OFFICIAL REPORT
AITHISG OIFIGEIL

DRAFT

Finance and Public Administration Committee

Tuesday 20 January 2026

The Scottish Parliament
Pàrlamaid na h-Alba

Session 6

Tuesday 20 January 2026

CONTENTS

FINANCE AND PUBLIC ADMINISTRATION COMMITTEE
3rd Meeting 2026, Session 6

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*Michael Marra (North East Scotland) (Lab)

COMMITTEE MEMBERS

*Patrick Harvie (Glasgow) (Green)
*Craig Hoy (South Scotland) (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 (University of Stirling)
Michael Davidson (Scottish Fiscal Commission)
Professor David Heald (University of Glasgow)
Claire Murdoch (Scottish Fiscal Commission)
Justine Riccomini (Scottish Fiscal Commission)
Dr Eleanor Ryan (Scottish Fiscal Commission)

CLERK TO THE COMMITTEE

Joanne McNaughton

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Finance and Public Administration Committee

Tuesday 20 January 2026

[The Convener opened the meeting at 09:35]

Budget Scrutiny 2026-27

The Convener (Kenneth Gibson): Good morning, and welcome to the third meeting in 2026 of the Finance and Public Administration Committee. We have one public item on our agenda today, which is evidence from two panels of witnesses on the Scottish budget for 2026-27.

For the first panel, we will hear from the Scottish Fiscal Commission. I welcome to the meeting Professor Graeme Roy, the commission's chair; Dr Eleanor Ryan and Justine Riccomini, who are commissioners; Claire Murdoch, the head of fiscal sustainability and public funding; and Michael Davidson, the head of social security and devolved taxes.

Having read out that list, I think that our time is just about up.

Before we move on to questions, I invite Professor Roy to make a short opening statement. Good morning, Professor.

Professor Graeme Roy (Scottish Fiscal Commission): Good morning, convener. I thank the committee for the invitation to come back and give evidence to you. I want to provide you with a brief overview of our outlook for the economy, our forecasts for tax and social security, and our assessment of the funding and spending context for the budget.

Once again, our publication comes against an on-going picture of global economic uncertainty. That has been a theme in our previous reports and it continues to affect our latest outlook. Overall, our forecast for the Scottish economy is broadly similar to our forecast of last December, with a small downward revision to growth in gross domestic product next year, from 1.5 to 1.3 per cent.

Income tax is forecast to continue to make a positive and growing contribution to the Scottish budget. Within that overall trend, however, there have been a few updates. First, the latest projections of the income tax net position for 2024-25 and 2025-26 are now more positive than the projections we set out in our last forecast, in June last year. That is largely because of lower than expected figures in United Kingdom data reducing the forecast block grant adjustment in those years.

Secondly, and in contrast, the projected net tax position in 2026-27 has been revised down, this time as a result of a more optimistic forecast for UK earnings from the Office for Budget Responsibility. On the basis of the OBR's and our latest forecasts, a positive net income tax position of £969 million is projected.

How the income tax net position evolves affects funding not only through the revenues that are expected each year but also through the projected reconciliations. We have seen a change in the latest projection for the 2027-28 reconciliation. The committee will recall that we had highlighted the possibility of a large negative reconciliation of £851 million for that year. However, as a result of changes in UK data, primarily, that is now projected to be a negative reconciliation of £310 million.

We forecast social security spending of £7.4 billion in the next financial year. Since June last year, the difference between spending on social security and the block grant adjustment has narrowed from £2 billion to £1.2 billion for 2029-30. That is largely because of UK Government changes, with the reversal of the planned restrictions to eligibility for the personal independence payment increasing block grant adjustment funding. On top of that, the removal of the two-child limit for universal credit and the resulting cancellation of the Scottish Government's two-child limit payment reduce spending. We have also reduced our forecast for the adult disability payment. The main factor in that reduction is lower than expected authorisation rates for new applications.

The Scottish Government is balancing funding across the spending review using borrowing, the Scotland reserve, Crown Estate revenues and the transfer of some funding from resource to capital. Despite that, the funding position remains tight. After adjusting for inflation, resource spending is set to grow by an average of 1.1 per cent in each of the next five years. Although the Scottish Government's decision to reduce the capital funding position in 2025-26 leads to a real-terms rise in funding next year, the spending review outlines real-terms cuts to the capital budget in all future years.

The spending review shows that health and social security spending will have the largest real-terms increases, but resource funding to local government is falling as a share of the budget over the spending review.

We highlight some risks within the spending review. The Scottish Government has identified £1.5 billion of efficiency savings to be delivered over the next three years. Delivering those savings will be key to ensuring that the spending allocations set out in the budget are deliverable. The spending review allocations for portfolios are underpinned by below-inflation pay awards of 1.1 per cent in 2027-28, as well as targets to reduce the size of the workforce. If pay is higher than assumed or if workforce reductions are less than planned, the pay bill will, of course, be higher.

I will end on a technical but important point. In our report, we present resource spending in 2025-26 as the position at the autumn budget revision but removing routine in-year transfers that have not been baselined. Although the Scottish Government has baselined £786 million of spending, which was transferred between portfolios in the 2025-26 ABR, there remains £606 million that was not baselined. We continue to recommend that all routine budget transfers should, from the outset, be contained in the spending portfolio to which they will ultimately move.

The Convener: I was, in fact, about to start with the last point that you raised, which was about transfers. Has the Scottish Government explained to you why it has transferred £786 million but not £606 million? It seems to me that you either put everything into the autumn budget revisions or you do not. We have a mixed picture, which makes it very difficult to make comparisons. No doubt, we will put the question to the Cabinet Secretary for Finance and Local Government, but has it been explained to you how this rather odd position has transpired?

Professor Roy: The first point to make is that it is a step forward.

The Convener: Indeed. The committee has been calling for it for years.

Professor Roy: Yes. However, the general point is that it is one step rather than going to the end.

From our perspective, it would seem that it is a work in progress. As I said at the end of my last answer, we would always recommend that, where routine transfers are going to take place, it is important—and it makes sense—that they are allocated into the year in which they would be allocated. That is why we made that adjustment to the figures for 2025-26—to make sure that the comparisons and growth rates are as accurate as possible.

The Convener: It makes it difficult for people to make comparisons year on year, which is certainly a concern for this committee and for anyone who might want to look at the figures.

One thing that stands out is the difference in the reconciliation, which is a change of more than £0.5 billion. You touched on the reasons for that, but only a few of them. Although they are in your report, could you go through them in a wee bit more depth for the record?

Professor Roy: I will talk briefly, and then Eleanor Ryan might want to come in as well.

In figures 4.7 and 4.8 in our report, we set out how the reconciliations have evolved since we first made the forecast, back in December 2023. It is interesting that, on this occasion, on balance, we have not changed our forecasts for income tax in a significant way. What has moved around much more is the block grant adjustment—that is, the OBR's forecasts for the equivalent performance in UK taxes.

That is largely simply about data revisions coming through. Data was coming through at the UK level that suggested that UK income tax receipts were growing much more rapidly than had been thought. That is why there was quite a significant change in the reconciliation in the publication last year—because the BGA was expected to be much higher. That expectation remained high in June, but new data that has come out since then has brought it right back down again. That is why we are now projecting a negative reconciliation of just over £300 million. Within the fiscal framework, the UK element has largely been the driving factor in how the BGA has been evolving.

The Convener: You also talked in your opening statement about social security. Paragraph 5.6 of the report states:

> "the number of people receiving PIP in England and Wales increased by 45 per cent, while the number of people receiving ADP and PIP in Scotland increased by 57 per cent."

Why is that? Figure 5.7 shows spending on adult disability payment rising significantly between 2025-26 and 2026-27—by some £452 million, which is around 12 per cent, in a single year. Why is there a difference between the rates in the two countries?

Professor Roy: As the committee will recall, we have spoken on several occasions about the fact that the new system of delivering those payments has been designed to be more inclusive and more supportive in enabling applicants to receive those payments.

The Convener: Before you say more on that, I note that paragraph 5.7 of the report states that there has been a decrease in the authorisation rate for new applicants, from over 50 per cent in 2023 to below 35 per cent in July 2025, whereas in England and Wales it is 45 per cent. It therefore looks as though fewer people are getting those payments, yet the numbers are still going up quite significantly.

That seems almost anomalous. One would expect the Scottish figure to be lower than the English figure, given that the authorisation rate is lower, so I am wondering how all of that transpires. We are talking about a potential difference of 35,000 people—that is, if the rate of increase were the same as in England, there would be 35,000 fewer people on that benefit.

09:45

Professor Roy: There are two things going on here. First, as I have said, the new system is designed to be more supportive and inclusive, which we projected would lead to more people moving on to ADP relative to PIP. We estimate that there are about 35,000 more people on ADP now than there would have been under the old system—under PIP—if those trends had continued.

Secondly, although, as you will recall, we suggested that that number might continue to increase over the next few years, we have seen that, despite there having been many more applications than there were last year, the authorisation rate—the success rate—of applications has fallen significantly in Scotland. That is what you see in figure 5.3 of the report. It is quite interesting that although, when ADP was first being rolled out and was coming on stream, the authorisation rate was around 50 per cent—about one in two people who applied for the payment were successful in receiving it—as you see from the chart, that number has fallen significantly and is now below 35 per cent, which is a lower rate than for the UK PIP.

The Convener: But there are so many more applications in Scotland that it still means that there is a significant increase.

Professor Roy: Yes, but there were so many more applications early on, and there was a high authorisation rate. The number of applications is still high now, but there is a low authorisation, or success, rate—it is low historically and relative to the rest of the UK. In essence, two thirds of the people who apply for ADP are not successful and only one third are, which is one of the really interesting things that we are seeing in the data.

We highlight in our forecast not only that, if that trend continues, fewer people will be flowing in than we forecast, but also the fact that it raises interesting questions about whether that is what the Government is expecting to happen with ADP—that two thirds of people who apply will not be successful and only one third will be—and about the long-term trend. Where that trend might move is a risk that we highlight from a public finances perspective.

The Convener: You are still predicting a 55 per cent increase in the amount of benefit money that will be spent on ADP over the next five years—rising to some £5,308 million by 2030. Are people really getting that payment more? Will there be so many more people with disabilities in the next five years, even with an ageing population? It is surely not ageing that rapidly—we are not all disintegrating quite that quickly, are we?

Professor Roy: We see that trend across the UK. Again, the key thing for the budget is not only what the trend is in Scotland but what the trend is in Scotland relative to what it is in the rest of the UK. The UK trend is of inflows into disability payments that have been happening over time.

Another thing that is a cause of concern, more from a policy point of view, is that the inflows into child disability payment are significantly higher than they have been historically. That suggests that people who are on child disability payment might spill over into ADP, and the number might continue to rise over time.

The Convener: Okay. Thank you. In your opening statement, you talked about the £1.5 billion savings that were identified and about the fact that the majority would be achieved in the health and social care portfolio. In your forecasts, you go through some of the predicted annual savings, and you go on to say:

> "The recent Audit Scotland Report on the NHS noted that progress has been made … in 2024-25 … However, just two territorial boards and three national boards achieved the 3 per cent recurring savings target."

With regard to your forecasting, how confident are you that those targets will, indeed, be met?

Professor Roy: Do you want to say something on that, Eleanor?

Dr Eleanor Ryan (Scottish Fiscal Commission): Yes. We do not really forecast that those targets will be met—that is not part of what we do—but we have highlighted that, if the Government is to live with the spending plans that it has set out across the spending review period, it will have to deliver on the savings that it has set out. All the different elements of those savings—the workforce reductions, the other efficiencies and so on—will undoubtedly be challenging, so the focus needs to be on how successfully those plans are delivered. It is very positive that the Government has set out plans, but the question is whether it can follow through and show how it will meet its targets.

The Convener: Thank you for that. One issue that many colleagues will, no doubt, want to touch on is pay policy, which you talked about in your introductory comments. In paragraph 50 of your report, you state:

"The Scottish Government has set the Spending Review allocations based on the existing three-year public sector pay policy."

You go on to say that

"there would need to be an average pay award of 1.1 per cent in 2027-28"

to complete that. There is no apparent change in the Government's approach to that, even though it is clear that an average pay award of 1.1 per cent will not be deliverable. I do not think that anybody believes that it will be. You also said that,

"For the majority of NHS workers it would require a pay award of 0.78 per cent",

and we all know that that is not going to happen.

How does that work with your forecast? You state:

"For the purposes of our economy and tax forecasts, we assume pay awards in 2027-28 equal inflation".

So, you are basically saying, "We know that the Government is not going to meet that, so our forecasts are just going to be what we believe the rate of inflation will be."

Professor Roy: That is perhaps not exactly the way that I would characterise it. However, you are entirely right that, if the Government sticks to its pay policy, based on the pay awards that have been made already, that suggests exceptionally small pay awards in the final year of the pay policy and, in essence, real-terms cuts in pay. Obviously, the Government has not moved from that policy—that is its position, and it has underpinned the allocation in the portfolios.

If we are to give the most accurate forecasts for income tax and the economy, we have to make a judgment about what we think is most likely to happen. On that basis, we decided to use our forecasts and return to our baseline for pay awards in the public sector rather than use the Government's projected pay awards. There are two points to make about that. One is that we think that that is a risk, and the other is that we know that the Government has said that it will revisit the issue for the budget in 2027-28. We have therefore used our baseline assumption rather than the current pay policy.

The Convener: Okay. I will jump back to income tax—I like to jump about, to keep you on your toes and all that kind of stuff, but I know that you know all of this inside out.

On page 98, you discuss the freeze in the higher rate threshold in 2027-28 and 2028-29, and you talk about behavioural change. The effect is £10 million in 2027-28 and rises to £20 million, £21 million and £22 million in the following years. You then compare that to the static forecast. Last year, I understood that the behavioural change effect for the tax would mean that—correct me if I am wrong—about 83 per cent of the tax would be lost, compared to the forecast. Is the behavioural change in this year's document on top of that? Are you looking at cumulative behavioural change or only at the fact that the threshold has been frozen? I am not seeing the big picture of the impact on the tax overall. Alternatively, are you saying that you have already baked that in and that these figures are just about the impact of the decisions in the draft budget that was published last week?

Professor Roy: I will make two quick points, and then Justine Riccomini might want to come in on the overall point about behavioural change.

I would need to get back to you on the specific figure of 83 per cent, but I wonder whether that relates more to the upper rate. There is a difference with the really top rates, which is where we think behavioural change is a significant proportion of the static cost, because those are the people who have flexibility.

The Convener: Indeed.

Professor Roy: The higher-rate taxpayer is much lower down the distribution, and that rate involves many more people on salaries and in employment, including public sector workers. There is less flexibility there, so we expect less behavioural change.

The Convener: Yes—it is about the upper rates. Apologies.

Professor Roy: That is where you get much higher behavioural change figures.

In our modelling, we start again when the Government announces a policy. We model the new policy and then estimate the behavioural change that goes with that. We do not estimate the entire behavioural change that has come through the cumulative policies. That sort of thing gets captured more in the tax-based performance gap, rather than—

The Convener: If you were to do that, that would give an overall view. For example, we could see that a tax was meant to raise £100 million but raises only £10 million, £20 million or whatever. If we look only at the changes, we could end up in a situation where the cumulative behavioural changes are more than the tax is intended to raise. We would not necessarily get a clear picture.

Professor Roy: No. To be clear, we look purely at the tax policy change that is announced in the budget and then at the behavioural changes that are associated with that.

If you are asking what the total behavioural change is as a result of all the tax changes that the Government has made over time, we do not estimate that. That gets into complicated things such as the counterfactual, the broader effects in the economy, UK Government policies that have an impact, and so on, all of which are factored in. The other extreme in our analysis is the tax-based performance gap, which is, essentially, everything in the relative difference between Scotland and the UK.

Justine Riccomini (Scottish Fiscal Commission): Another difficulty with behavioural change at the top end is its relative visibility. Not much data is available on people's behaviour. For example, they might be putting money into a pension, deciding not to take a promotion or working fewer hours. However, until the pay data comes through with real-time information on outturns, we do not really know how much less tax is coming through, and we cannot necessarily tell whether that is the result of employers reducing pay or getting rid of people, for example, or of individuals making choices.

The Convener: You mentioned that capital funding will fall by 5 per cent in real terms between 2025-26 and 2030-31. What measure are you using to calculate that? Are you using the normal GDP deflator or, for example, the Building Cost Information Service figures, which say that there will be a 15 per cent rise in construction inflation over the next five years?

Professor Roy: I knew that you were going to ask that question. We are using the GDP deflator, because that is standard practice in looking at public finances.

I know what you are going to say in—

The Convener: What am I going to say, then? [*Laughter*.]

Professor Roy: It is conventional practice that, in public finance accounting, we use the GDP deflator because that provides consistency across the board. However, you are entirely right that, when you start to look within individual portfolios, the inflation rates are different. For example, in the health portfolio, the health inflation index is different.

You are also entirely right about the direction in which—I think— you were taking your point. The cost of construction looks quite different from the GDP deflator, particularly if capital expenditure is being accelerated into specific years, because that pushes up the price and can, in turn, affect the spending power of that capital budget—

The Convener: Limits to capacity in certain geographical areas and skills areas have a distortive effect. Why would you stick to the GDP deflator on capital when you know that it underestimates that effect? It will not be a 5 per cent reduction in terms of the amount of road that can be maintained or the number of new houses that can be built. The reduction will be a lot more than 5 per cent, will it not? What is it likely to be?

Professor Roy: I do not know.

The short answer as to why we use the GDP deflator is that it is conventional practice and means that we are consistent when comparing our numbers—

The Convener: It is a practice that you know to be inaccurate. You are forecasting, and Governments must take decisions, but it is kidology if we all know that, factually, it is an underestimate of the reduction in what the capital spend can achieve.

Professor Roy: As I said, the reason why we do it is convention. It is also to do with consistency; we can compare like for like and see what is happening in, for example, the capital budget in health versus what is happening in resource budgets. We are using the same deflator across the board.

It is interesting that—I would need to double check—

The Convener: Sorry, but I would have thought that you could use the GDP deflator for resource and the Building Cost Inflation Service rate, or whatever it might be—some measure that can be agreed on—for capital. We use capital and resource completely separately. They are separated throughout your figures. It therefore seems to me that it would make sense to use two different measurements.

Professor Roy: We can definitely take that away and look at the nuances of how we might talk about the spending pressures within capital, for example. In terms of things such as our headline estimates, it is important to use the deflator for consistency and from a public finance accounting point of view. However, we can certainly then use other numbers to say, "Okay, this is the number." If you are looking at spending pressures within particular elements of the capital budget, we can certainly take a look at that.

The Convener: Sorry to come in, but it sometimes works the other way as well. I remember that, after the 2008 financial crash, one of the housing associations was building houses, and the tender came in 16 per cent below what it thought it would be because there was such a shortage of projects happening at the time and companies just wanted to stay in business. Companies were effectively building things without making any profit, just to keep themselves rolling forward.

10:00

It seems to me that, if you were able to measure inflation differently, you would be able to see whether the Government has clout. I am labouring the point a wee bit, but—

Professor Roy: In a sense. We are more than happy to—

The Convener: I think that Eleanor Ryan wants to come in.

Dr Ryan: On top of all the things that Graeme Roy mentioned about why we use the GDP deflator, another reason is that there are internationally accepted definitions and well-established sources for calculating it. I do not claim that it is the best or only measure of inflation for all purposes, and you are quite right that there are other ways to look at capital. However, if we were to start basing our analysis and forecasts on another inflation measure, we would need to be very careful to ensure that it was well understood, accepted and established in order to serve the committee well. However, as Graeme Roy has already said, we could definitely look at doing some supplementary analysis.

Claire Murdoch (Scottish Fiscal Commission): The key thing is that, even if you use the GDP deflator, the capital funding outlook over the next five years is still challenging. The Government is doing things such as using money from the Crown Estate and planning to switch some funding from resource to capital, but it is still looking at a real-terms cut if you use the GDP deflator. If you used a different measure for construction costs, the outlook would be even more challenging, which tells us something about infrastructure investment over the next five years.

The Convener: Thank you for that. I will let committee colleagues come in now.

Craig Hoy (South Scotland) (Con): Good morning, Professor Roy. To go back to public sector pay for a moment, by common consent, it seems to be an area in which a red light is flashing at this time. What estimates have you made about forward-looking public sector pay deals? Do they give you any confidence that a 1.1 per cent pay policy will be met now and in future years?

Professor Roy: We highlight in the document that the Government's public sector pay policy, which goes up to 2027-28, is risky because, if you look at what it says—9 per cent over three years—what is left in that overall envelope suggests a real-terms pay cut in the final year. If the actual pay policy differs from that stated bit, it means that more of that allocation must go on public sector pay, and the other aspects of the budget have to do the heavy lifting in order to make up the gap. That is the first point.

The second point is what that means for our forecasts. Given what I have just said and the history of where the Government has moved on pay, it is a significant risk to let us use a different forecast, which is a 2 per cent public sector pay forecast. That is not us saying that that is what the policy will be; we are just saying that, for our forecast purposes, we go to our baseline, which is that public sector pay will rise with inflation.

Craig Hoy: Other analysts of productivity have said that it would be heroic for the Government to meet its productivity targets in light of everything in the budget. Based on recent experience, it would be heroic for the Scottish Government to go into a room with trade union officials and come out having negotiated, presumably, a net real-terms reduction in pay. That will not happen.

Professor Roy: Ultimately, how to navigate discussions on public sector pay policy is a decision for the Government. Our general point is that, given recent trends, pay policy deals have been higher than the trajectory of the overall public pay envelope, and the Government must manage that as a risk.

In the document, we discuss other risks that are related to public sector pay, such as issues around workforce numbers. We also say a bit about the on-going costs within the pay bill and the drift in pay. We have changed our assumptions slightly to factor in that the Government has said that it has taken a more significant management approach to the overall pay drift; we have pulled down our forecasts on that as a result of the Government's stated policies.

Craig Hoy: Paragraph 52 of "Scotland's Economic and Fiscal Forecasts" states:

> "If pay awards are higher than the Scottish Government has assumed, to keep the paybill at the level used as the basis for the Spending Review, the Scottish Government would have to make larger workforce reductions than it has already planned."

The Government has put out quite a gutsy figure for public sector efficiency and workforce savings. What is the risk if it does not meet its forecast reduction in the size of the civil service, and if public pay deals turn out to be higher than 1.1 per cent and potentially above inflation? Where is the wiggle room within that? It strikes me that there is none.

Professor Roy: That reflects, in part, the fact that the Scottish Government's budget is largely fixed. Pay is around half of the budget in a lot of portfolios. That necessarily means that, if your decisions are based on the assumption that the pay award for 2027-28 will be lower than inflation, that you will make significant savings in public sector head count and will pull down on pay drift, and you then fail to meet any of those conditions, you will have to find the money from somewhere else. That must be either through increased revenues—the Government hopes that the block grant might increase or that it intends to increase taxation—or through finding that money within existing spend, which would mean saving money from non-pay costs, which would be the delivery of services.

Craig Hoy: Is there also a risk, given the current structure of the Scottish tax system, that, as public sector workers move into higher rates of tax, the trade unions who are negotiating on their behalf will be tougher, because they know that, in effect, 50 per cent of any pay increase will be handed back to the Scottish and UK exchequer in tax and national insurance?

Professor Roy: That is an interesting one. We have made a general point in our conversations over the past few days that we see the effect of the change in the tax base and the tax structure in Scotland. We say that, in 2016-17, just over 300,000 taxpayers in Scotland were higher-rate taxpayers. We project that next year, it will be more than 800,000. If you look at full-time median earnings in the public sector, that is pretty much around the threshold for higher-rate taxpayers now.

You are right that, as more pay awards come through, the Government will recycle some of that through higher taxes. As you know, there is a quirk–Justine Riccomini might want to talk about it more—with regard to the interaction with national insurance, which increased the marginal tax rate.

Justine Riccomini: Yes, absolutely. It is 15 per cent—it does not look as if any policy on that from the UK Government is going to change at any particular given time. We will have to see, if there is an election or something, whether that changes again. For the time being, however, there is an additional 15 per cent for employers national insurance contributions on the pay bill, so that will go up the higher that pay rises. If you increase something by 1 per cent, it is still increasing by more than it would do if salaries were lower, so it is a difficult one.

Craig Hoy: In responding to the convener, you mentioned behavioural change. What behavioural change do you think that a £32-a-year tax cut might effect in Scotland?

Professor Roy: It will all be modelled in our projections. In figure A.2 in the document, on increasing the basic rate threshold by 7.4 per cent, the figure for behavioural change is £1 million and the intermediate rate is £1 million, too.

Craig Hoy: We have also discussed the fact that, by freezing thresholds at the higher level, more and more people are being pulled into tax. That is now happening in the rest of the UK. How does that compare with other nations of our size and net wealth?

Professor Roy: I do not know, off the top of my head. I would always caution, in making comparisons with other countries, that you have to look at the entire tax and public spending systems, and at what people get.

The classic comparison would involve the UK and Scandinavia, where they have much higher tax rates. The Scandinavian countries tax the tax base much more—they do not just tax at the top end of income distribution; they tax more broadly across the income distribution in general. In exchange for that, however, they have much higher levels of public investment, much greater social security insurance and so on.

The challenge with trying to pick one element of the tax system in the UK and asking how it compares with Norway, France or the US is that you will always get a partial comparison, which can be quite misleading.

Craig Hoy: Is the phenomenon of pulling more people into what is deemed the upper rates of tax—in effect, changing the profile of the taxation system—occurring in other countries?

Professor Roy: I will make a general point about taxation, and then Justine Riccomini might want to come in.

If we look in general across most countries, we see that the tax base is rising over time. That comes back to some of the stuff that we have spoken about on demographics. As a result of that, we have high rates of tax relative to what was done historically, because we have an ageing population.

Justine, do you want to come in on that?

Justine Riccomini: I was just going to reinforce what Graeme Roy said about looking at the whole picture in each country. For example, in Switzerland, people pay a different rate of income tax depending on which region they live in. We also have to look at the amount of tax reliefs that there are in connection with earning that income.

When I worked at the Office of Tax Simplification, there were about 1,050 different reliefs, so we were trying to simplify that, which was a bit like telling the sea not to crash on to the shore. You have to look at everything in the round, but, generally speaking, it seems that more people around the globe are being brought into tax.

Craig Hoy: The interface between earnings growth and the tax take is interesting. You are projecting slightly lower earnings growth in Scotland than in the rest of the UK, and it has been downgraded. What impact will that have, moving forward, on the Scottish budget?

Professor Roy: I will say a couple of things on that. We have seen the net tax position become more positive over the past couple of years, and we have had the positive reconciliation, which comes in this year's budget, because earnings growth in Scotland is up relative to the UK, surprisingly. We have spoken previously about the decline that is associated with the downturn in oil and gas in the north-east, which affects higher earners and therefore has a disproportionate impact on Scottish income tax receipts.

We have seen from the data so far this year that the relative performance of Scotland in being ahead of the UK has disappeared, and now UK earnings growth is slightly higher than growth in Scotland.

The way the fiscal framework works is that, with all else remaining equal—let us assume that there are no changes in taxation—Scotland will gain in the net tax position if our earnings grow faster than earnings in the rest of the UK, and if the latter grow faster than Scotland, that next tax position will weaken.

That is why you see the slight pull down in the net tax position for next year. It is not really because we have changed our forecast for earnings; it is because the OBR has uplifted its forecast for UK earnings quite significantly. That then narrows the gap, and the net tax position is not as strong.

Craig Hoy: In his submission to the committee, Professor David Heald, who will be giving evidence in the next session, says that greater devolution of tax powers is actually increasing the risk in terms of the net effect on Scottish revenues. Is that a fair conclusion?

Professor Roy: I am conscious that David Heald is sitting in the public gallery behind me, so I will choose my answer carefully. [*Laughter*.] I do not know—I have not read about the specifics of that.

The principle is that tax devolution builds in risk, and that was part of the whole point in moving to devolution and fiscal devolution: that it would build greater risk—and reward, one could say—into the Scottish budget process.

There is a question around whether you have got the balance right with regard to the risks that you can and cannot control and whether you have the right tools to manage the risk. We have spoken previously in the committee about things like the reserve and the limits on borrowing, and whether those limits are sufficient to manage the reserve. That is one of the reasons that we highlighted the potential for quite a large reconciliation coming—that was going to lie outside how much the Scottish Government could borrow to smooth it, so there is a question about how you manage the risk as well as whether or not the risks are appropriate.

10:15

Craig Hoy: Another debate that is about to be had is on what the budget means for Scottish local authorities. Yesterday, the First Minister urged councils to consider potential council tax increases of 3 per cent. We know from speaking to councils that some of them are considering increases of 8 per cent or even upwards of 10 per cent. Having delved into the figures, what would you say is the real-terms position for council budgets, next year and moving into future years?

Professor Roy: There is a challenge in that regard in how the Government presents the figures and in the level of information that comes out afterwards.

In figure 2.8 in "Scotland's Economic and Fiscal Forecasts", we show the real-terms change in the local government budget between this year and next year, once all the transfers have been adjusted for. We think that that is a real-terms increase of 0.4 per cent. Figure 2.10 shows that, over the spending review period up to 2028-29, there will be a real-terms reduction in the local government budget of close to £500 million.

Craig Hoy: On that £475 million, the finance secretary said last week that local government was looking at 2 per cent year-on-year increases in real terms. Where would that figure have come from?

Professor Roy: That is not our number; you will have to ask the cabinet secretary about that.

That comes back to the point about what baseline is being used. For instance, the Government could be comparing budget to budget, which might be where the 2 per cent figure comes from—in other words, what was stated in the budget allocation in December 2024 versus what was stated in the budget position last week. We publish our estimate knowing that routine transfers take place, and we therefore adjust for them. That is where we get the 0.4 per cent, which we think reflects a like-for-like comparison.

Craig Hoy: So while councils say that they will potentially have to increase council tax and the Government says that they will not have to, you are clear in saying that there is a real-terms cut coming to council budgets—up to 2028-29, did you say?

Professor Roy: Yes—over the course of the spending review. By the end of that period, under the current plans, the local government budget will have been cut in real terms.

Craig Hoy: I have a question about business rates. Mention has been made of the fact that reliefs are baked into the tax system. It strikes me that, given all the reliefs in the business rates area—non-domestic rates—at the moment, perhaps the whole system needs to be looked at. The rates revaluation is coming through. There are a number of transitional reliefs, the small business bonus scheme and specific reliefs for hospitality.

Have you been able to estimate how many businesses in Scotland are going to be better off or worse off as a result of the proposed revaluations and the subsequent reliefs? Is there any specific sector or size of business that could be exposed to higher non-domestic rates bills? We are all hearing that hospitality, leisure and retail are potentially being hit through revaluation, whereas the Government is saying that it has now brought forward reliefs. Who will be the winners and who will be the losers, do you think?

Professor Roy: Justine Riccomini might want to come in on the specifics. In general, we do not go down to that level of detail, because we look at the overall funding position. The revaluation is designed to be broadly revenue neutral, so it is up to the Government to manage who gains from that and how to work through the appeals and so on. We do not go down to that level of detail—either by looking at things geographically or by looking at particular sectors—in any significant way.

Justine or Michael, do you want to add anything further?

Michael Davidson (Scottish Fiscal Commission): That is right: we do not go down to that level of detail. In 2026-27, the total value of all reliefs, as shown in our supplementary tables, comes out as £864 million. There is quite a lot to consider in the forecasting process, but, as Graeme Roy says, we just look at that on aggregate.

Craig Hoy: On the additional reliefs that were announced in the budget, relative to the proposed increase, my understanding is that there is still a significant shortfall in reliefs, as opposed to what will be brought in through the revaluation—if indeed it goes ahead. Is that fair?

Michael Davidson: Yes, that is correct. Do you mean the year-on-year increase?

Craig Hoy: Yes.

Michael Davidson: I do not have the figures for the year-on-year increase to hand, but the policy costing that we have done for the reliefs that are added takes a reasonable amount on that, but there is still a step up. That is in part because, in future years, we do not forecast revenue to continue to increase, because appeals will erode the value of the roll. There is always a sort of step up after the revaluation, and then a levelling off. Next time—in 2029, I think it is—we would anticipate another step up and levelling off.

John Mason (Glasgow Shettleston) (Ind): Inflation has already been mentioned. We had the OBR in last week, and it accepted that it had been a bit optimistic about how quickly inflation would come down. However, it still seemed to be quite optimistic that inflation will keep coming down. Are you broadly in agreement with that?

Professor Roy: Yes, I think so. Because the Bank of England has the remit of bringing inflation down to its target level, we assume that it will get inflation back down to that level. Over the past year, there have, again, been constant shocks. This time, the shocks have been on the inflationary upside: there has been the energy price change and food price inflation, while global instability has meant that world inflation has not come down, which has had an impact on food prices. That is why we revised our forecast up.

When we consider the material effects of inflation on the budget, it comes back to the conversation that we had about the erosion of the Government's spending power in its budget. However, protection against inflation comes through in areas such as social security, where benefits are uprated with inflation across the UK, which then feeds through to the BGA. The effect of inflation is to erode the Government's spending power, but there is protection in relation to the social security uplift.

John Mason: You mentioned global insecurity among those factors, which is a bit unpredictable—I certainly think that it is unpredictable. In principle, does inflation increase when countries bring in tariffs, or do tariffs just depress imports?

Professor Roy: On balance, tariffs would be inflationary and also dampening for the economy. Therefore, in the first instance, there could potentially be stagflation. How the specifics of that worked out would depend on which sectors were targeted. However, if we were to introduce tariffs, that would, by increasing the price on imports, lead to higher inflation. If other people put tariffs on our exports, that would lead to weaker growth.

John Mason: Thank you. Like the convener, I am jumping around a bit. With regard to the Scottish spending review, the Institute for Fiscal Studies said that there could be big changes in it in the future. It is not set in stone, and there are lots of things that could happen that would change it. How much confidence should we have in the Scottish spending review?

Professor Roy: There are a couple of points to make about that. First, the fact that the

Government has done a spending review is a step forward, and the fact that spending allocations have been made for the next three years is an improvement on what we have had in previous years.

To go back to the point about revisions within years, the Government has not gone down to different levels. It basically stops at level 2, and it does not always split the allocations between revenue and capital. We do not have the level of detail that we would want to have in order to know what is happening to, say, individual enterprise agencies or the overall higher or further education budgets.

My second point relates to portfolio efficiency savings and how those explicitly link to the Government's spending allocations. It is helpful that we have data for the next three years, but there are still a lot of unanswered questions about how it all adds up and what the genuine plans are.

John Mason: Should we be pressing for more detail?

Professor Roy: As you would expect, our answer to that will always be yes. The more detail, the better.

John Mason: Another document was published—the infrastructure delivery pipeline; I keep forgetting what it is called. I do not know whether you were expecting such a split between delivery and development. I had not realised that the Government would do it in that way. Is there enough detail in that document? Should we just be glad that it is a step in the right direction?

Professor Roy: It is a step forward that we now have a plan that the committee has been asking for for a wee while. The question is whether you have the level of detail that you need in order to be genuinely able to scrutinise the Government's priorities and what it plans to spend and when. I do not know whether Justine wants to add anything to that.

Justine Riccomini: With regard to the infrastructure delivery pipeline, the interesting points relate to annex A and annex B. Annex A sets out the projects that will definitely happen, because money has already been allocated to them and the work is under way. That is the case with the A9 dualling, the prisons and the peatland restoration programme. Annex B has a list of items for which the Government is developing a business case or an outline business case. Of those items, it is not particularly clear which will be included in a future spending review.

The Convener: Nor do we have timescales or budgets.

Justine Riccomini: We cannot really map it at all. That is also the case with annex C, which sets out the pipeline decision-making process but does not contain any timelines.

John Mason: That is especially the case with the projects that are listed in annex B. They have been approved in principle, but they might never happen. You said that annex A was quite good, but it does not contain any figures.

Justine Riccomini: No—it is just a list.

John Mason: I suppose that it is a step in the right direction, as they say.

I am still jumping around a bit. There has been quite a big drop in the revenue that we are expecting from landfill tax. It is not big money in the scheme of things, but that has come down from £50 million to £27 million.

Professor Roy: Michael Davidson might want to jump in on that specifically. The Government has on-going plans for how landfill is operationalised, with a view to disincentivising things going to landfill. Therefore, we would expect revenues from landfill tax to fall. It is a success if less goes to landfill, which in turn means that the Government receives less tax revenue from that.

John Mason: Could that mean a delay in some of the plans?

Professor Roy: Yes. We have talked about the biodegradable municipal waste ban.

Michael Davidson: Our forecast factors in incineration coming on stream before the implementation of the ban. We have made a few adjustments to our forecast. Had the ban applied and not been delayed, our forecast was that the revenues would have been around £10 million lower in 2026-27, but because more waste can still go to landfill, the revenues are higher than they would otherwise have been. Incineration capacity will come on stream before the ban applies, which is why the figure gradually decreases.

John Mason: Okay. Therefore, although the revenues seem to be falling quite dramatically, they could have fallen more dramatically.

Michael Davidson: Yes—that is right.

John Mason: I believe that two more council tax bands are to be introduced, although not in the coming year. It sounds as though the costs of introducing them will almost wipe out all the extra revenue. Is that correct?

Professor Roy: Unfortunately, we do not forecast or look at the effects of such a change, because council tax is a local tax that lies outside our remit. The only thing that we looked at is whether we thought that it would have an impact on land and buildings transaction tax and how it might change behaviours in that respect, but we estimate that the effect will be very small.

John Mason: Fair enough—that is fine.

The committee has previously been interested in preventative spend. I fully accept that it is difficult to pin down what is preventative spend and what is not, but the Government intends to tag it. Will that make a difference to the figures that we see, or will that information just be included as an annex? Will that affect your forecasts?

Dr Ryan: That issue has a very long history, which I do not need to tell the committee about. The key thing with preventative spend is to think about what gets in the way of it at the moment. Everyone has talked about the idea; the concept is well established and the Government welcomes it, as, I am sure, does the committee. What behaviour change is needed in order to shift more money towards prevention and to ease pressures on services in the future?

One way of doing that might be to have a category of preventative spend or to tag the spend. The key thing is to look at whether that will drive the behaviour change that you want. In addition, if you tag the spend, it is really important to follow that up and, later on, to evaluate what was achieved. It is fine to tag something as preventative spend, but, in three years, five years, 10 years or whatever the time horizon is, you need to ask, “What did it deliver? Did it work? What is the learning from that? How do we continue to drive the behaviours that we want?” It is always the follow-through part that is difficult.

10:30

John Mason: It could be quite a long-term process. As you have said, it could take 10 years.

Dr Ryan: It depends on the nature of the activity. As you said, there are issues around what is defined as preventative, and there are different time horizons. However, it should be possible—

John Mason: From your perspective, is there agreement on what preventative spend is?

Dr Ryan: There is extensive literature on preventative spend, and there are people who categorise different types of preventative spend. It is less about which definition you choose and more about everyone being clear about the definition that you are using.

John Mason: The UK, we believe, is moving towards having just one budget event—one fiscal event—every year, although the OBR will still produce two forecasts every year, if I understand things correctly. Will any of that affect the SFC?

Professor Roy: Not specifically. We will still need the BGAs in order to do the adjustments that happen over time.

However, there is a broader answer, which is that the interaction between the UK budget and the Scottish budget still feels as though it could be improved. The UK budget was relatively late, which meant that the Scottish budget had to be pushed back into January, which squeezes the committee’s ability to scrutinise it. The key issue from a Scottish perspective is less about the number of budget events and more about the timing.

John Mason: Professor Heald has been mentioned. I was interested in some of his input, which I will probably ask him about later. He mentioned the fact that the UK Government is able to handle social security spending in a different way from the Scottish Government. He used the phrase “quasi-DEL”, which I think reflects the idea that, if the UK overspends a bit because services are demand led, that is fine—it can simply borrow a bit more—whereas, if we overspend, we have a problem, because we have a fixed budget. Is that a fair comment?

Professor Roy: It depends, really. Michael Davidson and Claire Murdoch might want to come in on the specifics and technicalities of how it works. The key thing is the source of any social security increase in-year. Is the change relative to the situation in the UK, or is the UK making the change? If it is the latter, the block grant adjustment will change as well. If there was an acceleration—a shared increase in social security—the BGA would increase, which would help the Scottish budget. However, in general, where there is a relative difference, the Scottish Government will pick up that slack by managing its budget.

Claire Murdoch: The borrowing powers that the Government has through resource borrowing, which can be used for forecast error, can be used for in-year management of social security spending. It is more of an issue if there is longer-term divergence between Scotland and the rest of the UK, as that will put additional pressure on the budget that is harder to manage in-year.

Liz Smith (Mid Scotland and Fife) (Con): I have a question about the prioritisation or—perhaps just as important—the deprioritisation of Scottish Government spend. It relates to paragraph 54 in the committee’s report, in which we said that we sought clarity

> “on which areas of spending are being prioritised and deprioritised.”

That was on the back of comments from Audit Scotland, which was also looking for a bit more clarity on that.

Obviously, we have our bigger ambitions about tackling climate change, child poverty and economic development. However, it is very hard to see in the budget exactly which policies will deliver improvement in those areas. Do you agree with that concern and, if so, what extra information would you like from the Scottish Government?

Professor Roy: Claire Murdoch and I have been chatting about net zero and what has changed in the climate stuff, which might be quite useful. We have tried a couple of things to help that. For the first time, we have presented tables of portfolios as a share of the Scottish Government's budget, which show, arithmetically, areas that are being prioritised versus areas that are being deprioritised. The overall budget is going up very slightly, but you can look at what will take a bigger share in the overall increase and see that, unsurprisingly, areas such as health and social care and social justice are taking up a bigger share, which shows their priority. You then see the figures for local government and education and skills going down. In terms of relative prioritisation within the overall spending envelope, you can see which areas are being prioritised at an aggregate level and those that are less of a priority. That is what we have done to help in that regard.

We would like to see much more information on the detail in the spending review. As I have said, that goes to level 2 but not level 3, which is what the 2011 spending review did, I think. There is no split between revenue and capital, and we have spoken about the capital pipeline not being presented in any detail. There is a list of projects, but we do not know which ones will actually be delivered.

That is just on the allocations of spend, and, if you have not set out where the spending allocations have been in the first place, you cannot do the next bit to follow that up—"If you're doing all of that, what does that mean for your ambitions on child poverty or net zero?". You cannot do that.

Liz Smith: Thank you—that was very helpful.

At paragraph 62 of its report, the committee goes on to say that we are

"not convinced that the Scottish Government has set out sufficient evidence to support its argument that the future social security budget is sustainable."

That leads on to something slightly different, but it is on the same theme, because, in effect, it says that we do not have enough information available to provide the evidence that the social security budget—which, as we know, is increasing quite fast—will be sustainable. It is all part of the same thing: there is not enough detail. Is that a fair comment?

Professor Roy: I would make a general point on that. The social security budget is sustainable in the sense that the Government has to pay for it. There is then the question of how that is paid for elsewhere. We might come on to some of the revisions that have happened, which have changed the picture materially, relative to June, in narrowing the gap. In figure 2.1, for example, we say that the health budget will go up by just over £1 billion over the course of the spending review. Your question is about what outcomes that will achieve and what evidence the Government has that, underneath all that, the outcomes that it wants in terms of improving public health, tackling waiting times, delayed discharges and so on will all be delivered by that spending allocation.

We have a portfolio efficiency plan that talks, at high levels, about efficiencies, but how do those speak to the spending allocation and to the outcomes? That is a missing piece of the jigsaw—which is not for us to find, but it would be for the Government to set that out.

Liz Smith: I think that it is a very big missing piece of the jigsaw. In effect, we are getting information about the investment in Scotland on social security spend, and the Scottish Government tells us that the reason for the increase is that there is a future investment—which might go back to what you were saying about preventative spend—but we are not getting the detail on exactly how that will happen. That is the problem. In terms of the actual social security spend, we are not sure which areas of policy are having the best possible impact—for example, on child poverty—and which aspects of increased spending are almost having the opposite effect, in that they are not providing the benefits. That is quite a serious concern. The committee said that we did not feel that the medium-term financial strategy was giving enough information on that detail.

Professor Roy: A good example of that would be the Government's statement about the £125 million of savings on the two-child limit, with the money being invested in child poverty reduction activities. The question, from your perspective as a committee, is how to follow the money to determine that the £125 million saved is being allocated in the most efficient and effective way, based on the outcomes that you are trying to achieve. That is not our territory; we just look at the overall public finances. More could be done to set out the evidence base justifying why the allocations are what they are.

Liz Smith: On the recommendation in paragraph 73 of our report, we made it very clear that we wanted a debate on universalism, with some study of which universal payments are working best and which are perhaps not.

In response, there was agreement from the Scottish Government that the economic and fiscal environment remains "very challenging", which means that there are "tough choices" to make. It went on to say that it is developing an approach to public value that will

"embed a framework for understanding spending proposals"

in universal terms. Are you aware of what that framework is or of what is happening in terms of measuring that public value when it comes to universal payments?

Professor Roy: I am not aware of it. I do not know whether Claire Murdoch or any officials have anything to add?

Claire Murdoch: No, other than that we are aware of "public value" being one of the things that it lists as part of its efficiency plans in the spending review.

Liz Smith: To be clear, to your knowledge, there is no study or framework, at present, that will investigate which universal payments are working most effectively and which are not.

Professor Roy: Not that we have seen. It might well be something that the Government is working on developing, but we have not seen it, and I am not sure whether we would see it. In asking why we would see it, the question for us would be whether it would have a material impact on our forecasts and what the justification was for moving around some spending lines. It is probably something that the Government would work on itself, and we would then see it as part of the package—a bit like the unpicking of the portfolio.

Liz Smith: Except that the committee has asked for it.

Professor Roy: Yes, you would ask for it.

Michael Marra (North East Scotland) (Lab): There are a few points of clarity that you can perhaps help me with. Will the benefit or uplift from the changes to council tax—commonly referred to as a "mansion tax"—accrue to local authorities, or will it be banked centrally?

Professor Roy: We do not forecast that. However, my understanding is that, because it is a local tax, it would be a council tax, so it would accrue to local government.

Claire Murdoch: The answer depends on how the Government chooses to operate it and whether it chooses to alter the general revenue grant that goes to local government to account for that. However, we have not looked at that.

Michael Marra: You are not making an assumption that it will give an uplift to the central budget.

Professor Roy: No. As Claire said, part of it is that the general revenue grant is the biggest component, so there is a question about the net effect. It is a bit like the conversation that we had on council tax in general, in that we can increase council tax significantly, but, if the general revenue grant goes down, the budget for councils does not really change.

Michael Marra: On 22 December, you accepted a last-minute policy proposal. What was that in relation to?

Professor Roy: We set out the specifics of our timeline. There were two changes to the timeline. One was an ask to extend it slightly, and one was to give a slight extension for a policy coming in.

I cannot recall exactly what the policy was. Typically, we would not say what the policy was, in part because those are private conversations with the Government. It might ask, for whatever reason, to have a slight extension. Only if it were a significant, material extension would we publicly say that we had not included it. That is part of the day-to-day conversation that we have with the Government to work through the specifics.

Michael Marra: It was not material.

Professor Roy: No, it was a small change.

Michael Marra: That is useful. I have a broader question about the use of ScotWind money. There is comment about that on the front page of *The Scotsman* today, and I believe that you spoke about it at the University of Glasgow yesterday. Is it your understanding that that money will be used for general revenue, rather than for the purposes that have been set out previously around supporting the transition to net zero?

Professor Roy: There are a couple of things to say. In paragraph 2.22, we set out that, over the period from 2025-26 to 2029-30, £344 million of Crown Estate revenues, of which ScotWind is the biggest part, will be used for capital spending and £308 million will be used for resource spending.

The Government is clearly using all the flexibilities that it has at its disposal to boost expenditure, in both revenue and capital, over the period. It is entirely appropriate that it uses ScotWind revenues; if it does not, they are simply sitting there in a bank account and not doing anything of any value. The Government has been clear about wanting to use that as a mechanism to invest in net zero and as capital investment, and we know that it was doing that last year.

The projections for 2027-28 are particularly challenging. The Government's revenue budget has particularly weak growth in 2027-28, once you adjust for social security—it is going down in real terms—and our understanding is that the

Government has a presumption that it will use some ScotWind revenues, of about £236 million, to prop up resource spending in 2027-28.

10:45

I would make two points on that. One is that it is not great to use one-off resources to pay for day-to-day expenditure because, by definition, once you have used that, you cannot use it again. Secondly, as the Government is trying to manage its budget, it has in the past earmarked ScotWind resources to be used but has not followed through on that, because the block grant has gone up or something has happened on taxation. There is a fiscal management element, and I think that it is entirely appropriate for the Government to do that. However, we caution that, if the Government follows through on its plan and has to use ScotWind money for day-to-day expenditure, it will have spent it and will not be able to use it again.

Michael Marra: From a policy perspective, the stated intention for that money was that it was to be used for net zero transition, particularly in the north-east, for investment in skills and infrastructure, to ensure that we have that economy functioning in the future. However, you are saying that it is really being used to prop up the revenue budget on a one-off basis, rather than being a recurring investment in the future.

Professor Roy: There are two parts to that. One is about what to use the ScotWind resource for, and the Government has said that that is about its long-term plan around net zero. Again, given the constraints that the Government has and the fiscal tools that are available to it, such as the reserve and borrowing, the Government has, over the past few years, used ScotWind essentially as a fund—almost like an additional reserve—that it can earmark to spend. However, when it comes to the crunch, if it gets more money in, it does not actually use ScotWind money.

Michael Marra: Given the analysis from the IFS and the Fraser of Allander Institute, that looks unlikely. They are both predicting the likelihood of an in-year emergency budget—they say that that is a fair possibility, given how tight the numbers are. You say that the idea is that the Government will not draw down the money. I know that some of the allocations go into 2027-28, but it feels like one-off spending. Should we have an overall concern that the budget will not get to the end of the year?

Professor Roy: We would certainly not say that. We have not made a specific comment on that, or seen any evidence that that would be a problem. We should not lose sight of the fact that the Government has to balance the budget, and it has various tools that it can use to smooth expenditure over time. It is entirely appropriate for the Government to use borrowing when it needs to, to manage the reconciliations—that is the nature of the fiscal framework.

That is not borrowing—it is just shifting money between years. Similarly with the ScotWind money, that resource is there to be used, and it makes sense to use it. There is then a question about how appropriately the Government is using it, but it is entirely fine for the Government to plan to use it. Similarly, we know that the non-domestic rates income pool fluctuates, and the Government is entirely within its rights to potentially use that.

Typically, at UK spending reviews, money comes later, although this might be the first time ever that that does not happen. Therefore, the Government, in looking ahead, might be thinking that it has plans to smooth spend, but, if more block grant comes down the line, it will use that to meet its spending plans. It will then be able to free up some of the commitments that it has made on how much it will put into the reserve, how much it will borrow and how much of the ScotWind money it will use.

Michael Marra: Clearly, it is legally appropriate, and the Government can make those decisions as it wants, but it will be concerning to members of the committee that we are seeing predictions from independent analysts that the budget is running close to the rails, and that the Government is having to allocate one-off savings and one-off pots of money to try to get through the process. That has to be a concern. I am surprised that you do not share that concern.

Professor Roy: To be clear, the Government always uses its flexibilities over time to potentially manage the budget. The point that we make is that the overall funding envelope is exceptionally tight over the next few years—1.1 per cent real-terms growth is exceptionally tight. Once you factor in the conversations that we have had on pay and all those sorts of things, balancing the budget will be exceptionally difficult. It is unsurprising that the Government is using the various flexibilities that it has to boost the funding allocation as much as possible.

Michael Marra: There is also the analysis that referenced “heroic assumptions”. We have already heard that in relation to productivity, as well as some of the issues around workforce.

Let us discuss the £1.5 billion of projected savings. We previously heard a figure for that in the MTFS and the fiscal sustainability delivery plan, but, at that point, it was around £1 billion. Has the figure increased or is that just my recollection?

Professor Roy: There were different numbers at the time. The Government has broken it down into different aspects: efficiency savings, savings through the public sector workforce and savings in broader areas, such as public value. Our understanding is that the £1.5 billion represents the savings that the Government intends to make across all the various activities over the next three years. The figure includes things such as workforce and efficiency savings.

Michael Marra: Two thirds of the figure is from the 3 per cent recurring savings in national health service boards, but my understanding is that that money is retained by the health boards. In what respect is that a saving to the overall budget that allows us to close the fiscal gap between projected expenditure and the amount of money that comes in?

Professor Roy: You are right about the key point: our understanding is that the efficiency savings that are made in portfolios are retained. Overall, in health, there will be an increase in actual funding allocation of more than £1 billion in real terms during the spending review period. However, within that overall increase, the Government is asking the NHS to come up with and to evidence around £1 billion-worth of efficiency savings. It means that spending will grow by £1 billion, but the NHS will also have saved £1 billion in that period.

The key bit for us—this will be quite interesting when it comes to the spending review and the portfolio efficiency plans—is the couple of paragraphs in the spending review that are about how the savings are to be monitored over time. That is the really interesting question: where will those £1 billion-worth of savings come from? Will they be delivered? What will the money be used for? To which areas will the money be redirected? That is the bit that will come through in the delivery plans, through the evidence of efficiencies.

Michael Marra: Can you tell us how a member of the public would see the relationship between the efficiency savings and the resource gap? We have heard your repeated warnings about the size of the resource gap and the amount of money that has been set out. In essence, is that a curtailment of resource demand that is aimed at closing the gap?

Professor Roy: In the MTFS, the Government essentially said, “This is what we think, based on our current trajectories and using our social security system.” To be clear, the gap is the Scottish Government’s estimate rather than ours, but the Government used our numbers to push forward and say, “Based on trends on social security, based on pay, but also based on what we can see within our portfolios, this is how spending is likely to increase if we do not change tack.” That funding amounts to £2.6 billion-worth of resource. Clearly, that number will have changed because of the budget and the changes in forecasts and in social security spending, but it is based on what the Government thinks the level of spending would be if nothing else changed.

The efficiency savings are designed to manage overall spending demand, and additional funding will also flow in. The gap is not a gap in the sense of a deficit or something that you can see; it is an internal management process in the Government.

Michael Marra: Okay, that is useful. We have touched on the big tax changes, the fiscal drag and the numbers around those issues. In her statement, the cabinet secretary made great play of the tax change, despite a member of her tax advisory group saying that it

“may be the smallest tax cut in history”.

That seems to bolster the claim that Scots will pay less tax than people in the rest of the UK. The SFC has been caught up a bit in that discussion, due to the use of some of its statements. Are you comfortable saying that ministers have always made accurate and truthful statements regarding the SFC’s position on matters?

Professor Roy: Ultimately, it is up to the Government to defend and talk about what it does. In our report, we have expanded our analysis by looking at groups such as median earners. Based on our forecast, we say what we think the median income tax will be in Scotland over the next year or the next few years. Our understanding is that the Government uses that to help inform its tax decisions. It also uses that forecast to take the opportunity to say whether the median income tax payer in Scotland is paying more or less.

Of course, the picture changes over time. What we provide is a forecast, and the outturn data for actual median income tax payers will be different from that. It is not easy to put a number on the reality of what a median income tax payer is, because it depends on net figures, pension contributions and the like. The point that we were trying to explain to people is that, when we talk about the median income tax payer, that includes pensioners and so on. We have expanded our focus to consider what the median earner in Scotland is, and what their relative position is. That is where we get a different story. Different numbers give you different stories. We just produce the numbers.

Michael Marra: For 2023-24, we know that the claim is definitely false, because we have the outturn data—do we not?

Professor Roy: Yes—the outturn data will differ from the forecast, but that is quite different from talking about the Government using our forecast to determine what the median income tax paid will be for that year. It is entirely right to do that. You are right, however, that the outturn data might mean that that statement is different—the data will change. The figures will go up and down, because our forecast is always a forecast, rather than an outturn.

Michael Marra: At Christmas, I was telling family members and friends that Dundee United would definitely win the new year derby. I was basing that on the data in front of me and my perspective. That was my prediction about what would happen. We lost 1-0, however—and rightly so. The reality is that, if I continued to claim that we had won, I would be a liar, would I not?

Professor Roy: I am not going to predict Dundee United results—it is difficult enough to predict a forecast for the economy.

We do not get involved in the debate; we forecast income tax on median earners for the next year. If the Government sets its policy and says, based on that forecast, that the median income person in Scotland will pay less tax, that is where our work ends. It is not our job to go back and evaluate the outturn. The outturn will differ from the forecast—that is the nature of forecasts.

Michael Marra: So, we should stick with the outturn. Okay; thank you.

Patrick Harvie (Glasgow) (Green): Good morning. I was going to start on some of the issues that Michael Marra has just finished on, so this leads on quite well.

Earlier, you issued a bit of a warning when we were talking about making comparisons of tax policy here with that of other countries. You gave the example of Scandinavian countries, and made the point that a comparison is not easy to make and is not necessarily easy to understand, because it will not compare all aspects of the proposition that is put between Government and citizens, not only around tax but in relation to public services, investment and so on. Is it not reasonable that the same warning should be given in relation to comparisons with the rest of the UK—that there is an increasing gap not only in tax policy but in what people get in return for tax, and we should place less reliance on those comparisons?

Professor Roy: I would say a couple of things on that. First, we obviously have the same tax system relative to the rest of the UK, so that comparison is much easier to make than a comparison with somewhere like Scandinavia. We operate in a devolved framework within that context. What we do on income tax is relatively straightforward, because the definitions of income are the same and the personal allowance is the same. The question regarding an income tax payer in Scotland and the UK is, what is the relative difference in income that is taxed?

That can be calculated in exactly the same way as the equivalent for social security. The Scottish Government is spending an additional £1.1 billion on social security next year relative to what would be the equivalent if it delivered the same payments as in the rest of the UK. Your point is entirely right, but we do that on both sides: we do not just do it on tax; we do it on spending as well.

Patrick Harvie: Is it not fair to say, however, that the Scottish Government, more than anybody else, relies a bit too much on the political rhetoric about the precise proportion of people who pay less tax than they do elsewhere in the UK? That detracts from the fact that, as a result of those changes, people's kids will not be 50 grand in debt for getting a degree and their community will have fewer children growing up in poverty. Beyond the value that the Government feels is in the political rhetoric of saying that most people pay less tax, does the precise proportion of those people matter in relation to the responsible management of public finances?

11:00

Professor Roy: On the first point, we feel from our engagement with stakeholders in business and industry, for example, that it matters that a conversation takes place about the burden of income tax relative to the rest of the UK—Justine Riccomini might want to say a bit more on that from her experience at the Institute of Chartered Accountants of Scotland.

That comparison between Scotland and the rest of the UK has an impact. Some people might say, "Well, because we live in Scotland, we're not paying for university tuition and we're also receiving these other benefits," and the Government can decide how to use that political narrative. Equally, Opposition parties might use a narrative about Scotland being the highest taxed part of the UK or about the median taxpayer paying slightly more. On the latter point—although I get the politics of it—it seems that an exceptional amount of effort has gone into a specific debate about a relative difference of about £40, which, given everything else that is going on, seems like a lot of wasted energy.

Patrick Harvie: The point that I am trying to make is that, when Scotland moved from the three-band to the five-band tax system—what was implemented was pretty close to ideas that were developed in the 2016 Green manifesto—there was a reasonable case for reassuring people that the tipping point would be roughly in the middle. However, the longer that the system has been in place, the more spurious it has become to try to pin that down to precise figures and to maintain it absolutely at more or less than 50 per cent, because that area in the middle has become increasingly vague.

Professor Roy: I agree entirely, and we are talking about a small saving. It comes back to the conversation that I just had with Michael Marra, and the fact that the position will change over time. We make a forecast, and the Government must make its decision based on that. It does not know what the outturn will be—it could be different.

The broader issue—which, again, gets squeezed out by this conversation—is that the median income taxpayer in Scotland is different from the median full-time earner in Scotland, and the question of the number of people who are in bands is different again, and that will change over time. The broader conversation is, therefore, about whether the structure looks right, how it changes over time and whether it delivers the more progressive system that we want. For me, the issue is about those broader policy questions rather than the political rhetoric.

Patrick Harvie: I want to ask about the gap between what you call the policy-only position with regard to what the Scottish tax policy will generate and the reality. You call it a tax base performance gap. There are probably various reasons why it is happening—such as economic activity, behavioural change, or how both Governments apply policy—but could the Scottish Government implement specific measures to reduce that gap, beyond the aspiration to have a more successful economy, however you define that? Could some mechanistic changes reduce that gap?

Professor Roy: Yes. To be clear, the tax base performance gap relates to a modelled estimate that we do. We asked how much money the Scottish Government would raise from its more progressive tax policies if Scotland's tax base performed the same as the UK overall, and we came up with a figure for next year of just over £1.7 billion; we then asked how much the Scottish Government is actually raising and established the difference between the two figures.

There is a broad range of reasons for the gap, including issues such as behavioural change and the relative economic performance of Scotland and the UK. Some of that relative economic performance will involve performance that the Scottish Government can control, some of it will be the result of UK Government decisions having an impact in Scotland, and some of it will involve things that lie completely outwith the control of any Government, such as energy changes and the effects of tariffs or uncertainty. The final element would be what we call tax-rich growth. The fact is that the UK has the City of London, for example, so, with the same earnings and employment, it will collect much more in tax revenues than we would do.

The general question for the Government would be, how can it best understand all those different components, and what can it then do to try to narrow that gap, if it wants to?

Patrick Harvie: Within that, what are the elements that are most amenable to some kind of action to control them?

Professor Roy: The big drivers that we talk about involve earnings, particularly higher earnings. If you have a progressive income tax system, the more that you can do to grow high-earning employment, the more it has a relative impact on your tax take. That is not a political comment. If you are taxing people at 42p on their marginal earnings as they move up the income distribution, you will collect a lot more revenue if you have more people on that rate than you would if you were creating jobs and employment at the basic rates of tax.

If you have only one tax—income tax—and you have made it more progressive, the key thing to do for your tax system is to do your best to create high-value jobs, because that will have a disproportionate impact on the revenue that you collect.

We can share some rules of thumb that we have used in the past. Every percentage point improvement in Scotland relative to the UK raises about £35 million. Because of Scotland's more progressive system, every general increase in earnings will raise more revenue than it would in England, because we have these higher tax bands.

Patrick Harvie: Finally, I want to ask about some of the issues about local government that came up. I understand that you say that you do not make forecasts about council tax and you do not take responsibility for issues relating to it, because it is a local tax. However, aspects of the impact on local government finance do not derive from local decisions but from Scottish or UK decisions. In particular, some councils are experiencing significant pressure through homelessness as a result of a combination of changes to asylum policy at UK level and the nature of homelessness legislation that has been passed on a cross-party basis in the Scottish Parliament.

When there are devolved policy choices that have fiscal consequences, the framework says that the fiscal consequences sit with the devolved Government. When there are reserved policy choices, however, there is no mechanism that recognises that those fiscal consequences should sit at the UK level. Is there any effort to create a mechanism that would do something comparable to protect the local services that are under pressure because of UK decisions, in the same way that the fiscal framework says that the Scottish Government should carry the fiscal cost of making devolved policy changes?

Professor Roy: If I understand that correctly, in some reserved areas, such as the migrant surcharge, that flows into the Scottish budget. Even though it is a UK-wide decision on migration policy, the surcharge exists and is raised at the UK level, and the Scottish Government gets funding for it as a result of it flowing through. That is one example of where there is a direct mechanism for UK reserve changes flowing through to the Scottish budget, and it is up to the Scottish Government to decide what it will do with that. I do not know whether I have that number to hand.

Within the fiscal framework, there is the opportunity for the Government to raise concerns about where a reserved policy has a fiscal cost within devolved areas. Various mechanisms have been used in the past, such as the way in which funding for the Olympics passed through, so the Government could potentially use that.

The broader issue, which we can all see, is the overall allocation for local government. Issues such as homelessness and asylum seekers coming in will ultimately all be managed within the overall budgets that local governments have. The Government will set out various spending lines, but we would not go into that level of detail.

For 2026-27, the migrant surcharge is £198 million, so money will be flowing into the Scottish budget from that.

Michelle Thomson (Falkirk East) (SNP): I thank the witnesses very much for this session, which I have enjoyed a great deal. However, it strikes me that we have spent as much time talking about the fiscal framework in operation and the implications therein as we have talking about the budget.

Rather than asking Professor Roy, I invite Dr Ryan and Justine Riccomini to give us their reflections on their first sojourns into this process and to tell us what they think and why. I am not asking from any political point of view; I am asking a question about process.

In your answers, you might also want to reflect further on risk, but that is entirely up to you.

Dr Ryan: That is a very fair question. This is not my first outing with the fiscal framework. As you know, I have some history with it. I was involved in implementing the earlier iteration of it when I worked for the Government.

My reflection is that if you were able to start with a completely blank sheet of paper, you probably would not design the framework as it is now. Of course, you do not get to start with a completely blank sheet of paper. You have to introduce something that two Governments will sign up to, that the Parliament is prepared to accept and that takes into account all the different complications and wrinkles that already exist—I include in that the Barnett formula. A lot of the complexity of the way in which the fiscal framework operates reflects the political reality at the times when it was negotiated and renegotiated.

It is right that we spend an enormous amount of time on the fiscal framework, because it has a huge impact. Everything related to funding goes back to performance and UK Government decisions relative to Scottish Government decisions. That creates an environment in which we are constantly comparing them.

I will not offer a view on whether that is desirable for the future, but you are right to say that the framework is a big factor in everything that we consider.

Michelle Thomson: As Graeme Roy said earlier, David Heald will join our next session next week, when he will get on to this issue. A killer sentence from his submission said:

> "the fiscal flexibility of the Scottish Government does not match its exposure to fiscal risk."

That seems quite fundamental here and now, and even more so when we look forward to the potential introduction of Scottish bonds, for example. They are a different funding stream, but if they go ahead, they have the potential to produce even further complexity and therefore more risk. We will ask David when he is in front of us, but what is your thinking about the exposure to fiscal risk?

Dr Ryan: We have spent quite a bit of time talking about things such as Crown estate revenues, borrowing, the reserve and the tools that the Scottish Government has to try to manage the risks in the budget and match the spend to the funding that is coming through.

It is right to say that, although we talk about using things such as Crown estate revenues, borrowing and so on, the borrowing power and the Scotland reserve are built into the fiscal framework, and they are not huge compared to the scale of the risks that the Government is managing, which was Graeme Roy's point. That is why you wind up using all the other flexibilities that you can around non-domestic rates and Crown Estate revenues. There is definitely something about making sure that the tools that are available to the Government are sufficient to allow it to manage the things that all Governments, devolved and not devolved, have to do.

On the issue of bonds, you have to make a judgment. If you, as a Government, have decided that you want to borrow, you have the national loans fund and bonds as options. You have to evaluate what you are trying to do and what the risk profiles are. I do not think that it is inherently better or worse to issue bonds; it is a judgment that you have to make based on what you are trying to achieve.

11:15

Michelle Thomson: You are developing a capital market, for a start, which is a fundamental. I am sure that we will say more about that.

I want to get your reflections as well, Justine. You have background and experience from ICAS. Would any of your members have chosen to run their business like that? What are your reflections on going through the process for the first time?

Justine Riccomini: To give a very brief summary, it is a jigsaw with a lot of moving parts that is possibly sitting on a travelator. I have been an observer of the fiscal framework and everything else that goes with it since the legislation was passed and the powers came in. I have been watching from the sidelines, and I have done quite a lot of university lecturing and such things on all the different moving parts. I have asked the students, "How would you do it if you were a country that was doing this for the first time? Would you do it like this or would you do it differently?" We have had many of those discussions.

To me, the key to getting to the bottom of all the moving parts on the travelator is better data. The more transparent the reporting can be and the better the data can be, the better handle we can get on it and the better handle you, and the Scottish Government, can get on it. It should be much more visible to everybody. Visibility is key, because part of the risk element is the fact that the visibility is not always there. Therefore, you cannot assess the risk as accurately as you might like to.

I would not like to speak on ICAS members' behalf—the air might turn blue. Certainly, if you think of the Government as a business, you definitely need to be flagging the risks regularly, given that there is such a tight budget.

Michelle Thomson: I should probably, and appropriately, give the last word to you, Professor Roy. I will add one more consideration—that of short-termism. Two major political events are enmeshed in this process—the Scottish election and the UK general election, plus the moving parts of the late fiscal events that you have already alluded to and the on-going new money via fiscal transfers that turns out to not be new money.

Give me your final reflections on what I am saying and on the transparency point. If we have more transparency that merely enables us to obsess yet further about the operation of the fiscal framework, that may give us the illusion of a step forward, but it would not really be a step forward at all.

What are your final comments on all of that and on where we are? Things surely have to be better from an efficiency and effectiveness point of view.

Professor Roy: That is a fair point. Ultimately, our role is to talk about the fiscal framework, so we can comment about some things in the budget, but ultimately that is not our area. Part of the reason for that is so that we do not suck the oxygen out of the broader conversation about where the budget is heading.

When you have the cabinet secretary in next week, that will be an important opportunity to explore some of the specific details that we can only touch on in general about where spending is heading.

To comment on the broader fiscal framework—we have spoken about this regularly—it is exceptionally complex. The next review will give us an opportunity to consider possible variations that could make it more transparent or, at the very least, provide greater flexibility.

We have spoken about the reserve. If the reserve were bigger as a result of potential reforms, there could be more flexibility in managing it, and there would not need to be so many moving parts in other areas such as ScotWind or the Crown Estate.

My final point on this is that there are steps that Government can take to make things more transparent. Spending is the obvious example. Steps have been taken, such as routine transfers now being included in the budget revisions. However, the very first question that the convener put to me was to ask why some routine transfers are still not included in the comparisons. That is not to do with the fiscal framework. The Government could do that if it wanted to.

Michelle Thomson: Thank you very much.

The Convener: We are well over time, so Michael Marra's supplementary will have to be extremely brief.

Michael Marra: I will be very brief. Having seen the published Scottish spending review, I think that we are all still in the dark as to the methodology that was pursued. Do you know what methodology the Government pursued? If so, will you tell us what it is?

Professor Roy: No, I do not know. Obviously, we had a conversation with the Government. It walked us through the various decisions and how it came up with the overall numbers, but there was no detail on how those things were arrived at.

When we knew that the spending review was being carried out, we highlighted a number of things to the Government. One was that doing it was a step forward. Another was the need for detail beyond levels 1 and 2 and to have detail for level 3, which is split by revenue and capital. We also made the point—I have made it repeatedly—that the Government needs to set out the process that it goes through, including how it comes up with the numbers, how its efficiency savings link into all that, and how it will monitor, evaluate and track things. That information is not published anywhere in any detail. There are only two paragraphs on that in the spending review, and it would be really interesting to get more detail on that.

The Convener: There will be only one more question from me. First, I should say that I always find it a bit bizarre that everyone talks about whether 50 or 55 per cent of people, or whatever the figure is, are better off in terms of income tax. We all know that band D council tax in Scotland is about £770 less than it is in England, so that is a significant tax saving for most people who pay that tax.

Have your forecasts over the past five years proven to be more or less accurate than those of the OBR?

Professor Roy: We publish our forecast evaluation reports. Our job is to evaluate our own forecasts—we do not mark anybody else's homework.

The Convener: I knew that you would duck and dive that question. The OBR did exactly the same, as you are probably well aware. [*Laughter*.]

Professor Roy: We set out where our forecasts change. Clearly, there are a lot of moving parts at the moment—there are many changes to Government policy and the many economic changes, which mean that things are moving around. We try to focus on what we can do to make our forecasts better.

The Convener: In the past, you have said that the OBR has overestimated, for example, productivity growth. Clearly, you feel that the SFC's forecasts have proven to be more accurate.

Professor Roy: I would not say that specifically. We have revised down our forecasts on productivity as well. We highlight where there are differences in our forecasts relative to the OBR and talk you through the risk.

Earnings is the classic example this time around. Last year, we highlighted that there was a risk in that our forecasts were higher than those of the OBR. That was a risk to the budget. The OBR revised up and the forecasts are closer. I am sure that I will be sitting here in a year's time explaining why our forecasts have been revised and the OBR's have not.

The Convener: It is terrible when you are a politician and you cannot get a straight answer, is it not? [*Laughter*.]

Is there anything that you want to conclude with or feel that we should touch on that we have not mentioned? Are there any points that any of your team wish to raise? If so, now is your chance to do so. I see that no one wishes to come in. Thank you very much—we greatly appreciate your evidence.

We will have a five-minute break to allow for a changeover of witnesses.

11:24

Meeting suspended.

11:29

On resuming—

The Convener: For our next evidence-taking session on the Scottish budget 2026-27, I welcome to the meeting Professor Mairi Spowage, professor of practice and director, Fraser of Allander Institute, University of Strathclyde; Professor David Heald, emeritus professor, Adam Smith business school, University of Glasgow; and Professor David Bell, professor of economics, University of Stirling. Good morning to you all, and apologies for keeping you waiting—the previous session overran. I also thank you for your helpful written submissions.

We will move straight to questions, the first of which will be to Professor Heald, although the other witnesses can respond, too. Professor Heald, you say in your submission:

> "The Westminster Parliament does not take *ex-ante* scrutiny of public expenditure seriously, unlike the devolved legislatures. The disruption caused to the budgetary procedures of the devolved legislatures clearly does not rank highly in the timing decisions of UK Governments."

Can you expand on what the actual impact of that is?

Professor David Heald (University of Glasgow): If you want to see the truth of what I have written there, you should watch the estimates day debates in the House of Commons. The House of Commons, through the Public Accounts Committee, is very good at the ex-post scrutiny of public spending, but not of the budget before. It is partly a question of power relationships between the two Parliaments, but I do not think that the UK Government takes seriously enough the fact that the constitutional structure of the United Kingdom has changed and the devolved legislatures need time to set their own budgets.

A lot of effort went in at the beginning of the establishment of this Parliament, and then through the budget review group, to try to improve the budget process, but the issue is that the UK does not run its budget until the end of November. One of the issues that came up in the previous session was the increased interconnections between what happens at UK level and the Scottish funding position, and the UK ought to take the issue more seriously if it wants the devolved settlement to work.

The Convener: You go on to say:

> "The limited attention … to the detailed choices in the Scottish Budget 2026-27 is motivated by the urgency of securing Parliamentary approval in order to limit disruption to public service delivery."

Would I be right in saying that what you are saying there is that, because the UK budget comes so late, the Scottish budget process has to be truncated and the priority is really just to get a budget through?

Professor Heald: Yes. Clearly, I would want the Parliament and its committees to be debating what is in the Scottish budget, but I think that one of the things for which the Scottish Government deserves credit is actually getting a three-year spending review. There might, as was said in the previous session, be problems with the kind of information in it, but one of the things that has destabilised spending is the fact that there have been no UK multiyear spending reviews until the last, quite recent one.

We need to bear in mind that the complexity of the relationships between the two spending systems is increasing. Obviously, one of the difficulties that the Scottish Government has faced is that this spending review has come at the end of a parliamentary session, when the whole idea behind spending reviews is to have them at the beginning. I presume that, whatever the political composition of the next Scottish Government, it will want to have a relook at certain things, but I would very much urge people to understand that one of the things that would benefit efficiency improvements in the public sector in Scotland is having stability of funding. Not knowing what your funding is, is an issue; it is extremely damaging to have to search in-year for savings, because sooner or later people are going to learn how to spend their money earlier in the financial year, for fear that it will be taken off them later on.

The Convener: One of the things that Labour did way back when—in 1997—was to stick with Conservative budgetary decisions for two years, which, whether or not you agreed with those decisions, actually allowed for some stability. Are you suggesting that, if this budget goes through, a new Government should stick to those decisions, at least in the first year, and then it can perhaps develop its own proposals?

Professor Heald: I would recommend that.

The Convener: Okay—thank you.

Professor Bell, one of the difficulties for the Scottish Government is that it is really at the mercy of whenever the UK Government decides to have its budget, and it just has to get on with it. We saw in the period from 30 October 2024 to 26 November 2025 four weeks being taken out of the whole process, but our budget still has to be passed before the new financial year, so that local authorities, health boards and everybody else knows what their budget is, council tax can be set and so on. What, if anything, can the Scottish Government do about that kind of difficult situation in which, effectively, it just has to take what is given to it, with regard to the timing of budget decisions?

Professor David Bell (University of Stirling): I agree with everything that David Heald said.

I apologise for the brevity of my submission.

The Convener: It is not the shortest that we have ever received.

Professor Bell: I was committed to other stuff, and the whole process has been so truncated that it was difficult to find time to write something longer.

The latest version of the fiscal framework was established with an understanding that there would be good will between the parties. However, given the date selection by the UK Government, the Scottish budget has been so truncated that it has been difficult to put in place all those budgets for health boards, local governments and so on. Timetabling has to be raised as a significant issue in terms of the fiscal framework review.

The Convener: One point that not only the Scottish Parliament but other devolved Parliaments have made is that there is no real consultation on that issue. Is that right, Professor Spowage?

Professor Mairi Spowage (Fraser of Allander Institute): That is my understanding. If the UK Government had asked the devolved Governments whether the end of November was ideal from the point of view of their parliamentary timetable, obviously they would have said no, and the earlier the better.

From my perspective, there was no need to wait until the end of November for the budget. It could have been done much earlier, which would have solved some of those issues. I would hope for an earlier budget this year—not only because of the impact on devolved Governments but because of the general economic commentary and uncertainty caused by the way in which the budget was carried out, including the endless leaking of potential policies, which were then backtracked on, and so on. It was not good for the economic and business investment environment, as well as it being subpar for the devolved Governments and the parliamentary processes that we have to go through up here.

The Convener: The Chancellor of the Exchequer has said that she will have only one fiscal event, which is positive. She may, of course, wish to keep some flexibility, but do you think that it should be set for a date in the last week of October, so that everyone can plan?

Professor Spowage: I would welcome more predictability. There will always be times when they will reserve the right to change that decision, but it would be much better if that was broadly the expectation. We would then know that the Scottish budget could always be before Christmas, which would at least give us a bit more time for parliamentary scrutiny in evidence sessions such as this one, after the budget is published.

The Convener: One of the difficulties for this committee is that, in 27 years of devolution, we have never had a Chancellor of the Exchequer give evidence to this committee or any of its predecessors, despite numerous invitations. It has also been extremely difficult—we have certainly not managed it in this term—to get a Chief Secretary to the Treasury in front of the committee, although we have done so in previous terms with previous Governments. It is a real difficulty that we cannot talk to them directly, despite the fact that the UK Government provides through the block grant somewhere in the region of 60 per cent of our overall expenditure in this Parliament.

Professor Spowage: Absolutely. We would all welcome more respect being shown to this committee and legislature by politicians in the Treasury through their coming to speak to you. I know that there is good engagement with organisations such as the OBR, which has always been very willing to come and speak to the committee and answer questions.

The irony is that the devolution of significant powers means that budgets and what is happening at the UK level are even more interconnected than before those powers were devolved, given the fiscal framework and the block grant adjustments.

I welcome the engagement from the OBR, but it would be good to see much more engagement from the Treasury and Treasury ministers.

The Convener: Some of the questions that I was going to ask Professor Heald with regard to his submission were asked of the SFC in the previous session, and so I will not tread on my colleagues' toes, because they may wish to ask the same or similar questions here.

In the pages of the submission, Professor Heald has, I think, expressed frustration with regard to people's understanding of the tax system in Scotland relative to the UK. I will quote from it.

In a supporting document to the budget, the Scottish Government states:

> "54% of respondents felt they understood the UK tax system and the UK taxes paid. This compares to 41% of respondents who felt they understood tax devolution in Scotland and the devolved taxes they paid. This is broadly in line with the last three years."

However, your submission states:

> "If this were true … why do the UK and Scottish Governments engage in so much subterfuge?"

Are you referring specifically to fiscal drag, or have you concerns about a number of areas in which the Scottish and UK Governments are pulling the wool over people's eyes?

Professor Heald: Fiscal drag is the most obvious example of that. The Scottish Government wants the Scottish tax system to be more progressive than the tax system in the rest of the UK. Broadly, I support that political objective, but that can be done in sensible ways or in destructive ways. If the Government thinks that the tax structure in year 1 is right, freezing the personal allowance and the tax thresholds will distort that structure. As was mentioned in the previous evidence session, over time, more and more people are paying the higher rate in Scotland. If Scotland is going to have six tax bands, it is ludicrous that the differences among three of the bands are trivial and there is then a jump from 21 per cent to 42 per cent.

As was mentioned in the previous evidence session, that will start to affect pay negotiations. There is a famous story about when Newcastle United Football Club wanted to hire Ruud Gullit as manager. He asked for a salary of £2 million, which was a lot of money for managers in those days, but then he said, "No—I mean £2 million net." Increasingly, given that a lot of public sector professionals, such as surgeons, are paying the higher rates, trade unions and individuals will start to negotiate for net pay.

We need much more honesty. The Scottish Government goes on about 55 per cent of Scottish taxpayers paying less tax than they would in

England, but the proportion of Scottish adults who do not pay income tax is about 33 per cent, and I have calculated that about 30 per cent of Scottish adults are paying more tax than they would if they were in England.

Given the demographic trends, the international uncertainty relating to trade tariffs and so on, and the failure to recover from Covid and the global financial crisis, if the Scottish public want to keep the bundle of public services that they now get, everybody will have to pay more tax. The political choice is that we can have higher taxes and the same amount of spending, lower taxes and spending cuts or some mixture of that. That is the political reality that the Scottish Parliament and the UK Parliament must face.

The Convener: In relation to your Ruud Gullit anecdote, I remember that, in the 1980s, John DeLorean famously asked the UK Government for a billion to support his factory in Northern Ireland. He meant $1 billion, but the UK Government gave him £1 billion, so he was well chuffed.

As we know, Governments of all colours—Conservative Governments, Labour Governments and Scottish National Party Governments—have implemented fiscal drag. The reality is that all Governments try to raise as much money as possible while causing the least political damage to themselves.

I will ask this question to Professor Heald, but I will ask the other witnesses a similar question. You have been very concerned about the UK tax system, because it is not progressive in the sense that it does not look like a straight line—the line goes up and down like the skyline in New York. If you became Scotland's president for life in a devolved context, how would you make the current system more progressive, taking into account that Scotland would not be an independent country and would have to work with the UK system?

Clearly, it would not be perfect, but how could we do that while gathering much the same amount of revenue? Where would the splits be? You spoke about 21 per cent and 42 per cent. How would you do that? It might take five years, but how would it be done?

11:45

Professor Heald: If you are going to have six tax bands, they should go up more gradually. The crucial problem at the moment, which you have referred to, is that Scotland has a lower threshold for the higher rate of tax than in the rest of the UK and that, for national insurance contributions, the drop from 8 per cent to 2 per cent happens at the UK threshold.

Another problem is that in 2009, when he was chancellor, Alistair Darling brought in the withdrawal of personal allowance for incomes over £100,000. That figure is still £100,000, which leads to ludicrous peaks. If you wanted to provoke behavioural effects, that would be a pretty good way to do it.

The Convener: What would you do?

Professor Heald: You would basically try to get a reasonably smooth progression of average tax rates.

The Convener: We do not control the personal allowance because that is not devolved to Scotland, but where should the breaks be? For example, we all know that someone in Scotland who is earning £44,000 pays a higher marginal rate than someone who is earning £51,000 in the UK, because of the different national insurance implications. Where would you put the breaks or changes?

Professor Heald: Given the complex fiscal relationship between the UK and Scotland, I would not have higher rate thresholds that are different to those in the UK, particularly because of the national insurance issue.

I certainly would not have the withdrawal happening where it does. If you are going to withdraw personal allowance, that should be done at an income much higher than £100,000.

The Convener: I think that the Scottish Government does now realise that the £43,667 point at which people start paying the higher rate of tax is too low, but the difficulty in increasing that is that it would lead to a loss of tax revenue. That is the issue.

Professor Heald: In defence of the Scottish Government on the subject of fiscal drag, one of the considerations that the Government must have made this time is that, given the UK decisions, the block grant adjustment would have got bigger if Scotland had not done that. That goes back to my point about increased interconnections.

The Convener: Indeed.

What do you think, Professor Spowage?

Professor Spowage: Because Scotland's higher rate threshold has been frozen for so many years, that freeze has fundamentally changed which, and how many, taxpayers are paying tax at the higher rate or above. That figure was around 12 per cent of taxpayers in 2016-17, but, by the end of the forecast period in 2030-31, it is forecast to go up to about 30 per cent of taxpayers. That is a fundamental change in our understanding of who counts as a higher rate taxpayer and what proportion of the income distribution should be paying higher rates of tax.

As David Heald said, some of the quirks in income tax and in the national insurance schedule are UK ones, but the £43,000 to £50,000 one is uniquely Scottish. Given the complexity from a tax efficiency point of view, and looking at the marginal rates, it is important to ensure that we do not introduce a situation in which people make choices that we would rather they did not make—for example, about working less or going part time. It would therefore probably be optimal, from a tax efficiency point of view, for those thresholds to be aligned. If you cannot make the NICs threshold come down in line with the Scottish higher rate, those higher rates should be aligned. That could be offset by an increase in the intermediate rate of tax. Aligning the thresholds would cost around £600 million, which is a lot of lost revenue, but it would remove that quirk.

At the UK level, we can see a significant bunching of people earning under £100,000. That is because of the withdrawal of the personal allowance but also because of the issue affecting tax-free childcare at the £100,000 point, which is huge for working parents. There is a massive bunching of people who are keeping their income under that level so that they do not lose particular childcare benefits.

The £75,000 threshold that was introduced in the Government's last budget but one has exacerbated that problem in Scotland, because the marginal rate if you earn over £100,000 is 69 per cent. I know that there will not be a huge number of people in the country crying tears over somebody who is earning £100,000—that is fine—but the issue is that it is not a fair income tax schedule and it has implications for the decisions that people are making. We want someone who is earning £99,000 to increase their salary to £105,000, because then more tax comes in. We do not want such people taking measures to reduce their income so that they do not go over that level. That is not good for the economy and it is not good for tax receipts.

There are those issues with the income tax schedule. The Scottish Government has the power to remove the issue at the higher rate.

The Convener: There is also the issue of incorporation and people putting money into pensions and all sorts of stuff.

Professor Spowage: The Government could remove that issue while making changes to rates to offset that if it wanted the measure to be revenue neutral. The trouble is that it seems politically easier to keep a threshold frozen than to increase a rate, as the Government might pay a higher political cost for that.

Professor Bell: The Scottish Government could offset the very high marginal rates at just over £100,000 if it altered the rates that were charged there. In theory, it would be nice to have a much more gradual increase in schedules and a system that people could understand. I really think that the numbers that the thresholds are at must baffle people.

Your question was about the tax system and not just about income tax. We have to think more broadly about taxes. Taxes such as council tax are not very progressive at all. Income tax is the most progressive tax, but it is only part of the overall tax bill. Although the new mansion tax is a gesture towards progressivity, it will not will raise a huge amount of money. The argument that council tax needs to be reformed, which has gone on for decades now, has a lot of traction, if your concern is that the overall Scottish tax system is not sufficiently progressive.

The Convener: You have talked about loss aversion at this committee in the past. As we all know, the problem with council tax reform is that the losers will all be less than pleased with the Government—of whatever colour—that introduces it, which is why it has not happened in England, although it has been done modestly in Wales.

I want to switch tack. I want colleagues to come in, but I want to ask a couple more questions. I end up getting sucked into a big discussion and other people cannot come in. In the previous evidence session, we did not speak much about the sustainability of social care. You have touched on that, Professor Bell. What is your concern about that, given the tightness of the local government settlement?

Professor Bell: The reason why my submission is so short is that I was writing about social care in the context of the UK as a whole. I focused on four things in that, and, in some respects, the Scottish Government is ahead of the game.

One thing is the greater provision for carers. There are way more unpaid carers in Scotland than there are employees in health and social care put together. Supporting those people is extremely important not only because, when they are no longer able to support people, the effect on the person being cared for is negative, but because the requirement then falls on local government and the health service.

Another area that is particularly concerning is that we know that the number of people aged 85-plus in Scotland will nearly double between now and 2040, or thereabouts. That is the group most likely to need not just intensive care, but probably intensive care in a care home. We know that there is a huge need for more facilities in relation to that, yet Knight Frank, the property consultant, estimated that, in 2024, only 87 additional places were created in care homes across the UK as a whole. Not all of those will have been created in Scotland, and that number is incredibly low. That is because there is no properly scaled funding system to meet the potential costs. We are talking about costs of around £1,500 per week for self-funders, who are people who have more than £35,000-worth of capital, which is most people who are home owners. The effect of that is that there is not much investment in the sector. In England at the moment, there are around 2 million people with unmet need, who, in effect, are not getting care.

The overall position is severe, and it will become critical. There is continuing pressure on local government spending, which is the front line when it comes to this issue.

The Convener: You are saying that the situation is better in Scotland than it is in England, but it is still really worrying, and you are worried that it will become more concerning.

Professor Spowage, an issue that we did not discuss with the previous panel was that of the deficits that some health and social care partnerships face. Has the Fraser of Allander Institute looked at the implications of that?

Professor Spowage: We have not looked specifically at the finances of health and social care partnerships, but their situation, along with the efficiencies that NHS boards are expected to find as part of the spending review, casts quite a lot of doubt on the deliverability of some of the Government's plans and the extent to which it is reasonable to expect such cuts in overall spending envelopes, or—in the case of health—lower growth in the budget than would otherwise have been the case, without it impacting on front-line public services.

The real-terms cuts in local government funding over the spending review period are particularly worrying, given what was assumed in the MTFS in June and the extent to which the different areas of expenditure are lining up with one another. There was an assumption that social care spending would rise at the same level as health spending—that is, by 3.3 per cent, in real terms, a year—but, lo and behold, under the spending review, health spending will not go up by that much: it will go up by 6 per cent over the three years, which is not 3.3 per cent a year. It could be said that that is because of the efficiencies that it is assumed will be made. To what extent is it assumed that other parts of local government budgets will be eaten up by that increase in social care spending, or is the Government now assuming that social care spending will not grow to that extent?

People in the social care sector are extremely concerned about the deliverability of care packages and the changes in eligibility requirements for adult social care. The sector is absolutely creaking. Given that it is in crisis, the lack of funding that will, it appears from the spending review, go into social care is really worrying and is very different from what the Government thought it would need to spend as part of the MTFS.

The Convener: Professor Heald, the Scottish Government has a target of making £576 million of savings in 2026-27 through the portfolio efficiency and reform plans. Do you consider that to be realistic?

Professor Heald: I do not know a great deal about those plans, but it is clear that, in the present context, it will be very difficult to achieve that.

The Convener: Let me go back to Professor Spowage. Capital is a real issue. Along with colleagues. I was quite astonished to see that the infrastructure investment pipeline does not seem to include any timelines or any budgets for any of the projects. As we discussed with the previous witnesses, the overall capital budget is set to reduce by 5 per cent in real terms. That is the figure if we use the GDP deflator, which, in my view, is the wrong measure for capital, because, as we all know, construction costs are well ahead of that. The GDP deflator gives an unrealistic picture of what can be delivered, which is less than we would like.

What is your view on where we are going with regard to capital expenditure over the next five years and what can be delivered through it?

12:00

Professor Spowage: On the GDP deflator and which measure of inflation should be used, I can see it from both perspectives. An official source of forecast inflation needs to be used, which is not often done for individual sectors or individual items of spend. Something official needs to be agreed to that is always produced regularly and that can be used to deflate things so that they can be compared, and so that we can compare resource and capital budgets. I would prefer the GDP deflator to be used for the main series as the official source and sensitivities to be applied to illustrate the point that the convener is making.

If, as has been the case in recent years, construction inflation is running much further ahead—although that has not always been the case, as the convener pointed out in the previous evidence session—we need to establish the impact of that on the Government's spending power. We would want to see how construction inflation pans out in different scenarios. Higher inflation would mean that much less spend would be available, and we would expect the Government to say how it would respond to that. If its spending power is 10 per cent less than in the central scenario, we would want to know how the Government would respond and how it would prioritise spending.

As you said, convener, the infrastructure investment pipeline—that is not what it is now called, is it?

The Convener: It is the infrastructure investment pipeline.

Professor Spowage: I was right. The committee has been calling for an update to the infrastructure investment pipeline for a number of years, given the change in the situation.

The Convener: We have been calling for that since December 2023.

Professor Spowage: It is interesting that we have different categories of projects. As you say, we do not have much detail even for the projects that we know are going ahead or of the status of the projects that are in development, such as the Ardrossan harbour project. We would welcome, as part of the next iteration of the plan, more information on what will be delivered over the next parliamentary session.

To be honest, more broadly, I completely understand that the timing of the UK Government's spending review was not of the Scottish Government's choosing. However, after a new Government comes in, I would welcome a more detailed version of the spending review, so that we have more understanding of how the plans will filter to level 3 budgets and beyond. As part of that, there could be much more detail on capital and what that would mean for the projects that will be delivered over the next parliamentary session. That will be for the next Scottish Government to set out, but we would all welcome more clarity on that, perhaps even before the budget process for 2027-28.

The Convener: Joanne McNaughton has pointed out that the name has been changed to the infrastructure delivery pipeline.

Professor Bell: To add to the convener's misgivings about the GDP deflator, there are three things that we need to worry about in relation to construction costs. The first big thing is materials costs, with the current uncertainty around the world and the possibility of tariffs. Energy costs are another. Thirdly, migration and the restrictions that have been placed on migrant visas are a concern. Migrants are important in the construction sector and are very important in the social care sector, where they support the British-born or Scottish-born workforce.

The Convener: My understanding is that, since 22 July, people cannot come in on social care visas.

Professor Bell: That is correct.

Professor Spowage: I was just going to say that. Although there is a tail of previously approved dependents and so on coming in, you can see the collapse in those numbers. That is also a real issue for the skills system in Scotland. We need to ask ourselves how we can produce a pipeline of workers for the construction and social care sectors, which links to the discussion about colleges and college funding, given the nature of where people will acquire their skills in Scotland.

The Convener: Arran is in my constituency, and Montrose house is short of 15 staff, which is 30 per cent of the total. It has had to close five beds, which is causing real concern on the island.

Professor Heald, do you want to comment on anything related to capital?

Professor Heald: No.

The Convener: That is fine. I will open the session to colleagues around the table.

John Mason: I will start where I probably started the last time—with inflation. Last week, the OBR told us that inflation has stayed a bit higher than it had been expecting, but it was still hopeful that it is going to come down again. What are your thoughts on that, Professor Bell? Are you optimistic that inflation will come back down?

Professor Bell: I am not optimistic that it will. The SFC and the OBR are kind of obliged to assume that the Bank of England will get it right, so their forecasts end up at around 2 per cent. However, for some of the reasons that I have just highlighted in relation to costs, I think that there will be continuing upward pressure on prices, both from the goods side and, indeed, from wages. I just do not see wages coming down to 2 per cent plus whatever productivity growth we might have—which, given recent trends, is likely to be relatively low.

John Mason: You have already said that, if immigration is restricted, that will, presumably, push up prices.

Professor Bell: Sure.

John Mason: What about tariffs? Is there a risk in that respect? Do prices just go up if we put a tariff on American goods?

Professor Bell: Yes is the answer to that, but I think that that will have less of an effect than the general upward pressure on wages. I might be wrong—I ask the others to correct me if I am—but I think that there is not all that much American goods input to the kinds of products that most people buy. The Americans are not going to put tariffs on their high-tech or service exports, a lot of which come through software.

John Mason: Professor Heald?

Professor Heald: I have nothing to add.

John Mason: Professor Spowage?

Professor Spowage: I agree that the UK does not import a huge amount of goods from the US that could not be substituted fairly easily. The trade with the US is much more about our exports—that is, whisky—and our services relationships. Obviously, they could be impacted by the current situation, but that sort of thing will be less easy to see and model than something like tariffs on goods. As is so often the case in these trade conversations, everyone focuses only on goods, whereas the majority of our exports now are services.

John Mason: Sticking with you, Professor Spowage, I note that, in its paper, the Fraser of Allander Institute talks about

"a significant underlying deficit of … £659 million".

Can you explain what that means? After all, we have to balance our budget every year, so we cannot have a deficit.

Professor Spowage: Yes, but we were commenting on the Government's repeated statements that, unlike the UK Government, it has to balance its budget every year. We were just pointing out that if you are borrowing from one-off items, drawing down reserves or using money out of Scotland to make the sums add up every year, it is similar to borrowing money, as the UK Government does to balance its budget every year. It is building on a number of years of these sorts of one-off pots being used to balance the budget.

In the previous evidence session, you discussed at length the use of ScotWind money as a further fiscal management tool. The Government might say at the start of a year—particularly a year when it has been under pressure—"We will use £600 million from ScotWind," and then a UK budget in the middle of the year generates consequentials that mean that it does not have to use that money in the end. In the previous session, Professor Roy said that that was an appropriate use of the money. I would say that, if the policy goal of the ScotWind fund is to spend that money on capital in order to pump-prime the energy transition and make things happen with infrastructure so that we can grab what is, at the moment, the slightly diminishing opportunity to make the most of that economic opportunity, it might be understandable that the Government would want to use it as a fiscal management tool, but it is nevertheless an opportunity cost if we do not invest that money in the energy transition. In other words, although it is understandable, it does not really fit with ScotWind's policy goals and what it is about.

John Mason: Thank you.

Professor Heald, I was interested in the bit in your submission about annually managed expenditure and departmental expenditure limits, and how Scotland's social security budget, in effect, has an impact on the Scottish Government that is different from the DWP budget's impact at UK level. Can you explain what you mean by the term "quasi-DEL"?

Professor Heald: I invented the term for the purpose of that memorandum. The basic point is that whereas the Treasury will fund UK Government overspends on social security, which is outside Barnett, Scotland's social security benefits must be a charge on the rest of the Scottish budget, particularly when they are not matched by positive block grant adjustments. My concern was that there would be an erosion of the rest of the Scottish budget because of higher claims from social security, which are often unpredictable and create pressures for short-run changes.

More generally, the Scottish budget now has a lot of demand-led items in it. It is one thing to have expenditure that you can control by setting hard limits on delivery organisations, but another to have demand-led items where you have no control of how much is spent once you have set the rules—what you spend depends on how many people claim those benefits and are successful, unless you then change the rules. However, as we have very much discovered from recent UK experience, withdrawing people's benefits is extremely difficult politically.

There is a real problem with the Scottish budget. My view is that there is a paradox. The whole idea of getting devolved taxes was to give the Parliament more legitimacy, but although there might indeed be more legitimacy, there is also substantially more risk.

In the earlier session, there was talk about the fact that the swings that you can get in the reconciliation are quite large because of the relationship between UK changes and Scottish changes, for example in relation to borrowing powers and the rules about the reserve. If we are going to have that system, Scotland needs a bigger reserve capability and more borrowing powers. The problem is that the relationship between the Scottish Government and the UK Government is not good, and the UK Government will probably be very reluctant to extend the borrowing powers.

John Mason: Do you think that we were mistaken to take on some of those powers?

Professor Heald: No, but I think that there was less care about social security than was desirable. One of the problems is that it is very difficult for the Scottish Government to be less generous than the UK system. The whole point of devolution is to allow different policy choices, but when you are working within a broadly fixed budget, you cannot spend more on everything than the rest of the UK—or England, as the case may be. Basically, some of the Scottish budget that should be for spending on health, school, transport or other things is going into social security, and that kind of spending is very difficult to control once you have set the rules and eligibility.

John Mason: If either Professor Spowage or Professor Bell wants to come in on that point, you are welcome to do so.

Professor Spowage: There is a mixture of issues in relation to unpredictability with things such as the adult disability payment, which is the replacement for PIP; benefits such as the ones that they have in the rest of the UK and the devolved policy choices about how you administer those benefits and the sort of criteria you set around them; and the decision to introduce a new benefit, particularly the Scottish child payment. Although, given the Scottish Parliament's powers, those are absolutely legitimate devolved policy choices, they introduce additional risk with regard to budget management, because the more of your budget is taken up by that type of spending, the less easy it is to manage the risks around your budget. I guess that that is the point.

Professor Bell: I pretty much agree with all that. In fact, I made a submission to the Social Justice and Social Security Committee, which asked me to help it with its input to the fiscal framework review, and I concentrated on exactly that DEL-AME split.

The issue of demand-led programmes, along with the political costs of changing those programmes and the fact that it is very difficult for the Scottish Government to be seen as being less generous than the United Kingdom Government, are important points. The net effect of all of that is that there is a very substantially increased risk to the Scottish budget. You would think that the most obvious way to remedy that would be to increase its borrowing powers. However, throughout my long discussions around the fiscal framework, it seems to me that the Treasury has always been very resistant to a substantial increase in those powers.

There is more activity south of the border than here on programmes to get people off benefits. That is not necessarily a lose-win outcome; it can be a win-win outcome if the programmes are properly designed. However, I think that, overall, the net effect of the additional powers has been to substantially increase the risks to the Scottish budget.

12:15

John Mason: Given that level of increased risk and our lack of borrowing powers, which mean that the situation is unpredictable, is there any point in having a Scottish spending review?

Professor Bell: Obviously, the lack of borrowing powers means that there is a lack of an ability to smooth out and stick to a plan. I would be surprised if the UK Government does not, somehow or other, try to change eligibility for PIP and the way that it is run. That will have a BGA implication, which, in turn, given the size of the ADP budget, could have knock-on effects that could throw a spending review off course.

Professor Heald: The classic example of the uncertainty that is created by the relationship between the UK budget and the Scottish budget is when there was a briefing that the UK Government was going to reduce national insurance contributions for employees by 2 per cent and put 2 per cent on the basic rate of income tax, which would have cost the Scottish budget £1 billion extra in block grant adjustments. That just shows how vulnerable the finances of devolved Scotland are to changes that are made at the UK level. Obviously, if that had happened, borrowing powers would have been extremely valuable.

John Mason: Thank you. I could go on for longer, but I will stop there.

Michael Marra: I will start with the issue of transparency and comparability, which Professor Spowage commented on in the aftermath of the budget. You heard the evidence that we took in the first session regarding some of the changes to reporting against the autumn budget revisions and so on. What impact has that had on the transparency of the budget?

Professor Spowage: There are all sorts of issues with the transparency of the budget. Although it is welcome to see some of the transfers that we expect to see every year in the ABR baselines, it remains difficult to figure out what is going on. There are particular issues with local government, because of the interactions between that area and the health budget with regard to social care payments.

We have not quite got to the bottom of it yet—it has been a week since the budget statement, but we are almost there. We are trying to get an understanding of how much of the health and social care budget the Government has earmarked for social care and uplifts in pay in social care over the years, and which it has then baselined into the local government general revenue grant every year. That will let us understand whether it is putting more money into that this year than it did last year. However, a week on, I still do not know the answer to that question.

With those regular transfers, and with the Scottish Government providing support for things in local government, different amounts of which it then baselines every year, it is very difficult to see, on a like-for-like basis, the funding that is going to local government. We have this mad fight every year about whether the figure has gone up or down, the Convention of Scottish Local Authorities says one thing and so on. That is not helpful, and it does not add to the debate on the priorities that the Government is actually spending money on.

The Government has baselined some of the transfers, which is fine, but let us baseline them all. Let this year's ABR be the last one in which these things are done, and let us have the 2027-28 budget presented with all the money in local government that should be there and all the money in education that should be there for training doctors and nurses. Let us stop this immature nonsense of not baselining those transfers so that, on budget day, we can all see what the Government is actually spending and whether it has gone up or down.

Michael Marra: That is useful. We seem to have taken a half step in that direction.

Professor Spowage: Yes.

Michael Marra: I was speaking at the University of Glasgow yesterday, and the anger among stakeholders from various areas was palpable because of the fact that, a week on, they still do not understand the budget allocations for their sectors. That seems to be part of the problem. We have been advocating for this to be done but, by taking a half step and not going the full distance or giving the full picture, it almost feels a bit worse than what we had previously.

Do the other professors have any comments on that? I know that the issue particularly animates Professor Spowage, and rightly so. I will give the specific example of colleges. On the day of the budget statement, the cabinet secretary made great play of colleges, claiming extra funding of £70 million. I have now heard a variety of figures. It looked like it could be £50 million, and it is now potentially down to £40 million, when you take out the amount that was allocated to the single capital project in the college estate in the past seven years or whatever. Is there any clarity on that picture and on the claim that was made versus the reality?

Professor Spowage: My understanding is that the £70 million was about the allocation last year compared to this year, and that an in-year transfer for, I think, Fife College was not included in that baseline. It is also important to look at the evolution of the college budget over the parliamentary session. We cannot just look at how much it has gone up this year. We would all probably agree that there have been significant cuts to college budgets in recent years, and there is an issue about the extent to which the funding gets the sector back to where it started. It is also about the increased costs that colleges are facing, as are many parts of the public sector, because of employer national insurance contributions and all the other increases that most organisations have had to eat within their budgets. I am sure that the college sector will welcome the increase and the fact that it was a focus or priority in the budget speech. There was a focus on getting people out of poverty and upskilling, which is obviously linked to the college sector.

Michael Marra: The colleges welcomed the £70 million but if, within a week, it is now £40 million, that is a significant challenge. Of course, that is nowhere near meeting the 20 per cent real-terms reduction over the past five years that the Auditor General has set out. Is that £40 million figure accurate, as you understand it?

Professor Spowage: I have seen the commentary on that. To be honest, I do not know—however, we should know. The Government needs to work hand in hand with the Parliament to reduce the confusion about that sort of thing, so that, when the Government presents its draft budget, we are much clearer on what it is spending money on.

Michael Marra: Professor Heald, you said to the convener that a new Government, or this Government even, should stick to the current spending plans across the year. There has been significant commentary from your colleague Professor Spowage at the Fraser of Allander Institute and from the Institute for Fiscal Studies, saying that we could anticipate that there might have to be an in-year adjustment or another Scottish fiscal event within the year. We have become quite used to those, as there have been three in the past four years, and my understanding is that there was an internal one last year, rather than a public statement. That is partly because of the issues of managing the pressures that you have been exploring. Given the headwinds that the Government faces, is it a significant risk that, in essence, it is relying on something coming up within the year?

Professor Heald: Yes, it is obviously a significant risk. The point that I was making is that, if public sector organisations get reasonable certainty about their funding, that is a much better climate in which to try to achieve efficiency savings. If people are not certain what their funding is going to be, an awful lot of their attention will go on marginal activities, including getting the money out of the door as fast as possible, so that there is no money to be taken away later in the budget year. It is not just the Scottish Government that needs a greater degree of certainty about its funding—all the organisations down the delivery chain need more certainty.

I have thought for a long time that, if the UK had kept having regular three-year spending reviews, it would have been a lot easier for the public sector to cope with the pressures on spend. Not knowing what the future funding is going to be and having in-year reviews is particularly damaging for how organisations behave, for example. One of the lessons that has come out clearly from recent experience is that the Parliament needs greater borrowing powers.

Professor Spowage: One of my concerns about the coming year and next year is that 2027-28 looks as though it might be particularly challenging, depending on the size of the reconciliation, which was discussed in the earlier session. We will get confirmation of that in the summer.

There are huge issues around public sector pay that were largely unacknowledged in the budget documents. There was an integrated pay and workforce plan—that might be the wrong name, but you will know which document I mean—which restated the pay policy from the previous budget, which was 9 per cent over three years. The detail of that is that there should not be an increase above 3 per cent unless there is a clear commitment that the increase will be less than 3 per cent in future years. I might be wrong about that: one pay deal might have met that requirement, but the vast majority of pay deals that have agreed have blown the policy up.

Given that people have settled for a 4 per cent increase or whatever—when you look at the detail of the deal for resident doctors, you can see that the increase was much larger than it appeared—I do not think that it is reasonable to think that the 1.1 per cent increase, which the SFC is assuming in order for the parameters to be met, will happen, so a new pay policy will be presented alongside the 2027-28 budget. There is silence on the fact that the pay policy for the first couple of years has been blown to bits. There is no acknowledgement of that, and it feels as though that can has been kicked down the road to the next budget.

There is going to be real pressure on pay. We know that more than half of the resource budget is taken up by pay, so that will be a huge concern for the next budget. It does feel a wee bit like the problem is being shoved past the election.

Michael Marra: Professor Bell, the Institute for Fiscal Studies has said that the current spending plan might not get to the autumn. Do you share that concern?

Professor Bell: It is possible. It depends on the reconciliation and various other things that might happen in the meantime.

On pay, which is another potential issue that might mean a fiscal event, if price inflation does not ameliorate or drop, there will be more pressure from those who are seeking to increase their wages, which might blow a hole in the 9 per cent figure.

Michael Marra: We have touched on the spending review a few times. Professor Spowage said earlier that the timing of UK Government's spending review was not under the control of the Scottish Government, which might have concerns about that. The spending review was published on 11 June last year, and it took the UK Government 14 months to prepare it. Was there any reason why a spending review could not have been undertaken in Scotland prior to the publication of the UK spending review, at least in terms of methodology and taking a zero-based approach? Yes, we have the global figures and the UK's conclusions about what was allocated, but building a methodology from the ground up in order to look at where we are getting value for our budget and what we are looking at could have been done at that point, could it not?

Professor Spowage: I am sympathetic to the argument that that work could have been on-going, particularly if you were doing a zero-based review. The UK Government went through a process of asking departments to make pretty tough choices about the 20 per cent of activity that they would drop if they must drop something because of their budget allocation. There was a line-by-line look at everything that was done. The Scottish Government could have kicked that off prior to the publication of the spending review and its outcomes. Given the overall envelopes that were set in the previous UK budget, it was really about where departmental budgets would fall, so it is difficult to know the extent to which that allocation was going to move hugely, but I am sympathetic to the idea that it could have been doing that in parallel.

12:30

Michael Marra: Is what we have ended up with in the Scottish spending review a satisfactory document that allows organisations throughout Scotland to have sight of what they have to do?

Professor Bell: Professor Roy was clear that there are many missing pieces, going down to the detail at departmental level. It is good that we have something out there, but there is potential for improvement.

Professor Heald: It is very difficult, because there is almost always an election in some part of the United Kingdom, so there is a complicated relationship between the spending cycle and the electoral cycle. Gordon Brown's original idea about spending reviews was that they would take place at the beginning of a UK parliamentary session. The timing would have been better if the next Scottish Government did the spending review, but it was urgent that people got forward figures.

There is a need for a fundamental review of the fiscal relationships between the devolved legislatures and the UK Government.

Michael Marra: My final question relates to the mansion tax. Is there any clarity as to where that money will accrue? Professor Roy gave a slight half answer.

Professor Spowage: My understanding from rereading the *Official Report* is that that funding will accrue to local government. There is a line in the budget that says that £5 million has been allocated to do the valuations of the properties that are likely to be included in those bands. We do not know yet how much the tax will raise. It depends on the rate that is set, although I have seen that Ivan McKee has said that it could raise around £14 million.

My understanding is that that money will go into local government. However, it will only accrue to certain bits of the country, one would think, which will mean that how it will be pooled and how it will impact on the general revenue grant is to be negotiated.

Michael Marra: In essence, we think that most of that money will probably be generated in Edinburgh and a bit in the surrounding areas, but that the money will not be kept by Edinburgh. It will go into the general pool and be distributed around the country.

Professor Spowage: That is my understanding of how it will work in general, but we do not know that for sure.

Michael Marra: We can pick that up with the cabinet secretary.

Professor Spowage: It is a huge missed opportunity to not do something more fundamental on council tax.

The Convener: We might have one or two questions for the cabinet secretary next week.

Liz Smith: I think you were in the room when I asked the previous panel about social security. Those questions were about the committee's concerns that we are not getting sufficient detail about the rate at which social security spend is increasing as result of specific policies, and that we need much better information about the effectiveness of that spend. Does that also concern you?

Professor Bell: It certainly concerns me. I spend quite a lot of time in the weeds of the Department for Work and Pensions and Social Security Scotland websites, and various others, looking for data. I would not say that this is a data-free zone, but there could be a lot of improvement. There are general population-level statistics, but there is a need to understand what is happening at the individual level, which you can do only through survey work.

Liz Smith: Can you give some examples of data that is not there that would be helpful?

Professor Bell: I think I am correct in saying that I could not get much geographical detail. You would want very fine geographical detail that you can line up against, for example, census data. That is one example of data that would be useful that stands out. You can certainly get DWP data on that.

Professor Spowage: In order for researchers to understand the interaction between labour market incentives and payments—in particular, the Scottish child payment and other social security benefits—the interactions that somebody receiving ADP might have with the health service, the conditions that those people have and the policies that might help people who are on a particular set of benefits, we need linked administrative data.

There has been a lot of progress recently, including a new data set called RAPID—the registration and population interaction database—that is coming on stream, which links up information from the DWP and HM Revenue and Customs. There is a lot of support for researchers to think about how to use that data and what other data we could link it to. There are a lot of potentially exciting developments that will help us to understand some of the drivers.

One issue is that, often, data on the devolved social security benefits is not included in the data because that is not collected by the DWP. That will increasingly become a blocker for us in understanding what is going on for Scotland specifically.

Liz Smith: When will that RAPID system come on stream?

Professor Spowage: It will be made available in the secure research service very soon. Applications are out for fellowships to study it—that is happening right now. However, the data set does not include Scottish social security data, which is a limiter for us in understanding the implications for Scotland.

When tax and social security data and also, potentially, health data are in a linked data set, that allows us to create panels and to understand and make causal links about why people make different choices.

Liz Smith: The challenge for this committee in examining social security spend is knowing which policies are making the biggest difference to the Scottish Government's broad aims and which are less important in that sense. We all want to achieve better outcomes in social security delivery, but it is difficult to understand that because we do not have the relevant data.

That begs a question, which the committee raised in its report, about universal payments. If you run the argument that we are spending too much on social security, because we are not getting enough money in through revenue payments, there is a strong argument for examining universalism and what is and is not effective.

I do not want you to comment on Government policy—and I know that you will not do that—but is it your understanding that that debate is hampered because we do not have some of that detail?

Professor Bell: Probably, yes. On the universal payments, I am thinking about what information we can utilise on things such as bus passes, how effective those are and how much dead weight there is in the sense that there are wealthy people who use those universal services but who could afford to pay for them if there was a cost involved.

That goes back to the question whether we want a progressive tax system. A mirror image of that question is about the benefits that people get—which are not necessarily defined as benefits but are universal payments.

Liz Smith: It is a very complex area but, nonetheless, an important one. There has been exponential growth in social security spend. It has been rising, and it has been proved that, in some areas, it has been rising at a faster rate than in other parts of the UK.

The driver has to be the effectiveness of the policy commitments. At the moment, it is hard to come to conclusions about what is working well. For example, there is some evidence that the Scottish child payment has been working well. As you have said, Professor Bell, there are areas in which people who are well off can well afford the benefits—the universal payments, I should say—and so do not actually need them. It is a challenge to make social and economic policy more effective.

Professor Bell: In part, that goes back to the issue of data and the need to understand how the spectrum of different Government support enables the objectives that the Government has set to be achieved. It is necessary to understand people's circumstances and how they feel about the circumstances that they are in. Although the administrative data is good at giving us the facts with regard to how much people are getting or how much they are paying in, there is also a need to understand how people feel about the way that they are being treated by the state in relation to those payments.

Craig Hoy: I want to pick up on the idea of the Scottish Government increasing its borrowing capacity and the risk that could be associated with that.

Additional funds have flowed to the Scottish Government for the removal of the two-child benefit cap, to which it had allocated £155 million. That equates to its having an extra £126 million. When the Scottish Government received that money, it said that it was more than it was expecting, so it would spend the additional money on tackling child poverty, rather than on cutting tax or putting those funds elsewhere.

Given the way in which the Scottish Government approaches public expenditure, is there not a risk that, if its borrowing capacity were to be significantly increased, rather than looking at its budget, it would just use the increased borrowing capacity and, rather than going cold turkey, it would simply continue to spend in the way that it is doing at the moment?

Michelle Thomson: Just like the UK Government.

Professor Heald: Political choices have to be made about the level of spending and the level of tax, and people will come to different views about that. My point was that the interconnection between what happens at the UK level and what happens at the Scottish level has been intensified by the movement to devolve taxes, and income tax in particular.

A point that was made in the previous session is that a lot of attention is paid to the way in which the fiscal framework is working, rather than to the substance of spending. To make the existing system work, the Scottish Government will need more borrowing powers.

It is clear that the UK Government will not give the Scottish Government unlimited borrowing powers, but the Scottish Government needs to be able to deal with things such as a £500 million swing in the reconciliation payment, which is massive in relation to the choices it has at the margin.

Professor Spowage: It is probably the case that more fiscal flexibilities are required, given the level of risk that the Scottish budget is open to. The limit on the reserve is a fiscal restriction that could be relaxed without much risk to anybody. That would mean that there would be a larger bank account that the Government could put money into that it could then draw down. For example, if there were big unexpected consequentials in the middle of a financial year, the more space the Government had in the reserve, the more incentive it would have to pop that money into the reserve and keep it for the next year, if there was something coming down the line such as a big reconciliation.

At the moment there are resource borrowing powers to cover forecast errors, but there is a cap on those. Why is that cap there? Why has it been set at the level that it has been set at, given the level of risk? There could well be an £800 million reconciliation. The chances of that appear to have lessened, but it could happen. That is above the limit that the Government is allowed to borrow for forecast error. Resource borrowing because the Government has a policy priority is one thing, but resource borrowing due to forecast error is another. There are legitimate questions to ask about why there is a cap on that at all and why the cap has been set at the level that it has been set at, when it is eminently possible that the Government could have to deal with a reconciliation of more than £600-odd million.

Craig Hoy: Could the Government not simply build in more headroom year on year in the way that it approaches its budget, for example by using the reserve? Would that not be a more prudent way to approach the issue? A moment ago, my colleague said that the UK Government has hardly got a good reputation when it comes to its borrowing levels, either, but the Treasury borrows on behalf of the whole of the UK. In some tough years, some of the real-terms increases in the Scottish budget have emanated from increased borrowing at Treasury level.

12:45

Professor Spowage: Those have certainly been funded by UK-wide borrowing, which is something that we need to remember. Increased borrowing by the UK Government is one of the reasons why there have been large Barnett consequentials in the past couple of years. It spent more, and that spending flowed through into Scotland.

An argument could be made that, this time, the money that the Scottish Government has taken out could have been left in the reserve. However, such a decision would not have used all the powers that are at the Government's disposal to avoid having to cut spending or other things. These are political choices that the Government is making, but I have no doubt that it would have been politically criticised for doing that.

Craig Hoy: In the same way that you would get a bad credit rating if you were to fully utilise all your credit cards, so, too, would the Scottish Government if it were to fully utilise its borrowing powers or pull the Scottish money down—well, I will not get into the credit rating argument.

I will turn to local government. Last week, the Cabinet Secretary for Finance and Local Government said that, budget to budget, she is delivering a 2 per cent real-terms increase to local government. She described that as

"a settlement that is fair, and which recognises the important role of local government".

She said that that is "a reasonable deal" given cost of living pressures and urged

"local authorities to translate the settlement into reasonable decisions on council tax."—[*Official Report*, 13 January 2026; c 16.]

Having been able to interrogate those numbers further, do you think that that is a reasonable deal for Scottish local government? Should it mitigate above-inflation increases in council tax, if councils are to meet their statutory obligations?

Professor Spowage: From the commentaries that you have heard from councils, it is unlikely to be sufficient to avoid what will probably be fairly large—at least high single-digit—increases in council tax. Council budgets have been under significant pressure for years. In that time, overall funding for councils has formed a smaller proportion of the Scottish Government's budget. If we take account of in-year transfers, which we should, the Scottish Fiscal Commission has said that the increase will be 0.4 per cent in real terms. Therefore, it will be a very small real-terms increase to the local government budget.

As I said, the budget seems to have baselined a lot of previous transfers that the Government made to cover things such as the insistence that social care workers be paid at a certain level. Those sorts of baseline payments can make it look like the budget is going up when it is actually money that is going to local government to pay for a particular thing that the Scottish Government has insisted on. That is why it can be so difficult to unpick the underlying position.

Local government budgets are under huge pressure, particularly the social care part of budgets. Schools are also under pressure. I think that there will be some pretty big increases in council tax, because the budgets are under such pressure.

Craig Hoy: I will close with a question on capital. In some of its blogs, the Fraser of Allander Institute has identified that, with regard to projections for capital expenditure, the UK capital budget was front loaded but the Scottish capital budget is going to fall in future years. In the 2026 infrastructure delivery pipeline, there is apparently now a distinction between delivery and development. Post-election, in the early years of the next parliamentary session, is there a risk that some vital projects will be left to wither on a vine while the electorate is looking elsewhere because those projects will be categorised in a development pipeline rather than a delivery pipeline?

Professor Spowage: In a capital spending review, we would generally expect there to be a programme of work that has times and costs. We would expect it to say, "This is when this is going to start and this is when it is going to finish." The infrastructure delivery pipeline is a long way from that. I would like there to be an actual plan that includes what we would expect a capital spending review to say, which is, "This is what we are going to spend on each of these projects and this is when they will start." That would allow people to have an expectation of when the projects will be delivered and how much the Government thinks that they will cost at this stage.

There could also be some more commentary on how the Government will cope if costs overrun. Unfortunately, there is often an optimism bias on timing and cost when it comes to capital projects in the public sector.

The Convener: I am tempted to point to high speed 2, but I will not.

Patrick Harvie: Good afternoon. I will ask mostly about local government, but I will first pick up on one of the earlier questions from the convener, who referenced the proportion of people in Government-commissioned research who say that they feel that they understand the UK tax system or the Scottish devolved tax system. Do we have any reliable data on the proportion of people who accurately understand those system?

Professor Heald: I saw the figures some time ago, and I do not believe them at all. I was in a meeting with a really serious tax expert who said, "I don't understand it—and that's my living." The UK system is enormously complicated. A witness at your previous evidence session made a point about there being, I think, 190 kinds of exemptions and allowances.

Patrick Harvie: I am not suggesting that we should expect a huge proportion of the public to have a highly detailed and technical understanding, but there are some common broad-brush misunderstandings.

Professor Heald: Yes.

Patrick Harvie: In my inbox, I have correspondence from people who are very angry, saying, "I am on a below-average wage and I am paying the higher-rate tax." These are people who may just have read a *Daily Mail* headline or a political advert on Facebook. Do we have any understanding of the extent to which people have a broadly accurate understanding, as opposed to a profound misunderstanding?

Professor Heald: I do not know, but I would suspect that public understanding is very low. If public understanding was high, Governments would not get away with fiscal drag in the way that they do. They would not get away with the confusion between what happens to tax rates and what happens to tax bands. The UK Government has been on a sticky wicket about whether it has kept its pre-election promises. In my view, fiscal drag breaks the spirit of those promises, although people might argue that it does not break the letter of them.

Professor Bell: I have had many casual conversations with people who probably devote a very small part of their time to trying to figure out what is going on in the UK and Scottish tax systems. The general level of knowledge of the system is extremely low. The complexity is obviously part of it, but there is a lack of financial literacy, which we should perhaps be emphasising more in school. As David Heald says, our system—the UK system—is incredibly complex. We then add on all the complexities associated with how the Scottish and Welsh budgets are dealt with. I am not surprised that only a very small proportion of people fully understand it.

Professor Heald: A lot of people argue for more devolved taxes, and they seem to think that that means that the Scottish Government gets more money. The Scottish Government gets more money only if the actual tax revenue is bigger than the block grant adjustment. That is quite difficult to explain to people.

Professor Spowage: It goes above and beyond the tax system. I have teenaged children who are getting quite a lot of financial literacy education—and I am heartened about the next generation's understanding of the Scottish tax system, to be honest, given what my children tell me.

One of the things that people are often very poor at understanding is income distribution and the fact that the distribution of taxpayers is different from the distribution of all income earners—households and individuals. It is complicated. People will often think that they must get the average income, whatever they earn.

Patrick Harvie: Both people on below-average income and those on above-average income?

Professor Spowage: Mostly above, to be honest. People are often surprised at where the levels actually sit—for median income for taxpayers, and then for median income for all households. The level is much lower than many people expect, and I think that that is an important thing. We try to talk about it all the time, but the battle will probably never end.

Patrick Harvie: I want to come on to local government. Professor Spowage rightly acknowledged, about 10 minutes ago or a little more, that there is a dispute almost every year between COSLA or local government representatives, who say that the local government settlement is wildly inadequate and extremely unfair, and the Scottish Government, which says that it is bountiful and generous and as fair as it can possibly make it. The truth is usually somewhere in between—but it is not simple: it is a complex relationship to understand. That does not take away from the fact that the long-term direction of travel with local government finances has been really tough. Where will things stand if there are no fundamental changes? There has been an attempt to broaden the range of taxes that are given to local authorities, but that has not been done at a level that would make a profound difference to their financial situation.

There has been a long-running debate about the failure to fundamentally reform council tax. There has been a persistent lack of political consensus on what to do about that, even though everybody understands that the system is broken. If, over the longer term, there was a substantial increase in the block grant that local councils get, that would have to come from national taxation. As David Bell said, if we want to make the tax system more progressive, we need to make changes at the local level rather than make further changes at the national level.

Do you agree that, if none of those things change fundamentally in the relatively near future, councils will be at risk of breaching their statutory responsibilities, never mind all the additional things that people want and need from their council services and from social care?

Professor Bell: On the one hand, the fall in the fertility rate means that there will probably be fewer school kids in the future. It is very difficult to reduce spending on school education, but I think that that will be true. On the other hand, as I said earlier, the demands on social care will increase substantially.

It is important to bear in mind that local government budgets and health budgets are not independent of each other. A lot of additional spending is needed in health because local government does not have the capacity to deal with people looking for a place when they come out of hospital.

Worldwide, local government typically relies on property-based taxes. Our version is council tax, which has been in need of revision for many years. In some countries, local government gets a proportion of sales taxes, but it is really difficult to implement such an approach in our system. Given that we found it too difficult to adopt VAT at the Scottish level, local sales taxes are probably not an option. We are going for a tourist tax and things of a much smaller scale, which will not change the overall trajectory. I think that the point that you are making is that, under the current settlement, local government will probably have to increasingly focus on its statutory duties.

Professor Spowage: Whichever way you look at it, local government funding has become a smaller proportion of the Government’s budget. That position will continue over the spending review period, with real-terms cuts for local government. At the same time, the Scottish Government has mandated that local government must deliver certain things, so its flexibility to tailor services to local areas has diminished over time.

I worry about the sustainability of the situation for local government. From talking to people who work in social care, I think that we should all be quite worried about that. There is a potential danger that local authorities will not manage to meet their statutory obligations. To some extent, we can already see that in relation to housing and homelessness, given the pressure that local government is under in that regard.

As was said in the previous evidence session, there is a combination of policy objectives at the UK and Scottish levels, and local government is a real area of concern. The spending review highlights that the Scottish Government’s decisions on social security and other issues—which it is perfectly entitled to make—will, in the end, mean that there will be a reduction in local government funding at a time of increased demand on its services.

Patrick Harvie: I am reading from a survey of chief executives, leaders and directors of finance who represent 81 per cent of Scottish local authorities that has found that 70 per cent think it is likely that their council will be unable to balance its budget in the next five years, which is stark.

Professor Bell: It is possible.

Patrick Harvie: Does anyone have any further comments?

The Convener: That is only the case if nothing changes in the next five years.

13:00

Professor Heald: I would like to come back to a point that you raised earlier. My view is that too much attention has been paid to minor taxes, and not enough attention has been paid to the taxes that generate serious money. For example, we could run Scottish income tax in a more sensible way, reform non-domestic rates and reform council tax. My view is that nothing is fundamentally wrong with council tax; the problem is that we use 1991 values. The longer that it takes to reach revaluation, the greater the relative change will be. Certain parts of Scotland will do well, and certain parts of Scotland will do badly, which makes it politically extremely difficult.

A COSLA council tax consultation closes at the end of this month. One of the fundamental issues is whether the revaluation is intended to be revenue neutral or whether it is intended to raise money. I have mixed feelings on that, because you probably could raise more money, but it would be much more politically difficult if people who oppose revaluation say, "The Scottish Government is going to get more money out of us." There is a political argument to say that it should be revenue neutral, but local government clearly needs more money.

Patrick Harvie: Thank you.

The Convener: I would use a railways analogy to describe Scotland's different tax systems and how they relate to the UK. When a train does not arrive, people always blame ScotRail, but two thirds of the time it is because of Network Rail.

Anyway, just to wind up, we have not covered a lot of areas, but time is against us. I just wonder whether our guests wish to comment on anything salient that we have not touched on.

Professor Spowage: I will say quickly that I thought that it was interesting how, in the cabinet secretary's speech last week, the UK Government's removal of the two-child limit was framed as an opportunity to reinvest that money to prioritise tackling child poverty. Alongside the budget, there was little detail on exactly how the money had been allocated, but another news release came out on Friday that provided a bit more information about that.

The cabinet secretary talked about the additional payment for children under one—the top-up to the payment—breakfast clubs and some other things. The news release on Friday included the uprating of the Scottish child payment for everyone, which is statutory, so the release implies that it would not have happened anyway. That leads to another point about transparency, because it is not particularly helpful to present it as new money to be used to deal with child poverty, when some of that money was allocated to a statutory uprating that would have happened anyway. The committee might wish to explore that.

The Convener: Thank you for that.

Professor Bell: One thing that we have not discussed, which Graeme Roy spoke about and that I am completely confused about, is how we will account for the £1.5 billion savings over the spending review period, given that £384 million of it is supposed to occur in the next fiscal year, and how we will understand whether the NHS savings—they make up the majority of the savings—have been realised.

The Convener: Professor Heald, we started with you, so we will finish with you.

Professor Heald: I have nothing to add.

The Convener: Short, sharp and to the point.

Thank you very much, everyone, for your evidence today. I will call a two-minute break to allow our witnesses and official report and broadcasting staff to leave, and we will then go into a very brief private session.

13:04

Meeting continued in private until 13:08.

Official Report
Room T2.20
Scottish Parliament
Edinburgh
EH99 1SP

Email: official.report@parliament.scot
Telephone: 0131 348 5447

Published in Edinburgh by the Scottish Parliamentary Corporate Body, the Scottish Parliament, Edinburgh, EH99 1SP

All documents are available on
the Scottish Parliament website at:

www.parliament.scot

Information on non-endorsed print suppliers
is available here:

www.parliament.scot/documents

For information on the Scottish Parliament contact
Public Information on:

Telephone: 0131 348 5000
Textphone: 0800 092 7100
Email: sp.info@parliament.scot

The Scottish Parliament
Pàrlamaid na h-Alba