corporate tax so that there is less avoidance, but it is incredibly difficult and there seems to be a mixed record in how successful that has been.

One thing that the UK could do is to better resource the tax compliance function of HMRC. People talk glibly about the size of the tax gap, but HMRC has taken substantial staffing cuts over recent years. Governments like to say that they will get £X billion from less tax avoidance, but without any substance behind that. It seems to me that that is needed for both efficiency and equity reasons.

Taxpayer perception of the tax system is very important. If people believe that there is lots of tax avoidance, that might well tempt them to go in for tax avoidance themselves and, possibly, for evasion. Certainly, any moral qualms about tax avoidance will be reduced. More emphasis on that and better resourcing of HMRC are needed.

Some of the behavioural effects are perfectly legitimate reactions. Some can involve illegality, but a lot will result from people making different decisions. For high-middle earners, the interaction of the tax system with child benefit withdrawal creates incentives for part-time working. The movement of people to part-time working, not through personal preference but because of the incentives in the tax and benefits systems, is not conducive to the economic growth that is fundamental to achieving all four of the First Minister's objectives.

Richard Robinson: I want to strike an important distinction between compliance and legal behavioural change. Each year, the National Audit Office produces a report on assurances about Scottish income tax, and we produce a report alongside it for additional assurance in the Scottish context.

Currently, HMRC regards the compliance risk, which is the risk that people evade tax—they should pay tax but do not—as being the same in Scotland as it is anywhere else in the UK. In respect of how that factors in through the fiscal framework into the budget, it is treated in the same way as it is anywhere else in the UK; it is just divided up as a proportion of the amount. That will cause a problem if the divergence becomes so wide that the HMRC thinks that there is a specific different risk to Scotland—that people are more likely to evade tax in Scotland than people elsewhere in the UK are. That is not currently the case. It could be the case in the future, depending on how the situations might diverge.

That is slightly different from some of the behavioural elements, which are completely fine and are just to do with how people choose to live their lives, how many hours they choose to work, how they choose to pay themselves in a legal way or where they choose to live.

The issue—this is where the HMRC data that was mentioned comes in—is whether the Scottish Government has the best information to determine what will happen if it makes certain changes to the economy.

In all such things, it is about relative impact. As Professor Heald said, there is inactivity; there is an inactivity issue all over the UK. It will make a difference to the Scottish Government if inactivity improves more in Scotland than it does in the rest of the UK. The issue for the Scottish Government in the Scottish budget is what types of measures can be put in place in Scotland to help with inactivity and what have you, because the Government will see a relative return from that through increased taxes.

John Mason (Glasgow Shettleston) (Ind): The convener touched on the idea of longer-term planning and the medium-term financial strategy. I was struck by a line in Mr Robinson's submission that says:

> "More will be known following the UK budget expected on 30 October, at which point the Scottish Government must look to see how sustainable its current plans are".

That suggests that we cannot plan for the future, because, even for the coming year, we are having to wait until 30 October in order to see what the scenario is. The committee has been pushing for more long-term planning from the Scottish Government. Is that unrealistic?

Richard Robinson: I am not sure exactly where that is in the submission—

John Mason: It is on page 6, in answer to question 6.

Richard Robinson: As has already been touched on, some of that relates to the fact that Barnett consequentials play the largest role in the Scottish budget. What the UK Government does in its budget will have a large impact on what the Scottish Government has in place. That goes into a little of how the fiscal framework operates.

As we know, wage increases have been a substantial pressure on the in-year budget, and part of the reason for the changes that have been made to budgets has been to allow some of that movement. That was also driven by the fact that, as you know, the UK Government has announced similar measures on pay deals. If the UK Government decides to fund some, part, or all of those deals through increased taxation or increased borrowing, that will result in an increase to the Scottish budget through an increase in Barnett consequentials. In effect, there will be more spending and more money will be available, so the Scottish Government will get its additional money. However, if all the UK Government departments have to manage the increased costs within their existing budgets, there will be no additional money for the Scottish Government.

Apologies if I am saying things that members are already aware of, but that is why it will make such a big difference, because the extent to which the UK Government will pay for the wage deals by one means or another will affect the budget that it is within the gift of the Scottish Government to make its own decisions on.

John Mason: You are kind of underlining my point. If, for the next few years, the UK Government was to give a 5 per cent pay increase to everyone, we would be under huge pressure to do the same. If it gave 2 per cent, as had been thought, it would be different. It is almost impossible for us to plan further ahead.

Richard Robinson: I will go back to the recommendations of the budget process review group in 2017. It set out a number of recommendations for what would help to support the budget. Some of those relate to multiyear spending plans, which have already been mentioned. If the UK Government had a more regular spending plan in place, that would make it easier for the Scottish Government to plan in the medium term. That is slightly different from some of the recommendations about medium-term strategies, which are more about assessing what the Scottish Government would do in different scenarios. The idea of that is to allow the Scottish Government to have a more planned reaction, as opposed to a reaction that is based on what the UK Government might do in any given year.

Audit Scotland has always been of the view that, when things are uncertain—there will be uncertainty from the UK Government, and we have been through Covid, the cost of living crisis, and all the rest of it—planning is more, not less, necessary. The scenarios might be broader; there may well be more or less tax than we thought or spending might be more volatile than we thought. Ever since the inception of the fiscal framework, volatility and uncertainty have been a cornerstone. With great power comes great responsibility; the Scottish Government should be able to manage the uncertainty as best as it possibly can through medium-term strategies, but, undoubtedly, it is difficult. Barnett consequentials are a major factor in the budget decisions that the Scottish Government has to make.

John Mason: I do not know whether either of the others wants to come in on that point.

Professor Heald: In my written submission, I made two proposals that I would like the committee to take up. The Scottish Parliament controls the legislative framework for the Scottish Fiscal Commission. I think that there are two things that would massively improve the budget process.

First, the Scottish Fiscal Commission should be asked to do what the Northern Ireland Fiscal Council has done and provide systematic data on the cost of what Northern Ireland calls super-parity policies—policies that are more generous in Scotland than in England—and sub-parity policies. I make it clear in my submission that I am not against super-parity policies, such as the Scottish child payment and free prescription charges, but the point is that there is a big number attached to super-parity policies and a negligible number attached to sub-parity policies. The problem is that expenditure on public services in areas such as health, education and housing gets squeezed simply because Parliament operates under a fairly fixed budget. Therefore, it is very important that Parliament understands what the costs of all the super-parity policies are. As I said, the super-parity policies are very easy to find, but the sub-parity policies are not.

10:00

John Mason: Could you clarify that? I thought that we had that information—for example, I thought that we knew that social security costs about £1 billion.

Professor Heald: That information is not collected systematically. As far as I know, neither the Scottish Fiscal Commission nor the Scottish Government produces a data set that shows how much prescription charges and all the various different items cost. One of the points about those items is that they are often very difficult to control. Once eligibility criteria have been established, the numbers drive themselves, rather than being determined by policy.

My second proposal—this picks up on what happens in the Netherlands—is that the political parties should agree to have the Scottish Fiscal Commission cost their manifestos. There are two reasons for doing that. Everybody will say, “No, you can’t possibly do that,” but there are two very good reasons for doing it.

John Mason: Could you keep your remarks fairly brief? There would be a cost to that, and I think that that is quite a political issue.

The Convener: In the most recent Holyrood election, all the manifestos came out after about a quarter of the population had already voted by post.

John Mason: That is another issue.

Professor Heald: If what you are saying is that the system is dysfunctional, that is part of the problem.

When you have a fixed budget, especially in a context in which a proportional representation system is used, as is the case in the Netherlands, where coalition—formal or informal—is likely to be required, people will have coalition or agreement discussions without having knowledge of the policies that other parties have put forward.

Politically, that would be a big jump for parties in Scotland, but I think that it is essential in order to avoid the kind of problems that we have been encountering.

John Mason: I will leave that issue for now; I am sure that we could explore it further.

Professor Bell, you make the point, although others have made it as well, that if we grow the economy, that will help with other priorities. Is that definitely the case? To take an extreme example, if a lot of new businesses started and they were all incorporated and all paid dividends, they would pay corporation tax and tax on the dividends, but we would get the money only if there were employees or self-employed people paying income tax. The nightmare scenario would be that we could grow the economy substantially and get no extra money in Scotland.

Professor Bell: I guess that you would get business rates. Another consequence might be that you would also get additional Barnett consequentials, because you would be providing more money to the UK Government. Typically, the Scottish economy grows broadly in line with that of the UK as a whole, so we could reasonably assume that tax revenues would be growing across the UK as a whole, in which case some money might well come back in the form of Barnett consequentials.

I remind the committee that, broadly speaking, there is one issue that really matters in relation to how the block grant adjustment for income tax, which is by far the most important of the block grant adjustments, works, and that is income tax per head. Income tax per head is absolutely critical in how the block grant adjustment is assessed.

With regard to growing the economy, there is the additional effect that, if we manage to grow a bit faster than the rest of the UK, and the BGA—the amount that is taken out of our budget—is smaller, the net effect for us is positive.

John Mason: I could explore that further, but we are a wee bit pressed for time.

I have one other question for any of the witnesses. One of the plans for the current year is to take more of the ScotWind money out of the reserve that it sits in. Do you think that there were alternatives to that, or was that just something that we had to do?

Richard Robinson: I am not able to comment on what the specific alternatives would be.

Again, looking to the medium term, the main thing is that a one-off source of funding is being used to meet what will be recurring costs through wages.

One of the points that the Auditor General often raises is the extent to which the Scottish Government understands the recurring nature of some of its expenditure, especially those elements that are related to costs. The ScotWind money can be used but, as the Scottish Parliament information centre set out in its blog and briefing paper, it can be used only once.

John Mason: I presume that the alternative would be to make further cuts in other expenditure.

Richard Robinson: It is up to the Scottish Government how it chooses to prioritise. Obviously, if it is spending more than it has available to spend, it has to consider where it will spend less.

Michael Marra (North East Scotland) (Lab): I will stick with the same issue. Last week's announcements were a source of significant dismay for many people who were here to talk about a strategic approach to the budget, but what Richard Robinson has just said, on behalf of Audit Scotland, is that taking a set amount of money and using it to pay for recurring spending is a pretty short-term approach.

In October 2023, Audit Scotland said that

"The Scottish Government's projections suggest that it cannot afford to pay for public services in their current form"

and that the Scottish Government's approach to planning for future workforce and pay costs

"will not address current and future capacity challenges and is unlikely to balance public finances."

Do you think that the Scottish Government has heeded those warnings?

Richard Robinson: That is a difficult question. With regard to the workforce paper, we have been reporting two different things throughout our audits. The national health service overview report says that the system has vacancies and capacity concerns but, at the same time, there are policies that say that the way to a sustainable position has to include consideration of workforce costs.

What we expect to see, and what we recommended in that particular report, is that the workforce should be considered along with reforms and reform measures. We might go on to talk about the reform, and I know that the Scottish Government gives six-monthly updates on its reform progress. The extent to which those measures will help to address workforce challenges will be important.

It is also important to understand the balance of how much the Scottish Government can and wants to spend towards its workforce costs, which currently make up more than half of its costs.

In the workforce report, we say that we would expect better, more granular data on the different public bodies that are in place. Sometimes we picture the public sector workforce as one big group, whereas, in fact, it has employees across hundreds of organisations. Changes, for example, to the rates of pay and wages will affect different organisations differently, depending on how much of their costs are due to workforce. For example, it will affect the NHS differently from how it will affect Social Security Scotland.

We need a better understanding of the difference that reform will make to the Scottish Government's comfort levels as to how much of its budget it can spend on workforce.

Michael Marra: A year previously, in November 2022, Audit Scotland said that

"Rising costs and increasing demands mean that the Scottish Government has to closely and carefully manage its position"

and that

"The pace and scale of reform required across the public sector needs to increase."

However, there does not seem to be any evidence that those warnings have been heeded. I have a list of various reports from Audit Scotland over the years, and it does not seem that the Scottish Government is responding to those in any way by looking at finances even in the medium term.

Richard Robinson: We will be producing a report later on in the year on financial sustainability and reform, which will cover some of those issues as well. I think that it is fair to say that we have seen another year in which there have been substantial in-year changes to the budgets. Therefore, there is something about the extent to which the budget that is set at the start of the year can be relied on not to have to deal with large in-year changes. That point has also been raised by the Fraser of Allander Institute. Again, the need for data and realistic planning around what is acceptable, especially in areas of larger spending and important spending such as capital and workforce, is important.

It is difficult in the absence of a medium-term financial strategy. The most recent medium-term financial strategy was in May 2023. A lot has happened since then and we might not get another one until some point in the spring or summer of next year. Therefore, the ability to assess the speed at which things are changing within each department to make itself financially sustainable becomes difficult. However, as I have said, we will be speaking more about this when we report later in the year.

Michael Marra: Would you recognise that having three years of emergency budget reviews, with very significant in-year changes, is very inefficient and certainly does not allow departments or public services to deliver against strategic outcomes? Other witnesses are shaking their heads.

Richard Robinson: I would probably separate out a couple of factors. It is about events and reactions, so it is worth remembering that the past four or five years have been particularly disruptive, in particular with the two years of Covid-19, when there were large in-year movements, and then a little bit of uncertainty about what might come after Covid-19, which, as we know, included the cost of living crisis, inflation at very high levels and all the rest of it. Therefore, it is worth bearing in mind that, within that level of uncertainty and the unprecedented volatility that the Scottish Government budget faced, you would expect to see, as we did, movements during the year to react and to flex the budget to meet the resources that would become available.

Michael Marra: What in-year adjustments in the budget externally required the most recent revisions last week?

Richard Robinson: That is different from meeting in-year demands that arise from pay settlements, for example. One of the things that have been asked, whether in relation to multiyear planning, medium-term financial strategies or the budget itself, is, what is a reasonable assessment of what the growth will be and what scenarios can you plan out against that? Again, it comes back to what we said in those reports that you mentioned and in our submission. Understanding the flex of your budget—the elements that are fixed, the elements that can be changed but it will take time, and the elements that can be flexed quickly—is really important, as well as mapping that against scenarios of what the next year and the next three or five years could look like. That is missing at the moment.

Professor Bell: I will make a couple of points. As Richard Robinson mentioned, it has been a very unusual three or four years for a number of reasons, and I struggle to figure out how even a medium-term financial strategy would have dealt with, for example, the fact that UK debt repayments have tripled from £40 billion a year to £120 billion a year. That is much bigger than the defence budget—it is about the same size as the education budget in the UK as a whole now. That was partly caused by a monetary policy response to the rate of inflation that followed the pandemic, which in turn has propagated very large wage demands. The public sector was somewhat behind, and now we are in a catch-up period. Although that is stretching the budget quite markedly, those demands were potentially predictable, given that public sector wages had fallen behind those in the private sector in recent years.

The other point is that the Scottish Fiscal Commission has said that increasing demand on the health service will mean around 3 to 4 per cent real growth per year going forward. Based on what we have seen, if there is no increase in productivity, the NHS will need 3 to 4 per cent more people each year. That does not seem sustainable at the moment. Therefore, productivity in the NHS has to be looked at. If the NHS is going to attract more people, it will have to pay them higher wages than they are currently paid. That is part of the catch-up.

10:15

Richard Robinson made a point about how the additional payments that will be made south of the border will be financed. Whether that will come from department budgets, borrowing or another mechanism, it will have a very significant effect on the Scottish budget. The Government will have to deal with the consequences in the very short term.

Michael Marra: Those impacts are magnified by the fact that we have a larger public sector in Scotland and wages that are already higher than they are south of the border, so paying 5 per cent of a higher number and to more people is more significant.

Professor Bell: One obvious point is that the adjustments that have been made in-year this year will follow on to next year, because people's wages will not be falling back.

Michael Marra: Professor Heald, in the evidence that you have given today and in your submission, you have mentioned super-parity policies—which I will call "more generous policies", in layman's terms—and you raised that issue previously. On 8 March 2022, you said:

> "This is the time when Scotland should take stock of where it is. One thing that I would like to see in the spending review is serious data on what the future spend on the above-parity programmes will be in the next five or 10 years."—[*Official Report*, *Finance and Public Administration Committee*, 8 March 2022; c 5.]

However, you are here again, more than two years later, making the point about the gap around our more generous programmes and our lack of understanding of it. Is sufficient planning on understanding that gap and being able to express the difference so that we can plan for the future, even in the medium term, taking place?

Professor Heald: No, there is not sufficient data and there is not sufficient understanding. The public also do not understand that, if we spend more on not having fees for university students, on disability payments and on introducing benefits such as the Scottish child payment, the money has to come from the rest of the Scottish budget.

A long time ago, I regularly looked at the Treasury's public expenditure statistical analyses, which come out every July. At that point, Scotland spent significantly more per head on health than the rest of the UK. Over time, that has eroded. Essentially, we have a fixed budget. Now we have reached the point at which getting more tax revenue by introducing higher rates will be very difficult—politically and economically.

In essence, we have a fixed budget. We need to know how many demand-led programmes—social security being one and prescription charges being another—there are. The political difficulties that the UK Government got itself into by withdrawing the winter fuel allowance made it obvious that universal benefits are difficult to withdraw. My guess is that the Treasury has been suggesting to every chancellor for the past 10 years that they should abolish the universal winter fuel allowance, but previous chancellors have refused to.

In principle, I can understand the arguments for abolishing the universal winter fuel allowance, but we need to be prepared for the administrative procedures and aware of the public mood to know how to do that. The big issue seems to be that the pension credit income limits are actually quite low, so people fall out of being able to claim benefits at a point at which most of us would probably think that they still needed payments. If you are going to do such things, you need very careful planning of the administrative processes and eligibility. It is hoped that the UK Government and devolved Governments will realise that, even if you want to reduce some of these benefits, you have to approach it in a systematic and careful way.

Michael Marra: We took some very good evidence in Dundee recently from young people about their priorities for the Scottish budget. Their top priority was employment opportunities and careers. I was struck by the fact that that echoed evidence that we had taken from you on 19 September last year, Professor Heald, when you said that

> "Having an economy that makes the people whom we have educated at great expense want to stay in Scotland"—[*Official Report, Finance and Public Administration Committee*, 19 September 2023; c 15.]

would be your strategic priority. Is the Scottish Government succeeding in that regard on the basis of the evidence? That seemed to be one of the principal concerns of the young people whom the committee met in Dundee.

Professor Heald: I do not know of the data, but my experience as a university professor in Scotland was always that there was very substantial migration of our students south, so that is certainly an issue. The structure of the economy is probably more of an issue than tax itself, but getting people to come to and stay in Scotland is an important public priority.

Professor Bell: I have not looked at that issue recently. I imagine that it will soon be possible to interpret what is going on on the basis of the census on both sides of the border. Net migration flows tend to be from the rest of the UK into Scotland, so there will always be some people coming and going. I suspect that the average age of the people who are coming to Scotland is higher than that of those who are leaving. That is an empirical question for which I have only some heuristic evidence. That is the case in the Highlands, without a shadow of a doubt. However, it must be said that we have not been all that good at creating employment opportunities. Anton Muscatelli recently made the point that all of Scotland's cities must step up to the mark, because those are probably the places where most jobs are going to be generated.

Michael Marra: With regard to place-based opportunities and economic development in the Highlands, for instance, are there plans or strategies that will be able to deliver those kinds of jobs?

Professor Bell: That is extremely difficult in remote rural areas. That goes back to my earlier point that you probably need the public sector to take slightly bigger risks and induce the private sector to invest in those areas.

The Convener: In the 20th century, Scotland had the lowest population growth of any country on earth. I think that 2 million people migrated in the half century before this Parliament was established, so that is a long-term issue.

Michelle Thomson (Falkirk East) (SNP): Many of the areas that I am interested in have been covered. I want to explore the main theme of this evidence session. Thus far, the evidence has highlighted the considerable complexity that is illustrated by the fiscal framework. It also points to the fact that there is a bit of a johari window issue in that politicians are driven to look at very nearside issues in relation to the budget in hand at this moment in time, although our earlier conversation was about the lack of long-term infrastructure investment—capex and so on. Public sector net investment was 8 per cent of gross domestic product in the 1960s and had dropped to 0.5 per cent of GDP by the 1990s. That big thematic framing of the UK macroeconomy tends to be forgotten when we are looking at this exercise.

That is a long explanation for what is a simple question. Given that this evidence session is about a strategic approach to the Scottish budget, in summing up, what areas would you like to pull out that have not been considered thus far to genuinely attempt some consideration of a strategic approach to the Scottish budget?

You looked at me, Professor Bell, so I will go to you first.

Professor Bell: I must admit that, when I was asked to appear today, I was a bit uncertain about whether I would be asked about strategic issues or whether the focus of questioning would be on the problems that are currently faced. It seems to me that you should not waste a crisis, and the current situation is an opportunity to put in place a more coherent strategic view. I am interested in looking at international comparators on the issue. Yesterday, I heard an interesting discussion on, dare I say it, the "Leading" podcast about Taiwan and how public services and trust in Government have been transformed, basically through digital infrastructure.

On strategic issues, I have to say that I am concerned about whether the fiscal framework has longevity. I cannot imagine that it has all that much public support, because so few of the public have a clear understanding of how on earth it works. Another issue is that we have talked and talked about prevention, yet we have not really grasped that nettle. Surely now is the time to do that.

Professor Heald: I do not think that we can make much progress without better relations between the Scottish Government and the UK Government. There are all sorts of issues. When the UK Government makes changes in-year, those are perfectly feasible for the UK Government, but they have much bigger ramifications for the Scottish Government because of its limited fiscal flexibility. Equally, the Scottish Government needs a better relationship with local authorities. In the evidence that has been submitted to the committee for this inquiry, there are several local authority submissions, and they all make the point that so much ring fencing is going on, which deprives local authorities of flexibility.

I think that one needs better relationships between the UK Government and the Scottish Government, and between the Scottish Government and local authorities. The Scottish Government tends to treat local authorities as agents of itself, in a way that certainly happens in England as well. There needs to be better governance of those complex relationships, as well as a better understanding.

To go back to what David Bell said a minute ago, the revised fiscal framework does not give the Scottish Government enough flexibility. We are going through a period of a remarkable level of shocks. I hope that the shocks are over, but I am not very confident that they are over. In a period of shocks, it is very difficult to balance, year on year, a budget of the size of the Scottish Government's. The more the Scottish Government takes on demand-led expenditure, such as some social security benefits, the more the problem becomes intensified.

There is an issue to be negotiated between the UK and Scottish Governments and between the Scottish Government and local authorities. The council tax freeze clearly came as a big shock to local authorities and has caused a great deal of ill will. The UK Government tends to think that, if something goes wrong, we need more centralisation. The Scottish Government seems to think exactly the same: that we need more centralisation. My view is that, generally, excessive centralisation is one of the problems at both the UK and Scottish levels.

10:30

Richard Robinson: I agree with everything that has been said about the multi-Government dimension. It would really help to have a quantification of what it will take to get the Scottish Government towards a sustainable position.

The previous medium-term strategy was quite stark. There is a gap. It would help if the budget and the medium-term financial strategy could give us a clearer understanding of what will make the difference and get us over the line. If it is reform, it would be good to know how much fiscal sustainability the Scottish Government expects to see from reform, and in what timeframe, because it will not all happen immediately. If it is prioritisation, we need to clearly see which elements of spending or costs will be protected, because that is what makes the biggest difference. We would also like to see an honest conversation about the areas where the Scottish Government is prepared to disinvest, if needs be, during the year in order to manage its fiscal balance.

Better quantification of what is going to make the difference and get us towards fiscal sustainability would be quite helpful.

Michelle Thomson: Thank you everyone. That helpful thread has taken us back to the complexity of the big picture.

The Convener: Professor Bell, do you have something to add?

Professor Bell: I fully support what David Heald said about local democracy. I was at the Health and Social Care Committee last week discussing integration joint boards, which add a layer of complexity, because you are trying to marry local democratically elected bodies with NHS boards. It is unclear whether that is going to be successful. We have gradually been chipping away at local authorities' freedom to take action, which I do not think is a good thing.

The Convener: I am very keen on radical reform in that area. We will not go into that specific reform, but I have a couple of final questions, one for Professor Bell and Richard Robinson and the other for Professor Heald.

My first question is for Professor Heald. This is not specifically about reform but it follows up what you said. In your answers and responses today, you have been really good at putting a lot of what is in your document on to the record. I appreciate that. We have not really talked an awful lot today about the issue of improving public services. Your submission says:

> "I have long been worried by the squeezing out of public services expenditure ... by expenditure which is volatile and not amenable to precise forward planning."

You have talked about some of that already. You say:

> "In England, such expenditure is

annually managed expenditure

> (with the Treasury funding overspends due to higher claims on pre-set eligibility criteria), whereas in Scotland such expenditure is effectively"

departmental expenditure limit

> "(with the Scottish Government having to finance excess expenditure out of the combination of the Barnett formula-determined Block Grant and Scottish tax revenues). This constitutes a serious risk to public services expenditure."

How do we mitigate such volatility in our current situation?

Professor Heald: We have to go back and think about the fiscal framework in the context of the Scottish Parliament taking on more expenditure functions that are not plannable. I have already made the point that having fiscal flexibility from borrowing powers and a resource back-up is insufficient. There must be very careful thought about that.

There has been a theme of strategic thinking about expenditure, which I greatly welcome, but that will be ineffective if you have to have panic reductions in expenditure in-year. Once organisations know that the finance minister might come along and take back any money that is left in their budgets halfway through the financial year, you will find that organisations lower down the hierarchy start behaving differently.

I understand that we have gone through a period of repeated shocks. As has been made clear, some of the public sector wage settlements are catch-up, which ought to have been expected. Unless we get a period of stability—which I have doubts about—we will continue with the same problems. There is an issue with the Scottish Government talking to a UK Government early in its life about how one can manage certain pressures, some of which are completely outside the Scottish Government's control, without disrupting forward planning.

The Convener: Professor Bell, on the issue of public service reform, the Royal Society has noted

> "that there has been more growth in public sector pay at the lower end of the workplace scale than there has been at the top."

We know that, on average, the average public sector employee in Scotland earns £2,400 a year gross a year, and £1,500 net, more than those south of the border. You have said:

> "The public sector pay policy should align with the market value of the skills needed to deliver transformational change."

Do you think that the Scottish Government was wrong to emphasise pay rises for lower-paid workers? The alternative is to increase the size of an envelope that is already under strain from higher pay settlements.

Professor Bell: Having some higher pay settlements does not have a huge effect on the overall budget, because—

The Convener: Because of the numbers.

Professor Bell: There are not huge numbers of highly paid managers in the public sector. One difficulty associated with focusing on those at the bottom is pay compression, in that differentials get squeezed, and you may therefore find that people's willingness to take on additional responsibility or training is weakened. That is one possibility. There is another highly relevant question, about whether there are sufficient high-level skills in the public sector—managerial skills, leadership skills or even technical skills—to carry through the kinds of reforms that we have been talking about and just to make organisations function efficiently.

I am not sure whether it is in the long-term interests of the public sector to pursue a strategy of hiring consultants whenever you are confronted with a problem that you cannot easily solve, so that they can solve it for you. Overall, that will not necessarily reduce the overall size of the effective pay bill that you face.

Having emergency agency-type work is somewhat of an issue in the health service. People need to be satisfied with the pay levels that they have and the working environment that they are in, which could perhaps obviate the need for extensive use of external support.

The Convener: Yes, indeed. You were talking about HMRC earlier. I knew a colleague who was very good at chasing down people involved in tax avoidance in the private sector, and he doubled his salary in moving from HMRC. That is a real issue.

I would like to explore those things further, but time is against us. Richard, on the subject of reform by the Scottish Government, Audit Scotland has said:

> "it is unclear what additional spending is being allocated towards reform, what levels of cumulative savings its programme of reform will generate, and over what period these savings will be realised."

Richard Robinson: Yes. There are a couple of issues there, one of which relates back a bit to what we were talking about earlier. Some of the reforms will take time to do, and they are necessary. Those could include preventative measures, climate measures, or what have you. It is similar to the point that Ms Thomson was making earlier, which is that it is a matter of seeing the role that reform will have in managing fiscal sustainability.

We noted in our paper that there are different types of reform—everything from efficiencies to more structural changes. Some things may have costs to the budget. Is it clear how those costs are being met? Is it clear to those scrutinising the budget what the expected return is?

The Convener: Thank you for that. We have so much more that we could explore, but we have another panel of witnesses. Just before we wind up, would our witnesses like to make any further points on areas that we might not have touched on fully in our evidence taking?

Omertà—that is okay.

I thank our witnesses very much for their responses to our questioning. We will take a wee break now before hearing from the next panel.

10:40

Meeting suspended.

10:47

On resuming—

The Convener: We continue our evidence taking on "Managing Scotland's Public Finances: A Strategic Approach". I welcome our second panel: Vikki Manson, deputy head of policy at the Federation of Small Businesses Scotland; David Lonsdale, director of the Scottish Retail Consortium; and David Lott, deputy director for funding, reform and accountability at Universities Scotland.

I intend to allow up to 90 minutes for this session. If our witnesses would like to be brought into the discussion at any point, they should indicate that to the clerk and I will then call them. We have already seen your written submissions, so we will move straight to questions. The first question is a bit of a strange one. I thought that the answer to it might be just a wee bit different from the answers to the questions that we have been asking so far. It is one for you, Ms Manson. You said that

> "there have been consultations published proposing changes on a number of different areas",

and you raised concerns about the level of consultation that has been embarked upon. Will you comment on that?

Vikki Manson (Federation of Small Businesses): Yes, absolutely. I joined the FSB back in January. Since then, I have responded to seven consultations on various topics. Having spoken to our members, all of which are small businesses, I realise that many of them are not even aware of what consultations are and that, much of the time, they do not understand their content or the impact that they will have on their business.

I feel as though those who are running the consultations are at arm's length from small businesses. We have responded to quite a number of consultations on topics such as the circular economy and heat in buildings. There is a bit of a disconnect between small businesses and Government when consultations are held. It is usually organisations such as ours that would respond to them, but it is difficult to engage with small businesses to understand their opinions on the content of consultations. We try to reach out to understand their views and we hold round-table sessions, but small businesses suffer hugely from lack of time, so it is difficult to get them engaged. There are concerns that there have been a lot of paperwork, consultations and strategies without engaging with small businesses and understanding their views.

The Convener: You think that the Government is paying lip service rather than seriously consulting with the small business sector.

Vikki Manson: Yes. There are probably more creative ways to understand how consultations have an impact on small businesses. My head of policy at the FSB has been involved with the new deal for business regulatory sub-group. Over the past few weeks, some progress has been made on that, and there has been a commitment to analyse the deeper and cumulative impact of regulations on small businesses through a more detailed business and regulatory impact assessment. It is great that there has been progress, but we need to understand how that approach will be rolled out and how engagement with small businesses will take place.

The Convener: I am going to call our next witness Mr Lonsdale, rather than David. As four of the five male witnesses today are called David, that will make life a wee bit less confusing. We had a Richard on the earlier panel, just as a token, but you really have to be called David to give evidence here. For example, on previous occasions we have heard from David Eiser and David Phillips—there have been loads of Davids.

Mr Lonsdale, Vikki Manson touched on the regulatory burden, and you expressed concern about that in your submission. Will you expand on that a wee bit?

David Lonsdale (Scottish Retail Consortium): Thanks for the invitation to be here today. On the previous question, about consultations, and on your point about the regulatory burden, convener, I echo many of Vikki Manson's points.

In addition to our written submission, we have sent committee members a paper that we published on our Scottish budget recommendations. It outlines a number of regulatory initiatives that the Scottish Government is pursuing at present. Of course, we must also be cognisant of the fact that the new UK Government has quite a rich regulatory agenda, much of which we heard about in the King's speech a few weeks ago. That is a lot to take on at a time when trading conditions for the sector are pretty tough. At the moment, we publish our retail sales and shopper footfall data every month. The most recent figures, which cover the past 12 months, show that retail sales in Scotland fell by 0.3 per cent.

We were encouraged by the programme for government that was issued the other day. From what we have seen and digested thus far, it seems that no new additional regulatory initiatives are emerging, which is good. There was a recognition not only of the things that we have been saying to ministers and the Government but of the wider context of trading conditions and what is happening at the UK Government level. That said, there were no fewer initiatives coming forward, so the wide range of matters that we have articulated in our budget submission and to the committee are still on the table. We have yet to see the details on when those will come through.

On your earlier question, we feel that consultation is important even if we do not necessarily see eye to eye with the Scottish Government on a specific issue. The paper that the Government published two years ago on introducing in-store restrictions on alcohol marketing is seared in my memory. There was no consultation; it just published a paper that said, "This is what we are going to do," and there were no real discussions beforehand. Consultation is helpful and, I hope, leads to there being a more rounded and considered viewpoint on a given issue.

The Convener: I think, though, that you would prefer to participate more in the creation of such policies rather than just be consulted on them. Is that right?

David Lonsdale: Absolutely. Another topical example is last December's budget, when the Scottish Government announced that it was considering a business rate surtax on grocery stores. That came as a total shock to us—it came completely out of the blue. It completely flew in the face of the shared ambition that had been set out in the new deal for business, which was about involving business at the earliest stages of policy development. We have a whole range of other grumps and complaints about that proposal.

As I said, business and Government will not always agree on every issue. We tend to be a very progressive industry, and we will engage constructively with the Government and support most of its ambitions. On many regulatory initiatives, there is an issue with sequencing, and, as I said earlier, it is all about being cognisant of the wider economic and regulatory challenges at a given time.

The Convener: You mentioned your concerns about regulation. For the record, will you say which regulations you feel are surplus to requirements and could perhaps be repealed and which others you feel should not be implemented? I will ask Vikki Manson the same question. Do not worry, Mr Lott—I will be coming to you, too.

Vikki Manson: Yes. In terms of—

The Convener: I am sorry, but I was going to let David Lonsdale speak first, because he was already discussing that topic.

David Lonsdale: As I said, we highlighted in our budget submission seven or eight regulations that are on the table at the moment. Their sequencing and regulatory burden are key. At the moment, we do not know a tremendous amount of detail about some of them. Our understanding is that framework legislation will come first and the detail will come at a later stage, so it is difficult to be certain as to what the implications will be.

The Convener: You are telling us. We have to scrutinise it.

David Lonsdale: Absolutely. I do not envy you that.

Regulations are to be introduced on a range of things: the selling of products that are high in salt, fat and sugar; alcohol restrictions in-store, as I mentioned; the elevation of minimum unit pricing for alcohol, at the tail end of this month; vapes; and disposable cups—we are not convinced on the need for that one, as we think that changes that are already afoot in industry might suffice on that front.

There have been new restrictions on fireworks. There will be restrictions on the selling of peat. The deposit return scheme was aborted last year, but it looks as though it will come back at a UK level. Extended producer responsibility on packaging is coming in. A lot is happening in that area. As I said, we are not entirely convinced about disposable cups, and we have yet to see a lot of the detail on some of the other measures.

The Convener: Ms Manson, do you want to comment on regulation?

Vikki Manson: Yes. I agree with most of what David Lonsdale said. The issue is not so much the regulations themselves as their delivery on the other side and how they will be rolled out. Timelines are a contentious issue for us. Often, a period of 12 months is suggested for the delivery of regulations, whereas small businesses, in particular, need a little more time to put in place those new practices.

I echo a lot of what David Lonsdale said about the regulations that are coming forward. He spoke about single-use cups. We do not have too much of an issue with that, as we see it as being similar to the plastic bag charge. Again, it is more about how that will be delivered, what systems will need to be put in place, what financial support there will be for small businesses, the using up of existing stock and other such issues. All such things need to be teased out a little more, and businesses need to be allowed enough time at the other end to put them in place, rather than rushing things through in order to tick a box to say that it has been done.

There are also concerns about heat in buildings. Zero direct emissions heating systems are a concern for our small businesses. Again, it is about delivery: businesses need to be given enough time to put in place those new systems. How businesses will finance that is also a concern. We looked at research on replacing current gas and electric boilers. No finance was available for that. Loans were available, but a lot of small businesses cannot stretch to taking on more debt, so there is a need to look at grants and other creative ways in order to support them for the roll-out of new regulations.

The Convener: Are you suggesting that implementing those regulations would prevent small businesses from expanding or from focusing on what they are trying to do as businesses?

Vikki Manson: Yes, absolutely. In 2023, we undertook our “Big Small Business Survey” report. Some of you might be familiar with it. The survey looked at about 10 different areas for small businesses, and we had quite a lot of responses. One of the areas that we looked at in detail was the administration of small businesses. The data showed that most small businesses spend at least eight hours a week on admin tasks over and above their normal daily operational duties. They are overloaded, and they have to create time for anything additional that comes in. That hampers growth.

The Convener: Thank you.

Mr Lott, you have been very patient. On universities, one fundamental point that you want to make is about research grants and so on. The floor is yours.

11:00

David Lott (Universities Scotland): Our written response focuses on research, but a lot of the points that I will make apply equally to education, training and so on.

We consider that research can make a contribution across all the Government’s priorities but, if we were to choose one main priority to focus on, it would be economic growth. Our research base in Scotland is exceptional. It levers in almost £1 billion from outwith Scottish Government sources, which creates remarkable assets for Scotland. It is always worth remembering that research, in and of itself, is a significant economic actor. A lot of people—well over 10,000—are employed in high-quality research jobs, and sustaining that is dependent on leveraging that resource.

The other key point about research is its output, which contributes across Government priorities. It is the foundation from which we see company creation and innovation in our economy—recently, you visited Dundee and saw that for yourselves. A team in the University of Dundee’s school of life sciences will be sustained not only by Scottish Government resources, through the Scottish Funding Council, but, crucially, by leveraging money from other sources across the UK and internationally. The programme for government includes an example of work between the University of Dundee, AstraZeneca and the Scottish Government on kidney treatment. That work will feed into public services and will, I hope, result in better patient outcomes and a better return for the public purse.

Our concern is that, over a decade, the resources that have been made available through the Scottish Government have declined in real terms—by 20 per cent against the GDP deflator, which is the usual estimate. However, in recent years, that is inadequate to describe the costs that our members are facing, because many of those costs are rising above the retail price index and the normal things that we are experiencing in the economy as a whole—for example, members are buying equipment for which the inflationary pressures are very high.

We are concerned that that asset for Scotland is being diminished. Certainly, what could be there is not there. We are losing share of UK Research and Innovation resources, for instance. I note that the various research councils—the Medical Research Council, the Biotechnology and Biological Research Council, the Engineering and Physical Sciences Research Council and so on—are closely aligned to the themes of the innovation strategy. If our aim is to grow the economy—universities very much share that aim—we need to see a pivot back towards investment in those outcomes.

The Convener: One of the things that John Mason pointed out when we had a similar discussion a couple of years ago was that, at that time, the University of Glasgow had reserves of £770 million. Facts such as that make things difficult from our perspective. I can understand exactly what you are saying but, when some universities have that level of cash assets, it is difficult for us to say that we should take money out of other areas of priority expenditure, which we would have to do, given that the Scottish Government has a more or less fixed budget from which to provide funding. How would you respond to that? I know that not all universities are as prosperous as that, and perhaps Glasgow does not have quite as much money stashed away now as it did a couple of years ago, but how would Universities Scotland address that issue?

David Lott: We have 19 diverse members, and they are certainly in different positions. Audit Scotland acknowledges that reserves are an important part of an institution’s financial strategy, but it is important to remember that the reserves represent the accumulated value of the institution, so that figure will include buildings and equipment, which means that you can end up looking at a rather skewed picture. An ancient institution such as the University of Glasgow has a lot of assets, but they are not assets that can be easily turned into spend on staffing, equipment, heating and so on. What one certainly should look at is the underlying operating position, and the Scottish Funding Council's examination of the institutions’ forecasts for 2023-24 shows a deficit of £75 million at a sector level.

Rightly, the SFC would like to see institutions returning a surplus of between 3 per cent and 5 per cent, so the current situation is going in the wrong direction. One of the big reasons it is going in the wrong direction is that, although we have always had some cross-subsidy for research, we are also combining that with significant cross-subsidy for education and we are now very much reliant on income from international fees for that cross-subsidy, which has very much dried up in the recent past.

The Convener: In order to deliver the levels of innovation, productivity and economic growth that the university sector considers that we could deliver, what additional funding would you like from the Scottish Government in the year ahead, and what private sector leverage could that attract? I know that that is not an exact science, so perhaps you could respond on the basis of previous experience.

David Lott: Clearly, the budget ahead will be tight. A figure in the existing Scottish Government capital spending review, which we will point to in our budget submission, represents about a 3 per cent increase on the current level. You need to remember that universities are slightly odd in this context. It is a capital budget even though that resource, going through into the research funding for the Funding Council, is being spent on people and activity.

The Convener: Are you looking for a 3 per cent increase or three percentage points of increase?

David Lott: Yes. That is what—

The Convener: The former or the latter?

David Lott: It is a 3 per cent increase on the current level.

The Convener: Is that all? That is not incredibly ambitious.

David Lott: We are calibrating it to where we are aware the Scottish Government's position is for the year ahead. Over time, we absolutely need to grow the research budget. There will be a conversation then about how we can increase the Funding Council's research excellence grant and research postgraduate grant from that capital source.

I will try to answer your question about innovation and the economy. Importantly, as the innovation strategy is implemented, it has a recommendation to look at innovation and funding overall. Some priority needs to be given, within the resources across Government, including the economic development directorate, to the issue of how we invest in innovation through universities. At the moment, that connection is not made well enough, and we think that we can amplify the impact of that money if we work alongside Government in that area.

The Convener: What does 3 per cent represent in cash terms, and what private sector investment would that bring in over, say, five years?

David Lott: Off the top of my head—I would need to confirm this—it is in the low double-digit millions.

We might see a doubling of the amplification effect in terms of direct leverage and creating that research capacity. The analysis of the economic value of research activity is 8:1 across the piece.

The Convener: There are quite a lot of figures here. For example, according to your submission, London Economics estimates that there is a

"12.7:1 economic multiplier on resources won from UKRI".

The figures that you have given us all seem to be very positive in that direction.

David Lott: May I make one more comment?

The Convener: Of course.

David Lott: We have been discussing with the Government how we might achieve greater join-up on the economy side of its work.

In terms of leverage, there are policy changes, too. In its funding, Innovate UK has a limitation on the level of resource that can go into university projects. We think that that is not suited to SME-heavy economies such as Scotland's, because it is quite a challenge for a company to engage with a funding call from Innovate UK, and there are a lot of opportunity costs rolled into making such projects happen. If the universities can take the lead on behalf of business partners, we may be able to leverage more Innovate UK money into Scotland. We currently leverage about 6 per cent of the UK total, as far as we are aware. Although it has dropped significantly, we are leveraging 12 or 13 per cent of research councils' money, because that is about universities. There are policy measures beyond the budget that we could take to help businesses in Scotland to innovate and access resource.

The Convener: Ms Manson, what kind of relationship does the Federation of Small Businesses have with Universities Scotland? What can it do to help you, or vice versa?

Vikki Manson: There is not much of a relationship at the moment, as far as I am aware. We are more involved with Skills Development Scotland, so we are probably more on a level of modern, foundation and graduate apprenticeships. I can check that, but I am not aware of our having any engagement with universities at the moment. We would definitely be open to doing that.

Small businesses have found that there has been quite a large impact in relation to skills. Returning to our survey, a third of our businesses felt that lack of staff had had an impact on their business operations. Also, upskilling new employees is quite an issue for our small businesses, with more than two-fifths of them responding that they did not feel confident that they had appropriately skilled staff.

The Convener: I am tempted to ask about non-domestic rates, but I am sure that colleagues will be keen to come in on that, so I shall allow them to do so.

I will open out the session to colleagues, with Ross Greer to ask the first questions, to be followed by Liz Smith.

Ross Greer (West Scotland) (Green): My question is for David Lott. I will pick up on the convener's question about university reserves. The University of Glasgow's reserves come to £1 billion but it does not have £1 billion in cash; its reserves are not liquid and a lot of it is in the form of properties. The University of Edinburgh has reserves of about £2.7 billion, which is the largest of any university. A billion pounds of that is cash, although £1.7 billion is largely the university's property portfolio. Where a public institution has such substantial cash reserves—more than the Scottish Government has been allowed to have in its reserves, historically—do you acknowledge the challenge in providing even more public funding to that institution?

I acknowledge that no other university is in that position and that you are here to represent the whole sector, but has there been discussion in the sector that the inequality of reserves makes taking a blanket approach to public funding that bit more challenging?

David Lott: First, you probably have an advantage over me in knowing the detail of the University of Edinburgh’s accounts, but I would observe in general that, when we look at the cash figure, we need to be aware of where that has come from and what it is attributed to, and we also need to look at the debt figure. Sometimes, the figures can be very large, because some of the organisations are very big, but we need to look at the detail before reaching the conclusion that an institution is in a particular position.

I will make two points. One is that the institutions are delivering activity on behalf of Scotland by, for example, teaching people and carrying out research, but the resources that are being made available for that currently means that they are making a loss, and that is a significant issue. If an institution has cash, that enables it to invest and act to the benefit of Scotland. If we divert resource—that is behind what you are suggesting—to make up for the deficit that I am describing, that would remove that potential impact. We need to think very carefully before starting to explore whether, at this moment, an institution may be able to make a contribution to the cost of something.

Ross Greer: That is a fair point. I would like to expand on that in a huge amount of depth, but I have questions for other witnesses as well. I may come back to that later, if that is okay.

David Lonsdale, your initial point of complaint about the public health levy was, essentially, that the retail sector felt blindsided by it being included in the budget. I want to explore that a bit more. The language in the budget was simply a commitment to consult on its possible reintroduction. Is your position that either the retail consortium or the sector more broadly should have been informed in advance that that would be in the budget—that is, that they should have been informed before Parliament that there would be a consultation?

David Lonsdale: Yes, we were blindsided by that announcement. The new deal for business that Government and business had signed up to included a commitment about business being involved in policy development at the very earliest stages.

On how you put your question, the public health levy is a misnomer. That is not what is in the budget. Essentially, the budget contains a new tax—or, if you like, a regurgitated tax—to raise money. The budget refers to sustaining public finances, but, other than using the phrase “public health levy”, there is nothing about public health in it. It is—

Ross Greer: It is about alcohol and tobacco—that is, it is about health-harming products. I would know—I wrote that line of the budget. It is a tax on the retailers of alcohol and tobacco, which I think is pretty timely today, given that we have the excess alcohol death figures showing that almost 1,300 people in Scotland died of alcohol-related conditions in the past year.

In the first instance, I am confused about your position that you should have known about the proposal before the budget announcement. Obviously, we have different views on the policy, which is fine, and I would understand your position more if the announcement had been about the introduction of the policy, but it was not; it was a commitment to explore whether the policy should be reintroduced. I am aware, through the answers to written questions, that you have subsequently been engaged in that process, as have others from the business sector and alcohol harm reduction charities as well as health experts and so on.

11:15

What I am struggling with is that you apparently have a problem with the fact that, at the budget, it was announced that, without your being informed ahead of Parliament, there would be a consultation and that a policy would be explored. If it had been confirmation that the policy was going to be implemented, I would completely understand that, as policies should not be implemented without consultation, but it was not that. The announcement was just to say, “We are going to consult.” You have subsequently been consulted, as per the Government’s commitment to engage with business. I am struggling to understand what the issue is.

David Lonsdale: Contact is made with us on a range of issues before they come into the public domain. For example, the Government touches base with us in good time on a range of regulatory issues. Sometimes, the Government takes forward the proposals and sometimes it does not. The Government takes that approach to fill out its thinking and to enable it to make more rounded decisions, before it decides that there is probably something in a proposal and that it will take that forward. That is not unusual. It is reasonably common for us to be sounded out about stuff. That is where we are coming from on that one. As I said, I do not think that the approach that was taken matches up with the new deal for business.

On my point that the term “public health levy” is a misnomer, yes, there was something in place with that type of title a dozen years ago. As you said, that was related to stores that sold alcohol and tobacco. However, the fact is that the money went into the general kitty and was not ring fenced for public health, so I think that it is a misnomer.

Ross Greer: The proposal that the Fraser of Allander Institute has developed for Alcohol Focus Scotland is that the money would be ring fenced for drug and alcohol partnerships, or at least for health and social care partnerships. There would be some element of ring fencing to ensure that the money goes into prevention, treatment and so on that are specifically related to the harms caused by alcohol and tobacco.

At the moment, the value to retailers of minimum unit pricing is about £30 million a year. I think that it surprises quite a lot of people when they find out that the additional amount that is paid as a result of MUP does not go back to the public sector or the health service but is retained by the retailers. Given that we are talking about health-harming products that have not only a significant impact on people’s lives—that should be the focus today—but a really significant cost to the health service, is it not only fair to have a consequential levy or surcharge, or however it is phrased? That is particularly the case given that, at the moment, with MUP not being in place in the rest of the UK, retailers in Scotland pocket an additional £30 million a year as a result of MUP that they would not get otherwise? The proposal is that that money—we could set it at a rate that generates about that amount—goes back into the health service.

David Lonsdale: I am not 100 per cent clear on where you get the £30 million figure from.

Ross Greer: I think that it is from Alcohol Focus Scotland.

David Lonsdale: Okay. To reel that back slightly, there are a few assumptions out there about an increase in MUP generating additional profits for retailers. I think that those assumptions are misplaced. We talked about Governments consulting business in advance. Normally, when the Government publishes a proposal, it has a BRIA that accompanies that, and the Government tends to involve and consult business in advance to inform the development of that. I understand that, in this case, the Government’s BRIA was at pains to point out the difference between increased revenues from something like MUP and increased profits.

My recollection and my notes tell me that the BRIA talked about £16 million of increased revenues from increasing MUP, and that is right across the drinks industry supply chain. It includes manufacturers of drinks, logistics companies and all types of retailers. I think that there is more in the issue than you suggest.

I also understand that when MUP was introduced, volumes went down by 3.5 or 4 per cent. Another factor to bear in mind in any discussion of where profits are going is that, in all likelihood, there will be some sort of customer reaction. If prices go up at the end of this month, we could see customers deciding to switch from supermarket own brands to existing branded products with a similar price, which they will presumably see as being better quality but which generate less profit for retailers. The notion of vast profits is not borne out by the evidence or by the BRIA that the Government commissioned and I am not sure that it is what will happen in reality.

Ross Greer: I checked and that figure of £30 million came from Alcohol Focus Scotland.

I would love to go into more depth about that, but I am conscious of how much time I have taken up. My final question is for Vicky Manson. Does the FSB have any thoughts about the small business bonus scheme as it is currently constructed? Is it fulfilling its objectives or would you like to see reforms to the scheme?

Vikki Manson: We have been quite vocal about the small business bonus scheme. Businesses in Scotland no longer benefit from the relief that businesses in England and Wales get. We find that quite difficult because our members got so much benefit from that relief. When the scheme was coming to an end, we spoke to our members, some of whom said that they would not be able to continue without that support, which was critical to their continued operation and to the year-round employment of locals. That demonstrated how vital the relief scheme was for small businesses. I know that it is unlikely that there will be any change to that, but we are continuing to argue for that.

Regarding reform, there was a change to some of the criteria around the end of 2022, which meant that lots of members had to start paying fees. It would be good if there could be some sort of reform. We would love to engage with that and involve our members in shaping that.

Ross Greer: Do you have any concerns that the scheme, as it currently stands, benefits not only small businesses? The Scottish Parliament information centre estimates that shooting estates get between £3 million and £5 million-worth of relief each year from the small business bonus scheme, but most people would not regard shooting estates as small businesses. Is there a need to refine the scheme to ensure that it does what it says on the tin and is a relief scheme for small businesses?

Vikki Manson: It is important to distinguish between smaller and larger businesses, which face quite different challenges. When people think of a small business at the moment, they tend to think of a business with fewer than 250 employees, but there can be a huge difference between someone who employs 249 people and someone who employs two. The financial challenges are also far more acute for someone operating in a husband-and-wife situation. It is important to understand that the scheme protected the small business community and that our members fit that definition.

Liz Smith: Mr Lonsdale, I come to your submission. You have already spoken to the convener about different taxes that are coming in. You also say something really interesting:

> "The devolution of these"—

meaning taxes—

> "to local authorities appears to have been done in a piecemeal fashion".

You strike up a contrast, saying:

> "A kaleidoscope of differing local taxes may help plug gaps in councils' finances. However, it can add complexity and cost to the operations of businesses and make budgeting trickier".

This morning, we have been trying to find tax structures that are a bit more efficient. What would you like to happen to ensure that we do not have inconsistency and incoherence across the different types of tax, which is—in your view—knocking consumers?

David Lonsdale: The Scottish Government has a tax framework, which it is—I think—about to update. It has been renamed as a tax strategy, but they are one and the same.

There were six principles underpinning the strategy's previous iteration. There was a lot of good stuff in there around coherence, to go back to your point; on minimising surprises, which perhaps relates to an earlier point; and on the need for greater predictability. In reality, however, although that strategy has been followed on many occasions, on other occasions it has not. For example, we now have a business rate that is at a 25-year high. As we discussed, we also have the spectre of a potential business rates surtax on grocers, and question marks have been raised about making business rates reliefs and licences to trade subject to fair work conditionality.

Vikki Manson mentioned retail, hospitality and leisure rates relief, which has been withdrawn in Scotland in the past couple of years, in contrast to other parts of the UK.

We think that competitiveness should be built into the next iteration of the tax strategy. As I said, we think that the six principles are good but that coherence should be added to that. A more coherent approach to all these things would play into the other bits of Government policy making in Scotland, such as making sure that we have viable town centres, high streets and retail destinations that also have a degree of vitality about them.

Liz Smith: Do you feel that having different types of tax, as opposed to the actual rates, is having an effect on consumer behaviour? Is it easy to find the evidence to suggest that consumer behaviour is being affected by the type of tax rather than by their having to pay more?

David Lonsdale: That is a good question. This may not necessarily answer your question directly, but, over and above what we have seen with regard to changes in income tax, we have heard some announcements—and there has been some speculation—about what might happen to council tax in the coming year. If what has been reported is to be believed, it appears that there will be some pretty choice potential increases. Over and above that, there are a number of elements coming down the line.

We have touched a little on regulation and what could have an impact on consumers. We have talked about the cups levy and the deposit return scheme and things such as the visitor levy, which is outwith our sector. The extended producer responsibility for packaging is coming into effect at the tail end of next year, and we have yet to work out the implications of that for consumers, let alone for retailers. A lot is happening in this space for shoppers, and there are pressures on household disposable incomes.

That is why we suggest in our budget recommendations paper that policy makers should be alive to those different pressures. We can see that reflected in our own data on retail sales, which have flatlined, at best, in the past 18 months or so.

Liz Smith: I follow those developments regularly. I think that you are suggesting that, as things stand, the lack of coherence and there being too much inconsistency is creating a bit of a disincentive for consumers rather than adding the competitive edge that you would like to see, which would make businesses flourish. The Federation of Small Businesses is saying much the same.

Let me turn to Mr Lott. When the committee visited the University of Dundee, as you mentioned in your remarks, we heard a lot of really good things, and we were privileged to see some absolutely groundbreaking research. However, we also heard quite a lot about the difficulties that universities are having in attracting the people they need to attract. In part, that is because of visa issues, for which my party was partly responsible, but it is also because of the situation in some universities whereby it is much more difficult to bring your family.

Is Universities Scotland getting quite a lot of evidence on that? What do you suggest should happen to mitigate that? We desperately need those people in our world-class universities in order to improve the research side of things.

11:30

David Lott: Although it is somewhat absolute, there is a distinction to be drawn between staff and students. At the postgraduate level, those students often flow through into the staff body. The visa regime has differentiation, and the rights at PhD level and beyond are different. As you point out, that is certainly a factor in individuals' choices, as is the way in which they, personally, and their families are supported or otherwise by the system. It is a global competitive market.

The recent changes to dependant visas have an affect at taught postgraduate level and below. They have had a significant effect on recruitment, particularly for some markets, and they have coincided with a number of other factors that have come into play in the past year or so. Frankly, we are not picking up anything from the UK Government that suggests that it is likely to make any changes, which is a shame for universities, our economy as a whole and our reach across the world.

More broadly, the rapid review of the graduate visa caused uncertainty in the market that has caused a ripple of some significance for some time. Given that it is a complex issue, the movement on the dependant visa makes applicants from across the world uncertain, even if their concern is the graduate visa.

Liz Smith: Is it easy to tell which sectors of university research and which departments are particularly suffering because of that problem, or is it a general concern?

David Lott: I would have to ask my members about that. I have not heard anything in discussion with them that suggests anything other than that it is an issue across the piece.

Liz Smith: It has been put to the committee previously that there are issues with Scottish universities being unable to lead research projects. That is also partly a Brexit issue, but it has undercut our ability to be at the cutting edge, which is a great pity, because we should be at the cutting edge. It would be helpful if we could get some information on how much that situation is affecting universities, because it is also key to public expenditure.

David Lott: I would be pleased to do that.

Michael Marra: I know that some recent announcements about the next research excellence framework cycle have filled the hearts of academics across Scotland with gladness. Can you describe the relationship between a 20 per cent real-terms reduction in the research excellence grant and the slower improvement in Scotland in terms of REF outcomes in the most recent cycle, in comparison with the rest of the UK?

David Lott: The sector is still doing well—we must always return to that point. However, as I pointed out, the impact on research council funding is immaterial.

There is a time lag because the REF has very long cycles. Scotland continues to perform well in two of the research excellence pillars. However, there is a real concern about the research environment, which is about the way in which we bring forward and develop the people in the research system, the general capacity, equipment and so on. We are seeing investment in England specifically in the research environment, but we are seeing much more limited investment in Scotland. That is a real concern for our members when they are thinking about the next REF. If the research excellence grant and the research postgraduate grant keep pace with costs to some degree, institutions have their own ability to invest in those processes.

Michael Marra: Subsequent to our visit to the University of Dundee last week, there was an announcement about the major grant of £30 million from the UK Government for the protein phosphorylation and ubiquitylation unit—I will not say that again—at the university. We were made very welcome at the university.

Liz Smith has touched on issues around international talent, and we have heard your comments about recruitment. I was particularly concerned to ask about the management at the university and about where opportunities might arise for longer-term Dundonians—not new Dundonians, necessarily—to be involved in work and growth opportunities. The whole witness panel is concerned about the opportunities that arise from that kind of funding.

The university management pointed out a few issues with the withdrawal of upskilling funding and the mainstreaming of graduate apprenticeship funding into the core grant—essentially, the cut of that grant. Do you feel that opportunities for the development of talent in Scotland and for Scots to get employment through those major grants have been maintained? What can we do to improve those opportunities?

David Lott: The complete removal of the upskilling money is a significant blow to institutions and their relationship with employers in terms of giving individuals opportunities. We hope that the Government will look at that again in the coming budget, because we need not only to restore the limited amount of money that was there but to grow it.

If we look at the international situation, we are still doing well in terms of the proportion of our working-age population that has a tertiary qualification, but we are being overtaken. Australia's ambition is for 80 per cent of its working-age population to be qualified to tertiary level by 2050. I do not think that we are having that conversation, but if we look at our demography, and at giving people opportunities in what will be a changed economy, we absolutely need to have that conversation. We also need to try to bring in new Dundonians, as you put it. It is a significant concern. In so far as we can in the coming budget, we are going to be looking for the return of that upskilling money.

I agree that graduate apprenticeships are good things. Our members have seized that opportunity and would like to grow them—and grow them in new areas. Work is being done on growing graduate apprenticeships, but that will ultimately need to be resourced.

Michael Marra: In a conversation that I had with a vice-chancellor recently, they said to me that they believe that 14 of the 19 institutions that you represent are in significant financial strife. Do you recognise that figure?

David Lott: I would not necessarily agree with the end of that sentence, because I do not have that information. The information that I do have, and what all the projections show, is that we will most likely see that kind of proportion in deficit.

Michael Marra: What will the repercussions of that be?

David Lott: The institutions will have to look at their staffing numbers, and we are starting to see that coming through in their reports of the action that they are taking. They might go to a recruitment freeze, but they will have to reduce the breadth of courses that they offer in order to reduce their costs.

Michael Marra: Colleagues have commented on the significant reserves that are held by a small proportion of those universities. Some universities have significant reserves and others have next to nothing. There is a risk to employment and to the economic benefit to the whole country. You have a responsibility to represent the whole sector and to tell the good story about it. However, if there are significant job losses in some areas, the breadth of the sector in that regard will be a significant public policy challenge, will it not? It is also a challenge for you to represent coherently to us the risks that are at play.

David Lott: Well, yes. As you point out, a thriving university is an engine of growth, opportunity, local partnership, civic development and so on, and that is what is being eroded. Universities will continue to operate—they will continue to teach their students and carry out research—but their overall capacity and power to make a change, both at the Scotland level and locally, will be less.

Michael Marra: All the committee's evidence sessions in this inquiry are about taking a strategic approach to the use of public finances in Scotland. Overall, given the short-term and medium-term consequences that you describe—and, to be frank, the long-term trajectory—do you think that a strategic approach is being taken to the financing of our tertiary education in Scotland?

David Lott: The past decade has been marked by budget decisions, whereby there is now at least the implication that there is an understanding that cross-subsidy will need to take place. For a number of years, institutions have been able to generate that cross-subsidy, but, in the past two years, that ability has diminished significantly.

If that could be described as a policy or strategy for the resourcing of the sector, that risk was always known, and it has crystallised. We now need a different approach. We need a recognition that that risk has crystallised, and action in the light of that fact.

The Convener: I wonder how difficult it is going to be to find a joiner, a plumber or an electrician in Australia in 2050 if they move to 80 per cent of the workforce going into tertiary education.

I call John Mason, to be followed by Michelle Thomson.

John Mason: Thank you, convener—I was going to ask about that, too. Would Universities Scotland argue that 80 per cent of our population should go to university?

David Lott: No. In Australia, it is not solely about universities but about the qualification level across the entire population at the tertiary level. In answer to what the convener said, it is about the college contribution as well. Our observation is that we will have to focus on training and retraining our working-age population. Given the changes in our economy, the greater deployment of technology and so on, that will involve a higher proportion of tertiary education-level skills.

John Mason: Some people feel that we are already sending too many people to university and that we are short of skills such as plumbing. I have a nephew who did just a year at college but earns very good money through fixing wind farms.

David Lott: On whether we are doing the wrong thing, as I said, every other country in Europe and beyond is looking to grow its graduate rate; we would be completely at odds with that trend if we were to do otherwise.

John Mason: We are ahead at the moment, though, are we not?

David Lott: Let us see the figures in the next census. The European Union had a specific focus on growing the proportion of young people securing graduate qualifications, so that number is starting to rise in other countries across Europe and beyond. I will be interested in seeing, in the next census, where we are.

John Mason: Okay. That was a bonus question that I had not really planned.

Mr Lonsdale, in your submission you say that you would like

"to reduce the cost of running the government",

as

"this would ease the pressure on the funding of other services".

Are there risks in reducing the level of government? We have seen examples—the major recent one was Grenfell—of what happens when there is a lack of oversight and regulation and the Government is not involved enough. Are there risks around health and safety in cutting the level of government?

David Lonsdale: I am sure that there are plenty of risks, but I understand that, given the current budget scenario, there are plenty of risks in not doing something about getting on top of public expenditure in Scotland. The other day, the Cabinet Secretary for Finance and Local Government gave a fiscal update to Parliament in which she announced a number of measures to economise and make savings.

Our assumption is that, if further work is not done on that front, we may find ourselves facing a similar situation in relatively short order and/or looking at further tax rises. In our budget recommendations paper, we make a number of suggestions, as we have done for the past two or three years. We have not put figures on them, but they are areas that we think are worthy of consideration. They have been suggested in the past in, for example, the independent budget review. For example, are there more opportunities to outsource and take advantage of additional capacity in the private sector? In our document, we made a specific suggestion about pharmacy first, which I understand is going well—I have used it in the past two or three months—and which aims to ease pressure on the health service.

11:45

The Government's spending review a couple of years ago suggested that there are 129 public bodies. Is there an opportunity to rationalise what we do?

Like any business or organisation that is represented around this table, our members regularly have to cut their cloth on a number of fronts in order to deal with—in our case—a lack of money coming in the front door. Retail revenues have been pretty much flatlining over the past year or two, but we still have all the same cost pressures—in, for example, the supply chain, the wage roll, the cost of energy and business rates. Organisations are having to grapple with those things, and we have tried to point to a few areas that it might be worth looking at.

John Mason: You suggest that we should not raise income tax, in order to give people more money to spend in shops. On the other hand, there seems to be quite a lot of money out there. Given the prices that people were paying to see Taylor Swift, Oasis and, I believe, the Euros—they say that 200,000 people went to Germany for the Euros; if they spent £500 each, that would be £100 million—some people out there have a lot of money. I am not sure that changing their income tax rate would impact on your sales.

David Lonsdale: I had better declare an interest in that I was in Germany for 10 days to follow the Scotland team.

John Mason: I will not ask how much you spent. [*Laughter*.]

David Lonsdale: Please do not. Do not tell my wife.

Off the back of Covid, people are prioritising spending on experiences—for example, on following their football team, weekends away and eating out. In that sense, retail sales have taken a back seat. Over the past few years, retail sales and consumer spend have been somewhat becalmed.

In last year's budget, there was an increase in income tax. There was also an increase in council tax. Taken together, those took a bite of around £250 million out of consumer spending in Scotland. There are a number of other factors. If what I have read is to be believed, it looks as though there will be a hefty increase in household energy bills this autumn. We need to be alive to all of that.

We have put forward some suggestions on how to get the economy motoring—which, ultimately, is the best way to generate the tax revenues that can fund anti-poverty and other measures, and public services. For us, that is about bearing down on the costs that retailers have, so that they can invest in growing their business and all the rest of it—but it is also about helping consumer spend.

John Mason: Do you accept that there needs to be some redistribution of wealth or income within the population? Some people have a lot of money and can do a lot of luxury things, but other people are in poverty. It is not automatic that, if we grow the economy, people in poverty are helped, is it?

David Lonsdale: No, but probably one of the top ways to do that is to provide more money to help grow the economy and create more economic opportunity for people who do not have jobs—although that is not the only indicator of poverty—to get on.

John Mason: Okay. Ms Manson, thanks for your submission, too. One of your themes seems to be the need to reduce business rates—non-domestic rates. Have you any suggestions for how we should fund that?

Vikki Manson: In our response to the programme for government, we used exactly the same phrase as David Lonsdale about small businesses having to cut their cloth accordingly and make lots of changes because of the financial pressures put on them.

I caught the tail end of the previous session, in which you delved a little into the Scottish Fiscal Commission's data on public sector pay, which is higher in Scotland than in the rest of the UK. I think that there are ways to save money on public sector pay. Obviously, the more that that rises, the less money there is for other areas of spending and the tougher the decisions are that have to be made.

Non-domestic rates are a big issue for many small businesses. They represent huge sums of money for small businesses, and they are astronomical compared with domestic rates. The small business bonus scheme has now been reformed, but it relieved a lot of pressure for many businesses. It meant that they were able to grow and to provide more to the economy, and socially. The benefit of cutting rates is that it increases economic activity by so much.

John Mason: These days, there is a lot of talk about means testing for personal benefits such as the winter fuel payment. Should we also try to do that with businesses? It strikes me that some small businesses are incredibly profitable while others are struggling. I see the same in the hospitality sector, where some appear to be doing very well and others are very quiet. If we have limited money, should we target it at the businesses that are struggling?

Vikki Manson: I cannot comment on specific businesses. Some do exceptionally well, some are just making ends meet and some are really struggling. It would be good to do an analysis of those businesses and to look at the drivers of those differences—to look at what sets apart those that are doing really well from those that are really struggling. Means testing could be considered in order to target those businesses that are really struggling. You will probably find that those that are thriving have been established for longer and were able to ride the wave during Covid, compared with those that had set up just prior to Covid or that are fairly new.

John Mason: Glasgow has some very good examples of businesses in the hospitality sector that are expanding and seem to be doing very well.

Vikki Manson: Yes, and there are probably practical lessons that can be learned from those businesses with regard to their practices and what they have done to succeed. It is not all about the financial side of things. However, any financial assistance that could be given to smaller businesses that are struggling would be really appreciated.

The Convener: If you means test businesses, those that are doing particularly well or that are innovative, profitable and have in-demand products will be disadvantaged compared with those that might not be as well run, that might sell something that nobody wants or that are based in a location that nobody visits. That is the opposite view to John Mason's point.

Vikki Manson: We have members across many different sectors. We have many businesses with innovative products, and new businesses are coming through the doors. We have many bread-and-butter members, such as joiners and retailers—small newsagents and so on—as well as businesses that are coming up with amazing carbon capture technology, for example. The approach to different types of businesses needs to be well thought out, because it will not be the same for them all.

Michelle Thomson: Good morning. I have a few random questions. David Lonsdale, I want to ask you about your intriguing comment about competitiveness pertaining to the tax strategy or framework, as you described it. Can you give us a bit more flavour of that? For the record, you said that tax strategy should include an additional principle of competitiveness

"to stimulate greater levels of private sector investment and consumer demand, to ensure a strong economic recovery."

David Lonsdale: I am glad that someone found the document intriguing. I will take that as a compliment, because I may not get too many.

The Scottish Government has made a number of changes to non-domestic rates in recent years and we have been fully supportive of more regular revaluations, of the commitment to restoring parity of the business rate for larger premises with the rate for those down south, and of one or two other changes.

We think that the Government has fallen short in some areas. Vikki Manson spoke earlier about retail, hospitality and leisure rates relief, which is less generous here than it is down south. About 2,500 shops and about 12,000 commercial premises overall in Scotland, across a range of different sectors, fall within the crosshairs of the higher property rate. That is costing our members alone an additional £10 million a year. There is also the potential surtax on grocery stores.

There are various areas in which we could be more competitive. We think that that would send businesses a positive message that Scotland is a place to invest and would help them to cope with trading conditions as they are. A large number of regulatory initiatives are coming down the track. They are all expensive and will all require retailers to shell out. That relief is the right approach and is outlined in the new deal for business agreement between the Government and the business community. It would be good to have that reflected in the next iteration of the tax strategy, in line with what we said earlier about coherent policy making.

Michelle Thomson: That is interesting and I suspect that it will be picked up further.

Vikki Manson, there is an intriguing bit in your submission, which I will quote for the record:

> "It is simply impossible to expect to see an increase in economic activity when the proposed Economy National Outcome intends to deprioritise economic growth."

You go on to refer to the wellbeing economy. That is being looked at and we know that work is under way, but I would like to get a little more flavour of what you mean by that. Also, given that you made your submission prior to the budget, do you now have more confidence that the budget will encourage economic growth?

Vikki Manson: That proposed national outcome was really strange. I had to reread it about three times and check with my colleagues that that was what it meant. I think the wording was about a

> "wellbeing economy that is sustainable, de-prioritising economic growth".

I thought that that wording was really odd.

Things have moved on since then and we heard some encouraging things in the programme for government. The Federation of Small Businesses has spoken a lot about procurement and there was a commitment to bring forward a community wealth building bill. We think that there is a really good opportunity there to level the playing field for small businesses. The issue of public contracts has been an on-going problem for our members, who have really not had a bite at those over the years. There has been movement on procurement reform, but we still think that there is quite a lot of work to do and we think that the bill will provide an opportunity to put in statutory targets for small businesses to access public contracts.

A colleague of mine who gave evidence on procurement a couple of months ago gave me some data. Spending on goods and services by micro-operators fell from 7 per cent to 4.7 per cent between 2016-17 and 2021-22, which shows that we are going backwards a little. We hope that something will be built into the community wealth building bill to support small businesses in getting a fair bite of that public contracts apple.

Michelle Thomson: I suspect that some of those themes will be picked up by the Economy and Fair Work Committee, of which I am also a member, which is convenient.

My final question picks up on a point that my colleague Ross Greer alluded to. As we are taking a strategic look at the budget, I am interested in the panel's views on hypothecated taxes, by which I mean those that are aligned to particular purposes. Through the use of the term "ring fencing", we have seen such an approach being passed on to councils, yet it is not being applied to the Government itself. Ross gave the example of minimum unit pricing. There has also been a suggestion that the £640 million of ScotWind moneys would just go on building supply-side infrastructure and so on for renewables. This is a bit of a throwaway question, but what are your thoughts on the principle of hypothecated taxes? Would that intrigue you, given that this session is about strategic budgets? David Lonsdale is going first on that one.

David Lonsdale: Thank you for that one. We are open to suggestions. When there are no specific suggestions, it is difficult to understand the pros and cons of certain approaches and whether they would work in good or bad economic times.

I will pick one example. A number of years ago, the UK Government brought in the apprenticeship levy, which, in theory, is hypothecated to spending on apprenticeships, as the name suggests. However, that is not the case if you are in Scotland, Wales or Northern Ireland. As I understand it, the revenues that are collected across the UK go into the Treasury. In England, employers who are liable for the levy can claim most of it back for spending on apprenticeships. However, the way that things work in Scotland, Wales and Northern Ireland is that the money goes into the Treasury and then comes back through the Barnett formula. Like the other devolved Governments, the Scottish Government would have spent a given amount beforehand, it was taken away from it, in a sense, and then the apprenticeship levy came in. Therefore we have a tax whereby retail employers in Scotland, and other employers who are subject to it, do not get the money back to then spend on apprenticeships. Therefore the levy is, in effect, an employment tax.

I have deliberately cited an example that is not particularly great and does not inspire much confidence. A different one is that, in the previous iteration of the public health supplement, which was in play a dozen years ago, the money just went into the general kitty. Therefore, to be honest, I am slightly sceptical about the notion. However, if sensible proposals were to emerge, we would consider them in the round. Ideally, they would not affect retailers or customers.

Michelle Thomson: That is an excellent response. In asking that question, I was not making a singular plea for hypothecated taxes—it was merely a question.

Have David Lott and Vikki Manson anything to add on that? I appreciate that it is a bit of a left-field question.

Vikki Manson: I reiterate what David Lonsdale said about ring fencing. For us, one of the most recent examples is the visitor levy. I know that it is still undergoing analysis, but the expectation of small businesses was that the money would come back into the community and be used for services. We are currently going through a consultation on single-use cups. I know that the intention is to give some of the charges that will be applied to those back to small businesses for operational costs. The question is whether that money will be ring fenced or will simply be lost in the abyss.

Michelle Thomson: You have touched on the subtle point that I was making, which is less rigid than the one on hypothecated taxes. It is about following the funding of such measures.

David Lott: I will echo the point about the apprenticeship levy. As happens with many hypothecated taxes, we can look at the levy and think that it is a good approach because employers will want to train people. Our members' experience, though, is that employers want to engage graduate apprentices, but the way to resource that is not clear. As was mentioned earlier, such apprenticeships have been rolled into the overall funding system without any extra money being provided. The issue is about implementation, is it not? If such resource was readily available through that route, perhaps one would perceive the levy as a hypothecated tax that is working well. However, at the moment there is no such clarity for employers and organisations that provide training.

The Convener: I am tempted to say something, but I am not going to.

Jamie Halcro Johnston (Highlands and Islands) (Con): Good afternoon. I have a couple of questions. The first, for David Lonsdale and Vikki Manson, follows up some of the questions that have already been asked. Both of your organisations welcome the recent statement's focus on economic growth. However, funding for enterprise bodies has been cut over the past few budgets; visitor levies have just been discussed; DRS introduced huge costs to the sectors but was dropped; and there has been the licensing of short-term lets. Regulatory burdens go up. There is also a differential between the rest of UK and Scotland in rates relief. I look for an honest answer: although you may welcome a refocus on economic growth, how confident are you that it will be delivered?

David Lonsdale: Ladies first.

Vikki Manson: Thank you. [*Laughter*.]

That is a really difficult question. We were encouraged by some things in last week's programme for government. For us, the main thing is to see concrete action. When the First Minister came in, in May, he spoke about reducing strategies and consultations and having concrete work done that would make a difference. That is probably the key: to have those commitments brought forward so that we can see how they will impact on small businesses. As things are, the next year will be challenging. There is no doubt about that. Will that burden fall on small businesses again? Will they have to make further reductions, and cut their cloth again to try to see things through for another year?

David Lonsdale: Essentially, I echo what Vikki Manson said.

In his party conference speech, the First Minister talked about "investment, investment, investment". In his programme for government last week, he said all the right things about creating the conditions for commercial investment and investment-friendly policies. As I said earlier, no new regulatory initiatives that have come forward from the programme for government have caused us concern. However, as Vicky Manson said, a range of things are on the table at the moment, and we need to grapple with their cumulative impact.

We are encouraged by the direction. However, the hoary old chestnut is about the proof of the pudding being in the eating, and the Scottish budget is a key test in that respect.

I have walked you through several of the areas in which we have some concerns, and on which there needs to be further action to deliver on the objectives. Growing the economy—bringing in higher revenues for the public services, alleviating poverty and all the rest of it—is a shared objective.

However, we need to get the economy moving, and that requires action on the regulatory front and on some of the taxes that we outlined in our budget submission.

Jamie Halcro Johnston: David Lott, you talked about the cross-subsidy for research, in particular. I have a very simple question. Is there a concern that, if there is a squeeze on some of the funding for research, universities' focus may well be on the return on investment—on the areas that attract the largest grants—and that some research that might have social good will be deprioritised?

David Lott: It is worth stating that our research effort as a whole requires cross-subsidy, albeit that some elements are closer to breaking even or may generate a surplus. I fear that we will just do less, and I cannot break down where that loss will reside. By having fewer and smaller research teams, we will not generate what is a very direct economic impact.

I have had regular discussions with the Scottish Government about how that leverage of research money should be viewed as a foreign direct investment. It is very significant as an economic entity in itself, and it flows into all the other benefits that we discussed earlier.

Institutions would have to take a view. Over the years, some institutions have noted that, as the resource through the Scottish Government reduces, they are becoming much more selective about what they bid for, as they cannot afford to win—frankly. That seems a very poor place for Scotland to be in.

The Convener: Vikki, you have said:

> "To enable the economy to grow, it is critical that support is given to the small businesses who make up almost all enterprises".

You have mentioned

> "the reintroduction of targeted reliefs for the retail, hospitality, and leisure sector."

We know that £685 million is going into rates relief across the board this year but, given that the Scottish Government is under severe pressure with its budget, which is more or less fixed—unless we put taxes up, which no one seems keen on at this point, apart from John Mason—and given what we heard from David Lott, who said that £10 million or £15 million of additional funding for research could perhaps bring in eight times that amount in economic activity, should scarce money not go to that sector to create greater innovation, productivity and output, rather than to small businesses, for example, if there is additional money available? That is the kind of question that the Government is wrestling with, so what would you say in response to that?

Vikki Manson: There will obviously be an argument from everybody about who gets a share of the pot. Small businesses make up 99 per cent of all businesses in Scotland. They contribute a huge amount to the economy—£110 billion—and they employ more than 1.2 million people. That, in itself, demonstrates their contribution towards the economy. Without that, where would we be?

The Convener: I completely agree with that, and it is a really important point. Given that scale, surely £10 million would have only an infinitesimal impact in that sector, whereas £10 million or £15 million could have a significant impact on Scotland's R and D footprint and its global competitiveness at university level.

Vikki Manson: Of course that would have an impact in terms of universities, but there is a bit of a disconnect between small businesses and Government, for a number of different reasons. They perhaps feel a bit overlooked sometimes, because the relationship is probably not there, and it falls on organisations such as us to try and bridge that gap.

Regarding what small businesses provide to the economy through employment and the supply chain, they want to be involved in the net zero initiatives and so on. I spoke about public contracts earlier. Small businesses bring a real value to Scotland, and providing some financial support to them could have real benefits. You say that £10 million would be a small sum of money, but that would probably have a much bigger impact for small businesses than it would for larger organisations. Not only would it help to boost small businesses financially and with respect to growth; it might reinstate a bit of confidence for them, through the Government, and it could help them to engage more proactively.

The Convener: David Lonsdale, where do we strike the balance? When the UK Government had consequentials for the hospitality sector last year—apart from the islands, which I lobbied for—that was not passed on. The Scottish Government said that the money was being put into the NHS. People who run small businesses and who work in retail rely on the NHS, too, just like everybody else. Where do we strike the balance, given the restricted nature of the Scottish budget? What would provide for the retail sector and the businesses that you represent in the wider Scottish budget and economy?

David Lonsdale: I would remind you that business rates are at a 25-year high. I have said already that several thousand shops and other businesses in Scotland are paying a higher business rate than businesses down south. As I said earlier, there is currently a threat on the table with regard to a potential surtax on grocery stores.

We need to take some of those things in the round, at the same time.

Obviously, we were not exactly happy about the fact that Scotland got the consequentials but did not then replicate what was happening in Wales or England at that time. We do not envy the finance secretary in what she has to do, but there are broader areas that require action; we just need to be alive to them.

12:15

The Convener: Thank you for that. Time is against us, so I want to give our guests an opportunity to make any final points if they so wish. Vikki Manson, you can go last, because you started first. Would David Lott or David Lonsdale wish to add anything further?

David Lonsdale: Convener, your first question to me was on whether there are any regulatory initiatives that we think should not be taken forward. One example that we put in our submission to the committee, and in our wider Scottish budget paper, is the consideration that is being given to applying work conditionality to business rates reliefs and to licences to trade. That was in the Scottish Government's 2022 document on becoming a fair work nation; I am not totally convinced that the potential implications of that were factored in at the time. That is a specific answer to your question.

The Convener: Are you hoping that the new UK Government will look at, for example, the imbalance in paying rates between businesses on the high street and online businesses? Is that something that you are looking at?

David Lonsdale: The new UK Government has talked about reforming business rates down south, and any change that comes in could have Barnett consequentials or may influence the policy in Scotland. We are shy of the detail of that and what it means in practice. We will see whether the new Chancellor of the Exchequer will say a bit more about that in the budget, for example. We are shy of the detail on a lot of different issues at the moment, in both a Scottish and a UK context.

The Convener: Indeed.

Vikki, the last word is with you.

Vikki Manson: To go back to your final question on how the pot is shared, we believe that the Scottish Government has legislative levers that it can use. David Lonsdale and I have spoken at length about the cumulative impact of regulation. Reducing that for small businesses would, in itself, have a huge positive impact for them. We need to see those promises translated from words into actions, and that can be done, in terms of the financial aspect, probably fairly easily.

The Convener: Yes—there would be a minimal cost to the Government but a benefit to business.

Vikki Manson: Yes. There is the proposed community wealth building bill, too. I spoke earlier about public contracts; putting a statutory target in the bill for small businesses to get an opportunity to bid for public contracts could, again, be quite easily introduced and could have a huge positive impact on the small business community.

The Convener: I thank our witnesses—Da-Lo, Da-Lo and Vikki—for their evidence this morning. We will publish our thoughts once we have taken further evidence. We now move into private session.

12:18

Meeting continued in private until 13:17.

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